From Plan to Market: A Twenty-Eight Country Adventure

Director Alan Gelb on the World Bank's new Development Report

The new World Development Report is in the bookstores. The one-year project draws on years of research and operational expense across the Bank. It summarizes the major features of transition: what is common to the experiences of the once centrally planned economies, comprising one-third of the world's population, that are changing to market or at least to market-oriented economies. The authors did not seek to produce an "operational manual" explaining how to make transition easy and painless. Instead, the report summarizes the lessons learned over the past seven years, in order to inform and educate the worldwide public, including the "actors" themselves: the policymakers and the populations in the transition economies. Staff Director Alan Gelb was interviewed by the Transition editor, Richard Hirschler.

Q. Before taking on the job a year ago as director of the new World Development Report (WDR), you headed the Transition Division in the World Bank's Policy and Research Department for six years. Given your long exposure to transition issues, did you experience any surprises working on this report, which summarizes the transformation experiences of twenty-eight countries from the World Bank's perspective?

A. We point out in the report that initial differences among reforming economies—originating from their distinctive geographical situation, historical background, and social fabric; their governments' administrative capacity; their leaders' proficiencies—influence successive developments: This was no surprise to me. But I was quite surprised to see such strong similarities between countries in terms of how people and businesses respond to reforms. We tend...
to think of countries like China and Poland as very different, but when we look closely, we see that smaller businesses, often involved in services or exports, are among the most dynamic sectors in both economies. Another surprise was that when we considered the root cause of the extensive output decline in the transition economies we found that it had much less to do with restrictive macroeconomic policies, and much more with the drastic changes in the structure of demand.

Q. Another surprising element in the report is the neutral view taken in the Big Bang-versus-gradualism debate—not taking a side on this issue. Did the World Bank change its earlier position?

A. The optimal speed of reform—that is, whether radical Big Bang reform or gradual reform works better—has been one of the most widely debated issues both outside and inside the World Bank. The report spells out the conditions under which one or another kind of reform can work well. We all know that reforms don't proceed at the same pace. If you want to bring inflation down from very high levels, you have to move quickly. If you cannot afford to subsidize a huge, overbuilt state sector, you have to act rapidly, otherwise you will go off into hyperinflation. But we also now recognize that the size and nature of sectors repressed under the previous economic system make a huge difference. China, for example, could achieve a great deal of growth and productivity increase once it liberalized its large repressed sectors, such as agriculture. This gave them space for gradual reforms in other areas. We now understand these linkages much better. In general, we should avoid being dogmatic and saying that one type of policy is always the best for all countries. You have to look at each country and judge the policies on their merits. This approach is reflected in the report.

Q. Another hotly debated issue is the relationship between economic liberalization and political freedom. How closely are they related?

A. From the cross-country evidence and also the evidence over time, it is quite clear that in Central and Eastern Europe and the former Soviet Union, there has been a close relationship; in other words, economic reform has been led by political change, and generally, where the political change has been sharpest, the economic reform has also been sharpest. There are several reasons for this. One theory that was developed eloquently by Mr. Balcerowicz is that a sudden political change created a window for reform, during a period of extraordinary politics. This allowed reforms to proceed much more rapidly than they normally would in a political environment where political groups oppose any type of radical reform. The opinion polls in these countries also suggest that on the level of individuals there is a close relationship between attitudes toward political reform and economic reform. This might be specific to Central and Eastern Europe and the FSU, and does not necessarily prevail in other countries around the world.

Q. To take on another controversial issue, what does the report suggest is the right size for the government and the state sector?

A. Again, much depends on the particular situation of a given country. In several countries, including the Baltics and most CIS economies, the government sector has shrunk sharply both in absolute size and as a share of the economy. Nevertheless, their major problem is still how to secure enough revenues to fund the government's essential functions as the revenue base has also declined sharply together with output. In the economies of the more advanced reformers (those of the Visegrad countries), governments and state sectors are still large. Tax rates are high, while tax administration is not as effective as in the industrialized countries. As a result, there is a tremendous pressure toward informalization of the economy, and the black economy spreads like mushrooms.

Q. Under these circumstances, what are the biggest challenges on the government spending side?

A. A large part of government spending is accounted for by social transfers, of which the largest single component is often pensions. Here we have a difficult problem. The impact of the transition differs for different age groups. Young people have more opportunities now—they can make their way in the market economy and they can look forward to higher earnings. Many of the elderly, on the other hand, are in a difficult situation—they were unable to save, or if they did, the savings have been eroded by inflation. Governments try to soften the negative effects of transition. To some degree they have already done this through, for example, early retirement programs. But the fiscal burden is extremely high, especially if the measure becomes institu-
tionalized as part of social policy. This means that some very difficult reforms, such as raising the retirement age, need to be introduced rather quickly in these countries.

Q. But this and other social policy reforms will certainly influence the political attitudes of voters. Looking around Central and Eastern Europe and the FSU, parties preaching piecemeal, cautious reform in the social arena are surging ahead, even in the Czech Republic, the ultimate archetype of courageous reforms....

A. We have to remember that the Central and East European countries, particularly, are historically and culturally part of Europe, and the problems of an overdeveloped welfare state are common in many parts of Europe, not only the CEE. But in most transition economies the levels of social transfers, government spending, and the burden of taxation are much higher, maybe by 20 to 25 percent of GDP, compared with other countries at comparable levels of per capita income. These latter countries thus have far more space for investment and the potential of achieving higher growth. In a sense, transition countries face a tradeoff. They may have to swap some degree of rapid growth for meeting their social obligations. If they can sustain reforms and a favorable macroeconomic environment, direct foreign investment can complement the missing domestic investment to some degree. But it would not be enough to compensate for relatively moderate rates of saving. Thus, the real tradeoff is the choice between a very high growth track with temporarily small social transfers panning the way for an increased pie to redistribute, or a lower growth track with large social transfers.

Q. The report's suggestions are rather general in nature, lacking specific policy recommendations.

A. Country-specific policy recommendations are usually not part of the WDR. The 1996 WDR is, however, unique. Earlier reports usually dealt with global topics, such as labor markets, infrastructure, and poverty, issues with a fairly long history of research, study, and record. This WDR deals with the ongoing transition process, where many aspects are still uncertain; and it focuses on certain parts of the world. It makes a large number of policy recommendations, typically to address problems experienced by many countries.

Q. What would the Bank like to accomplish with the release of this report?

A. First, to stimulate learning across the transition countries. Some are well ahead of others. There is room for drawing lessons from experience, informing the public, and forming consensus on important issues. These countries have a very different tradition of economic analysis; and though some are relatively well-versed in market-based economic analysis, others have had little experience with it. This report is translated into Russian and Chinese, and is widely disseminated. Second, the WDR provides a synthesis and interpretation of the events of the past five years for policymakers in these countries. Third, we want to present major elements of the transition process to other, developing countries that are trying to develop a more effective market system and are struggling with similar problems. Again, some countries have moved far more quickly than others in addressing problems in the transition to market and their experiences can be very instructive to others.

Q. How much independence did you enjoy in completing this report? Were you subject to any kind of pressure from member countries?

A. During the research process we felt quite independent and able to give our views about what is going wrong and what policies seem right in the various countries. One reason for this is that the difficulties of transition are well recognized. There is no such thing as a perfect reform in any transforming country. The major purpose of the report, as I said, was to learn where the problems were, to be able to find matching policies.

Q. While the WDR points out that "transition is not over and the process continues to have profound social, political, and strategic effects," the Bank's Transition Division has been dissolved. This being the case, will research on transition within the Bank be wound up?

A. I don't think that research on transition economics will be wound up. The transition economies are important members of the Bank, and still face significant problems, and in some respects their problems are very distinctive. But the research department has traditionally been organized along more functional lines, with divisions having functional responsibilities. The effect of the reorganization will be to shift work on transition economies into the functional divisions. Even though the division will close down, researchers will move to other units of the research department and will be able to carry on with their work.

The World Bank/PRDTE

Postsocialist Media: Watchdog Over Fair Market Practices?

by Richard Hirschler

With the 1989-91 revolutionary changes in Central and Eastern Europe and the collapse of the Soviet Union, overt political oppression and censorship became a thing of the past in most countries of the region. Press freedom has been declared as part of the legal foundation of the new democratic systems. In most countries new media (press) laws have been approved or are awaiting parliamentary approval, or new constitutions contain provisions guaranteeing freedom of the press. Newspapers and radio and television stations have started to mushroom across the postsocialist world. But in many countries of the FSU and Central and Eastern Europe the state retains (or has recaptured) control of national television and radio networks, while subtle, more direct government interference can be detected in the written press and broadcasting. (See box on page 5 for a cross-country comparison of press freedom in Central and Eastern Europe, the FSU, and other countries.) Major trends on the media front are already discernible:

**Government interference.** Although privatization has made spectacular progress in the written press and local broadcasting, sale of the national radio and television networks has stalled in many countries, and proceeds only slowly even in the advanced reformer countries, like the Czech Republic, Hungary, and Poland. The state-run postal systems often have near-monopolies in distributing newspapers and magazines, while television and radio-transmitting facilities and licensing (access to frequencies) are still under direct government control. (Although this is true in many industrial countries as well). Governments appoint the heads of the state-owned media or select members of the overseeing boards in radio and television organizations. In many countries the state controls the media in part through ownership and funding. (In Belarus 90 percent of 700 publications with a national circulation of 10 million is owned fully or in part by the government. In Ukraine the state owns and finances 46 percent of the registered media.) The government can funnel advertisements of state-owned companies or agencies to favored papers and broadcasts, and provide other forms of subsidies. Discrimination against the independent press is evident in high taxes and fines, or refusal to deliver newsprint.

**Tough finances.** The short-lived media boom that followed the 1989-91 period gave way to a consolidation of the communications market. Many papers closed down as state subsidies dried up and newsprint became both expensive and in short supply (for example, in Albania and Romania). Production and distribution costs increased, and yet the distribution systems remained inadequate. With the deteriorating economic situation fewer people could afford to buy newspapers. (Armenia’s 2.6 million adults purchase only 40,000 copies of the country’s dailies.) In Russia only 15 percent of the country’s 10,500 publications are financially self-sufficient. Foreign investment has made headway in some countries, primarily in the Czech Republic, Hungary, and Poland. In mid-1994, 50 percent of Czech media assets were in foreign hands, and sixteen of the major twenty-five dailies were foreign-owned. In Poland foreign owners hold an average 56 percent of the equity in national and provincial newspapers.

**Tabloid versus responsible journalism.** An increasing number of private newspapers and radio and television stations in transition economies choose

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**Morxes—Inspirator of the economic agenda for Russia’s communists**

From the Russian daily Nezavisimaya Gazeta.
to entertain and satisfy mass demand (and powerful advertisers), in order to increase readership and audience, and hence, profits. It is an open question whether the limited national media markets can adequately support vehicles for responsible journalism, which advocate democracy; communicate public opinions, concerns, and hopes; and investigate abuses of political and economic power—in other words, which fulfill the watchdog role of the press. Investigative reports have been a favorite genre in the transition media, but reporters face particular difficulties (if they survive at all, which is not always the case as has been seen in Russia):

- Enterprises, banks, and government institutions are reluctant to provide information and data even if these do not constitute business secrets (freedom of information acts are still not in effect).
- Editors are under pressure not to disclose compromising information. (In Belarus newspapers were prevented from publishing a report, delivered to parliament in December 1994, in which the Belarus government was accused of corruption. The government canceled a printing contract with eight independent papers, which in turn had to halt publication for ten days.)
- Media owners with a hidden stake in not embarrassing friends in business or government may prevent publication of compromising stories; or, in cases where such stories are pushed through, the surviving "old boy networks" may see to it that the disclosures carry no consequences (that is, incriminated individuals are not indicted, faulty business practices continue).

In China the press is still under government control and is considered a useful medium for persuading and mobilizing the public. (In 1986, for example, Hu Yaobang ordered that 80 percent of news should deal with the positive aspects of modernization, and 20 percent with the shortcomings.) But as the Chinese economy opens up, and as state subsidies dry up, the survival of media outlets, including radio and television stations, becomes more and more dependent on advertising income. Investors—government and party officials—are now launching profitable television ventures in their jurisdictions. Many officials, in charge of controlling the press in the regional party-branches, have acquired shares in "their" papers and are thus motivated to seek these papers' commercial success. To increase circulation, they actively promote advertising and the publication of popular stories. This trend seems unstoppable, despite efforts to control the news: for example, private satellite dishes have come under scrutiny and were banned in 1993 (1 million were already in use). The encroaching Internet further frustrates advocates of state press monopoly.

(The assistance of Professor Leonard N. Sussman, Freedom House, New York, and Professor Everette E. Dennis, Freedom Forum Media Studies Center, Columbia University, New York, is greatly appreciated.)

(1995 ratings in parentheses)

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2. Developing monitoring capacity—partial press freedom (60-30)

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3. Advanced monitoring capacity—press freedom (30-0)

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Private Sector Expansion in Central Europe
by Michael S. Borish and Michel Noël

As the immediate aftershocks of the transition to market subside, the founders of the Visegrad Group—the Czech Republic, Slovakia, Hungary, and Poland—face the challenge of achieving sustainable economic development. (The fifth member of the group, Slovenia, joined in January 1996, and is not considered in this article.) One key ingredient of this growth is the development of a competitive, financially sound, and dynamic private sector. The latest statistics confirm that—quantitatively at least—the private sector share of these countries' overall output, employment, investment, and trade has noticeably increased.

In the four Visegrad countries the private sector in 1995 accounted on average for 60 to 70 percent of GDP (up from 4 to 25 percent in 1989), and for 55 to 65 percent of employment, compared with 10 to 20 percent in 1989—except in Poland, where employment already stood at 47 percent in 1989 (see table). Although part of this growth has come from privatization, particularly in the Czech Republic and, more recently, Hungary, much of the private sector growth has been from new startup enterprises with no links to the earlier tenets of central planning. New businesses in the region—though often self-employed or small-scale and in the service sector—are generating far higher profit margins than the state-owned sector.

The surge in private activity has been accompanied by an industrial decline in the Czech Republic and Slovakia, while in Hungary and Poland, ownership changes have resulted in a setback in agricultural production. Meanwhile, the expansion of services, as a percentage of GDP, has been pervasive. In all four countries, ownership changes have been relatively slow in industry, and more vigorous in agriculture and the service sector.

Private Sector Growth in the Visegrad Countries, 1989-95

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Note: The base year for credits and deposits is 1991.
*—Not available.
a. Including households.
Source: The authors.

Czech Republic

The private sector share in the Czech economy has grown from about 5 percent of GDP in 1989 to 60 percent in 1995. Most of this growth is due to small-scale, owner-operated businesses, while the output of the large-scale industrial state enterprises has declined. New businesses are mushrooming, especially in labor-intensive light manufacturing and service industries, and last year the private sector already employed 65 percent of all workers, up from 16 percent in 1989.

The private sector's share in total credit rendered increased from 13 percent in 1991 to 69 percent in 1995. This increase was helped by the Czech Republic's balanced fiscal strategy, which included government recourse to domestic credit, as well as the aggressive enterprise privatization program and the bank lending flows, as part of bank restructuring policies. The private sector share of bank deposits has been stable over the period. While the household sector is a net lender, the difference between household deposits and loans to the sector is much narrower (7 percent) than in other Visegrad countries, where households provide most of the financing for the government and enterprise sectors. (On bank privatization, see box on next page).

Fixed investment declined from 27 to 29 percent of GDP in 1989-90 to 20 percent in 1993-94, and then shot up to...
Czech Bank Privatization: Postponed

Privatization of the Czech Republic’s four largest commercial banks, the Česká Sparitelná, Komercní Banka, Československá Obchodní Banka (CSOB), and Investiční a Postovní Banka, owned largely by the National Property Fund (NPF), the state privatization agency, has been postponed, the Czech National Bank (ČNB) announced just before the May election.

Earlier, the government had rejected a plan to sell part of the NPF’s 45 percent stake in Česká Sparitelná through a global depositary receipt (GDR) issue. Česká Sparitelná currently controls about 55 percent of all retail deposits in the country, mainly owing to its role during the communist era as the only savings bank for ordinary citizens. The bank expects its net profit to double in 1996, having fallen to 1.37 billion koruna ($50 million) in 1995 from 1.63 billion in 1994. The GDR issue was intended to finance the bank’s restructuring program, aimed at rationalizing its branch network and its use of human resources, as well as financing new investment designed to diversify its customer base. It had expected to raise up to $80 million for this purpose. However, privatization, and not the raising of funds, was the principal aim of the GDR issue.

The NPF’s stakes in the other three large banks are as follows: 49 percent in Komercní Banka (the country’s largest bank), 33 percent in Investiční a Postovní Banka, and more than 20 percent in CSOB. In addition, 20 percent of CSOB is owned by the Czech Ministry of Finance, 27 percent by the ČNB, and 24 percent by the National Bank of Slovakia. The four largest banks between them account for around 70 percent of the banking sector. All of them are expected to perform strongly in 1996.

The Big Four play a crucial role in the economy. They are a primary source of debt financing for most of the country’s large and medium-size companies, and they also have significant shareholdings in many companies through subsidiary investment fund companies. Critics of the voucher privatization scheme have pointed to this as evidence that the state still controls the country’s industry through its shareholdings in the large banks (though no investment fund is allowed to own more than 20 percent stake in a company, and many large investment funds are not associated with the banks).

Another argument for bank privatization is the perceived need for strong foreign partners. So far, only a limited number of foreign banks—including Citibank, ING, Creditanstalt, and Bayerische Hypotheke und Wechsel Bank of Munich—have received licenses to operate, while some have moved into the Czech market through acquiring stakes in smaller-size local banks. This is now changing, as the profitability of the sector increases, and as many banks shift their focus from corporate banking to retail and private banking services. The ČNB reversed its two- and a-half-year moratorium on new banking licenses, announcing that it is granting licenses to Westdeutsche Landesbank Girozentrale and the Midland Bank. It seems likely, however, that licenses for foreign banks will be reduced to just one or two each year for the next two years.

A partnership with a foreign player is not necessarily the only option available to the banks. Komercní Banka predicts a further rise in profits in 1996 to 6 billion koruna, up from 5.1 billion in 1995. The bank plans to declare a 20 percent dividend out of its 1996 profits, compared with 19 percent in 1995 and 12 percent in 1994. On May 22 Komercní Banka reported net profits of 2.26 billion koruna for the first quarter of 1996, a 54 percent rise over the same period last year. The increase in profits was largely due to higher income from foreign exchange and securities operations, as net interest income fell by 8.6 percent.

CSOB, although still almost fully state-owned, outperformed all other domestic banks in terms of earnings per share in 1995, outdoing the 1994 top performer, the privately owned Zivnostenska Banka, which is closely associated with the German-based BHF-Bank. All of the largest four banks have recently received good international credit ratings. Although heavy bad loan provisions have hit recent profits, it is widely felt that the worst is over, and the prospects for future profits are healthy. Although the competition in the market is expected to intensify, the banks seem determined to restructure quickly without the need for pressure from new owners.

Based on news agency releases and reports of Oxford Analytica, the UK-based international consulting firm.

31 percent in 1995. The decline in domestic investment until 1995 was partially offset by an increase in foreign investment, which totaled $3 billion by the end of 1994, or 2.5 percent of GDP during 1991-94. The country attracted significantly greater investment than Poland or Slovakia. Lower tax rates, lower property rentals, better telecommunications services, and solving some other infrastructure problems faced by businesses would probably ensure a steady flow of foreign investment.

Hungary

The private sector share of GDP in Poland rose from 20 percent in 1989-90 to 70 percent in 1995, a more than five-fold increase in dollar value over a period of six years. There has been a shift in the sectoral mix toward trade and services, as in the other Visegrad countries, with the number of infrastructure firms slightly up and manufacturing firms down. In 1993 three times more private businesses were registered than in 1990, but their average number of employees was only about one-fourth of the 1990 figure. Labor productivity and value-added per worker have increased over this period. Aside from the rise in small-scale new businesses, the number of self-employed has also almost doubled since 1990, to around 800,000 people.

Due to persistent fiscal deficits, credit to enterprises has declined, while credit to the government (in the form of secu-
ers since 1991, provide most of the lending to the public sector. Three-quarters of the total deposits in the system are attributable to the private sector.

As elsewhere in the region, total investment declined as a percentage of GDP over the transition period. Total investment accounted for 26 percent of GDP in 1989, declined steadily to 15.5 percent in 1992, and recovered after 1993, reaching 22.5 percent in 1995. This recovery was a result of the surge in foreign investment, which offset the decline in domestic investment in real terms. Over 1991-95 as much as 28 percent of investment in Hungary was foreign. With $10.6 billion in cumulative FDI during 1991-95, Hungary attracted more foreign investment than all its transition neighbors. The Privatization Law adopted in 1995 to pursue privatization aggressively through 1997, including the sale of partial or total stakes in blue chip infrastructure companies, has already had a dramatically positive impact on FDI: Hungary attracted $4 billion in 1995.

**Poland**

The private sector share of Poland's GDP rose from 28 percent in 1989 to 59 percent in 1995, representing a threefold increase in dollar value between 1989 and 1995. The Polish private sector now produces mainly in trade and industry, although most industries are still in the state sector. Newly privatized companies in Poland last year showed an average rate of return more than double that of Polish enterprises as a whole, according to a recent report of the Central Statistical Office (GUS). Net profitability for firms that were privatized was 4.3 percent in 1995, compared with a profit rate of 2.0 percent for all enterprises. Over the past six years, 1,022 state-owned companies employing 1.1 million people have been turned over to private hands. As in Hungary, the share of agriculture in GDP has declined, while the shares of industry and services have increased.

As elsewhere in the region, the average private Polish business is small-scale. Attesting to their dynamism, small-scale businesses created 3.5 million new jobs between 1991 and 1993 and provided real wage increases of 3.5 to 4.0 percent in 1994 when public sector wages were stagnating.

Despite the evidence of a dynamic private sector, lending to this sector has been limited due to the increase in credit to the government—and to some large but troubled state-owned enterprises—which has taken as much as 70 percent of lending since 1991. The private sector share in total credit increased in 1995, but has generally been low despite real GDP growth of 4 percent since 1992. On a net flow basis, between 1991 and

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**Returning To The Old Country**

"Godfather Balog proved to be an efficient crisis manager in the United States."

From the Hungarian daily *Nepszabadsag.*
The Visegrad Group: Inducing Trade by Reducing Tariffs

The idea for the Visegrad Group was formulated in Bratislava in May 1990 after the disintegration of Comecon and the Warsaw Pact. On February 15, 1991, at a summit in Visegrad, Hungary, the leaders of Czechoslovakia, Hungary, and Poland signed a declaration agreeing to cooperate in matters of common interest. The members also formed the Central European Free Trade Agreement (CEFTA) to induce trade in Central Europe by reducing tariff barriers. Tariffs for so-called medium-sensitive goods (chemicals, paper, and timber) have been lifted as of 1996; for more sensitive goods (textiles, steel products, and electrical equipment) tariffs will be fully liberalized in 1997; and for selected textile, steel, and paper goods, as well as cars, present duties will remain effective until 2000-02. Customs duties for several agricultural goods have been cut as of this year, and the process continues. Slovenia joined CEFTA on January 1, 1996; Bulgaria and Romania could also be included eventually. Visegrad is considered an interim arrangement to facilitate trade while the formulas for European Enlargement and NATO membership are being worked out for these countries.
Debate
Privatization and Social Acceptance—The Flip Side
By László Csaba

The social consequences of privatization are completely different in the West and the postsocialist countries. In the West, privatization of even large public companies has marginal significance in terms of the overall economy. In a low-inflation environment, the income redistributional effect is also marginal. The public can be persuaded that once these companies are sold to private owners, efficiency improves through better control over corporate management, through transparency, and through elimination of government interference. Mass privatization (for example, in Britain) usually meant the sale of a few selected companies to a large number of small investors. The outcome usually had no negative effect on the well-being of the average voter; on the contrary, the small investors benefited from the cash-in of quick dividends, and the public at large from, for example, improved railway and phone services.

In the postcommunist hemisphere, on the other hand:

- Privatization was launched at a time when significant redistribution of income and wealth was already underway. Thus, social sensitivity was already badly hurt, before any redistributional impact of privatization could be felt.

- Privatization was preceded by decades of ideological prohibition and indoctrination. Thus, both the public and the government were by and large psychologically and technically unprepared for the massive changes in ownership structures. Disrespect for rules, corruption, misuse of dominant market position, monopolistic behavior, hostile takeovers, transfer pricing, tax evasion, arbitrary and massive layoffs, closures, and the like are nothing new for students of modern business economics. Regulatory systems of the OECD countries apply elaborate rules and procedures for how to deal with these developments. Countries in the East, however, were unprepared, they lacked the elaborate regulatory system and the human resources they needed to cope with these problems.

- Many agents of privatization have been representatives of the postcommunist parties. Those who at first preached their misgivings about capitalism, later turned into the vanguard of the newly born entrepreneurial class. The old economic elite has converted the situation rents into palpable private wealth. Since previously hidden income differences have become visible, the apprehension about and rejection of the old/new bosses, also in their capacity as persons interested in maximizing asset value, is hard to overestimate. The point that no other alternative was open to find competent owners, since no one else was realistically available, may well be true, but it does little to dispel protests against this type of power and wealth redistribution.

- Sale has initially played little if any role in privatization. In Hungary, for example, the nouveau riche became asset holders by capitalizing on their advantageous positions as managers or party apparatchiks—for example, through spontaneous privatization (managers pick their owners or turn themselves into their own bosses); through collection of vouchers, compensation notes, or acquiring the controlling package through an employee-management buyout; and through cooperation with authorities (to privatize claims of a company while nationalizing its liabilities, as was the case with several bank consolidation programs).

- Improvement of corporate governance has not been a major issue. If managers or the state pick owners, it is difficult to expect more efficient control over managerial activities. This applies to various free distribution schemes, designed to overcome social apprehension over spontaneous privatization. Companies that are supervised by state-owned or investment funds are merely operating under a more sophisticated, indirect form of public ownership. As no new money or managerial skill is invested into these pseudo-privatized firms, their overall performance rarely improves dramatically. If it does, it has more to do with competitive pressures exerted by liberalized imports and subsidy cuts, than with the reorganized ownership structure.

- Finally, many privatized firms continue to depend on government support, requiring tariff protection against imports competition, and demanding subsidies and debt writeoffs for retaining workers. Appropriate liaisons to the government can secure big business deals.


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May-June 1996
Toward an Unleaded Environment: World Bank Support to Transition Economies
by Magdolna Lovei

The World Bank has made an urgent plea for a worldwide phase-out of leaded gasoline, saying that the phase-out needs to come faster and sooner than replacing old cars with new ones would permit, and sooner than could be achieved by placing catalytic converters in every car. The World Bank's call to action was presented during the recent City Summit, the U.N. Conference on Human Settlements (Habitat II), held in early June in Istanbul.

A Beast in Your Tank

Following the discovery in 1921 that lead improves the quality of gasoline, the worldwide use of lead additives surged. By the early 1970s cars burned annually 375,000 tons of lead with fuel. Lead concentrations in gasoline reached 0.6-0.8 grams per liter. But lead, a heavy metal that has long been known as a neurotoxin, is a substance that adversely affects the nervous system even at low levels of exposure.

Recent studies indicate that no safe level of lead exists. Children are especially susceptible to ingested lead because their digestive systems have fast absorption rates. Their intellectual development suffers permanent damage manifested by learning disabilities, hyperactivity, and other behavioral abnormalities. A significant negative relationship has been found between exposure to lead and the IQ of children. For adults, even low levels of lead exposure—occurring usually through inhalation—causes hypertension, high blood pressure, heart disease, and early death.

People may be exposed to lead from various sources including lead pipes, lead-based paint or solder in food cans and water supply systems, and ceramic glazes. In some countries notorious "hot spots" were created by industrial sources such as lead smelters that expose workers and the local population to extremely high levels of lead. In most cities, however, leaded gasoline accounts for 80 to 90 percent of airborne lead pollution. Airborne lead disperses widely, and accumulates in the soil, persisting for long periods of time.

Because of soaring increases in automobile use worldwide, the problems will only worsen if leaded gas continues to be used. In 1990 there were some 518 million cars and trucks worldwide. By 2010 that number will grow to 816 million, with most of the growth occurring in developing countries and Central and Eastern Europe. Not only is automobile use increasing in cities, but because urban populations typically have higher concentrations, larger numbers of people are being exposed to dangerous lead pollution. Today, 1.7 billion people live in cities—by 2025 the global urban population will double to 4 billion. Several countries have banned all leaded gasoline, including Austria, Brazil, Canada, Colombia, Japan, Slovakia, Sweden, and the United States. With World Bank support, Thailand banned lead gasoline in 1995 after converting its petroleum production to unleaded fuel.

In most developed countries the widespread use of catalytic converters will soon "crowd out" leaded gasoline. It is also possible, however, to get rid of leaded gasoline in those countries where the renewal of the car park is slow, and where most vehicles are not equipped with catalytic convert-

ers (most transition economies belong to this category). Cars can run on unleaded gas without a converter, and only some older models need lubricating gasoline additives to substitute for lead. Such additives have been used to support the total phase-out of lead in Austria, Slovakia, Sweden, and Thailand.

The Cost of Elimination

In 1995 Bulgaria launched a regional initiative to accelerate the lead-elimination process in Central and Eastern Europe. Slovakia, first to take action among the transition economies, phased out leaded gasoline by 1995, increasing the market share of unleaded gasoline from 6 percent in 1992 to 100 percent last year. In Romania, on the other hand, the lead content of domestically used gasoline has remained high, and most of the unleaded gasoline production has been directed to export markets. In most countries of the former Soviet Union, the permitted lead content in gasoline is still twice the level that the European Union allows, and in several develop-

Lead Use in Gasoline in Selected Transition Economies, 1995

<table>
<thead>
<tr>
<th>Country</th>
<th>Maximum Lead Content in Gasoline (g/l)</th>
<th>Market Share of Unleaded Gasoline (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bulgaria</td>
<td>0.15</td>
<td>15</td>
</tr>
<tr>
<td>Croatia</td>
<td>0.60</td>
<td>—</td>
</tr>
<tr>
<td>Czech Rep.</td>
<td>0.15</td>
<td>18</td>
</tr>
<tr>
<td>Hungary</td>
<td>0.15</td>
<td>50</td>
</tr>
<tr>
<td>Latvia</td>
<td>0.37</td>
<td>23</td>
</tr>
<tr>
<td>Poland</td>
<td>0.15</td>
<td>21</td>
</tr>
<tr>
<td>Romania</td>
<td>0.60</td>
<td>6</td>
</tr>
<tr>
<td>Russia</td>
<td>0.37</td>
<td>45</td>
</tr>
<tr>
<td>Slovakia</td>
<td>0.00</td>
<td>100</td>
</tr>
</tbody>
</table>

— Not available.

Source: The author.
ing countries in Africa, Latin America, and the Middle East, lead concentrations are four to five times that level.

Generally, countries can recover five to ten times the cost of converting to unleaded gas in health and economic savings. The United States, for example, saved more than $10 for every $1 it invested in the conversion due to reduced health costs, savings on engine maintenance, and improved fuel efficiency. Leaded gasoline, because it contains lead salts and halogen acids, causes greater corrosion of automobile exhaust systems and requires more frequent oil and spark plug changes. According to U.S. studies, switching from leaded to unleaded gasoline may increase engine life by as much as 150 percent.

Refinery modernization typically facilitates the phase-out of leaded gasoline production. A recent study has pointed out that phasing out lead from gasoline at a technically less advanced refinery in Russia would cost between $0.005 and $0.02 per liter of gasoline (depending on technical alternatives) under the current production structure. It would cost only half as much, however, if the refinery’s production structures were modified to better reflect market demand.

Although the technical process of phasing out lead from gasoline is simple and the costs are modest, implementing such programs is a complex task that requires a broad social consensus and appropriate price, tax, and import policies. Also, governments should educate the public about the economic and health benefits of using unleaded gasoline, and about proper fueling practices. Promoting social consensus among affected government agencies, consumer groups, and nongovernment organizations, raising public awareness, regulating fuel specifications, and introducing incentives—for example, imposing lower taxes on unleaded gasoline—are necessary to carry out lead phase-out programs. If governments allow refineries to earn a reasonable return on their investment, financing is usually available from commercial sources.

Unleading the Environment

The World Bank recommended during the Istanbul meeting the total phase-out of leaded gasoline. It urged those countries in Africa, Asia, Eastern Europe, Latin America, and the Middle East that still use large amounts of lead in gasoline to take the first step by reducing the lead content of their gasoline to 0.15 grams per liter or less, and to follow up by introducing incentives to encourage the use of unleaded fuel and to accelerate the elimination of lead. The Bank also urged countries to pursue the total phase-out of leaded gasoline independently from the use of catalytic converters. Countries could get rid of leaded gasoline within five years if they would commit themselves to pursue a comprehensive phase-out program and set the proper policies. The Bank is assisting governments in their efforts to increase public awareness of the problem, design lead phase-out strategies, set in place supporting fiscal policies, and mobilize financing for refinery modifications.

The author is economist in the World Bank’s Environment Department.

Bosnia Projects—A Correction

In the previous issue of Transition (volume 7, number 3-4, 1996, page 11), reference was made incorrectly to twenty approved World Bank reconstruction projects in Bosnia and Herzegovina, as of April 30, 1996. In fact, only seven were approved by the Board of Directors as of May 31, 1996. Following is the correct list of approved and proposed World Bank projects.

World Bank Projects in Support of the Priority Reconstruction Program in Bosnia and Herzegovina, as of April 30, 1996 (USS million)

<table>
<thead>
<tr>
<th>Project Name</th>
<th>Project Cost</th>
<th>WB Group Support</th>
<th>Approval Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>Approved Trust Fund-supported Projects</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Emergency Recovery</td>
<td>160</td>
<td>45</td>
<td>February 29, 1996</td>
</tr>
<tr>
<td>Emergency Farm Reconstruction</td>
<td>50</td>
<td>20</td>
<td>March 28, 1996</td>
</tr>
<tr>
<td>Water, Sanitation, and Solid Waste Urgent Work</td>
<td>70</td>
<td>20</td>
<td>March 28, 1996</td>
</tr>
<tr>
<td>Emergency Transport Reconstruction</td>
<td>161</td>
<td>35</td>
<td>March 29, 1996</td>
</tr>
<tr>
<td>War Victim Rehabilitation</td>
<td>30</td>
<td>10</td>
<td>May 14, 1996</td>
</tr>
<tr>
<td>Emergency Education Reconstruction</td>
<td>33</td>
<td>10</td>
<td>May 14, 1996</td>
</tr>
<tr>
<td>Emergency District Heating Reconstruction</td>
<td>58</td>
<td>20</td>
<td>May 14, 1996</td>
</tr>
<tr>
<td>Proposed IDA-supported Projects</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Transition Assistance Adjustment</td>
<td>110</td>
<td>90</td>
<td>June 1996</td>
</tr>
<tr>
<td>Emergency Landmine Clearing</td>
<td>67</td>
<td>7</td>
<td>June/July 1996</td>
</tr>
<tr>
<td>Demobilization Support and Local Public Works</td>
<td>43</td>
<td>15</td>
<td>June/July 1996</td>
</tr>
<tr>
<td>Microbusiness/Local Initiatives</td>
<td>15</td>
<td>7</td>
<td>Summer 1996</td>
</tr>
<tr>
<td>Demobilization Support and Training</td>
<td>20</td>
<td>7</td>
<td>Summer 1996</td>
</tr>
<tr>
<td>Emergency Natural Gas System Rehabilitation</td>
<td>58</td>
<td>15</td>
<td>Summer 1996</td>
</tr>
<tr>
<td>Emergency Housing Repair and Reconstruction</td>
<td>50</td>
<td>15</td>
<td>Summer 1996</td>
</tr>
<tr>
<td>Essential Hospital Services</td>
<td>95</td>
<td>15</td>
<td>Fall 1996</td>
</tr>
<tr>
<td>Education Reconstruction</td>
<td>60</td>
<td>20</td>
<td>Fall 1996</td>
</tr>
<tr>
<td>Transport Reconstruction II</td>
<td>158</td>
<td>20</td>
<td>Fall 1996</td>
</tr>
<tr>
<td>Emergency Forestry</td>
<td>35</td>
<td>15</td>
<td>Fall 1996</td>
</tr>
<tr>
<td>Water Management Rehabilitation</td>
<td>80</td>
<td>15</td>
<td>Fall 1996</td>
</tr>
</tbody>
</table>
Fears and Hopes—New Democracies Barometer Surveys

By Richard Rose and Christian Hearpfer

Life in the market economies of Central and Eastern Europe is a novel experience for hundreds of millions of people who have spent almost all their lives in a command economy. For decades, politicized bureaucracies rather than market mechanisms allocated goods and services. Transition has therefore been a learning experience in the college of hard knocks.

To understand what has been learned in the abnormal circumstances of the economic system transformation, we can turn to the normal social science method of the sample survey. The New Democracies and New Russia Barometer surveys of the Paul Lazarsfeld Society, Vienna and the Centre for the Study of Public Policy, University of Strathclyde, Glasgow, systematically collect data about mass response from nationwide representative samples of more than 12,000 people in eleven countries of Central and Eastern Europe and the former Soviet Union.

Major Concern: Inflation

Inflation and unemployment are much greater causes of anxiety in transition societies than in established market economies. The restructuring of the economy puts at risk the employment of people who thought socialism promised a job, if not work, for life. The introduction of market prices has been met by governments trying to print their way out of the resulting squeeze on incomes, making inflation a matter of great concern.

Three-quarters of Central and East Europeans see inflation rather than unemployment as the greater threat to their family after exposure to the twin threats of transition (table 1). There is little difference between countries in the degree of anxiety caused by inflation. This is especially striking given the very substantial cross-national differences in inflation. In Russia 62 percent of the population regards inflation as the greater threat.

Table 1. Inflation Is a Greater Threat than Unemployment.

<table>
<thead>
<tr>
<th>Country</th>
<th>Inflation</th>
<th>Unemployment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Czech R.</td>
<td>86</td>
<td>14</td>
</tr>
<tr>
<td>Slovakia</td>
<td>82</td>
<td>18</td>
</tr>
<tr>
<td>Romania</td>
<td>77</td>
<td>23</td>
</tr>
<tr>
<td>Poland</td>
<td>76</td>
<td>24</td>
</tr>
<tr>
<td>Slovenia</td>
<td>73</td>
<td>27</td>
</tr>
<tr>
<td>Hungary</td>
<td>70</td>
<td>30</td>
</tr>
<tr>
<td>Bulgaria</td>
<td>69</td>
<td>31</td>
</tr>
<tr>
<td>Average</td>
<td>76</td>
<td>24</td>
</tr>
<tr>
<td>Russia</td>
<td>61</td>
<td>38</td>
</tr>
</tbody>
</table>

Source: The authors.

The demand for price stability is rising, even though inflation rates are falling. In the 1993 New Democracies Barometer survey, an average of 57 percent of Central and East Europeans named inflation as the bigger threat. In the autumn 1995 survey the share of those who regard inflation as the more dangerous foe, hitting households as well as financial institutions, had risen to 76 percent.

Inflation hits everyone, including pensioners who are outside the labor force and people who work all year—and zooming prices affect the unemployed, too. By contrast, an annual average of 10 percent unemployment is also indication of 90 percent of the labor force in work. The annual average understates the percentage out of work at some point during the year. Yet, the wider the pool of unemployed, the shorter the period when individuals on average are without a job temporarily for any given annual unemployment rate. Among the two-thirds of CEE adults in the labor force, 76 percent report that in their family, no one has been unemployed during the past year. Even among those who have experienced recent unemployment, an absolute majority still regard inflation as the greater threat.

Supply: Rather Unaffordable Than Unavailable

Everyone in a transition society has experienced two radically different ways of regulating demand: through shortages and through prices. There are thus very few "don't knows" when people are asked: Do you think it is better to have lots of goods in the shops even if the prices are much higher (capitalism), Is it better when prices are kept low by the state, even though there are often few goods in the shops (socialism)? In every transition society, opinion divides into two more or less equal groups: an average of 55 percent in Central and Eastern Europe prefer a "window-shopping" economy (have an abundance of merchandise, if only to
glance at it through the shop window), and 45 percent prefer stable, low prices even if it means shortages (table 2).

Table 2. It Is Better To Have More Goods than Controlled Prices.

Q. Is it better to have lots of goods in the shops even if the prices are much higher, or is it better if prices are kept low by the state, even though there are often few goods in the shops?

<table>
<thead>
<tr>
<th>Country</th>
<th>Prefer More Goods</th>
<th>Prefer Controlled Prices</th>
</tr>
</thead>
<tbody>
<tr>
<td>Poland</td>
<td>69</td>
<td>31</td>
</tr>
<tr>
<td>Slovenia</td>
<td>63</td>
<td>37</td>
</tr>
<tr>
<td>Romania</td>
<td>62</td>
<td>38</td>
</tr>
<tr>
<td>Czech R.</td>
<td>56</td>
<td>44</td>
</tr>
<tr>
<td>Hungary</td>
<td>49</td>
<td>51</td>
</tr>
<tr>
<td>Bulgaria</td>
<td>47</td>
<td>52</td>
</tr>
<tr>
<td>Slovakia</td>
<td>41</td>
<td>59</td>
</tr>
<tr>
<td>Average</td>
<td>55</td>
<td>45</td>
</tr>
<tr>
<td>Russia</td>
<td>59</td>
<td>41</td>
</tr>
</tbody>
</table>

Source: The authors.

Age accounts for much of the difference in preferences between the two systems. The under-thirties are a window-shopping generation; two-thirds prefer high prices and lots of goods in shops. By contrast, among the over-sixties, only 44 percent prefer more choice and higher prices in a market economy. Differences by age are consistent across all countries in the region (see the figure).

In the 1995 Barometer survey, an average of 56 percent said their household was worse off now than five years previously; only 17 percent said they were better off (table 3); the rest reported that their situation was unchanged. Macroeconomic evaluations similarly show a tendency to view the transition economy less favorably than the old system, although in the Czech Republic, Poland, and Slovenia a majority are now positive about the transition economy and negative about the command economy. Almost half the families in the CEE region expect their economic situation to improve in the next five years, and only a sixth expect it to get worse. In Russia, however, pessimists are almost as numerous as optimists.

Table 3. There Are More Pessimists than Optimists.

Q. Is your household better off now than five years ago? Do you expect your situation to improve in the next five years?

<table>
<thead>
<tr>
<th>Country</th>
<th>Past-Present</th>
<th>Present-Future</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bulgaria</td>
<td>18</td>
<td>46</td>
</tr>
<tr>
<td>Czech R.</td>
<td>26</td>
<td>51</td>
</tr>
<tr>
<td>Slovakia</td>
<td>16</td>
<td>42</td>
</tr>
<tr>
<td>Hungary</td>
<td>9</td>
<td>37</td>
</tr>
<tr>
<td>Poland</td>
<td>20</td>
<td>49</td>
</tr>
<tr>
<td>Romania</td>
<td>15</td>
<td>47</td>
</tr>
<tr>
<td>Slovenia</td>
<td>15</td>
<td>48</td>
</tr>
<tr>
<td>Average</td>
<td>17</td>
<td>46</td>
</tr>
<tr>
<td>Russia</td>
<td>22</td>
<td>25</td>
</tr>
</tbody>
</table>

Source: The authors.

When Central and East Europeans are asked how long they think it will take the government to sort out their respective country's economic problems, two-fifths say they don't know. Among those with an opinion, half think it will take at least another decade to get the national economy right. Similarly, the average citizen in these countries expects that it will take five to ten years to reach a satisfying economic situation.

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Christian Hefner is scientific secretary of the Paul Lazarsfeld Society, Vienna. (Information: tel., (44141) 552-4400, fax (44141) 552-4711; [Internet: http://www.strath.ac.uk:80/Departments/CSPP]).
Quotation of the Month: "East Germany's whole economy was value-subtracting and cost-unconscious."
Professor Jan S. Prybyla on the Price of German Unification

The East German economy was in much worse shape than had been expected, not least because the intrinsically flawed communist idea—central command planning included—translated it with humorless but disciplined diligence into nonviable structures and catastrophic policies.

With a view to corporate takeover, Volkswagen AG sent a Herr Heuss to Zwickau to find out how the Trabants (relatively cheap, East German cars) were made there. He emerged shocked from the huge plant, babbling "My God!" The Trabant operation was value-subtracting: valuable material, labor, and capital inputs went in at one end; shabby Trabies came out at the other, their bodies made from compacted trash. The final output was worth less than the sum of the inputs. What was not fully understood at the time was that East Germany's whole economy was value-subtracting and cost-unconscious.

In 1989, Hans Modrow, the last communist head of the GDR, put the East German economy's net worth at 1.5 trillion West German marks (DM). A year later, his Christian Democratic successor, Lothar de Maizière, slashed the figure to DM 800 billion. After unification, Detlev Rohwedder, head of the privatization agency Treuhand, put the value of the assets on his agency's books at a comparable DM 600 billion, but on second thought, a year later, lowered this assessment to zero—assets and liabilities just balancing each other out. In 1994 Birgit Bruel, Rohwedder's successor, put the figure at minus DM 300 billion. By the end of 1995 some DM 700 billion gross (more than $1 trillion) and DM 500 billion net ($750 billion) of public money will have been spent on the "cure of Trabies."

From the perspective of market democracy (free enterprise and representative constitutional government), the damage done to the easterners' psyche by forty-five years of Marxist-Leninist socialism coming on top of twelve years of National Socialism, is not easily captured in deutsche marks or expressed by any figures of arithmetic. The short list of alleged disabilities includes weak personal initiative; demotivated work ethic; deficient sense of individual responsibility for one's life; strong aversion to risk; overdeveloped sense of entitlements, particularly with respect to security of income and employment and provision of rudimentary housing, health, and recreational services supplied by government at zero or nominal prices; preference for egalitarian outcomes; confusion over personal and political identity; and negative, often hostile attitudes toward private property, profit-making, entrepreneurship, and the material achievements of the market system, which is seen as too selfish, harsh and shallow (reflexive anticapitalism).

Now market democracy is a mansion of many rooms, capable of putting up (and putting up with) all sorts of guests, including uncongenial ones. Contrary to conventional wisdom, the communist-induced attitudes of today's east Germans (Ossis) and the democratically formed attitudes of the west Germans (Wessis), while in many respects dissimilar, are not qualitatively all that different. The similarities are remarkable in areas such as preference for generous welfare infusions into the market mechanism and for a high social content of property; tolerance, indeed ready acceptance, of government intervention in and regulation of many areas of private and civic life; deference to hierarchies and bureaucratic authority; acquiescence in far-reaching redistributionism; emphasis on economic security, social stability, and managed competition (Ordnungspolitik); and avoidance—at least in public pronouncements—of sharply defined ideological positions. Thus, despite the talk of spiritual rift between east and west Germany, there exists, not far below the surface a hard core of shared cultural and national habits and affinities chiseled over the centuries.

From the German national standpoint, the window of opportunity for unification had to be used when it opened in 1989-90. The unique historical opportunity was political, first and foremost. Some out-of-pocket expenses, later much decried, had performe to be borne in advance of formal political unification in contravention of economic theory's short-run dictates. Two good examples are the monetary union (July 1, 1990), carried out at the unrealistic exchange rate of 1:1 between the deutsche mark and worthless ostmarks; and the short time schedule envisaged for raising nominal wages in the east to western levels based on overly optimistic assumptions about increases in the marginal productivity of eastern labor in the proximate future. These politically motivated deviations from the prescripts of economic analysis were followed by large fiscal trans-
fers from west to east, to the tune of DM 180 billion a year gross, directed at a population of 16 million (roughly half the total west German tax revenues, 4 to 5 percent of west German GDP a year, DM 11, 250 per east German head), and DM 130 billion net, in the first three years after unification (90 percent of it transferred through the federal government), transfusions that helped raise the share of public spending in and the ratio of public debt to gross domestic product to uncomfortably high levels. (Interest payments on the public debt of DM 100 billion a year, not counting the $50 billion annual cost of servicing the debts of municipal housing authorities, the railroads, the post office, and Treuhand, are the second largest item of public spending after welfare.) If assistance on the same gross scale were given to Russia, it would cost DM 2 trillion a year, fifty times what was sent by the entire West in 1993.

A large part of the transferred resources has been spent on weaving social safety nets in the east that is, for insurance against social unrest. The downsizing and reconfiguration of the overmanned and distorted east German economy entailed by 1994 the shedding of 3 million jobs (2 million of them in manufacturing, nearly 1 million in farming), a drop in industrial output in 1990-91 of 65 percent, and open unemployment of 18 percent, not counting additional disguised unemployment of roughly one-third of the labor force. Germany also paid the Soviets to take out their 340,000 military personnel, directly by subsidizing housing construction for Soviet soldiers returning home, and indirectly by extending economic assistance to the Commonwealth of Independent States. And it is still paying for the environmental mess left behind by Soviet troops.

All in all, given the gargantuan dimensions of the undertaking and the relatively short time that has elapsed since the signing of the formal unification documents on August 31, 1990, the results have been positive and encouraging.

**Slowdown in Eastern Germany (Too)**

The Berlin-based German Institute for Economic Research now estimates east German growth for 1996 at less than 4 percent, compared with earlier estimates of 4 to 6 percent. Over the past couple of years, eastern Germany has become Europe's fastest-growing region, with industrial expansion rates of 20 percent in 1994 and close to 15 percent in 1995. But the boom has been significantly affected by the slowdown in western Germany in the second half of 1995. Signs of faltering growth became apparent in autumn, with a decline of 4.5 percent in manufacturing output in October.

The slowdown in growth can be attributed to three main factors:
- Six percent appreciation in real terms of the German mark since early 1994.
- Wage increases of around 5 percent for 1995, with a similar level expected for 1996.
- The increasing tax burden, which has dampened consumer spending.

Public and private investment in the east totals DM750 billion ($504 billion) and productive investment per person is one-third higher than in the west. Nonetheless, output is still heavily dependent on construction and installation as well as on sectors sheltered from extraregional competition. Industries such as brick making, food processing, and light metal working account for 40 percent of manufacturing output, compared with only 13 percent in the west. The east's merchandise exports make up only 1.8 percent of the German total.

The labor force has shrunk by 40 percent since unification and there are now only 622,000 people employed in industry. Improvement in the labor market has been steady after the lows of 1992 and 1993. In 1995 there was a 2 percent rise in employment and the numbers receiving assistance under special labor market programs fell by 71,000. An increase of 33,000 in the unemployment total over 1995 reflects changes in the labor participation rate. Job creation remained strong in the artisan craft sector, which, through regional assistance, has been targeted as a priority. This year, however, unemployment in the east could rise to 15.5 percent, up from 14.0 percent last year.

Harmful effects of wage harmonization with the west have declined and, since 1994, productivity has grown in line with wages. The final move to parity with western wage levels—those set by collective wage bargaining—will take place in July 1996. At present, wages in the engineering and electrical industries are equal to 94 percent of western levels. Unit wage costs in the east are, in the aggregate, 31 percent higher than in the west, although in manufacturing the disparity is only 11 percent.

Transfers on the order of at least DM 200 billion gross (DM 140 billion net) can be expected for several more years, despite widespread calls for a reduction of west-to-east transfers—to avoid the creation of a subsidy mentality. The 1996 federal budget foresees the following investment support in the east, targeted at the manufacturing sector and particularly at small and medium-size firms:
- Special investment grants to the manufacturing sector (DM 16.4 billion).
- Regional investment grants (DM 3.2 billion).
- Research and development assistance (DM 2.1 billion).
- Capital injection assistance for small and medium-size enterprises (DM 1.35 billion).
- Labor market assistance (DM 25.5 billion).

To sum up, investment assistance remains crucial to the development of the Eastern German economy.

*Based on reports of Oxford Analytica, the UK-based international consulting firm.*
"Wither Socialism?" is not—as the title might suggest—another refutation of the now-disintegrating real socialism of the 1970s and 1980s by contrasting it with the pure model of competitive capitalism widely used as reference point in much of the literature on system transformation. Rather, the book's focus is "market socialism," by which the author means neither the incoherent blend of central planning and market coordination tried by some Central European countries in the 1980s, nor a utopian "third way." Instead, Stiglitz focuses on the market socialism model of Lange, Lerner, and Taylor, prevalent in the 1930s, which was based on the assumption that if public enterprise managers enjoy enough independence in their business decisions, they behave rationally (equalize marginal revenue to marginal cost)—that is, that the efficiency of the free market system can be reproduced without private property.

Stiglitz is widely known as one of the pioneers of the new information economics; according to the bibliography he is the author or coauthor of 129 publications in this area. Information economics challenges key assumptions of the competitive capitalism model and focuses on information inefficiencies, such as imperfect competition (oligopolistic practices); incomplete markets for goods, labor, capital, and land—in particular, forward markets; and incomplete and costly information, as well as limits and costs of processing available information. Other constraints, such as increasing returns (including research and development, learning-by-doing), further weaken the basis for competitive capitalism. Stiglitz concludes that both capitalist and market socialism models are operationally irrelevant.

Let us summarize the author's position on four closely related issues: competition, privatization, capital markets, and the role of the state.

**Competition.** Change of ownership will improve performance automatically and swiftly only by assuming perfect competition. But in modern economies, due to informational and other constraints, imperfect—mainly oligopolistic—competition prevails. Thus, subjecting firms to real competition is more important than changing ownership. Competition serves crucial functions: it generates information about the success or failure of firms, which in turn enables management to develop rational incentive structures; and it promotes innovation.

**Privatization** is viewed as having fallen under the spell of the "property myth...[which] holds that all one has to do is correctly assign property rights, and economic efficiency is assured. This myth is a dangerous one because it has misled many of the countries in transition to focus on property rights issues, on privatization, rather than a broader set of issues. Resolving property rights is certainly not sufficient, and may not even be necessary," the author remarks. Voucher privatization, that is, free distribution of assets, amounts to a "negative lump-sum tax." This loss of government rents requires raising tax revenues, which has distorting consequences. Although the theoretical argument for fast and complete privatization is questionable, practical economic arguments may yet support such a strategy, especially if the government is losing control over state-owned enterprises.

Privatization can provide other practical benefits, such as a consequent change of incentives, a hardening of budget constraints, and a demonstration of political commitment to systemic change. Efficient corporate governance—the main argument for swift privatization—is highly unlikely, whatever privatization model is used, and there is no plausible answer to the intriguing question of who would monitor the monitors—in other words, who would control the business decisions of the managers if share ownership were dispersed. Therefore, banks should be given a prominent role as owners. Indeed, banks have the information derived from, and power exerted through, granting or withholding financing. (Stiglitz urges the transition economies to adopt the continental European and Asian model of banking.) Mutual or peer monitoring by a coalition of the major "stakeholders" (including state holding companies) could provide...
more competent corporate governance than any alternative, in contrast to the fashionable focus on shareholder value.

**In the capital markets**, information shortcomings have particularly grave consequences. The social return of information generated on the security markets is negligible; nor is such information useful for developing rational patterns of savings and investment—even in highly industrialized economies. Reshuffling existing state ownership—the primary function of the stock market—is essentially a zero-sum game, predominantly driven by rent-seeking and by perceptions, rather than information on fundamentals, with at best minor effects on aggregate efficiency, the author claims. Stock markets, therefore, are primarily "the rich man's horse track, or the middle-class' gambling casino," with little effect on raising funds and allocating resources. Even mature equity markets may distort enterprise behavior; a good example is the linking managers' rewards to short-term stock price fluctuation. Therefore, it is a myth that a good stock market is all one needs, Stiglitz points out.

**Role of the State.** The scope for massive coordination failures resulting from information deficiencies in competition, privatization, and capital markets leads to the rejection of the "folk theorem" that "anything the government can do, the private sector can do better." Stiglitz believes that on the contrary, there is no intellectual foundation for the separation of efficiency and equity concerns. Government intervention can improve welfare beyond correcting the traditional market failures, such as externalities, public goods, and monopolies. Economic history offers innumerable examples of both market and government failures, but no "controlled experiments" exist that could settle the question in favor of one or the other institutional arrangement. However, empirical evidence suggests that transition economies with a weak government can be better off with private arrangements. The role of government, therefore, cannot be defined on the basis of the insupportable normative axiom that government should be as small as possible. A pragmatic approach would be more proper, choosing between the public or the private alternative, depending on which would perform better under the existing informational and institutional constraints.

Only in the last few pages of the book does Stiglitz offer a veiled answer to the title's question. In a philosophical rather than economic conclusion, the author tries to explain the incessant appeal of Marxism over more than a century. He predicts that although the "great socialist experiment" has run its course, its perseverance suggests that the "dream of a better world, ... a central theme in the development of Western civilization since the Reformation," is likely to persist in one form or another. He suggests, further, that even forgetting its theoretical shortcomings, the narrow neoclassical model which holds that individuals' self-interest is the only motivating force for economic and social relations will not convince those who have decided to quest for a more humane and egalitarian society. The author makes no secret of his conviction, pointing out, "the question is whether the insights of modern economic theory and the utopian ideals of the nineteenth century can be brought closer together?"

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Milestones of Transition

Worldwide flows of foreign direct investment (FDI) soared to a record $325 billion from $222 billion in 1995, UNCTAD's World Investment Report 1996—to be published in July or August—points out. Inflows to developing countries climbed to an all-time high of $97 billion in 1995 from $86 billion in 1994. China accounted for the lion's share, attracting $38 billion last year. FDI flows to Central and Eastern Europe posted record inflows of $12 billion, double the previous year's total, with the Czech Republic, Hungary, and Russia prominent among recipients.

Russia

The Russian government is preparing a package of emergency measures to boost revenues that will be implemented within weeks if President Boris Yeltsin is reelected, government officials reported. The measures are likely to lead to higher prices for consumer goods, gasoline, electricity, and alcoholic beverages, thus also raising taxes. The government is considering cutting subsidies for rent and utilities, restricting corporate cash transactions, and banning corporate dividend payments until all state and private debts are settled.

Failure to collect taxes remains the Russian government's major headache. Tax revenues have been far below expectations this year and forecasts for the future are even more pessimistic, according to Finansovye Izvestiya reported May 28. From January through April 1996, the federal budget collected 58 trillion rubles in taxes, 15.5 trillion rubles (or 22.6 percent) less than planned. And the government's tax collection record is getting worse, not better. January's tax income was 13.9 trillion rubles, February's 12.8 trillion rubles, March's 17.6 trillion rubles, and April's 13.5 trillion rubles. Of the 19.6 trillion rubles that should have been collected in May, only 4.9 trillion rubles had been collected by the middle of the month. (Uncollected revenues at the end of the first quarter totaled 48.4 trillion rubles, up more than 15 trillion rubles from the start of the year.)

Russian Prime Minister Viktor Chernomyrdin said the tax reforms currently being prepared by the government for implementation next year will cut taxes on companies that were up to date with their tax payments. Companies that have given up bartering and paying assessed taxes in full will qualify for a 3.5 percent reduction in taxes on their profits. Tax-paying businesses will also qualify to compete for state contracts, and will be eligible for state loans and credits. Chernomyrdin said the government plans a tougher corporate tax environment in which tax deferments are granted only to enterprises on the brink of bankruptcy. He also predicted that interest rates will fall by up to a third by the end of the year if monthly inflation continues at or below 1.5 percent.

Russian GDP fell by 3 percent in January-May compared with the same period in 1995, Goskomstat reported on June 19. Industrial production fell by 4 percent, with a steep 24 percent fall in light industry and construction materials, according to Finansovye Izvestiya. Although the decline in production had stopped as of April, it resumed in May. Inflation meanwhile fell from 4.1 percent in January to 1.5 percent in May. (A survey of Russian industry showed that more than 80 percent of plant managers expect production to start stabilizing in the second half of this year.) The other positive trend is foreign trade, which grew by 12.1 percent in the first four months of 1996, reaching $42.8 billion. Trade with CIS states made up 26 percent of the total. The continuing decline in GDP will make it more difficult for the government to deal with the yawning budget deficit because of its impact on tax revenue.

The average subsistence minimum during January-April 1996 was 360,000 rubles per month ($75)—73 percent higher than for the same period in 1995, Goskomstat reported in mid-May. The number of people living in families with incomes below the subsistence minimum during January-April was 35.4 million—9 million fewer than for the same period in 1995—and real incomes in April 1996 were 3 percent higher than in April 1995. Goskomstat Chairman Yurii Yurkov said that these figures, calculated according to the labor ministry's methodology, should be regarded as the minimum to ensure physical survival. Income differentials have grown again: the incomes of the richest 10 percent of the population were 13.6 times higher than those of the poorest 10 percent; the equivalent figure for January-April 1995 was 13.3 times. The average salary in April was 775,000 rubles ($155), 4 percent higher than in March. During the first quarter of 1996 gas industry workers earned the highest salaries, making an average of 2.75 million rubles ($570) a month, while agricultural workers earned the least, about 260,000 rubles. At present, the minimum wage is 75,900 rubles ($15), and the minimum pension is 69,575 rubles ($14) a month. The wage debt to workers in state-funded enterprises and organizations is growing again. Goskomstat reported on June 19 that the debt to state workers has reached 4.2 trillion rubles ($838 million), up 20 percent from early May. The total wage debt has risen to 27.1 trillion rubles.

There are 877,000 small businesses in Russia, accounting for about 15 percent of the labor force and 12 percent of
Russia’s GDP, Vyacheslav Prokhorov, chairman of the State Committee for the Support of Small Business, said on June 6. Small businesses—defined as those with fewer than 200 workers—employ 8.9 million people full-time and another 5 million part-time. Their registered number has shrunk by 2 percent since 1994. Private investment in the sector reached about 28 trillion rubles ($5.6 billion) by the start of 1996.

President Yeltsin approved the criminal code on June 13. The code was adopted by the Duma on May 24 and the Federation Council on June 5 and will go into effect on January 1, 1997. The new code pays particular attention to economic crimes, including unfair competition and money laundering.

The government hopes to raise 12.4 trillion rubles ($2.5 billion) this year by selling stakes in major energy and communications companies, Federal Property Fund Deputy Chairman Vladimir Malin has announced. The fund intends to sell off a 34 percent stake in Norskoil, a 29 percent stake in NAFTA-Moskva, and a 1.5 percent stake in LUKoil, as well as 25 percent of shares in Svyazinvest, 22 percent in Moscow Central Telegraph, and 1 percent in the national power grid EES Rossii. Malin said the government will probably not repeat the controversial loans-for-shares auctions.

The Russian Ministry of Agriculture expects this year’s grain harvest to be 75-78 million metric tons, up from the 67 million last year, which was the lowest since 1963.

As of July 1 the rouble will be allowed to float within a range of 5,000 to 5,600 to the dollar, instead of the present range of 4,550 to 5,150 rubles to the dollar. Then for six months the Russian currency will be allowed to depreciate gradually to between 5,500 and 6,100 rubles to the dollar. The precise value will be set each day. The central bank will be able to defend the currency against steep falls, using its substantial reserves of about $13 billion in central bank and finance ministry gold and foreign exchange assets.

**Baltics**

The Bank of Estonia has announced that bad loans accounted for about 2.2 percent of the loan portfolio of Estonia’s commercial banks at the end of April. The value of bad loans grew by 7.5 percent in April, to reach 178 million krooni ($15 million) out of an overall loan portfolio of 8 billion krooni. The Union Bank of Estonia held the most bad loans (37.5 million krooni), followed by the savings bank and North Estonian Bank, with bad loans of 30.5 and 29.6 million krooni, respectively. The Innovation Bank had the lowest number of bad loans (900,000 krooni).

Preliminary results of the first household budget survey conducted by the Lithuanian Statistics Department indicate that about two-thirds of most family budgets was spent on food and housing in the first quarter of 1996. The survey of 2,133 households found that the average monthly per capita income was 446 litai ($111.50), with urban income at 517 litai and rural income at 403 litai. The family budget was spent on food products (47.7 percent); housing, heating, and electricity (18.4 percent); clothing (7.6 percent); leisure and entertainment (2.2 percent); and education and culture (1.0 percent). Only 0.4 percent of those polled considered their living conditions to be very good, and 6.1 percent said their conditions were very bad. A fifth said that they had experienced difficulties in the past few years in making timely payments for their apartments and communal services, while 45.1 percent said they had not.

**Belarus**

President Alexander Lukashenko on May 28 issued orders that impose strict control on Belarus’s twenty commercial banks and order 178,000 private businesses to reregister by January 1, 1997. The Belarus Central Bank was to review by mid-June whether state property was legally transferred to commercial banks when they were established and was charged with ensuring that the state is compensated for any losses. The government will be able to impose temporary management on a bank if it reports losses for more than three months. Banks are obliged to report transactions exceeding $10,000, and each bank has to reregister its operations with the government by September. Commercial businesses face closure by a wide array of legal bodies such as tax authorities, the president’s office, and the KGB security service. Reasons for closure include tax evasion, not earning a profit, not filing a financial report with the government in a specified period, and inactivity for six months. The Belarus government lost a third of its budget revenues last year due to unpaid taxes. These tighter regulations come a week after Lukashenko brought the bank payment-clearing institution under state control, saying laws were broken setting up the center and funds were misused. The Minsk currency exchange was nationalized in April and strict controls were put on the foreign exchange market. "The state and only the state will run our country, our economy," Lukashenko said earlier this month.

**China**

China’s GDP is expected to grow 10.4 percent in the first half of 1996 over the same period a year earlier, the State Planning Commission reported. China’s fixed asset investment in the first quarter grew by 16.2 percent over the 1995
level, which was down 18 percent from the previous year. Retail prices rose by an average of 7.6 percent year-on-year in the first four months of 1996. The trade deficit for the first four months of the year was $700 million. The trade deficit could reach about $500 million this year after a $16.7 billion surplus in 1995. Foreign reserves rose to $80.8 billion at the end of the first quarter from $73.6 billion at the end of 1995.

China's labor ministry has warned that in a worse-case scenario there could be 153 million workers without jobs by the turn of the century if the government takes no action.

Effective May 1 the central bank cut interest rates on loans and deposits by an average of seventy-five basis points and ninety-eight basis points, respectively. The rate cuts follow the reversal in real interest rates from negative to positive since October 1995. Retail price inflation fell to 7.7 percent in the first quarter of 1996, well below the 10.9 percent interest rate on a one-year loan. China's central bank has freed interest rates on the national renminbi interbank market as of June 1, a key move toward making interest rates market-driven.

Bulgaria—Dancing On the Brink

Bulgaria's government is trying to pare its heavily indebted state sector and shore up its ailing banks. Over the past six years the six governments that have come and gone, and the consequent shifting of ministers and programs, have resulted in confusion that has dried up foreign investment. Privatization is stalled, the state-controlled economy is dominated by Soviet-era companies, and Bulgaria is in an economic crisis. Foreign debt payments for the whole year will total $1.2 billion. The country's foreign reserves are below $600 million. The government expects to receive between $700 million and $1 billion in financial assistance after reaching an agreement with the IMF and the World Bank.

Prime Minister Zhan Videnov, in an address to parliament on May 29, announced new austerity measures agreed with the IMF. Videnov said that by adopting the austerity program the government hopes to be able to collect 140 billion leva ($1.47 billion) in 1996. The measures include:

- Gasoline price hikes of up to 80 percent.
- Increases in the VAT rate from 18 to 22 percent beginning in June.
- Increases in excise duties on alcohol.
- Introduction of a 5 percent import surcharge on imports, effective from July 1, 1996, to June 30, 1997. Certain intermediate goods will be exempt from the import surcharge which will be phased out by the end of the century. Crude oil, natural gas, electricity, coal, nuclear fuel, metals, cotton, pharmaceuticals, and unrefined sugar will be exempt from the duty.
- Closure of sixty-four loss-making companies that account for 25 percent of total losses of the state owned enterprises and employ 25,000 people. They will add 0.6 percent to the 12.5 percent unemployment rate. Another seventy companies are to be cut off from state-owned bank loans and given one year to devise restructuring plans. Job losses could reach 60,000 when companies that cannot be closed, such as the state railways, are restructured.
- Acceleration of privatization; 42 percent of all state-owned firms are to be sold for cash or privatization vouchers. (The Center for Mass Privatization announced on June 17 that just over 3 million people—or 48.7 percent of those eligible—have bought privatization vouchers.)
- Consolidation of the banking sector, including shutting down up to five insolvent banks. The Bulgarian parliament on May 14 passed amendments giving the national bank the right to declare commercial banks insolvent and to recommend to the court that they be declared bankrupt. Several banks facing a liquidity crisis have been taken over by the Bulgarian National Bank, such as the state-controlled Mineralbank and First Private Bank. Individual savers would get all their money back.

The announcement of the stabilization package came just days after Bulgaria on May 27 reached a preliminary agreement with the International Monetary Fund on a standby loan that Bulgaria urgently needs to meet its foreign-debt obligations. The IMF's Executive Board is to meet in July to consider Bulgaria's application for a $600 million standby credit.

"Bulgaria could receive the first tranche of World Bank lending in September, earliest, on the condition that the government persisted in carrying out tough reforms agreed on in May." Alberto Musalem of the World Bank's Sofia office stated during a news conference. The bank is waiting for progress on structural reform, including the closure of unprofitable enterprises, before it releases $30 million to be used to cover severance pay for displaced workers. The Bank has been holding back $400 million in project loans to Bulgaria, but it could redirect some of those funds to help alleviate the social side effects of shutting down state enterprises.

Bulgarians are being hit hard by the country's economic crisis and falling living standards, at a time when their monthly wages have shrunk from the equivalent of $10 to just $70, due to the plunging value of the leva against the dollar. Bulgaria's currency, the leva, has lost some 70 percent of its value since the beginning of 1995. The National Statistical Institute announced that the prices of goods monitored by the government went up by 10.8 percent in the first half of June. This is twice the increase predicted by economists and statisticians. The country is experiencing a severe grain shortage, as producers have been unwilling to sell at the low government-controlled prices. Falling bread supplies and grain shortages have triggered panic in several Bulgarian cities. Bakeries throughout the country have been forced to close or to ration their sales.

Based on press reports and briefs of Oxford Analytica, the UK-based international consulting firm, and the contribution of Zeljko Bogetic, World Bank Country Economist for Bulgaria.
Czech Republic

The Czech Republic's first-quarter 1996 GDP growth in real terms reached 4.3 percent, keeping the country on track for annual GDP growth of above 5 percent this year. However, capital investment growth slowed while household demand—driven by real wages growth—accelerated. Real growth of Czech exports in 1995 was 7.9 percent against real growth in imports of 19.2 percent. Foreign capital flooded the country in 1995, raising national bank reserves to $13.9 billion at the end of 1995 from $6.2 billion a year earlier. But foreign currency reserves fell to $12.6 billion by the end of April 1996, from roughly $14.2 billion at the beginning of February.

The trade deficit increased sharply in April with the cumulative deficit for 1996 rising to koruna 38.9 billion ($1.4 billion) at the end of April from koruna 26.3 billion ($950 million) a month earlier. This puts in jeopardy government forecasts of a roughly $3 billion year-end shortfall. The koruna has appreciated by more than 2 percent in the past two months alone. The quarter's current account deficit widened to $541 million from $217 million in the same period last year. The capital account surplus fell sharply in the first quarter to $90 million from $2.1 billion for the period last year.

A survey conducted by the Center for Empirical Studies (STEM) indicates that 50 percent of Czechs are dissatisfied with their families' economic situations. A report issued on May 21 stated that some 45 percent of the poll's 1,595 respondents agreed that "the government's effort to reduce differences between the rich and the poor damages the national economy," while 55 percent disagreed. About 53 percent expected the privatization of formerly state-owned companies to help resolve the country's economic problems. Respondents were evenly split between those agreeing that unprofitable companies should be closed immediately, even if such steps result in higher unemployment, and those who thought that the government should keep such companies afloat.

Hungary

The European Bank for Reconstruction and Development (EBRD) approved ECU 1.073 billion worth of modernization projects in Hungary in 1995. The EBRD is now reviewing applications for eight new projects in Hungary, the largest being the proposed ECU 32 million credit aimed at financing development of Budapest's Ferihegy Airport.

Hungary hopes to complete the sale of state-owned enterprises within two years, Privatization Minister Tamas Suchman has announced. Privatization of the energy sector will be completed, and fifteen to eighteen large industrial enterprises will be offered for sale. The current value of all state enterprises is about HUF 1,200 billion; two-thirds of these will be put on the block. Hungary hopes to increase the private sector's share in GDP to 85 percent by 2000, from the current 70 percent.

The Budapest-based economic research firm GKI forecasts 1996 GDP growth of around 1 percent, a 25 percent inflation rate, and a $2 billion balance of payments deficit. Real wages are expected to drop by 6 percent.

Kyrgyzstan

The government will sell its controlling interest in 100 industrial companies in order to increase the inflow of foreign capital into the economy, according to Askar Sarygulov, head of Kyrgyzstan's State Property Fund. An article in the May 16 Finansovye Izvestiya reported that companies such as the Khaidarkan Mercury Plant, Mailisuu Electrical Lamp Factory, and Ak-Suu Corn-Processing Plant are expected to attract foreign investors. The government also intends to step up privatization in such sectors as energy production, telecommunications, and mining. In addition, it will allow foreign firms to manage local enterprises in order to improve the latter's financial situation.

Poland

Poland's foreign trade, which has been growing steadily for the past five years, reached a record $51.9 billion in 1995, with exports reaching $22 billion and imports $29 billion. The value of 1995 exports per capita was $593. In highly developed countries, the figure ranges between $5,000 and $15,000.

Poland's Main Statistical Office (GUS) has issued two very different estimates of the extent of poverty in 1995, Rzeczpospolita reported on May 16. According to the Institute of Labor and Social Affairs, each household needed 359.3 zlotys ($135) per person per month to meet basic needs. Using that standard, GUS has estimated that 49 percent of households lived in poverty in 1995, compared with 34 percent in 1990. According to GUS's second method, however—the one employed in the EU—only 12.8 percent of households live below the poverty line. This method sets the poverty line at a per capita household income equal to 50 percent of the average monthly expenditures of a single-person household, a calculation which for 1995 results in a figure of 207 zlotys per person. According to the second method, poverty incidence has remained stable since 1993.

Poland's government plans to lower income and corporate taxes in 1997 to maintain high economic growth and low inflation, the finance ministry has an-
The government envisages average annual economic growth of at least 5.5 percent and calls for reducing the budget deficit to 1.7 percent of GDP by 2000.

As of end-April Poles had purchased 55,600 new imported automobiles already this year, as many as in all of 1995, according to Gazeta Wyborcza reported on May 27. Although this year’s duty-free allotment of 37,000 cars has been exhausted, the 25 percent customs fee now levied on imports is showing little sign of slowing the import boom.

Trade union representatives have rejected the Polish government’s plan for restructuring the coal-mining industry by 2000, saying the plan is incomplete and calling for a coal summit. Twenty of sixty-five coal mines will be liquidated and 80,000 of 270,000 employees will be laid off in five years. Industry Minister Klemens Scierski said that Poland produces as much coal as the entire European Union, which has about 200 mines. But the EU mines employ 170,000 people—100,000 fewer than work in Poland’s sixty-five mines. Two unprofitable mines will be liquidated by 2000. Production will decrease by 20 million tons annually, from the current 100 million. Some 80,000 workers will take early retirement or be laid off, although many of the latter will be requalified in other lines of work. The restructuring will be subsidized by the government. The industry lost $316 million in 1995 and has accumulated debts of $1.78 billion. The average miner’s basic monthly wage is 700 zloty ($277).

Work on this year’s privatization of state enterprises via public offer has been seriously delayed, so that it will be a miracle if any firm is sold before the third quarter, Privatization Minister Wieslaw Kaczmarek announced on May 23. According to the "Directions for Privatization in 1996," the government is to sell off shares in fifty-seven state enterprises, including those of Polish Copper, the nation’s second most profitable firm. Problems in selecting an adviser for the privatization and conflicts about the numbers of shares to be sold to domestic and foreign investors have reportedly contributed to delays. The group of large and profitable firms to be privatized this year include the Paper and Cellulose Factory of Swiec, the Pulawy Fertilizer Company, and Impex Metal.

Romania

The National Federation of Pensioners rejected the Romanian government’s plan to increase pensions by a mere 8.3 percent starting on June 1. In response to the pensioners’ protest, the government of Nicolae Vacaroiu announced a rise of 10.5 percent. Even this higher increase leaves retired Romanians with only 67.4 percent of the purchasing power they had in 1990. Yet many in the government worry that the latest rise is dangerously high. Vacaroiu warns that unless measures are taken to prevent early retirement, the state will be unable to pay all pensions by the end of 1997.

Romania has every chance of maintaining last year’s 7 percent GDP growth rate for the foreseeable future, Economic Reform Minister Mircea Cosea said in mid-May. With 90.5 percent of Romanians having already exchanged government coupons for company shares, the country’s privatization program can be considered a success, according to Cosea.

The World Bank has decided to unblock an $80 million credit line representing the second tranche of an EFSAL loan, Romanian media reported on May 27. National Bank of Romania Governor Mugur Isarescu announced on the same day that the bank will float a $150 million Eurobond issue in June jointly with Merrill Lynch International in order to increase Romania’s foreign exchange reserves. The Romanian branch of Citibank will finance the purchase of U.S. farm equipment with a $90 million loan.

The Association of Entrepreneurs and Constructors of Israel (AECI), the country’s largest importer of foreign labor, has suspended hiring of Romanian workers and will repatriate almost 45,000. The move should stem the steady stream of workers into higher-paying illegal jobs. Ten or twelve thousand Romanian building workers have left their legal jobs and are now working on the black market, according to Israeli sources. This embargo will cost the Romanian labor market $500 million. The planned repatriation could boost Romania’s 9.4 percent unemployment rate.

Ukraine

Pavlo Lazarenko, Ukraine’s new prime minister, announced that his government will allocate another 35 trillion karbovantsi ($189 million) to bail out the country’s troubled coal industry, Ukrainian television reported on May 30. Part of the funds will go toward payment of the government’s 38 trillion karbovantsi wage debt to miners, while some 6 trillion will be used for state coal purchases. Coal Industry Minister Serhii Polyoakov said the government plans to shut down 100 unprofitable mines, mainly in the Donetsk and Luhansk oblasts. He said there are plans to transfer all social facilities and services in the country’s coal mining towns to the jurisdiction of local councils.

In an attempt to avert growing social tension, Ukraine’s parliament on May 23 voted to use a $150 million foreign credit to start paying off more than $1 billion in wages, pensions, and student grants. "We recommend the govern-
ment use the credit from Japan to cover our wage debts, which are growing daily and which now amount to $1.19 billion," parliamentary banking committee chief Viktor Suslov told the chamber, which voted 279 to 3 in favor of the motion. Many teachers and doctors have not been paid since the beginning of the year. Parliament also directed the government to cut some capital projects for 1996 and use the money for wage payment.

Deputy Prime Minister Anatoly Kinakh said Ukraine's monthly inflation rate should be 1 to 2 percent by the end of the year. Inflation was 2.4 percent in April, down from 9.4 percent in January. Industrial output fell by 2.5 percent in the first four months of the year compare with a 12.7 percent drop in the same period last year. Central bank chief Viktor Yushchenko predicted GDP would fall between 1.8 and 2.0 percent this year after an 11.8 percent fall in 1995. Ukraine has slowed a steep fall in GDP and forecasts an annual inflation rate of 34 to 40 percent, down from 181 percent last year.

Slovakia

Slovakia's trade deficit for the first four months of 1996 reached 21.5 billion crowns ($693 million). Slovakia had its highest trade deficit with Russia, while its trade with the Czech Republic was balanced. While exports fell by 1 million crowns in April compared with the previous month and were lower than in the same period last year, the growth in imports caused foreign currency reserves to drop by $80 million since the beginning of the year, reaching $3.3 billion in mid-May.

Data released by the Slovak Statistical Bureau showed year-on-year consumer inflation was 6.0 percent in April, down from 11.2 percent in the same month last year. But energy prices are still fixed by the state. The state electricity monopoly recently proposed to the government price increases of 10 percent for retail customers and 5 percent for wholesale beginning July 1. The state gas utility is seeking a 7 percent retail price rise. Slovakia has the lowest inflation rate in Central and Eastern Europe, beating the Czech Republic, which had an 8.9 percent year-on-year rate in March.

Slovenia

An economic package to improve economic competitiveness and stimulate growth in the second half of 1996 has been approved by the Slovenian government. The plan will go into effect the beginning of July. Labor-intensive industries, whose international competitiveness has been most eroded by the tolar's real effective appreciation, will get extra support. Key features of the package include reductions in the social security tax rate from the current 42 percent to 38 percent, and increases in the investment tax credit from 20 percent to 30 percent, in order to reduce the tax burden and labor costs in the enterprise sector.

Slovenia has received the highest initial credit rating of any country in transition, putting it at or above the rating enjoyed by the Czechs. Moody's has rated it at A3, while IBCA and Standard & Poor's have given it A ratings. These ratings came before Slovenia's first Eurobond flotation; some $200 million in bonds will be sold in June. But while the rating agencies praised Slovenia's macroeconomic management, they stressed the need to restrain wage costs, accelerate privatization, and reform the pension and health care systems. Meanwhile, the Slovenian inflation rate was up to 1.2 percent in April, a higher month by rate than seen in the previous twelve months, raising concern that inflation will hit the double digits in 1996, rather than be held to the 6 to 7 percent planned.

Viet Nam

Viet Nam and its commercial bank creditors have announced an agreement on general financial terms to settle about $1 billion of debt principal and interest arrears. The agreement, signed in Hanoi in mid-May, will clear the way for the country to tap international markets for investment capital. Hanoi will be able to write down about 50 percent of a large chunk of its debt.
World Bank/IMF Agenda

Russia Negotiates $1 Billion World Bank Loan

World Bank President James Wolfensohn announced May 23 during his Moscow visit that the World Bank will lend Russia over $1 billion to overhaul its coal-mining industry ($530 million) and reform its agricultural sector ($500 million). The loan follows an agreement on a $350 million Bank loan for repairing bridges. The loans bring the total amount the World Bank has lent to Russia to $6.5 billion, making the country the Bank's third-largest client after China and Mexico.

Recently Approved Loans to Russia:

• May 8: $300 million to help finance the transfer of housing from enterprises to new private owners in six pilot city projects. Housing is the largest of the social assets owned by Russian enterprises. They have been encouraged to divest housing since the launch of the mass privatization program in 1992, but tenants and local councils are reluctant to take over housing because of the burden of maintenance and utility costs. In the pilot cities the councils already have managed to increase the proportion of operating costs paid for by tenants from 13 percent to 35 percent. The six cities, chosen by competition, are Novocherkassk, Orenburg, Petrozavodsk, Ryazan, Vladimir, and Volkhov. The Russian government will spend another $250 million on the project, mainly for building repair and the installation of meters.

• May 30: $89 million to support the development of capital markets in Russia: to improve the markets' regulatory infrastructure and supply telecommunications and computer equipment; and to create a computerized system at the finance ministry for monitoring the issuance of government securities.

• May 30: $80 million to finance two environmental projects—subsidizing the gradual elimination of chemicals that damage the ozone layer (produced in the aerosol and refrigeration sectors); and protecting rare animals and plants to preserve biodiversity.

• June 4: $270 million for a medical equipment project at primary and secondary health care facilities in thirty-four selected oblasts, providing medical equipment, consumable supplies, and technical and clinical training in the operation and maintenance of equipment. This loan will also finance consultant services for survey design and data collection, as well as computer hardware and software, to support the implementation of a system of national health accounts.

• June 16: $58 million to support legal reform in Russia. The project, with a total value of $89.4 million, aims to improve the performance of Russia's legal systems.

Ruble Convertibility

Russia formally accepted the obligations of the IMF's Article VIII governing currency convertibility for current international transactions. The IMF said Russia's acceptance of the obligations was a welcome step toward full convertibility of the ruble and marked an important milestone in the country's rapid integration into the global economy. Russia has met economic targets in the latest review of its performance by the IMF Board, opening the way for a fresh $330 million Expanded Financial Facility drawing.

Yuan Convertibility Next Year?

Central bank Governor Dai Xianglong said China plans to adopt current account convertibility for the yuan by the time it hosts the IMF and World Bank Annual Meetings next year in Hong Kong. Among the policy changes planned for the second half of this year are an extension of the pilot scheme allowing foreign-funded enterprises to hold foreign exchange and trade it freely with banks. The central bank also plans to increase as of next month the limit on individual foreign exchange purchases from banks. Dai dismissed suggestions by some Western economists that the 8.7 percent decline in China's exports during the first quarter of this year meant that its currency was overvalued. He said the $1.2 billion first-quarter trade deficit was caused by delays in paying tax rebates to exporters and heavy imports of capital goods. China is still enjoying a capital inflow that supports the yuan exchange rate, according to Dai. If inflation continues to fall, Chinese authorities will consider a further relaxation of credit later this year.

Loans to China

The World Bank on May 30 announced it had approved loans worth $360 million to help improve rural living standards and road networks in two Chinese provinces. In Gansu the Bank will contribute $150 million to a $259 million project to build the Changma Dam on the Shule River and finance the voluntary resettlement of 200,000 poor people to newly developed irrigation land. Another World Bank loan of $210 million will help build an 85-mile (136-km) highway segment and improve 1,000 miles of rural roads in Henan province.
IDA Credits to China—For How Long?

By the end of this century China is going to lose access to the World Bank's low-interest credit window, and in the future borrowing money will be more expensive for the country, reported the South China Morning Post on May 26. This is the result of changing government donor attitudes and reduced availability of concessionary funds for poor countries. "China is now in a position to borrow money on international capital markets," Pieter Bottelier, head of the Bank's Beijing office is quoted as saying. "In just a few years China has the historic opportunity to make the jump from a receiver to a donor country and contribute to World Bank funds," Bottelier said. The World Bank has committed to date some $25 billion to China.

World Bank Halts Programs to Belarus

The World Bank has suspended all programs for new credits to Belarus. The remaining $55 million of $170 million already allocated by the Bank will be distributed once Belarus restarts privatization and converts 250 state-run enterprises into joint-stock companies. (By the end of last year 550 enterprises had changed hands, although the government had promised to turn 800 enterprises over to the private sector.) The Bank has already halted successive tranches of a $300 million standby credit accorded in 1995. Restrictions on foreign exchange markets remain in place, there is no sign of abolishing the fixed exchange rate, and monetary and credit policy are not as tight as required by IMF guidelines. An extra $480 million in farm subsidies constitutes a major danger to stabilization. Belarus has plunged into a foreign investment crisis, with the lowest level of invested foreign capital in Eastern Europe, according to World Bank economist John Hansen. Hansen added that the Belarus government could improve trade balances by freeing the exchange rate, which is propped up artificially at about 12,500 to the dollar, roughly 25 percent below black market values.

Ukraine: IMF Supports Reform Efforts...

The IMF has approved a nine-month standby credit equivalent to about $867 million to support the Ukrainian government's 1996 reform program. The loan will be disbursed in monthly installments subject to monthly monitoring of the government's fulfillment of program targets. The main goals of reform include: lowering inflation of the karbovanets to a monthly rate of 1 to 2 percent by the end of 1996, reducing the budget deficit to 3.5 percent of GDP by the end of the year (from 5 percent in 1995), further cutting state subsidies to enterprises, expanding liberalization of foreign trade, and accelerating privatization. Auctions of state enterprises are being stepped up with the aim of privatizing at least 70 percent of the shares in a total of 5,000 medium-size and large enterprises by the end of 1996.

Worl Bank Stepping up Bosnia Loans

The World Bank approved on May 14 three projects worth $40 million for Bosnia-Herzegovina. The Bank will provide $20 million of a $40 million project to renovate Sarajevo's gas and heating systems. It will also come up with $10 million of a total $33 million to restore seventy primary schools and build five new ones; the EU's Humanitarian Organization is also participating in this project. In addition, the Bank will provide $10 million of a total $30 million for rehabilitation of war invalids, psychological assistance for war victims, and medical equipment and orthopedic devices. (See page 12).

Appeal to International Donors

The international community has pledged $1.8 billion to Bosnia for reconstruction
in 1996, but several key donors have not yet committed their funds, according to a World Bank report discussed during the recent Bosnia Reconstruction conference held in Florence, Italy. The Bosnian government worked out a $5.1 billion three-to-four-year plan that was endorsed by donors in December to start repairing the estimated $50 billion war damage. "About 20 percent of 1996 pledges are still unconfirmed or uncommitted," the World Bank said.

With the reconstruction program now under way, 1996 growth rates could reach around 35 to 40 percent. Assuming growth averages about 10 percent a year between 1998 and 2000, GDP could recover to close to two-thirds of its pre-war level by 2000, the Bank pointed out.

**$50 Billion GAB Facility**

During their recent Paris meetings the G-10, the ten leading industrialized countries, approved a new $50 billion emergency borrowing facility (General Agreement to Borrow, GAB) to bolster the International Monetary Fund's resources. Members of the G-10 will contribute some 75 percent of the doubled borrowing facility. The remaining 25 percent will come from a group of countries including Australia, and Austria, Singapore, and Spain, in recognition of their increasing role in the global economy. Saudi Arabia is also expected to take part. The new members will have the right to be consulted before any credits are advanced, giving them greater official recognition in global finance. The facility is not seen as a substitute for more permanent expansion of IMF resources through a capital increase.

**Camdessus Reappointed**

The IMF Board of Executive Directors unanimously selected Michel Camdessus to serve a third five-year term as managing director, beginning January 16, 1997. It will be the first time that an IMF managing director has served a third term.

**IMF Agrees with Kazakhstan on ESAF**

Kazakhstan and the IMF on May 20 signed an initial agreement on a three-year ESAF (extended structural adjustment facility) loan of undisclosed amount (according to the Financial Times, about $450 million), subject to IMF Board approval. Kazakhstan had earlier received a $290 million one-year standby facility but has not used it because of its large foreign reserves. In the fall of 1995 Kazakhstan adopted a three-year program aimed at accelerating privatization and reducing inflation from 60 percent in 1995 to 27 percent in 1996, and then to 12 percent in 1998. Some economists predict that the Kazakhstani economy will exhibit positive growth this year for the first time since independence in 1991.

**MIGA Guarantees to Transition Economies Surge**

In the first nine months of the current fiscal year, starting in July, 1995, MIGA (the Multilateral Investment Guarantee Agency, an affiliate of the World Bank Group) has issued more than forty contracts of guarantee for the European and central Asian transition economies, covering about $575 million worth of projects. (The region now accounts for almost 25 percent of MIGA's total outstanding portfolio, covering projects in Bulgaria, the Czech Republic, Hungary, Kazakhstan, Kyrgyzstan, Poland, Russia, Slovakia, and Uzbekistan.) MIGA recently launched the Investment Promotion Agency Network (IPAnet), an electronic investment marketplace, with an internet web site (http:\ipanet.net) providing macroeconomic information on various topics, such as investment climate or investment law codes in specific countries. (MIGA facilitates the flow of private foreign direct investment by providing coverage—guarantees—against the major political risks of currency transfer and currency expropriation, as well as war and civil disturbance, and by offering legal advice and marketing services to developing and transition countries. Information on MIGA: Shaila Fernandes, Room U12-135, tel. (202) 473-8058, fax (202) 522-2630, (Email: sfernandes@worldbank.org).

**Wolfensohn in Viet Nam**

Ending a four-day trip, World Bank President Wolfensohn announced on May 15 that the Bank will provide Viet Nam with $1.5 billion in IDA credits for the coming three-year period starting July 1. To keep economic growth on track, the government needs to promote fair competition and unleash the creative energy of the Vietnamese people, the president pointed out in his closing press conference in Hanoi. Viet Nam's challenge is to reduce widespread poverty while coping with a high debt burden left over from the prereform period. To gain access to international capital markets, the country needs to renegotiate (restructure) its outstanding commercial debt and ruble debt, said Mr. Wolfensohn. (Viet Nam, after China, is now the second-largest recipient of IDA credits, receiving about $500 million a year.)

**Credit to Viet Nam's Bank for the Poor**

On May 7, 1996, IDA approved a $122 million rural finance project to improve living conditions in Viet Nam's rural areas by encouraging private sector investments and strengthening the banking system's ability to finance them, while increasing the rural poor's access to financial services. The project includes a line of credit for viable rural
investment through the Bank for the Poor, created by the government in August 1995.

**IFC: Emerging Stock Markets Expand**

Investors in emerging markets fared poorly in 1995, but that did not stop the stock markets themselves from continuing to develop and expand, the World Bank's IFC said in its annual "Emerging Stock Markets" Fact Book. New stock markets opened, and the number of listed companies grew by 14 percent, an increase the IFC termed "impressive" given the drop in many share prices last year. The IFC Investable Composite Index fell 10.3 percent last year as investors reevaluated the outlook in the wake of Mexico's peso crisis.

**Armenia, Georgia Consultative Groups Meet**

The second Consultative Groups for Armenia and Georgia met in Paris on May 29-30 under the chairmanship of the World Bank to mobilize continued external support for the two countries' economic programs. Both countries have sharply reduced inflation, narrowed fiscal deficits, eliminated trade restrictions and price controls, and nearly completed small-size business privatization. However, despite these improvements, energy shortages remain a critical constraint to output recovery, and limited revenues have forced the governments to postpone public expenditures, even for basic maintenance.

*Armenia's economy grew 5.4 percent in 1994 and 6.9 percent in 1995. Currently, about 3,000 small enterprises and 500 medium- to large-scale enterprises have been privatized. In 1995, 52 percent of GDP was produced by the private sector; this figure is likely to rise to more than 75 percent by the end of 1996. Armenia expects to maintain growth at about 6 percent a year in the medium term, but this will depend on the availability of external financing for investments.*

*Georgia—with its per capita GDP of $410 in 1994—is among the poorest countries of the former Soviet Union. Inflation declined from more than 60 percent a month in 1994 to an average of about 3 percent a month in 1995. A new currency has been successfully introduced, the exchange rate has been stabilized, and the economy grew 2.3 percent in 1995. Seven thousand small firms are already in private hands, 125 medium- and large-scale enterprises have been privatized, and the privatization program will be completed by the end of 1997. Further land privatization is being pursued (47 percent of cultivated land has been privatized). In the past six months the World Bank has provided about $90 million in credits to Georgia.*

**World Bank Activity in Lithuania**

After talks in Washington in early May, the World Bank signed a negotiation protocol for a $10 million loan to help finance a project to provide insulation for Lithuanian residences. (Altogether, 1.1 million apartments should be included in the heat insulation program.) The World Bank on May 9 approved a $5.9 million loan and a Global Environment Facility (GEF) grant of $6.9 million to enhance the use of geothermal energy in Lithuania. Designed for the city of Klaipeda, the project will demonstrate the advantages and benefits of geothermal water as an energy resource in district heating. A World Bank structural adjustment loan to Lithuania may not be approved unless the government makes significant progress in reforming the banking sector, reducing border tariffs on agricultural products, and raising local consumer energy bills, according to an AP-Dow Jones report.

**Poland Receives Water and Capital Market Loans**

On June 4 the World Bank approved loans for $12 million and DM13.2 million for a water and wastewater project in the provincial capital of Bielsko-Biala. Existing treatment plants will be rehabilitated and upgraded. The project includes technical assistance and training and engineering services. With support from another loan—$89 million (approved on May 30)—Poland's capital markets will be fostered through providing advisory services, training, and information technology to the securities and capital markets commission and through support for key regulatory programs. The loan will also provide software and telecommunications equipment for secondary market trading services and for the finance ministry computers. Poland's local communities will receive a $50 million credit line from the World Bank to develop local infrastructure.

**...and in Estonia**

The World Bank has granted Estonia a $15.3 million loan to boost private enterprise, in support of a $31 million project to promote privatization of agriculture and to modernize agricultural drainage systems.

**Estonia's New Economic Policy**

The IMF representative to Estonia, Basil Zavoico, revealed on May 23 that the country's new economic policy memorandum pays great attention to the public sector debt, which could grow to as much as 4 percent of Estonia's GDP. The main problem is the lack of fiscal policy coordination between the central and local governments. Zavoico added that the pressure by farmers to introduce high customs tariffs should be resisted since similar tariffs in Latvia and Lithuania proved ineffective.
Supporting Kyrgyz Telecommunications

The World Bank and the EBRD will participate in financing a major telecommunications project in Kyrgyzstan. The World Bank has agreed to provide a thirty-five-year, $18 million credit to the government with a ten-year grace period, to be used to open a fifteen-year credit line for the state-owned Kyrgyztelekom company. The EBRD has agreed to provide a direct, government-guaranteed $9.4 million loan to the company, along with a $1.5 million grant for personnel retraining. Kyrgyztelekom has said that the company will invest $5 million of its own money in the project. In May the International Development Association provided the following credits to Kyrgyzstan:

• $20 million to rehabilitate the thermal powerplant and heating system in Bishkek, upgrade transmission and distribution facilities in the north of the country, and help finance oil exploration; $18.5 million to assist health sector reform; and $11.6 million to increase sheep and wool production.

Praises and Credits to Moldova

The World Bank on May 8 announced its approval of a $10 million loan to support Moldova's efforts to boost agricultural exports and increase farmers' incomes. Another $10 million World Bank loan, approved on May 23, will help create better energy management and reduce energy imports, which currently consume 41 percent of the country's total earnings. Another goal is to commercialize Moldova's gas and electricity sales and to make the state-owned companies financially viable. The IMF has approved credits worth $200 million to support the Moldovan government's reform programs for 1996-98. Reviewing the government's performance, the IMF found that financial stabilization has largely been achieved; inflation is the lowest among all the former Soviet countries; interest rates are down to moderate levels; the exchange rate is free and stable; exports have increased, particularly to non-CIS countries; the production decline has been halted; and notable progress has been achieved in trade liberalization and privatization. At the same time, only limited success has been achieved in enforcing budget constraints on enterprises and in privatizing agriculture. The Moldovan government's objectives for 1996-98, agreed with the IMF, include sustaining 4 to 5 percent annual GDP growth, lowering annual inflation to 6 percent and the budget deficit to 3.4 percent of GDP, substantially improving collection of taxes and other revenue, reducing energy debts (incurred to Russia), completing privatization with external cash auctions, and establishing a market-based agricultural sector complete with trading in agricultural land.

Loan to Macedonia's Agriculture

The World Bank's International Development Association (IDA) approved on May 20 a virtually interest-free loan of around $7.9 million to Macedonia. The loan is intended to help fund pilot projects in agriculture, support privatization of veterinary and epidemiological services, and improve small farmers' access to commercial credits. According to the IDA, agriculture accounts for some 20 percent of Macedonia's economy, while some 70 percent of farmland remains divided into small private plots. The loan is repayable over thirty-five years, with a ten-year grace period.

Support to Tajikistan

On May 16 IDA approved $5 million for Tajikistan to support an institution-building technical assistance project. The goal is to shore up the State Property Committee, the agriculture ministry, and the financial sector. The World Bank is ready to lend the country more to promote privatization, agricultural reforms, and poverty relief, Michael Mills of the Bank's Dushanbe office said. Earlier, on May 8, the IMF approved a $22 million standby credit to help Tajikistan's economic program. Its goals include cutting inflation from 1,200 percent in 1995 to 180 percent in 1996; curbing economic decline from last year's 12.5 percent to 7.0 percent; and carrying out structural reforms such as land reform, further privatization, and enactment of legislation enabling the national bank to exercise full and independent control over monetary and credit policies.

Premature Vendetta

"It's your wife on the phone, Mr. Swinburn. She made a mistake with the numbers. You've only won $10.00."

From the World Press Review.
Conference Diary

Economic Transformation—Inequality and Social Sector Reform
September 19-20, 1996 Washington, D.C., United States


Russian Economy in Transition
September 23-24, 1996, Helsinki, Finland


Values and Rules for Actions in Management and Economic Policy
October 2-4, 1996, Prague, Czech Republic

Organized by the Research Institute for European Affairs, Vienna University of Economics and Business Administration. Topics include: Transfer of management techniques; Intercultural human and organizational development in the East-West context. Information: Claudia Feichtinger, Forschungsinstitut fuer Europa-fragen, Wirtschaftsuniversitaet Wien, Althanstr. 39-45, A-1090, Vienna, Austria, tel. (431) 3133-65084, fax (431) 3133-6758, (Email: feichtin@fgr.wu-wien.ac.at).

Intercultural Dimensions of Labor and Human Resource Development
December 2-4, 1996, Vienna, Austria

Organized by the Research Institute for European Affairs, Vienna University of Economics and Business Administration. Topics include: Transfer of management techniques; Intercultural human and organizational development in the East-West context. Information: Claudia Feichtinger, Forschungsinstitut fuer Europa-fragen, Wirtschaftsuniversitaet Wien, Althanstr. 39-45, A-1090, Vienna, Austria, tel. (431) 3133-65084, fax (431) 3133-6758, (Email: feichtin@fgr.wu-wien.ac.at).

The Fourth Annual Conference on Marketing Strategies for Central and Eastern Europe
December 4-6, 1996, Vienna, Austria

Organized by the Institute for Foreign Trade, Vienna University of Economics and Business Administration, and Kellstadt Center for Marketing Analysis and Planning, De Paul University, Chicago. Information: Institute for Foreign Trade, Vienna University of Economics and Business Administration, Althanstr. 39-45, A-1090, Vienna, Austria, tel. (431) 3133-65084, fax (431) 3133-6758, (Email: feichtin@fgr.wu-wien.ac.at).

Third Annual Conference of Central European Real Estate Associations
October 3-5, 1996, Budapest, Hungary

Sponsored by the Hungarian Real Estate Association, the Central European Real Estate Association network (CEREAN), and the Eastern European Real Property Foundation (EERPF), with funding from the United States Agency for International Development. Information: EERPF, Suite 550, 700 16th Street, N.W., Washington, D.C. 20001, United States, tel. (202) 383-1296, fax (202) 383-7549.

43rd International Atlantic Economic Conference
March 12-17, 1997, London, United Kingdom

Organized by the Atlantic Economic Society. Information: International Conference, Campus Box 1101, Southern Illinois University of Edwardsville, Edwardsville, Illinois, 62026-1101, United States, tel. (618) 692-2291, fax (618) 692-3400, (Email: jvirgo@eniac.ac.siu.edu).

The Rule of Law, Foreign Investment, and Sustainable Development in Central Asia
March 1997, New York, United States

Organized by the New York University School of Law. Topics include: Soviet, Islamic, and Western influences on legal development in Central Asia; Role of foreign investment and the rule of law in addressing the region's environmental problems; Evaluation of foreign investment in the region. Information: (Email: ser8086@is4.nyu.edu) or (mgt4598@is4.nyu.edu).

Social and Economic Problems of Coal Regions during Transition to Market
September 23-25, 1997, Donetsk, Ukraine

Organized by the Institute of Industrial Economics, National Academy of Sciences of Ukraine. Information: Mikhail Popov, Institute of Industrial Economics, 77 Universitetskaya Str., Donetsk, 340048, Ukraine, tel. (380662) 550-261, fax (380622) 558-147, (Email: popov@iee.dipt.donetsk.ua).

May-June 1996
New Books and Working Papers

The PRDTE unit of the World Bank regrets that it is unable to supply the publications listed.

World Bank Publications

To receive ordering and price information for publications of the World Bank, write: World Bank, P.O. Box 7247-8619, Philadelphia, PA 19170, United States, tel. (202) 473-1155, fax (202) 676-0581; or visit the World Bank bookstores, in the United States, 701-18th Street, N.W., Washington, D.C. or in France, 66 avenue d'Iena, 75116, Paris, (Email: books@worldbank.org) (Internet: http://www.worldbank.org).

Policy Research Working Papers


The allocation of fiscal revenue and expenditures between central and local governments in China has affected economic growth since reforms began in the late 1970s. Authors claim that fiscal decentralization has lowered provincial economic growth over the past fifteen years. The central government is constantly constrained by limited resources for public investment in highways, railways, power stations, telecommunications, and energy, which are national priorities and nationwide externalities. These key projects may have more significant impact on growth across provinces than their counterparts in each province. This argument challenges the view that fiscal decentralization contributes positively to provincial or local economic growth. To order: Cynthia Bernardo, Room N10-053, tel. (202) 473-7699, fax (202) 522-1154, (Internet: prdpe@worldbank.org).


In the former Soviet Union (FSU)—especially Russia—unemployment has remained low and employment in state and privatized firms has remained high, while at the same time the informal or unofficial economy has grown swiftly. Authors trace this development to a combination of factors. Firms have remained the primary site for social protection; subsidies for social benefits have effectively been a subsidy to employment and have promoted the worker's continuing attachment to these firms. Firms, instead of laying workers off, significantly cut hours and wages, sometimes through wage arrears. The nonmonetary share of worker compensation is significant and has grown during the transition. Workers, in turn, keep their jobs but try to earn additional income through moonlighting or getting involved in the informal economy.

Despite privatization, managers have preserved their discretion in decision-making, and are slow to fire their workers, in order to keep them cooperative and possibly to repel outsider interest. (Workers own a substantial chunk of shares, together with the managers.) Many firms still operate under soft budget constraints, so they are under less pressure to reduce employment levels than enterprises in Central and Eastern Europe. If the subsidy to insider-dominated firms disappears, those firms will scale down employment and the provision of benefits.

To order: Latifah Alsegaf, Room M7-036, tel. (202) 473-6442, fax (202) 676-0965, (Internet: lalsegaf@worldbank.org).

Country Studies


Sustaining rapid growth with low inflation in China will require continued market reforms and a reorientation of government involvement in the economy. China lowered inflation in 1995 to below 15 percent while keeping growth above 10 percent, and at the same time further improved its balance of payments, with the current account surplus expanding to 2 percent of GDP, inflows of foreign direct investment reaching $38 billion, and foreign exchange reserves exceeding $73 billion.

For 1996, China is in a good position to keep inflation below a target rate of 10 percent and growth at 8 to 9 percent. But the government will need to place greater reliance on market forces, with an emphasis on reform of state enterprises, the financial sector, and public
finance. In these key areas China should:
- Continue to diversify ownership of state enterprises and reduce subsidies; promote competition to encourage greater efficiency by bringing down trade and investment barriers; and encourage privatization of smaller enterprises.
- Transform state banks into genuine commercial banks; and strengthen regulation of nonbank financial institutions.
- Increase revenues by 6 percent of gross domestic product to meet public finance requirements and balance the budget, through a combination of continued economic growth, a broader tax base; and more rigorous tax collection.

Technical Papers


The volume draws lessons from the contrasting experience of five transition economies (Hungary, Poland, Romania, Russia, and Ukraine) in corporate governance—that is, management and oversight—of private enterprises. It also contains relevant experience of state asset management in Austria and New Zealand; railways in Canada and Germany; energy, coal, and telecommunications in France; and steel in Britain.

Other World Bank Publications


Investors in emerging markets fared poorly in 1995, but that did not stop the stock markets themselves from continuing to develop and expand. New stock markets opened, and the number of listed companies grew by 14 percent, an increase the IFC termed "impressive" given the drop in many share prices last year. The IFC Investable Composite Index fell 10.3 percent last year as investors reevaluated the outlook in the wake of Mexico's peso crisis.


The volume provides the planning framework for future World Bank programs in rural development and the basis for detailed implementation planning, skill gap analysis, and budgeting.


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The report forecasts foreign direct investment flows into the region at about $20 billion a year in 1996-2000, or almost $100 billion in total. Poland and Russia are expected to become the main destinations, with Hungary falling to fourth place. Foreign direct investment into Eastern Europe (in US$ billion):

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The report describes Russia's business
landscape. Aimed at Western companies planning or developing their regional operations (as a source for raw materials imports, markets for their products, and/or production sites), the report shows regional variations in size, wealth, and importance to the outside world.

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Richard Rose and Stephen White, Boris Yeltsin's Changing Popular Support, SPP no. 261, 1996.


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Central European University Press publications

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Roman Frydman, Cheryl W. Gray, and Andrzej Rapaczynski (eds. and contributors), Corporate Governance in Central Europe and Russia: Banks, Funds, and Foreign Investors [volume 1], Insiders and the State [volume 2], World Bank/CEU Privatization Project publication, Central European University Press, Budapest/London/New York, 1996, 341 p. and 310 p.

Written by distinguished economists, legal experts, and sociologists, these two volumes present an overview of emerging corporate governance institutions in the transition economies of Central Europe and Russia. The studies in the first volume concentrate on the creation of new governance systems, covering such financial institutions as banks, private pension funds, and investment funds, as well as the role of foreign investors. Studies in the second volume focus on the more spontaneous development of existing institutions and management practices. They discuss the possible evolution of various ownership forms, such as employee, managerial, interfirm, and residual state ownership.


Ownership, Corporate Governance and Enterprise Performance in Central Europe [volume 3], 1996, 320 p.


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Leon Podkaminer and others, Continuing Improvements in Central and Eastern Europe: Russia and Ukraine Have Not Yet Turned the Corner, WIIW no. 225, February 1996, 109 p.

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Since the beginning of the transition from real socialism to capitalism the Hungarian innovation system has been going through a number of changes. The turbulence the industrial research and development (R&D) system has been facing is even rougher than the changes the rest of the innovation system has to put up with. Despite a number of revisions of governance and funding mechanisms as well as a more realistic approach of government to short- and medium-term goals for R&D in Hungary, industrial R&D still is neglected. For an explanation of this fact the interest group structures of the R&D system are analyzed. The results of the analysis imply a solution for the problem. Finally, a few measures are suggested, which should help to realize Hungary's economic potential.

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Christopher Findlay, Andrew Watson, and Harry X. Wu (eds.), Rural Enterprises in China, Unibooks, Australia, 1996. To order: The University of Adelaide, Department of Economics, Chinese Economy Research Unit, Adelaide, Australia 5005, tel. (08) 303-4460, fax (08) 303-4394.


In 1995 economic developments in the transition economies showed increasing divergence: while many East European countries achieved rapid growth, economic decline continued in Russia and other CIS countries. In 1996 growth in the Czech Republic, Poland, and Slovakia will likely remain in the 5 to 6 percent range. Growth is expected to pick up in the countries of the former Yugoslavia. In addition to reform uncertainties, Eastern Europe's dependence on West European import demand also affects its prospects for growth. In Russia positive GDP growth this year is far from certain.

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It is the poor, those with lower levels of education, those with inferior qualifications, those living in the countryside, those whose vision of society emphasizes public virtues rather than private gains, who have lost out in the present stage of transition. The articulation of the interest of the losers, not only through the institutions of politics but also by local political interests, may yet frustrate and possibly reverse the drive for marketization, the editor points out in his introduction.


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Michalski, M. Banking on Telecommunications for Growth: The Case of Poland. Competitive Banking (Poland) 1995, pp. 177-84.


China


CIS and the Baltics


