Descending the Stem of the J-Curve — Interviews from Bangkok

The painful but inevitable transformation process of the Central and East European countries was one of the major topics at the 1991 World Bank/IMF Annual Meetings in Bangkok in October. Early enthusiasm for reform has been replaced by sober calculation about how far the CEE countries have progressed toward their goals of stabilization, liberalization, and privatization, how long the process might last, how to cope with increasing social tensions, and who should bear the high price tag for the changes. High-ranking government officials from Hungary, Czechoslovakia, Bulgaria, China, and Tanzania spoke to Transition editor Richard Hirschler about the successes and failures of their economies. (A second series of interviews will appear in the next issue of Transition.)

Suranyi Gyorgy, president of the National Bank of Hungary

Q: Do you agree with the controversial proposition that Central and Eastern Europe has much to learn from the economic policies of the East Asian "tigers"? And how would you respond to those who want the Hungarian Central Bank to give up its strict monetary policy?

A: The East Asian model could hardly function in our region, and without too much generalization, I would like to point to four major differences. First, in East Asia, collective accomplishment and group solidarity, as well as workers' respect for their superiors, are deeply imbedded cultural elements. Religious traditions are different also, and individualism plays a lesser role than in CEE.

Second, in East Asia the private sector has always been dominant. As a result, government policies, even if wide ranging and pronounced, have a more balanced outcome than in Central and Eastern Europe, where we were "blessed" with an overwhelming public sector. Third, institutions for multiparty democracy are in an infant phase in most East Asian countries, whereas in Central Europe, with the collapse of communism, the newly institutionalized checks and balances are challenging the governments and limiting their economic maneuvering.

What's inside...

Opinion polls in Poland: Cautious support for market economy
Support for radical economic changes has dwindled while the movement for gradual reform has gained ground. The public increasingly favors private ownership and foreign investment, especially from the U.S. (page 5)

Letters to the Editor
Two comments on a recent article by I.J. Singh on socialist economic reform theory. (page 6)

Quotation of the Month
The Soviet business weekly, Commerciant, outlines three scenarios for future inter-republic price relations: no change, a shift to world market prices, or inter-republic price agreements along the model of the defunct COMECON. In any event, among the republics, Ukraine and Byelorussia will fare well, and the Central Asian Republic will come out in the worst position. (page 9)

Research Update
Reallocation of labor at the lowest possible social cost presents a major challenge in Central and Eastern Europe. A new research project in the World Bank's CECSE unit will investigate the effects of unemployment on workers and their reemployment possibilities. Research will focus on labor market dynamics in Slovenia. (page 12)

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The current social system in the post-socialist countries, which is a legacy from the former regimes, can no longer function. Although it had undisputed advantages — providing social security for a large section of the population — it disproportionately favored high-income groups over the truly needy, functioned inefficiently, and provided benefits that were not commensurate with the high costs. Reform, that is, to withdraw the social benefits, is politically difficult, especially where many people are severely distressed economically. Yet a considerable section of the population in the Central and Eastern European countries would be able to pay for better quality social services, and resources could be freed for creation of genuine social safety nets. Although this observation applies to the region generally, what is uniquely Hungarian is that the social system eats up an unusually large chunk of GDP. Right now the budget is redistributing 60 percent of Hungary's GDP, and a major part (more than 50 percent) of this goes for social expenditures.

Bringing inflation under control would be the greatest social benefit for the lower income groups. Price increases are more or less compensated by the middle class, but not by the poor, as historical experiences prove. The paradox is that unless social systems undergo overall reform, inflation stabilizes at a high level, as the inefficient systems need to be maintained by ever increasing taxes; otherwise the budget deficit increases. And both are fueling inflation.

In answer to your second question, I disagree with the experts who blame the National Bank's monetary policy for the sluggish economy and call for drastic changes. There is abundant capital in Hungary if somebody wants to invest, although it is possible that commercial banks are not too eager to take on long-term risks, as the inflationary psychosis is still alive. In my opinion, money should play a neutral role in the business cycles; otherwise money creates its own cycles, thus seriously damaging the economy. The Hungarian economy is still in a sluggish phase, with the GDP shrinking.

We suffered an unprecedented shock with the sudden loss of the Soviet and East European markets. No monetary policy in the world could have mitigated the impact, which equaled about 10-15 percent of our GDP. Our harsh monetary policy played its role so that the forint [the Hungarian currency] held stable, the gap between the official and black market rate disappeared [the rate is about 80 forints per dollar], and inflation never became an uncontrollable menace. On the other hand, without adequate monetary austerity, such countries as Romania, Bulgaria, Yugoslavia, and the USSR were unable to stem the acceleration of price increases nor the deep fall in production. When we notice real change in the economy, we shall reverse course for our monetary policy.

We know that export-oriented growth is the only option for Hungary. A very strong adjustment process already is under way. The inflow of foreign capital has accelerated. About a billion dollars came in the first eight months of 1991, compensating for the accrued interest Hungary has to pay annually on its foreign debt [about 20 billion dollars]. The inflow of foreign capital could reach nearly 1.3 billion dollars by year's end. Our monetary reserves have filled up and now cover about three months' imports. Instead of the predicted 1.2 billion dollar deficit, the current account might be balanced by the end of the year. However, the present inflation rate of about 33-36 percent has to be brought down to 20 percent by the end of next year and to a single digit by 1993. To improve the supply response, privatization will be further accelerated, and the private sector's share in the economy probably will reach 20 percent by the end of the year; two years ago its share wasn't even 10 percent. What is of utmost importance, I repeat, is radical overall reform of the health, education, and social security systems.

Vaclav Klaus, Minister of Finance and Deputy Prime Minister of Czechoslovakia

Q: You are called Czechoslovakia's "messiah of the market economy," preaching permanent reform day and night. How do you assess your country's economic situation nine months after the large-scale liberalization measures? Some say you believe that the World Bank is not giving you hard enough advice along with the hard currency?

A: The reform is a continuous process and must go on without hesitation or interruption; otherwise, opponents have time to prepare a defense against change. If we want to be successful, visible results are required, certain peaks must be conquered. Swift, overnight deregulation of the market, with liberalization of prices and foreign trade, was the first peak, in January, 1991. I would argue that this has been a tremendous success. In the meantime, inflation, which speeded up after price liberalization, has been checked: it is zero for the third consecutive month. Our balance of payments situation is stable, and the budget is and will remain in surplus, although likely to drop somewhat by the end of the year.

On the other hand, output has fallen, and unemployment, from being zero a year ago, has increased to 5.6 percent as of the end of September. Although, I must add, statistics are not very reliable any more, due to the dramatic restructuring of the economy and the dynamic development of the private sector.

The second peak is privatization. It can be done gradually, as in some other East European countries, or through a mass privatization process.
The latter is what we are undertaking. The first wave, the distribution of voucher booklets, started in October. People are lining up at post offices where the vouchers are sold. [A booklet of vouchers costs 1,000 crowns, worth 1,000 points toward shares. Enterprise shares will be auctioned late next year, with share prices set according to demand and supply.] At the same time, on the supply side we are preparing the “bundles” of firms, the several hundred companies being privatized fully or partially via vouchers. This privatization peak has several consequences: it will shift a substantial portion of state assets to private hands. Just as important, it will start a teaching process whereby millions of people will start to care about investments and share values.

But of course there are hundreds of everyday equally important changes, which I do not consider peaks, such as radical reform of the taxation system, introduction of the value-added tax, and legislation (such as was recently passed) on bankruptcy and on regulating the stock exchange.

The problems are standard, and necessarily there are unfavorable side effects such as the J-curve. [Reforms are accompanied by a steep fall of the economy before it gathers steam, just like the shape of the letter J.] The task is to change without the unbearable destruction of economic activities. Many irrational activities, such as the artificial demands created by the old system, must be eliminated. The question is how to do it.

Social tensions are remarkably low in Czechoslovakia. We really have created a political consensus, unlike other countries in the region. It is our permanent job to appear in public and preach with strength and clarity about the costs and benefits of the transition process. We were able to create a political party [Vaclav Klaus is leader of the Liberal Democratic Party] that is an organized constituency for economic reform.

Concerning the World Bank’s role, indeed, we are more interested in project-oriented financing, joint development of our energy resources, the financial sector, the telecommunication systems, and protection of our environment. We are less interested in consultations, in technical assistance, or in advice on running our economy. But, I repeat, we more than welcome the Bank’s participation in our development projects.

Ivan Kostov, Minister of Finance for Bulgaria

Q: Your delegation came to Bangkok in the midst of a crucial election in Bulgaria. You, as a leading economist, were one of the driving forces behind the restructuring and stabilization program. How do you evaluate Bulgaria’s reform process?

A: On balance, it is clear that we succeeded in liberalizing prices, eliminating barriers to foreign trade, setting up a functioning foreign exchange market [the rate was about 20 leva per dollar in the middle of October], and starting to demobilize industry. We reduced inflation to a manageable level, however, liquidation of the command economy’s structures and the consequent faltering of many enterprises, aggravated by new taxes and the collapse of Soviet trade, as well as the shortage of hard currency even for basic imports, have resulted in a production crash. [GDP for 1991 is expected to fall 20 percent, following a drop of 12 percent last year. Foreign trade is only 16 percent of its 1989 level, and servicing of the 11 billion dollar foreign debt, suspended last year, is still awaiting rescheduling.]

Not much has happened in the area of privatization either. A privatization law has been drafted, but its approval will be left to the new legislature. The legal framework for private farming was created in early 1991, but it has had little effect. Systemic changes must be accelerated, and beginning in 1993 we can expect recovery of the economy. Unemployment is a burning issue, reaching 10 percent this year. One solution could be to encourage women — 93 percent of whom are employed — to leave the workforce and return to their families, even if it means a temporary loss of purchasing power for the families. Also, the new government has to negotiate with the IMF for a stand-by credit, and we hope that World Bank financing will go ahead in areas such as infrastructure, highways, and telecommunications.
Li Ruogu,* Deputy Director, People's Bank of China

Q: What is the main thrust of reform in China? Will central planning dominate the scene, or will market forces take over? What is your comment on a recent article in The Economist that China is able to achieve a spectacular annual growth rate thanks to the special economic zones, and despite the officially endorsed policies?

A: We started the present course of economic reform 12 years ago. Now we want to move forward in several fields. Price liberalization will continue; even basic prices such as for coal and electricity will be freed. Housing reform will go ahead. We are introducing cost-related rent, with a corresponding increase of wages. We also have set up special savings banks to provide credits for housing. Developing the social safety system means introducing unemployment benefits, creating training facilities, and providing security for the temporarily unemployed. We are also progressing on enterprise reform, making state companies stand on their own. Loss-makers will be liquidated, or they will have to merge with more efficient enterprises. (In other countries) mass privatization of large- and medium-sized enterprises is not the only solution. If enterprises are efficient, it does not matter whether they are state-owned or privately owned.

No country can be described as a pure market or a pure planned economy. Governments have numerous tasks, even in the self-acclaimed market economies. Planning is still very important in a country the size of China, but I think market forces will prevail in the future. Planning, however, will not fade away; rather, its traits will change, with a focus on longer-term policy issues. Planning agencies will become more efficient and forward-looking, and able to devise alternative scenarios for the next 5-10 years, thus enabling enterprises to adjust their strategies accordingly.

In the southern part of China, economic development is very dynamic for several reasons. Policies are more flexible, and there has been longer experience with economic management, compared to other parts of China. Those provinces and cities are close to Macao, Hong Kong, and the southern Asian countries, and their products are exported via Hong Kong, the liaison to these areas. Foreign investments are abundant. These regions are called the "windows" to the international economy, through which experiences are gained, skills learned, and foreign trade developed, with benefits spread all over the country. These windows can be enlarged in the years to come, until the ever-larger building will have only glass walls.

* The views expressed by Li Ruogu are his own and were not expressed on behalf of the Chinese delegation or the Chinese Government.

Kigoma A. Malima, Minister of State for Planning in Tanzania

Q: What is the main lesson from the collapse of communism for Tanzania, once a bastion of African socialism? Will the country's economic policy change course, endorsing private enterprise?

A: The fall of socialism in Eastern Europe reminded us that it is not enough to provide employment or increase real income. People also have to be involved in policymaking. They need assurances that excessive power can be controlled. Therefore, Tanzania is addressing the issues of political democratization as well as economic liberalization.

The Foreign Investment Code approved last year is a very clear sign that the government is favoring private investments, whether they are local or foreign. Last July the Investment Promotion Center was set up. Price liberalization is making headway: of the 350 commodities that were controlled in the 1980s, only 10 now remain under price restrictions. The share in the economy for the private sector is substantial: 40-50 percent of agricultural production is in private hands, for example. Unprofitable public enterprises will be sold off, and we expect more active participation by the private sector in developing the economy. Mass privatization is a difficult question, however. In colonial Africa, the economic stratification of the society was developed on a racial basis, with whites and Indians occupying the key economic and business positions. After independence, the "Tanzanization" of the economy meant that the state sector played a dominant role. Our own entrepreneurial class has to be developed and educated, and this takes time.

Changing economic course, in the sense of reducing centralized, bureaucratic control? Yes, but for creating an egalitarian and just society, our course will not change. We must be conscious of the dangers of excessive inequalities in society, when a few have so much and many so little. The government aims at social harmonization, guaranteeing equal opportunities for education, health services, and general social welfare. Leadership ethics and principles must be kept.

The economic difficulties are enormous. Our savings rate is low. The country badly needs a well paid, motivated, highly efficient civil service. The "brain drain" is getting worse; the best professionals and civil servants leave the country because they are not willing to serve for 120 dollars per month — in Botswana they can make 2,000 dollars. As a result, inefficient bureaucratic red tape is seriously hindering investment in Tanzania. This is one of the reasons for the slow progress: the GNP is growing about 4 percent annually, but population growth is 2.7 percent. The greatest problem is how to accelerate the growth rate, and the World Bank can support our goals. But a well functioning government is a basic necessity.
Poles Support Market Economy — with Caution
Opinion poll reveals split society

Nearly two years of "shock therapy" have taken their toll on the Polish public's willingness to endure economic hardship, according to a series of nationwide, public opinion polls commissioned by the U.S. Information Agency. In early 1990, more than 56 percent of Poles thought that Finance Minister Balcerowicz's radical economic reform program correctly addressed Poland's economic woes. But public support quickly waned as the adversity of the reform process became a daily reality. By late 1990, only 30 percent favored radical economic reform, and by mid-1991, support had dwindled to 17 percent. In contrast, a solid majority of Poles — 72 percent as of mid-1991 — said they preferred a program of gradual reform. [This certainly helps to explain the huge abstention rate — 60 percent — and the inconclusive results of the recent parliamentary election.]

However, public favor of two key components of reform — private ownership and foreign investment — increased in the six months up to mid-1991. As of late 1990, 48 percent of Poles thought most businesses should be owned by the state, while 39 percent thought they should be privately owned. By mid-1991, support for privatization had risen to 45 percent. Support for private ownership of business was highest among the young (18-29), the university-educated, and urbanites. Nevertheless, Poles still voice less support for privatization if it is thought to affect them personally. For example, just three in ten of those who worked for state-owned firms said they wanted their firms to be privatized, five in ten said they did not, and the rest of those surveyed offered no opinion. Those who supported privatization were more optimistic about their long-term economic future and were likely to favor radical reform.

Given the burdens of economic transition in Poland, it is hardly surprising that in 1991 economic questions topped the public's list of the most urgent issues facing the country. Unemployment headed the list of concerns for women, the young, workers, those with a secondary education, and those living in mid-sized cities. The cost of living, the need for more order in the economy, the economic reform process, and agricultural issues completed the roster of urgent economic concerns. In contrast to their concerns about economic issues, few Poles cited such political issues as political stability, development of freedom and democracy, or removing former communists from power, as being of much urgency. In late 1990, public attention had been somewhat more evenly divided between political and economic issues. The shift in attitude not only suggests the depth of public concern about the economic changes occurring in Poland, but also illustrates the view that most Poles do not believe there are looming threats to Poland's new pluralistic system of government.

In mid-1991, most Poles expressed a positive attitude toward a market
The presumption is that private property is necessary for a market economy: 85 percent believed that "an economy only functions if business people make a profit and that this benefits the whole society in the long run." More specifically, 67 percent thought that under a free market economy some people might have a lot more money than others, but in the long run everybody is better off than under socialism. Likewise, seven in ten of the Poles surveyed indicated that private property is necessary for economic progress, and six in ten thought a democratic society was possible only under a market economy. Overall, the young and the well-educated were the most likely to agree with these statements.

Even so, many Poles showed concern about particular aspects of a market economy. More than 59 percent said they believed that people are more exploited when they work for a private business than when they work for a state-controlled one. A similar percentage believed that a market economy is characterized by coldness in human relationships. But only 35 percent thought private property was a major cause of social injustice in society, while 75 percent said unemployment would be too high in a market economy, and a similar number thought that there were too few safeguards for weaker members of society. Overall, the less educated and older Poles were the most likely to express concern about the effects of a market economy.

As these data show, the Polish government clearly faces a problem — the public's willingness to endure prolonged economic hardship has diminished, and a majority remain uncertain about the benefits of the new economy. During his 1991 presidential election campaign, President Lech Walesa promised to "accelerate the process of reform." This was apparently interpreted by many Poles to mean less hardship and more prosperity. But the bedrock of Walesa's economic program remains continued austerity. Unless more Poles begin to prosper, or at least think they will, public opinion is likely to turn against the government. One group, however, appears to transcend the public fray over economic reform measures — foreign investors. Many Poles welcome foreign investment and prefer American investors over others.

Mary McIntosh, chief of the CEE unit
Martha Abele Maclver, research analyst, CEE Office of Research, USIA

Letters to the Editor
A Walk or a Rush? — Comments on I.J. Singh's recent article

There is an opinion, eloquently argued both inside and outside the Bank, that the East European countries should learn from China's success with gradual economic reform to modify their more radical approaches toward creation of a market economy. The presumption is that slow, piecemeal reforms and second-best policies, such as multiple exchange rates, industrial policy, trade barriers, and continued use of subsidies, will minimize the social costs of transition while advancing reform far enough to tap the efficiency gains from a more liberal economic order. Both the presumption and the argument fail to take account of fundamental differences between China and Eastern Europe. For example, GNP per capita, the international environment, the role and performance of agriculture, the overall performance of the state sector, market size, and the long-term costs of interventionist policies are vastly different between China, on the one hand, and Eastern Europe and the Soviet Union, on the other. All this points up that a "Chinese-style, go-slow" reform of the system and policy in Eastern Europe would be a recipe for prolonged stagnation, if not economic disaster.
First, China is at an early stage of development, enjoying high growth rates because, *inter alia*, its starting base was low, and growth is still largely extensive (i.e., originating mostly from the expansion of factors of production rather than from a pure increase in factor productivity). Several decades ago, when Eastern European economies were similar to the current Chinese economy in terms of economic structure and level of development, they, too, achieved high growth rates despite highly centralized and autocratic systems. However, we know today that a lot of that growth (statistical problems aside) occurred in military and heavy industry, thus hardly contributing to the main goal of development: a sustainable increase in the standard of living. Nowadays, Eastern Europe has mature but grossly inefficient economies that can be revitalized only through relatively fast restructuring and liberalization of domestic and foreign activities. Slow reform will block transformation while ensuring a stagnant status quo.

Second, Eastern European economies are small and necessarily open economies that have much to gain right now from the exchange of knowledge, technology, investment, and ideas with the European Community. While China can afford some isolation from the world markets, mainly due to its immense size, Eastern Europe clearly cannot. In addition, Eastern Europe is the textbook example of small open economies forced to adjust to permanent shocks. It is unlikely that China will face external shocks of similar magnitude in the near future; consequently, there is much less urgency for a radical change. Highly interventionist policies, which China is pursuing at this stage, would almost certainly isolate Eastern Europe from the benefits of integration into the European Community.

Third, contrary to some perceptions, the dramatic decline in output in Eastern Europe over the past two years is systemic and as much the result of long-term problems as of short-term exogenous shocks, such as the collapse of the CMEA and the use of restrictive stabilization programs. Just as no stabilization of a hyperinflationary economy is achieved without a fast break on inflation sources, no structural reform in Eastern Europe can succeed without quickly arresting the systemic causes of extreme structural imbalances and inefficiencies: the wrong incentives for workers and managers; overextension of state ownership and interference in the economy; systemic, pervasive, and arbitrary subsidization; and lack of accountability, reward, and effort.

Fourth, in Eastern Europe the performance of state enterprises and banks, the cornerstones of an economy, is appalling, compared to the situation for these institutions in China. Eastern Europe's state enterprises and banks have been undergoing reform and introducing various market criteria for more than a decade (for several decades in Yugoslavia), but they have failed to bring about substantial results. This is because the governments failed to alter fundamentally the structure of ownership and the corresponding microeconomic incentives. In Yugoslavia, frequent institutional reform and continuous institutional experimentation were followed by extreme financial indiscipline and the entropy of the system. In fact, the country grew more rapidly before reform. Slow reform in Hungary and Poland over the past decade created instability and was accompanied by expansion of the black market economy. In Bulgaria, for a full year after the overthrow of the Zivkov government, failure to start systemic reform contributed to the severe downturn of the economy. Clearly, piecemeal reform never managed to reverse the continuous decline of the East European economies, a decline that became more drastic and obvious only in the past two years.

Fifth, as long as China's piecemeal reforms work, its government will not want to embark on more radical reform that it cannot easily control. In China, peer pressure, the Communist party influence, and family and community ties apparently work as important complements to the standard market incentives. In Eastern Europe, these factors effectively dissolved in the tumult of the disappearance of the political monopoly, while market incentives are still to develop with the emerging private sector. Given the incentive and institutional gaps, the need for privatization in Eastern Europe is more urgent than it would be in China, for example. Although the entry into the market of new private firms is already impressive, it cannot alter the character of these economies in the immediate future, and, thus, privatization is the pragmatic imperative of the day. And the longer it is delayed, the clearer it will become that the all-encompassing state sector alone cannot pull the economies out of their depression.

Finally, the international economic environment and the strong integration forces at work in Western Europe clearly favor countries that are firmly committed to radical reform and free market policies. Why should Eastern Europe not take advantage of this historic opportunity to get the "best of the West," and in record time? The readiness of the West to provide advice, technical expertise, and knowledge is more critical for Eastern Europe than is a deluge of money at this time, short of humanitarian aid and the economies' lifeblood of short-term trade credits. For their own benefit, East European countries need to implement systemic reform, particularly privatization, as quickly as possible. Waiting will delay the benefits of reform too far into the future, while the costs will grow and possibly strangle the current changes.

Zeljko Bogetic
EMSCO, The World Bank

Béla Csikós-Nagy:

Whatever actually happens in Central and Eastern Europe (CEE) and China, is there really only a two-track approach to economic reform? Inderjit Singh's excellent article in *Transition* touches on the concerns about countries with a socialist economic pattern.

Nevertheless, let me look at this problem from a different point of view. I do not believe that CEE, on the one side,
and China, on the other, can be examined at the same level. In CEE a system transformation is going on, whereas in China only the reform of socialist economic planning is on the agenda. In the first case, a transformation can be observed—from a socialist economy to a social market system, and what happens is actually a re-capitalization process. In contrast, China wants to transform its "socialist commodity-producing economy" into a socialist market system. What actually is happening in China (including the restoration of quasi-private property rights) is similar to the Hungarian economic reform of the early 1980s.

The two-track approach certainly exists, although only in the context of Central and Eastern Europe. Investigating the matter from this aspect, the issues debated in the article must be expanded. I suggest addressing the following:

• privatization vs. reprivatization;
• popular privatization vs. the commercial variant;
• liberalization and deregulation: a harmonized vs. a controversial solution;
• social cost: narrow vs. widespread interpretation; and
• maintaining international solvency vs. suspending debt servicing, etc.

Last but not least, as I see it, the author was influenced by the overwhelming view so typical of the period 1989-90: the time when shock therapy was considered to be an adequate remedy for crisis management in post-communist societies. This comes to the fore strikingly in the paragraph headed "Price reform: radical vs. piecemeal." I do not think the actual situation at the end of 1991 is what was expected by policymakers propounding this line in 1989/90.

Béla Csikó-Nagy is a prominent economist and president of the Hungarian Economic Association.

**Moscow Joke**

**Question:** What is the new relationship among the pound, the dollar, and the ruble?

**Answer:** A pound of rubles = 1 dollar.

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**World Bank/IMF Agenda**

**First aid from the "Sisters"**

With the USSR now a special associate member of the IMF, the Fund can begin immediate and wide-ranging technical assistance. IMF experts are already in Moscow, providing advice on macroeconomic policies, exchange and payments systems, tax and banking reform, and statistics, and Soviet officials will be invited to IMF training courses in Washington. The stipulations for the former Soviet Union's special association can be extended to individual Soviet republics as well. The World Bank signed a technical assistance agreement the USSR and the Republics, to be financed from a $30 million trust fund. The agreement focuses on assisting development of a social safety net, reforming the energy, agriculture, and housing sectors and other key industries, developing the private sector, and training officials. The Bank will also open an office in Moscow to facilitate the implementation of the agreement.

**IFC in CEE**

According to the International Finance Corporation's recent annual report, the greatest expansion of its investment activity in the 1990s will occur in Central and Eastern Europe. Out of an expected $4 billion a year in financing, the IFC expects to approve up to $350 million annually for the CEE region—a 190 percent increase over the amount approved in FY1991. Algeria, Czechoslovakia, Mongolia, Namibia, Romania, and Bulgaria have joined the IFC in the past year, raising the number of member countries to 142.

**Financial boost to Nicaragua**

The World Bank approved a fast-disbursing $110 million "economic recovery credit" to Nicaragua from IDA, the Bank's concessional-lending affiliate. The credit is providing support to cut public sector employment, revitalize the civil service, reform the financial sector (provide a new regulatory body and license four private banks), and privatize vast sectors of the economy (return 350 state-owned businesses to the private sector). The IDA credit also supports the introduction of trade, tax and regulatory reforms to promote private-sector production. The Inter-American Development Bank is expected to co-finance the IDA credit with $130 million. In addition, the IMF recently approved a $55.7 million standby loan. At the same time, IDA is mobilizing additional concessional aid through its chairmanship of Nicaragua's consultative group of aid donors.

**Romania's health care**

Romania will begin overhauling its health-care system, control the spread of AIDS, and improve family-planning services through a project supported by a $150 million World Bank loan (see TRANSITION, September 1991). The project aims to reverse the worsening health conditions and improve the health-care system. It includes improvements to rural health-care centers, a health-education campaign, strengthened family-planning programs, training for health-care workers, and provision of medical supplies for hospitals and other health facilities. The loan will finance imports of medical supplies, including disposable syringes and autoclaves. The project will make birth control devices affordable and widely available.

**Support to Laos**

An IDA credit of $40 million will promote the Laotian Government's efforts to institute a market economy. The credit will support public enterprise reform and privatization, efforts to boost government revenues, and measures to improve the management of public resources. The government's privatization program began in 1991. The Bank will assist with auctioning off small public enterprises over the next three years. Larger public enterprises with 30 or more employees will be sold at the rate of 20 to 30 a year.

(continued on page 14)
Quotation of the Month: Ukraine and Byelorussia will clearly be the front runners in a new economic alliance

*Commerzent* on future inter-republican ties

The real economic independence of sovereign republics will in many ways depend on their place in inter-republican exchanges. These contacts will determine, regardless of whether an economic agreement is concluded or not, the business relations of enterprises in the new states, their balances of payments, and, if the ruble zone comes apart, the exchange rates of their national currencies.

The combination of two factors — the export possibilities of the breakaway territories and the formal principles of an economic agreement — will decide the evolution of economic conditions in every region. Computations demonstrate that under any scenario of forging an economic alliance, Ukraine and Byelorussia will clearly be the front runners, while the Central Asian nations will not be able to achieve economic independence.

The most economically independent regions include: the Russian republic, where products supplied by other republics account for only 8 percent of gross consumption; Ukraine (12 percent); and Kazakhstan and Azerbaijan (some 16 percent each). Only three of these republics report a surplus in inter-republican trade in current domestic prices — Azerbaijan (+23 percent), Russia (+3 percent), and Ukraine (+0.6 percent). Elsewhere, supplies from other republics are responsible for 20 to 25 percent of overall consumption and exercise much greater influence on local economies.

**Scenario A: With current prices**

Although trade agreements among republics will probably be drastically changed in the near future, existing economic relations between enterprises in various regions may be preserved in the transitional period, and commodity exchanges between them may be based on current prices. This possibility is linked to the central authorities' position through the Yavlinsky program. The inertia of inter-republican contacts is also due to the fact that more than a quarter of republican GNP is involved in inter-regional exchanges.

Should this forecast come true, Russia, Ukraine, Byelorussia, and Azerbaijan will remain donors (if one also takes into account republican contributions to exports to third countries). Byelorussia will then shoulder the heaviest donor burden. All other regions will have to be subsidized because of the lopsided distribution of centrally-imported resources and the balance of payments deficits in inter-republican trade. However, Latvia and Lithuania will almost be able to balance their accounts in dealing with other regions. This will also be true of Georgia, Armenia, and Moldavia if their political situations stabilize and if the raw materials blockade is lifted.

**Scenario B: Changeover to world prices**

Most republics see a way out by converting to world prices on exports to other regions and by introducing their own currencies as a means of protecting their economies. Should the national balance of payments be divided completely among republics and they adopt separate currencies, two options are possible:

- Republics will trade with third countries independently on the basis of world prices.
- Republics will rely on world prices for commerce among themselves.
The two options may actually be phases of the same process. Yet neither of them provides for preserving an integral “hard currency—ruble zone.” It is possible though that in the first case the ruble will retain the status of a yard-stick in inter-republican exchanges.

In the first case, republics less dependent on imports from third countries and with a larger export potential may be in a more advantageous position. Computations show that Russia will suffer the heaviest balance of payments deficit, with imports exceeding exports by 13.7 percent of the entire trade turnover, including inter-regional exchanges. This is because products from third countries account for more than half of all Russian imports. For comparison’s sake, the share of import supplies in Ukraine and Byelorus, trailing the Russian republic in this respect, is twice as small. In addition, the deficit will, to a large extent, be due to the cheapness of raw materials exported to other republics.

The Central Asian region will end up in an even worse position, with the combined balance of payments deficit there equaling -17.8 percent. Ukraine may also suffer a balance of payments deficit of -6.3 percent due to the high proportion of supplies from other republics in its overall imports. Byelorus, in contrast, will enjoy a surplus of 5 percent, as it is overwhelmingly the black in inter-republican exchanges. Transcaucasian republics will have a surplus of 1.5 percent for the same reason.

The switch to world prices will change things dramatically. Russia will be the only republic with a trade surplus (12.8 percent of the entire turnover). Ukraine and Kazakhstan will be able to slash their deficits, but other regions will suffer catastrophically. Transcaucasian republics will develop a balance of payments deficits at a level of -11.8 percent, with Armenia and Georgia the hardest hit. The Central Asian region’s deficit will burgeon to -21.5 percent. The aggregate Baltic deficit will nearly triple, to -21.3 percent, and the Moldavian deficit will likely swell to -35.6 percent.

No republic will be able to avoid the disastrous effects of such a downturn. The changeover will provoke a severe structural crisis in republics around Russia, as hundreds of enterprises running on Russian raw materials go broke. An unprecedented recession in unemployment may follow, with possibly up to 40 percent of the workforce in the Baltics losing their jobs.

Russia can be expected to achieve a surplus in trade with Georgia quickly, within a month-and-a-half after the switch, the Baltics in two months, the Central Asian region in two-and-a-half months, and Kazakhstan in three-and-a-half months. All indications are that structural maneuvering will soon give a boost to the Byelorussian and Ukrainian currencies. After a brief transitional period, their exchange rates may even appreciate against the ruble because the two republics will enjoy a trade surplus with Russia in agricultural products and food.

Scenario C: Transferrable ruble resuscitated

In the volatile situation of price deformities and uncertainty about the division of foreign debt, the republics may preserve the Bank for Foreign Economic Activities (Vneshekonombank) as the single agency answerable to third countries for the former USSR’s state liabilities and to act as the chief manager of government credits. The republics might use Vneshekonombank for transferring all account-settling in export/import activities to republican foreign trade banks. Raising prices on fuel, power, cotton, ferrous and non-ferrous metals, and, possibly, grain will be a compromise whereby raw material exporting regions will not consider their interests infringed upon and raw material importers will not find themselves in a critical state. Taking their cue from the defunct COMECON, republics can sign state contracts among themselves to supply products at prices that will remain stable for stipulated periods.

In this case, inter-republican exchanges under state contracts and direct agreements between enterprises in different regions can be served by an imaginary currency (a new transferrable ruble), with a stable exchange rate in relation to hard currency. The rate most likely will be regulated by an inter-republican agency patterned on COMECON’s International Bank for Economic Cooperation — effectively a committee consisting of national bank representatives engaged in facilitating inter-republican payments. Republics may still introduce their own currencies. Fluctuations will be determined mostly by the availability of goods in the markets, the currency-creation policies of republican banks, and the progress of economic reform in the regions. Should this scenario materialize, regions enjoying a surplus in foreign trade will naturally take the dominant positions in the new International Bank for Economic Cooperation.

From “Will it really work?” in the Soviet business weekly Commerzent. The authors, Nikita Kirichenko, Lyubov Siritzhkova, and Vera Shirobakova, comprise a research group.
Milestones of Transition

In late October, Boris Yeltsin announced a program of drastic economic reforms for the Russian republic. The plan would free prices and remove subsidies by the end of the year, privatize large sections of state-owned industry and agriculture, and create a more viable currency. (Oil products and some consumer staples, such as bread, are likely to be excluded from the price liberalization.) The price move will be preceded by a financial stabilization program designed to mop up some of the billions of excess rubles in circulation and cut the former USSR's deficit, slash grants to inefficient enterprises, cut defense spending, stop funding for about 70 Soviet ministries as of November 1, and end all economic assistance to foreign countries. Other measures include: dealing with newly independent Soviet republics in hard currency at world prices, ending subsidization, joining other republics in a new economic community, and providing safety nets for low-income families. Yeltsin proposed a new "inter-state" bank to be created by Russia and the other republics if the latter refrain from issuing their own currencies and agree to a system under which each republic's vote would be proportional to its capital. If not, Russia would form its own state bank and introduce its own currency, said Yeltsin, adding that he was ready to head a new government of national unity. Inflation has reached a critical level, and 55 percent of families were living below the poverty line, he stated.

The European Bank for Reconstruction and Development is considering establishing a new bank to finance trade from Eastern Europe to the Soviet Union. EBRD vice-president Ronald Freeman reminded a Paris conference that several East European countries have approached the EBRD for help in exporting to the USSR. An EBRD official in London said such a bank could be set up with the help of the World Bank, the IMF, the OECD and the EC, with the EBRD charged with coordinating the new bank's activities. EBRD President Jacques Attali raised the idea of creating the bank during the World Bank/IMF Annual Meeting in Bangkok in October.

Poland's president Lech Walesa has hinted that he might appoint former Finance Minister Leszek Balcerowicz as head of the central bank. Walesa wants to reorient economic reforms to soften their impact on the population, give each Pole stock in privatized state industries, intensify job retraining, and stimulate local officials to begin auctioning vacant state property in their areas. Poland could have as many as 3.5 million unemployed next year, which would be the highest proportion of jobless in Europe, said Jerzy Eysymont, chief of the Polish Planning Office. If current trends in the Polish economy continue, unemployment could reach 16 to 18 percent of the workforce.

Last year the Soviet Union's budget deficit reached 300 billion rubles, or 25 percent of GNP, and according to Soviet estimates, it will be over 450 billion rubles next year, according to the latest figures of the Soviet central statistics office, Goskomstat. The Soviet money supply shot up sharply in June and August when up to 20 billion new rubles went into circulation. The state issued an additional 13 billion rubles during September. In addition, Soviet oil exports are expected to fall to 1.4 million barrels a day in the first quarter of 1992, half the level of the corresponding period in 1991. Goskomstat has announced that national income, the main indicator of the USSR's economic performance, fell 13 percent in the first nine months of 1991. The grain harvest is expected to be down a quarter from last year's harvest, at just 160 million tons. Goskomstat official Igor Pogosov told reporters that a unified financial and credit policy has effectively broken down and that the republics are pursuing separate and uncoordinated policies.

Romania's new prime minister, Theodor Stolojan, says his top priority is to redress the impoverished economy. Recent riots cost Romania's economy almost $3 billion in delayed foreign loans and lost investment, according to Economy Minister Eugen Dijmarescu. The cost of living has more than tripled in the past 11 months. Official figures showed that prices soared 219.4 percent between October 1990 and October 1991.

Germany's five leading economic research institutes report that western Germany's economic growth will slow to 2 percent in 1992 from 3.5 percent this year, but eastern Germany's recovery with growth seen at 12 percent in 1992, following a 10 percent contraction this year — will expand united Germany's economy by 2.5 percent in 1992. In their annual economic report, the five institutes predicted that the expansion would be uneven, however, with strong growth in the construction, retail, and service sectors and continued weakness in heavy industry.

Inter-Korean trade has surged in 1991, totaling $25 million dollars in the first eight months, as against 1990. Currently North Korea is informally seeking participation from South Korea in a possible Special Economic Zone on the border with China and the USSR.

The Chinese economy grew 6.8 percent in the first nine months of 1991, compared with the same period last year; this makes the rate for the whole year above 6 percent, according to Zhang Zhongji, spokesman for the State Statistical Bureau. The national economy has regained normal growth, but some problems and unstable fac-

(continued on page 15)
Massive displacement of workers and a labor shortage for certain skills will be critical factors in the economic transformation of Central and Eastern Europe. Therefore, reallocation of labor at the lowest possible social cost will present a major challenge that will require policies and programs responsive to the changing nature of employment opportunities and to workers' needs. Experience elsewhere demonstrates that governments can play a key role in speeding reemployment while cushioning the drop in earnings of the displaced workers.

To understand better the labor market adjustment now underway in CEE, the Socialist Economic Reform Unit of the World Bank has prepared a new research project to answer the following questions:

- Which groups of workers are most threatened with unemployment?
- What is the likely duration of post-displacement unemployment?
- Which groups of workers become reemployed first, and which groups experience the most difficulties in securing new jobs?
- How do the earnings of the reemployed compare with their previous earnings and with the earnings of other workers with similar characteristics?
- Are there certain groups of workers experiencing particularly large wage losses?

The answers will help in assessing the distributive consequences of transition from a command to a market economy and will provide insight about the design of labor market policies. Some groups of workers (the older and the less skilled) might experience special reemployment difficulties, while others (women, minorities) might be particularly vulnerable to job loss over and over. In such cases, targeted assistance measures might be appropriate, particularly training or other reemployment programs. Such findings may point to the need for measures to prevent workplace discrimination.

The project will also investigate the possible adverse effects of unemployment insurance benefits on individuals' behavior as they search for new jobs. Such benefits are often viewed as overly generous in socialist countries; if appropriate, the project will propose corrections to existing policies. It will also explore whether advance notice of job layoffs could influence the duration of subsequent unemployment and whether wage structures set through collective bargaining adversely affect labor reallocation.

The empirical analysis will rely on (i) the estimation of hazard models for analyzing the determinants of labor market transitions and (ii) the estimation of earnings functions for analyzing the determinants of displaced workers' reemployment earnings.

The project will focus on labor market dynamics in the Republic of Slovenia (one of the Yugoslav republics), although the findings should be of more general interest. The research focuses on Slovenia because of three factors: (i) The economy possesses unusually rich administrative data on the personal characteristics and job history of virtually all labor force participants. The data are unmatched by anything available for the other Yugoslav republics or other socialist countries. (ii) Although Slovenia is a special case among the transforming economies, it still has more in common with the other CEE countries than with any Western country: notably the dominant social ownership, full employment combined with substantial hidden unemployment, high female labor force participation, a relatively highly educated labor force, a heavy concentration of employment in industry, low labor mobility, an egalitarian wage structure, generous fringe benefits, and substantial government involvement in wage determination. (iii) Slovenia is currently undergoing large-scale dislocations of the sort that ultimately will be required in all East European countries. For example, last year the labor force decreased by 5 percent; social sector employment decreased by 7.7 percent; unemployment increased by 62 percent; the jobless rate reached 5.8 percent; and the number of layoffs due to plant closures increased more than threefold. (To date, the rapid rise in Slovenian unemployment is parallel only to the rates in Poland and Bulgaria.)

Significant differences between Slovenia and the other socialist economies exist, however. For example, Slovenia historically has been more market oriented than most other regions of Eastern Europe, and it is wealthier. But the differences should not be overstated. Formidable constraints on labor and capital allocation have determined the working of the Slovenian economy, as in the other socialist economies.

The project will be a joint undertaking of the World Bank and Slovenian counterparts. The World Bank team consists of Milan Vodopivec, CECSE, principal investigator and project manager, and Katharine Abraham, a professor at the University of Maryland at College Park and the principal external consultant.

For further information, contact Mr. Vodopivec, World Bank, 1818 H St. NW, Room N-6-045, Washington, DC 20433. Tel: (202) 473-6996.
New Initiatives in Entrepreneurship Development
August 19-22, Kuala Lumpur, Malaysia

Organized by the International Labour Organization, the International Center for Public Enterprises, and the Malaysian National Institute of Public Administration (INTAN). Officials from China, Czechoslovakia, Laos, Mongolia, Vietnam, and Yugoslavia discussed ways to foster entrepreneurship, such as self-employment and microenterprise promotion, public sector support to small businesses, spin-off effects of franchising, and community-based schemes.

Information: Igor F. Pavlin, ICPE in Developing Countries, Titova 104, P.O. Box 92, YU-61090 Ljubljana, Yugoslavia. Tel: (386) 182-331, fax: (386) 346-389.

Accounting Aspects of Privatization
September 24-26, Geneva, Switzerland

Expert Group Meeting of the UN Centre of Transnationalists, sponsored by UNDP. Representatives from Germany, Hungary, and Czechoslovakia assessed the deficiencies in accounting that could restrict the efficacy of privatization efforts. While estimating the future earning power of enterprises, difficulties arise in evaluating the nature and extent of monoply power, the degree of international competitiveness, the pattern of government policies for liberalization, foreign exchange constraints, and the structure of wage negotiations. A forthcoming meeting will be devoted to the training requirements of accounting.

Should the West Lend to the East? Lessons from the Developing Countries
October 11, London, UK

Organized by the Centre for Economic Policy Research. Focused on Daniel Cohen's recent paper, The Solvency of Eastern Europe (CEPR Discussion Paper No. 539). The author (Professor of Economics at the Paris I University) concluded that developing countries that borrowed abroad during 1973-90 experienced lower growth, on average, than those that did not. East European governments should limit their foreign borrowing. Eastern Europe will grow faster than the developing countries because of higher levels of educational attainment. However, even at a potential growth rate of about 4 percent annually, it will take 25 years to catch up with Western Europe. Of all East European countries, Hungary has the greatest per capita debt, at $4,261 — more than 50 percent higher than the corresponding figures for Bulgaria and Poland. However, Hungary is viewed on the secondary markets as one of Eastern Europe's better risks, essentially because it has never reached its debt.

Centre for Economic Policy Research, 6 Duke of York Street, London, SW1Y 6LA 1, UK. Tel: (44) (71) 930-2963.

Forthcoming:

Privatization and Market Reform in Eastern Europe and the New Soviet Republics
November 21-22, Frankfurt, Germany

International forum sponsored by the Wall Street Journal (Europe) for corporate advisers, senior decisionmakers, and government officials. It will focus on six key issues: the role of international advisors working in Eastern Europe; funding privatization and infrastructure programs; private sources of hard currency funds and the potential for local currency funding; the privatization methods of Czechoslovakia, Poland, and Hungary; privatization and market creation in the new Soviet republics, and obstacles to privatization: environmental and restitution issues; and tax treatment of foreign investors.

Information: The Conference Desk in the UK. Tel: (44) (71) 221-2291, fax: (44) (71) 229-2636.

Global Economic Reform: Toward the Twenty-First Century
November 13, Washington, DC

Organized by the U.S. Chamber of Commerce Center for International Private Enterprise (CIPE). The meeting will receive the findings of a 32-country Economic Reform Survey and will address the question of whether economic reform is compatible with democracy, based on country and regional experiences. CIPE will launch its new public policy magazine, Economic Reform Today, which presents case studies on how specific countries are undertaking economic reforms.

23rd National Convention of the AAASS
November 22-25, Miami, FL

Hosted by the Southern Conference on Slavic Studies. Highlights include a roundtable discussion on Russia after a year under Boris Yeltsin's leadership and discussions of recent economic changes and reform prospects in the USSR. Topics will include: Yugoslavia in the 90s; Is Latin America the Future of Eastern Europe? East Central Europe Today: Continuity and Change; NEP as a Market Economy: Model or Myth? Company Laws and Property Rights: A Comparative Analysis; Beating the System: Borrowing, Earning and Spending Rubles. There will also be a roundtable debate on current Soviet economic development and on demonopolization and international competitiveness in Eastern Europe.

Information: 128 Encina Commons, Stanford University, Stanford, CA 94305-6029. Tel: (415) 723-9668, fax: (415) 725-7737.

Finance and Development in Europe
December 13-15, Santiago de Compostela, Spain

Organized by CEPR, the conference will synthesize recent advances in financing economic development and apply these insights to the less developed areas of Europe. The conference will focus on current questions about market vs. institutional solutions to the problem of regional development in Eastern Europe and the potential competition for funds between Southern and Eastern Europe.

Impediments to Transition: East European Countries and the Policies of the EC
January 24-25, 1992, Florence, Italy

Sponsored by the European University Institute. The conference will focus on the debt overhang, trade obstacles, payment difficulties, investment flows, and EC enlargement.

Information: EUI, European Policy Unit, tel: (39) (53) 509-2235, fax: (39) (53) 509-2298.
Other actions include: financial supervision of enterprises that remain under state control, promotion of foreign investment, and creation of a national tax and customs administration.

IFC-EBRD cooperation in Poland

The Polish Business Advisory Service (PBAS) has begun a project to assist firms with assets between $1 million and $10 million with financial and technical advice, including the preparation of business plans and investment proposals, technical advisory work, and general operational support. The service is being co-sponsored by the IFC and the European Bank for Reconstruction and Development. PBAS will have its headquarters in Warsaw and will eventually create branch offices in other industrial centers. It will be funded in part by contributions from IFC, EBRD, Denmark, France, the Netherlands, Sweden, and the United States.

Latest member: Albania

Albania became the 156th member of the International Monetary Fund and the World Bank on October 16. Albania also joined the Bank's affiliates: the International Development Association (IDA), the International Finance Corporation (IFC), and the Multilateral Investment Guarantee Agency (MIGA). It is the 140th member of IDA, the 143rd member of IFC, and the 85th country to ratify the MIGA convention.

IMF: $30 million to Mongolia

The IMF approved a $30 million standby credit to Mongolia "to help it through immense economic difficulties as it switches from 70 years of communism to capitalism," said IMF Managing Director Michel Camdessus after his recent visit to the country. If Mongolia keeps fighting inflation and pushing free-market reforms, the IMF would advise the world community to continue its support, Camdessus added.

Books and Working Papers Briefs *

Michael Burawoy and Kathryn Hendley
Strategies of Adaptation: A Soviet Enterprise under Perestroika and Privatization

The present political and economic uncertainty in the former USSR has multiplied organizational choices within any enterprise. The triangle of bureaucratic despotism — the Communist Party, the trade union, and firms' management — has disappeared, and bargaining with the state has lost its former importance. Different interests within an enterprise openly conflict (within the firm, between members and non-members of cooperatives, and between the labor council and management, etc.). This significantly determines enterprise strategies. The authors base their claims on a two-month case study in Resina, a 75-year-old Moscow enterprise that makes rubber products and has about 3,500 employees.

Information: BDOP c/o Kimberly Neuhauser, Dept. of Economics, Duke University, Durham, NC 27706.

Karen M. Brooks
Decollectivization and the Agricultural Transition in Eastern and Central Europe

Agricultural transition is an essential part of stabilization and adjustment in Central and Eastern Europe, but the supply response is complicated by the removal of consumer subsidies and constrained export demand. Distribution of agricultural land is proceeding in an atmosphere of acute uncertainty and declining farm income. Still the state is gradually withdrawing as residual claimant of positive- and negative-rents for the use of agricultural resources, passing that role to landowners.

The author — taking into consideration the significant differences in agricultural policy and farm organization in the individual countries—transcends those particularities by creating a stylized country in agricultural transition. She concludes that transition is especially difficult when demand is constrained, and the removal of subsidies on feed, fertilizer, machinery, energy, and even on credit, shifts the terms of trade against agriculture, particularly against the large livestock sector. Needed institutional changes on the supply side would feel an impetus from the growth of productivity, which in turn requires a boost in demand. This would come from improved export performance or by encouraging domestic demand.

To order, call Cicely Spooner, The World Bank, tel: (202) 473-0454.

Manuel Hinds and Gerhard Pohl
Going to Market: Privatization in Central and Eastern Europe

Although "large-scale" privatization programs for industries in Eastern Europe involve less than is generally perceived — about 10-15 percent of national assets, on average, and around 25-50 percent of GNP in the individual countries — privatization is a major challenge. One dilemma is whether privatization or restructuring should come first. The authors argue that governments should carry out the first stage of restructuring, such as a managerial shake-out, without making major investments, and that the second stage must await full privatization.

Enterprise privatization versus bank privatization presents a further difficulty in sequencing. The banking system should be split, and newly-created private banks should lend to new private ventures and privatized enterprises. Old banks should be left to clear up past loans; for example, they would be responsible for returning non-performing loans to the government in exchange for interest-bear-
The authors conclude that although selling enterprises is an efficient way of extending the private sector, and although it introduces the element of choice for the investors, it has drawbacks, such as magnifying the inequalities within the society. Uncompensated transfers emerge as the most equitable, quick, and efficient approach to privatization in this region, claim the authors.

To order, call Luz Housepian, The World Bank, tel: (202) 473-7297.

Other recent World Bank PRE Working Papers:

Esra Bennathan, Jeffrey Gutman, and Louis Thompson

Farid Dhanji and Branko Milanovic

Andrzej Olechowski

Oleh Havrylyshyn and John Williamson
Order from: IIE, tel: (202) 328-9000.

Don Van Atta
The Return of Individual Farming in the Soviet Union
Information: George Bellerose, Editor, Geonomics Institute, 14 Hillcrest Avenue, Middlebury, VT 05753, tel: (802) 388-9619, fax: (802) 388-9627.

Vittorio Corbo, Fabrizio Coricelli, and Jan Bosak (eds.)
Reforming Central and Eastern European Economies — Initial Results and Challenges

Ronald I. McKinnon
The Order of Economic Liberalization — Financial Control in the Transition to a Market Economy

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

**New Books and Working Papers**

Hans Blommestein and Michael Marese
Order: OECD Publications, 2 Rue Andre Pascal, 75775 Paris Cedex 16, France, tel: (3-31) 4524-8200.

Order: OECD Publications, 2 Rue Andre Pascal, 75775 Paris Cedex 16, France, tel: (331) 4524-8200.

Kathleen Woody

George M. von Fürstenberg
Pareto-Optimal Privatization for Gaining Political Support
Kredit und Kapital (Berlin) 24, 2: 147-175.
Tel: (0307) 900-060.

Joseph Hanlon

Dimitri Demekas et al.

**Milestones** (continued from page 11)

...and counter the depreciation of the currency. Spending for subsidies had rocketed from 2.1 billion dinars in 1987, to 22 billion in 1990, to 49.8 billion so far this year.

The head of the Ukraine national bank, Vladimir Matviyenko, said Ukraine plans to replace Soviet rubles with coupons as of 1992. The coupons will be valid for payment toward services and will be convertible to an equivalent amount of rubles. Coupons will be a step toward establishing a Ukrainian currency, which is forecast for 1993. Ukraine's Supreme Soviet in late October approved a five-year privatization program as well. During the first phase (1992-1993), the republican government would sell small factories and 200-250 larger enterprises. Private ownership of land and foreign ownership of property are envisaged.
BIBLIOGRAPHY OF SELECTED ARTICLES

Post Socialist Economies


Central & Eastern Europe


USSR


Africa


Asia


Latin America


* Staff may contact the Joint Bank-Fund Library, 202-623-7054.

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"Socialist" Agriculture Transformed — Perspectives on Food Trade

The present farm structure of the Central and East European (CEE) countries developed after World War II through collectivization. At first, the German Democratic Republic, Czechoslovakia, Bulgaria, and Romania took their inspiration from the Soviet agricultural model. The "socialist" reorganization of agriculture meant the creation of huge state farms and cooperatives although each country's system developed unique characteristics as well. For example, in Bulgaria, agro-industrial combines were created that merged state farms and cooperatives. By the mid-1980s, 150 of these gigantic combines stretched across most of the country's arable land. In the GDR, plant cultivation and animal husbandry were separated and pursued as entirely different enterprises. In Hungary, cooperatives enjoyed relative independence, while household farming survived on private plots. Poland also preserved private farms, but the government impeded their economic progress.

Throughout CEE, the traditional private farms were driven to the periphery of the economy; they became merely household farms and accounted for part-time agricultural production. Private farmers in the CEE countries primarily bred animals and grew fruits and vegetables; grain production and plant cultivation in the tillage areas were almost exclusively reserved for the big farms. The private sector's share in total agricultural production was lowest in the GDR — a mere 10 percent — and highest in Poland — about 65 percent. In Czechoslovakia the contribution of the private sector was 10-12 percent, and in Bulgaria about 25 percent. No reliable figures are available for Romania.

The legacy from decades of socialism is largely similar, however, in all the CEE countries. On the eve of transition, the agricultural sectors of Eastern Europe and the Soviet Union were characterized by:

- large, inefficient farms burdened with high production costs;
- subsidized food prices;
- excess demand for food at those prices;
- a high level of food consumption relative to other market economies at a comparable economic level;
- macroeconomic imbalance, characterized by budget deficits, inflation, and foreign debt; and

What's inside...

All-Union Food Crisis
The World Bank is stepping up its activity in the Soviet republics, as disruptions in food distribution threaten grave shortages this winter. (page 3)

More interviews from Bangkok
Romanian, Hungarian, Polish, and Lithuanian government members talk about their economic plans. (page 4)

Letters to the editor
Additional comments bring new arguments to the discussion of I.J. Singh's recent article. (page 6)

World Bank/IMF Agenda (page 8)

Quotation of the Month: How not to destroy an economy
In a recent address on the transformation of the Baltics, Larry Summers suggested that the Baltic states learn the lessons of the CEE countries. (page 9)

Milestones of Transition (page 11)

Conference Diary
Detailed account of a one-day conference on the disintegration of the Soviet empire. Participants, among them Aslund, Brown, Sachs, Nuti, and Williamson, analyzed the social, economic, and political consequences of the Soviet breakup. (page 12)

Books and Working Papers Briefs (page 14)

New Books and Working Papers (page 15)

Bibliography of Selected Articles (page 16)
• pervasive monopolies in food processing and distribution.

Bread and butter issues

The general objective in these countries is to develop an agricultural structure based on private initiative and ownership. Therefore, the main direction for transforming those agrarian economies to market-oriented and competitive agricultural structures can be pinpointed relatively easily. Agricultural policies should:
• create marketable land;
• change today's large-scale farming structure into small- and medium-sized private ventures, supported by voluntary cooperatives of various types, and state or communal farms;
• support the emerging private ventures and reduction of the cooperative sector;
• create a real agricultural market where the rules and institutions guarantee fair competition;
• facilitate increased efficiency of production using the same means as in the developed countries while striving to achieve income parity for agricultural producers;
• dismantle the bureaucratic structures of central planning and replace them with streamlined institutions that have regulatory and trade policy functions; and
• support environmental policies and the dissemination of nature-friendly agricultural production technologies.

The experiences of former socialist countries indicate that consistent reform packages implemented quickly lead to faster, more visible, and positive results than do partial, stop-go actions.

In the early stages of transition in CEE, the disappearance of cooperatives and state farms was generally expected, as most of them were oversized, inefficient, and inflexible. However, it is unlikely that most cooperatives will be fully dismantled after all. This seems to be because, in the short run, a remarkably high number of cooperative members are abstaining from starting their own enterprises. Numerous factors constrain their activity:
• a shortage of accumulated savings to start independent farming operations, aggravated by a lack of collateral for obtaining credit on reasonable terms;
• lack of banks in rural areas for processing credit applications or handling private farmers' credit needs;
• limited availability of machinery and tools for private farming and limited service facilities for them;
• insufficient supply of auction facilities, farmers' markets, and modes of transportation;
• lack of a distribution network (besides the still-surviving rigid state monopoly system). Networks of rural shops selling inputs and instruments to private farmers are non-existent, and sophisticated systems of wholesaling agricultural products have yet to be developed. Above all, cooperative members and state farm employees have little knowledge about running business operations or about financing, accounting, taxation, and entrepreneurial risk-taking.

For the time being, loosely structured cooperatives probably will emerge, focusing on finance, processing and marketing, and services. They will probably "prepare the soil" for individual farming at a later stage. The state farms, some of which have already been transformed into joint-stock companies, will continue supplying grain seeds and breeding stock; other state farms could develop into agribusinesses or be taken over by foreign companies. In any case, most of them could undergo privatization.

Agenda and scenarios

During 1990-91, all the CEE countries, except the USSR, have made substantial progress toward liberalizing food prices and eliminating subsidies. Liberalization has been almost 100 percent complete in the more developed countries (Poland, Hungary, and Czechoslovakia) while less complete in Romania and Bulgaria. Initially, food prices increased everywhere by an average of 30-40 percent in real terms, but in response to recent excess supply, they are declining. In this short period, consumer adjustment has been remarkable, but adjustment on the producer side seems much slower. And although citizens have received partial compensation, targeted programs of direct food relief were not attempted in any CEE country. The promising experiences of Central Europe so far should encourage the USSR's proposed price liberalization.

With the disappearance of the state monopoly on foreign trade, a new foreign marketing structure, including competitive trading and direct sales by producers, should take shape relatively soon in the CEE countries. A coordinated system of tariffs, customs duties, and taxes should replace licensing. Liberalization of foreign currency regulations is also crucial for development of a viable agricultural trade.

The supply of basic inputs and machinery services has critical importance as well. Development of a private-sector commercial system is the most suitable way to supply inputs and machinery services. A network of farm supply shops should be created also. For the short term, new cooperatives could become the major supply institutions. Over the long run, private firms, including some foreign firms, will likely become involved. Credit availability to cover inputs and services should also be organized.

What the future holds

• In the countries with the most developed agriculture (Poland, Hungary, and Czechoslovakia), production might decline for a number of years while domestic demand drops as a result of the economic slump. Recovery or a possible increase of output is not likely to occur until the second half of the decade, helped by expanding exports to the developed countries.
• Reform measures and the liberalization of prices could make their influence felt relatively quickly in Romania and Bulgaria; food production might increase over the short term, followed by an appreciable upswing overall.
• In the Soviet republics, assuming that their reform process will be slow and that the current political and economic tensions will continue, agricultural production will likely stagnate or, at best, increase only slightly.
It will remain below the average global growth rate until the end of the decade.

New trade patterns

The crisis of the ex-Soviet Union has had a serious impact on food exports from the CEE countries — in 1990, CEE food exports declined considerably, and the free fall continued in 1991. However, it is highly unlikely that sales of CEE agricultural products will completely abate. During the years when most CMEA trade was based on “CEE food for Soviet energy,” a large supply infrastructure for energy — for oil, gas, and electricity — was built between the USSR and the CEE countries (pipelines, compressor stations, electrical grids, etc.). Furthermore, the republics are geographically close and could be attractive market outlets for CEE agricultural products. Therefore, food exports to the east probably will be maintained, although on a different basis and at a lower level than before.

Meanwhile, the Soviet Union is replacing CEE agroproducts with purchases from the OECD countries. These products (mainly grain and meat) are supported by credits and favorable prices.

Although inter-republic trade has the potential for maintaining food self-sufficiency for the republics, altogether they will remain a net agricultural importer over the medium term. Their economic difficulties will almost certainly constrain their food imports in the coming years unless Western countries are ready to finance sales through extended credits. A significant part of these credits could finance CEE agricultural exports to the republics and, thus, be a form of assistance to Central and Eastern Europe as well.

For CEE agricultural products, access to the Western markets is better than at any time in the past two decades. Association with the European Community offers further possibilities for Poland, Hungary, and Czechoslovakia, which have substantial comparative advantages and significant production potential. Difficulties related to unclear property rights, the transition to a modern ownership system, and lack of funds for export subsidies obviously could constrain sales. At the same time, international payments obligations force these countries to try to increase food exports, especially meat, to the developed countries. In the short run, expansion of agricultural exports is easier to achieve than boosting the sale of manufactured goods.

Expansion of agricultural exports, particularly from the “northern” CEE countries is possible even when production stagnates or declines.斯塔

All-Union food crisis and the World Bank

To devise long-term solutions to the Soviet Union’s food shortages and distribution problems, Union (Soviet) officials and representatives from the World Bank and the OECD agreed on November 11 in Paris to carry out a study. World Bank President Lewis Preston had previously announced in Moscow that the Bank would set up a $30 million trust fund to finance technical cooperation with the Union and the individual republics in their reform efforts, with food security being a priority issue. "Widespread reforms are called for throughout the food distribution chain and to increase production and improve storage, processing, and transportation. This is a big and urgent task, and we hope that we can move fast enough for some reforms to have an impact before the next planting season," Preston said.

According to Oxford Analytica, the London-based research group, production shortfalls and the inability to finance imports threaten many cities and regions of the ex-USSR with famine this winter. Independent sources expect the total Soviet grain yield to reach about 185 million tons, a 22 percent (52 million ton) fall from 1990. Wheat has fallen the most, to 80 million tons, which is about 26 percent lower than the 1990 crop yield. However, the 1990 level of production has been maintained for potatoes (65 million tons), vegetables (26.27 million tons), sunflowers (6.7 million tons), and sugar beets (83-85 million tons). The drop in production volume is paralleled by the swift decline in state purchases. So far in 1991, the state has purchased only 18.5 million tons (live weight) of livestock and fowl, which is 86 percent of the 1990 level, and 67 million tons of milk (87 percent of the previous year). State purchases of grain have fallen off even more drastically — 44 to 46 million tons — and are not expected to exceed 65 percent of last year’s figures. Unlike in recent years, it will be difficult to finance imports, the only means of meeting demand. Disruption of the inter-republican distribution system for imported grain remains an unresolved problem, especially since the usually grain-exporting Ukraine and Kazakhstan will need imported grain themselves this year.

Distribution cannot be resolved until there is a lowering of the restrictions on the movement of goods among the republics. On October 31, republican leaders reached tentative agreement on the food supply; they agreed to:

- maintain supplies to the Inter-Republican (formerly All-Union) Food Fund to feed the army, militia, and certain cities (Moscow, St. Petersburg, and other major industrial centers) and to build up a reserve;
- continue centralized state purchases of foodstuffs;
- retain external credit accounting, to retain the trust of Western creditors;
- guarantee unobstructed and untaxed movement of goods throughout the former Soviet territory; and
- maintain until mid-1992 the prices of basic agricultural products, although it is proposed to introduce coefficients for inter-republican accounting to discount actual expenditure. (In early November the all-Union import tariffs on food and other essential goods also were abolished to ease acute domestic shortages.)
Examining the burdens from the past
More interviews from Bangkok

The following report continues the interviews conducted by Transition’s editor Richard Hirsher in Bangkok during the Bank/IMF Annual Meeting in October. The first group of interviews appeared in Transition No. 9 of October 1991.

Florian Brecea, Romania’s Minister of Budget

Q: You were recently appointed to the new government of Prime Minister Stolojanc and were sworn into office after the miners’ riot in Bucharest. Is it possible to meet the social demands of the needy without depriving the economy of the scarce resources for carrying out reforms? How can the government survive this “Catch -22” situation?

A: The message our delegation brought to this meeting is that the Stolojanc government will continue the reform process. The leu will be internally convertible [see Milestones, page 11]. Price liberalization should continue, but the public can not tolerate a 200 percent inflation rate, as the events in Bucharest illustrated. A general freeze of wholesale prices will be applied for 90 days, and 15 basic consumer goods and services — including rents and energy, which are centrally controlled until mid-1992 — will also be frozen. At present, automatic wage increases compensate for about 40 percent of the price increases; a more sizable wage compensation has to be considered. Although there is a need for increased social expenditures, budget revenues might be less than anticipated because many enterprises went bankrupt and were unable to pay taxes. [Industrial production stands now at less than 75 percent of the 1989 level. This year GDP will drop 5 to 10 percent, and exports 20 percent.] Nevertheless, we are trying to keep the 1992 budget deficit within 2 percent of GDP. Inefficient enterprises with their huge state subsidies must be eliminated. However, restructuring must be in a certain sequence. A too radical approach could drastically increase unemployment; and funds to help the jobless have been depleted already. The new government has to initiate massive public works programs, creating employment possibilities and a modern infrastructure.

Privatization will go ahead. Re-institution of private farming and the sale of small enterprises, workshops, and restaurants, for example, must not be delayed — 30 larger enterprises will go on the block within a year. Large-scale privatization starts early next year and will be completed probably in five to ten years.

At the same time, the government will set up a state ownership fund and five private ownership funds. The state fund will retain 70 percent of the capital of the commercialized state-owned enterprises and sell them to Romanian or foreign investors. Proceeds will be used by the fund to restructure and consolidate struggling companies. The budget’s gain will come from a 10 percent tax after the fund’s income is allocated. Certificates for the private-ownership funds will be distributed free to the population; those funds will hold 30 percent of the capital in the state-owned enterprises.

Article IV consultations with the IMF on the next extended credit facility will resume shortly. It is hoped that the World Bank will resume preparations of a $300 million structural adjustment loan to assist with private sector development, reorganization of the financial sector, and reform of agriculture.

Stefan Kavalec, Poland’s Under-Secretary of State, Ministry of Finance

Q: Barczelowicz, your Minister of Finance, [was] conspicuously absent from the Bangkok meeting. The IMF suspended negotiations with the outgoing government. According to the latest opinion polls, support for radical reform is eroding. How would you describe the economic situation now, considering all these bad omens?

A: After normal consultations with the IMF, both parties agreed to wait until 1992 and resume negotiations with the new government. [Disbursement of two IMF tranches of $102 million each has been delayed.] External conditions turned out much worse than expected. Trade with the USSR fell dramatically — the loss this year equals 5-6 percent of GDP.

Our budgetary revenues are 20 percent less than projected, due to a further slowdown of production. Since 1989 the cumulative fall in Poland’s GDP has exceeded 20 percent. Unemployment in the non-agricultural sector has reached 15 percent and is still rising. Although we tried to cut our expenditures, the budget deficit is higher than agreed with the IMF, exceeding 3 percent of GDP.

Systemic changes are much more difficult to implement than it seemed two years ago. But radical changes already have taken place. In fact, our market is more open to foreign products than are Western markets to our exports. The zloty is convertible for current transactions. The private sector already dominates the retail trade. Several hundred state companies have been privatized, through auctions, public offerings, trades, or liquidation. Half our labor force works in private businesses now. Privat-
Privatization is gaining momentum, but it is not as fast as it should be. According to our mass-privatization scheme, 10-20 privatization funds will be set up with the help of foreign experts. Shares of enterprises will be distributed among these funds. Each enterprise will have one fund that is the major owner and keeps about 30 percent of the enterprise's shares. The funds will oversee management of the enterprises. Distribution of vouchers will mean distribution of the funds' stock among the population. (In Czecho-Slovakia, on the other hand, vouchers will be directly exchanged for enterprise shares.) The procedure should start when the new government takes over.

Vytenis Aleskaitis, Under Secretary of the Government of Lithuania

Q: As an economist-mathematician by profession, how do you describe the economic changes in your country since its independence from Moscow? What do you expect from the West?

A: Our parliament has already passed almost all major laws regulating economic activity, in line with the legal framework of the European Community. As to the practical steps, we started privatization in January. Employees were able to buy up to 10 percent of the shares of their enterprises. Last September, 100 small enterprises were sold through public auction, and another 100 firms were offered through share subscriptions. The parliament has agreed to sell 110 large enterprises for hard currency, among them shoe, furniture, knitwear, and electronic enterprises. Domestic investors will use vouchers because savings are still low. (Also, we did not want the USSR to use the ruble as a weapon with which to buy up the Lithuanian economy through their KGB network.) About 2 million people have received vouchers (out of the 2.7 million who are entitled to them). Voucher-holders can bid for an enterprise or for shares in an enterprise; 5 percent of the price must be paid in cash. We hope to privatize 20-30 percent of all state-owned industrial assets by the end of this year and to complete the process by the end of 1992.

One of the major concerns is the reintroduction of the latus, our currency, which was introduced in 1922. For strategic and economic reasons we shall postpone this action until next year; we hope to get Western support for a stabilization fund of about $200 million. Price liberalization is also progressing, with 40 percent of prices already free. About 90 percent of all prices will be freed by the end of the year. Wage increases compensate for about 70 percent of the price increases. We also want to create a specific commodity reserve fund with our Western partners. Warehouses are empty, and we need goods to prevent skyrocketing prices. We do not ask for direct credits, but rather goods, the production of which also ensures jobs in the West. We expect IMF membership soon; the Fund is sending an expert group in mid-November.

Mihaly Kupa, Hungary's Minister of Finance

Q: What is your prediction for 1992? What prevents Hungary from switching to an expansionary economic course?

A: Next year we hope to be the first country in the region to reverse the protracted economic decline and achieve a modest increase of consumption and investment. We expect a further influx of foreign capital and the continuation of the favorable trend in our exports, which increased 30 percent this year. The budget deficit in 1992 should not exceed 2 percent of GDP. Due to the sharp fall in GDP this year, tax payments will be less than expected, and the budget deficit — although budgetary expenditures are kept under tight rein and supported by the monetary policy — will reach 3 percent of GDP.

To reverse the present downturn will be hard. First, the lack of modem infrastructure is the main stumbling block. We have to make painful choices, either to tie up scarce capital resources in infrastructural development or to finance the development by imposing new taxes on the already burdened population. The lack of modern infrastructure hinders our fight against ecological degradation as well.

Second, the social costs of transition are enormous. The public wants changes but is not prepared for the accompanying unemployment and the growing social inequalities. Tax revenues to the budget decrease as the economic performance and income-generating potential of the taxpayers plummet. Increasing taxes will not solve the problem; rather, it discourages entrepreneurs and increases interference from the state just when the goal is to diminish the state's role. On the expenditure side, our education, social security, and health systems are overburdened and financially unviable. Reform in these areas is politically sensitive and will be costly. Finally, of the three evils — inflation, imbalance, and stagnation — inflation must be attacked first, then the current payments account. Only then can the economy focus on accelerating growth. All this takes time — many, many years.

With one voice

From the Slovak weekly Rohac
Letters to the Editor

Reform vs. replacement

Two reactions to I.J. Singh’s article “Is there schizophrenia about socialist economic reform theory?”

The article about socialist reform theory (TRANSITION, Vol. 2, No. 7, July - August 1991) is interesting and thought provoking. The issues raised are important for policymakers in both Central and Eastern Europe (CEE) and the World Bank. The author’s basic premise and implicit conclusions are misleading, however.

Countries in CEE are in the process of transforming their economies into market economies — they are replacing one system with another. Therefore, it is misleading to call the process “reform.” China’s strategy, on the other hand, is based essentially on the belief that market elements can be successfully introduced into decision-making processes parallel to and based on continued overall plan coordination. The Chinese leadership does not appear committed to private ownership of the means of production; [that is, they do not see this] as an important constitutional element of a market economy. Once we accept this key difference in starting points, it is not surprising that [the Bank’s] advice on key policy issues in China and in CEE can be quite different.

In terms of the private vs. the state sector, the author compares the intended privatization of state-owned enterprises in CEE with China’s preference for making such enterprises behave as if they were privately owned. Planners in CEE had tried repeatedly to make enterprise managers behave as if they were semi-independent decisionmakers in “markets,” with the result that the incentive structure became even more distorted.

Incidentally, the article mentions that “governance reform” in state-owned enterprises is gaining importance in CEE if only because privatization proceeds slowly. This assessment is not quite correct. It is one thing to try to improve the operations of state-owned enterprises that will remain in the public domain (because markets cannot be expected to provide certain goods or services that are subject to performance rules and incentive systems in an otherwise market-environment). It is quite another thing to attempt to make public enterprises more efficient in an environment where all enterprises are state-owned, managers are not accountable to private owners, and plans, rather than price signals, allocate resources. Such efforts have failed all over CEE, and this is why the governments now emphasize fast and massive, rather than piecemeal, privatization.

In terms of intervention vs. a laissez-faire approach, the article contrasts China’s active industrial policy with the “hands off” approach advocated in CEE, where macro- and microeconomic policies are expected to bring about, over time, the necessary structural changes. Under central planning, CEE governments attempted to activate industrial policies through direct intervention and preferential allocation of resources — all such attempts failed. Today in the rapidly and dramatically changing CEE economies, direct intervention would not be able to create an industrial structure in line with the individual countries’ comparative advantage and would risk directing scarce public resources in the wrong direction.

A more fundamental point is that liberalized prices and liberalized trade, complemented by restrictive fiscal and monetary policies, are the main, indirect, industrial policy tools that will bring about structural changes. A lasting increase in output and improvement of its quality, in response to the demands of domestic and foreign consumers, can only develop in an environment where enterprises are forced to economize resources, improve management, and motivate employees to survive in competitive markets.

The article pointed out that rapid and far-reaching trade liberalization might result in a country’s substantial loss of industry; [it also suggested] that the only relief from the “shock therapy” of import competition and worsening trade deficits is to continue devaluation. Unfortunately, it is becoming obvious that large segments of the CEE economies are not competitive at world prices. The question is whether more gradual trade liberalization promises better adjustment results than does rapid liberalization. We probably will never know the answer because trade liberalization in CEE has occurred simultaneously with the disappearance of the CMEA trade and payments system and the disruptive developments in the Soviet Union.

Nevertheless, arguments in favor of fairly rapid trade liberalization are convincing. Both producers and consumers need to know the real economic cost of producing goods and services. Enterprises would be forced to make maximum survival efforts rather than hope for sector- or even enterprise-specific protection in addition to what is provided through the exchange rate and a moderate tariff level. Moreover, leav-
“Apples and oranges”

I found Singh’s article impressive and unsettling. He has outlined two radically different approaches to the transition from central planning to the market economy: one, in which governments embrace “shock therapy” economic reform; another, in which the authorities allow only gradual, piecemeal change. But in comparing China’s experience in the 1980s with that of post-communist central Europe over the past two years, he is really comparing apples with oranges. Moreover, he leaves the impression that in most cases governments can afford the luxury of choosing between “shock therapy” and gradual change.

An example highlights the latter point. There is no known gradual or piecemeal antidote to hyperinflation, as Mr. Singh well knows. Instead, the universal prescription, based on lots of experience in Latin America and elsewhere, is shock therapy: cut budget deficits and domestic credit growth immediately to sustain exchange rate to a reasonable level. This means having to reduce government subsidies and tighten credit policies. If these measures are done piecemeal, or gradually, or according to “heterodox” rather than “orthodox” theory (the euphemism employed in Brazil several failed economic programs back), hyperinflation comes back with a roar.

The point is subtle but cannot be too emphasized: the hyperinflationary economy that was inherited by the Polish reformers was the cause of the subsequent recession, and not the stabilization measures that had to be invoked to rein it in. A contractionary adjustment was unavoidable. You may say that the stabilization measures were too stringent, but I will refer you to Poland’s experience in the latter half of 1990, when expansionary demand policies produced virtually no additional production or employment, but ticked up inflation dramatically.

Now, about apples and oranges. During the 1980s, the Chinese experiment could be counted among the most liberal of communist efforts at decentralization of economic decisionmaking and control. The reforms centered first in the rural agricultural sector and later extended to special economic zones (SEZs) in the coastal provinces. Vast amounts of foreign investment have flowed into these provinces from neighboring Hong Kong and Taiwan. The SEZs, through those patrons, have participated in an extraordinary export boom. This is what has driven Chinese economic growth. The reforms were not so much gradual and piecemeal as they were regional and sectoral. One can only speculate about the overall economic growth levels that might have been achieved had the reforms not been restricted to the rural and coastal areas.

By way of contrast, the impetus for central European reform was Soviet withdrawal, politically and militarily, from its coercive role in the region. Almost immediately, the new democracies faced much higher oil import costs, mainly because the Soviets began requiring payment in hard currencies. Exports to their principal external market—the Soviet economy—dropped to a fraction of their historical levels. Except in eastern Germany, no foreign patrons stepped forward to pump in massive amounts of foreign investment. Some countries faced very high debt burdens inherited from previous regimes that had borrowed, in part, to avoid having to make systemic economic reforms. Others inherited extreme economic and financial crises. In these circumstances, adhering to the old, rigid, centrally planned structures, dependent on Soviet subsidies and trade, while pursuing gradual and piecemeal economic reforms, did not appear to be a viable option.

Instead, the Central European response was to implement incredibly bold and far-reaching economic and institutional reform programs designed to create market economies—and to invite foreign investors in. Mr. Singh cites China’s success over the past decade. In fairness, this performance over many years never should have been compared with that of Central Europe over less than two years of wide-ranging economic reform and contractionary adjustment. One can only speculate about the average growth rates that the Central European economies will have sustained by the end of this decade. I think that they will be quite high—if the Central Europeans stay the course.

From Scott Thomas, principal economist for Poland, Hungary, and the Federation of Czech and Slovak Republics (formerly Czechoslovakia) in the Europe Bureau of the Agency for International Development, Washington D.C. The writer’s views are entirely his own and do not necessarily represent those of USAID.
World Bank/IMF Agenda

New WB loans for Hungary

The World Bank is preparing a $200 million Enterprise Restructuring and Privatization Loan to Hungary to accelerate privatization as well as the reorganization of the ownership structure of state enterprises. Loan approval is slated in the current fiscal year. Hungarian manufacturers, agroprocessors, and distribution companies can expect an $80 million-$100 million product development loan from the World Bank, possibly at the end of 1992, said Wayne Ringlien, the leader of a recent Bank mission to Hungary. Mission specialists underscored the importance of integrating both wholesale and retail trading and of further developing "cash and carry" and discount stores and the franchising system.

Bank and IDA support to China

To help Beijing overcome its pollution problems, the World Bank has approved a $45 million loan while IDA, its affiliate for concessionary lending, has approved a further credit of $80 million. The project, with a total cost of $304.5 million, will lay the foundation for Beijing's comprehensive environmental program to improve living conditions for 6 million inhabitants. The financing will cover a 32-kilometer heat transmission pipeline to provide heat and hot water to about 800,000 people (and reduce air pollution from coal burning - the main source of air pollution in Beijing is the 20 million tons of low-grade coal burned each year by industries, power stations, and households). Also, a hydropower and agricultural development project, supported by a $30 million World Bank loan and a $37 million IDA credit, will help alleviate poverty and improve economic productivity on Hainan Island. An IDA credit of $162 million will support a project in Guangdong Province that will help increase fish production in the South China Sea. In another development, the IMF opened a resident mission in Beijing, headed by Scott Douglas, tel: (8) (61) 501-2551.

IMF: staff redeployment

The IMF will redeploy staff temporarily to handle the volume of work growing out of the Special Association agreement with the USSR and to provide assistance to the separate republics. To accommodate this shift of resources, some changes have been proposed for the IMF's Article IV Consultations with its members. About two-thirds of the member states (about 50 countries) will undergo economic performance review every two years, replacing the annual consultations. (However, member countries will have the option of remaining on an annual cycle.) There will be no change in the annual consultations for about two-thirds of the membership: the major industrial countries, those countries currently receiving or requesting IMF support, and members in arrears. The IMF's Executive Board will review the plan in a year.

IDA to help Tanzania's financial sector

An IDA credit of $200 million will help Tanzania create a financial system that operates on market-oriented principles, is efficient in mobilizing and allocating resources, and fosters long-term economic growth. The plan is to set up a private banking system by 1993 and a stock exchange and other sophisticated financial markets. A series of reforms aims at allowing foreign banking competition, freeing up credit for investment by local and foreign businesses, and ending easy loans to inefficient state companies. Foreign banks could begin operations in Tanzania by 1993. A recent Bank of Tanzania report asserted that existing institutions exhibit low levels of productivity and that customer service is poor. The changes are taking place during a key stage of the four-year-old economic recovery program of market-led policies, which is supported by the Bank and the IMF.

Broadened ECO facility

The World Bank is broadening the scope of its Enhanced Co-financing Operation to make it easier for commercial banks to participate in aid projects in developing countries. Under the ECO facility, the World Bank has recently agreed to cover risks partially on loans extended by foreign and domestic commercial banks for aid projects in various countries. The ECO will be used in countries with extensive privatization programs and should broaden the potential for private sector equity participation in infrastructure projects.

MIGA executive programs

Reaching more than 130 executives from member countries, the Policy and Advisory Services (PAS) of MIGA (part of the World Bank Group) implemented its first series of executive programs recently. They focus on finding foreign business partners, international marketing and bank practices, evaluation and negotiation of foreign business deals, and exploration of various foreign investment options. The first programs took place in Portugal, for the Lusophone African countries (September 23-27), Hungary (September 25-26), and Czechoslovakia (October 1-3). Future MIGA services may include development of business strategies, identification of financing sources, and management training.

Transformation

From the Slovak weekly Rohac

November 1991
Quotation of the Month: “If the best way to destroy an economy is to bomb it — and if communism is a close second — rampant populism is third”
Larry Summers is not joking

M any people are pessimistic about the Baltics. The difficulties of simultaneous transition to a market system and to independence are very real. But there is no inherent reason why citizens of the Baltic nations should not be as prosperous as Scandinavians. They have the skills, motivation, and resources to succeed even in a very competitive world economy:

- The most recent estimate of GNP per capita for the Baltics is $2,200, which is about $300 higher than that of the Soviet republics as a whole. This puts the Baltics approximately on a par with South Africa, Brazil, Argentina, Venezuela, and Hungary.

- Although agriculture has fallen far behind non-communist northern Europe since the 1930s, due to Soviet economic control, this sector still does better in terms of crop and livestock yield than the Soviet republics. The Baltics are agriculturally self-sufficient; with the right policies, they could become major food exporters.

- By the standards of countries at their income level, the Baltic states have a very well educated workforce. More than 10 percent of the Baltic labor force has benefited from post-secondary education, a figure on par with that of far richer nations. While South Korea has an illiteracy rate above 12 percent, the Baltics’ rate is less than 2 percent. (As a whole, the Soviet republics produce one-third of all the world’s doctorates in science and engineering and employ more people in research and development than Japan and the United States combined. Engineering skills in the Baltics are even more developed, engaging 40 percent of the total Baltic industrial workforce.)

- Labor costs in the Baltics are extremely low. It is hard to know what exchange rate to use in evaluating wages paid in rubles, but there is no reasonable calculation by which Baltic laborers get close to $.40 an hour.

- In the 1930s, Estonia and Latvia had a level of urbanization and industrialization similar to that of Finland. Today, Finland’s per capita income is roughly $22,100, more than ten times that of the Baltics. Yet there is no reason to think the Baltics have less potential than Finland.

The reality is that no one knows the best way to transform an economy from socialism to capitalism — much less how to extricate a republic from a decaying nation at the same time. Nonetheless, experience in Eastern Europe and with economic reform teaches some lessons that the Baltics would do well to heed:

First, respect the universal laws of economics. Nationalists and populists often lose sight of certain basic principles and are especially likely to forget that the laws of economics, much like the laws of engineering, cannot be repealed for policymakers’ convenience. Everywhere too much money causes inflation. Everywhere farmers respond to incentives. Everywhere price controls create shortages.

Second, contain populist and nationalist pressures. If the best way to destroy an economy is to bomb it, and if communism is a close second, rampant populism is third. The hallmark of populist policies is a commitment to avoid real income reductions for urban workers. This often means large deficit-financed subsidies to consumers, restrictions that prevent the shedding of excess labor, and unrealistic exchange rate and credit policies. When the root problem is excessive purchasing power relative to the supply of goods, as in the Baltics today, populist palliatives only put off the day of reckoning (as they have through 40 years of Argentine decline, for example).

The nationalist impulse is no better as a guide for economic policy. It invariably translates into unreasoning protectionism and hostility toward foreign investment and can lead to ugly employment discrimination. The Baltic republics need help that includes enfranchising and covering everyone who lives within their borders.

Third, recognize that it is actions, not laws or codes, that count. There has been a distressing tendency in reform efforts both in Eastern Europe and in the former Soviet Union to confuse “laws written” with “reforms undertaken.” Paralysis through analysis is a real threat to economic transformation. It is critical that the Baltics not delay the job of freeing up prices, instituting small-scale privatization, reforming agriculture, and setting up social safety nets.

Fourth, welcome foreigners, foreign investment, and foreign goods. Even together, the Baltics are far too small to be viable economically without international trade. Western know-how will come only if policy is hospitable, restrictions on foreign investment are dropped, barriers against imports...
abandoned, and strong export incentives applied. The currency must be freely convertible for international trade without support from government licensing systems.

Fifth, clarify interrepublic arrangements. Unless the Baltics seek clarification of their relationships with other republics — who pays for what — a viable fiscal policy will be unattainable. Until it is clear how debt will be handled, it will be difficult to attract capital. And until trade relations with other republics are clarified, the Baltics will be in no position to serve as a gateway to Russia. Ambiguity is often good politics but rarely good economics.

Part of seeking clarity is recognizing reality. When goods are revalued at world prices, the Baltics run a massive deficit vis-à-vis the Soviet republics. This means that economic transition will impose very large unavoidable costs.

Sixth, create institutions that establish monetary stability. The Baltic currencies will be important symbols of what has been achieved; they offer the prospect of restoring the viable market system that the repressed inflation of the ruble has destroyed. But the new currencies are a substitute for, not a complement to, the hard measures necessary for stabilization. What are those hard measures? The principle is simple: governments must ensure that the supply of currency does not increase much more rapidly than the supply of goods. This means keeping spending in line with tax collections and limiting the supply of credit offered by the central bank.

Seventh, do not rush the introduction of a new currency. It would be a serious mistake to introduce a new currency before other structural reforms progress — until a tax system is in place, until there is some clarity in the division of labor between the Baltics and the Soviet republics, and until it is possible to receive extensive financial and technical assistance from the West.

Eighth, and most difficult of all, be patient. The unfortunate lesson of history is that even the best reform programs take time to have an impact. Germany and Japan endured long periods of pain during their post-war reform processes. The benefits of reform should be visible quickly in the form of fewer shortages and a flourishing private sector, but output and living standards will decline for quite a while.

The Baltics cannot expect vast amounts of Western money over the next several years. Budgets are tight and claimants are many. Fortunately, there is a precedent for the idea that limited amounts of aid, properly delivered and levered, can make a big difference. The Marshall Plan accounted for about 2 percent of GNP for Western Europe — to achieve a comparable level of support for the Baltics would cost about $500 million a year. This is a reasonable target for Western assistance and one that can help maintain living standards in the Baltics during the painful reform process.

Where should aid go? Technical assistance is the highest priority. Stabilization funds to support new currencies come next. The greatest sectoral need will be in the area of energy conservation. Oil imports are the source of Baltic balance of payments problems, or will be as soon as the Baltics are charged world oil prices. Estonia itself consumes nine times the amount of energy for every unit of national income as does Sweden; even halving this gap would make an enormous difference.

It is worth recalling that many of the world’s greatest economic success stories were written off much too soon. Those who are pessimistic about Baltic prospects should heed the words of German reform hero Ludwig Erhard, who described his nation’s situation in the post-World War II era as follows: “It was calculated that for every German there would be one plate every fifty years; a pair of shoes every twelve years; a suit every fifty years; and that only every third German would have a chance of being buried in his own coffin ... Few realized that if people were allowed once more to become aware of the value and worth of freedom, dynamic forces would be released.”

Excerpted from a speech by Lawrence Summers to the Hudson Institute Conference on Baltic Economic Reform on October 29. Mr. Summers is Vice President and Chief Economist of the World Bank.
Milestones of Transition

After 11 months of negotiations, the European Community has initiated wide-ranging trade accords with Czechoslovakia, Hungary, and Poland. The so-called association agreements are scheduled for signing on December 16. These pacts pave the way for complete free trade between the EC and the three East European nations within 10 years, coupled with phased-in liberalization of the former command economies. Previously, concerns raised by Spain, France, and Italy over steel exports from Poland, Czechoslovakia, and Hungary were resolved, clearing the last major hurdle to EC association agreements. Under a compromise, the EC would be able to reduce imports from the three countries if an EC member indicated that the imports were destabilizing the EC's own steel market.

Up to $6 billion of the principal on Soviet debt could be deferred in the next year, said U.S. Treasury Under-Secretary David Mulford recently. He estimated total Soviet external debt at $85 billion to $70 billion, including debt owed to G7 governments. The G7, in an accord with eight republics, have agreed to defer all of $3.6 billion in principal payments over the next year. But another 10 creditor countries will participate and will therefore increase the amount, said Mulford. Under the agreement, the republics also have the option to borrow up to $1 billion from G7 nations in return for gold. Mulford said the republics would sell the gold with an option to buy it back later at a fixed price. The Union and the eight republics have committed themselves to a program of IMF-supervised economic reforms. Among other things, the program includes currency reform and free trade among republics. The republics have decreed that they will adopt and implement during the first quarter of 1992 comprehensive and ambitious macroeconomic and structural adjustment programs.

Just a few days before the crucial presidential election in his republic, Vitold Fokin, prime minister of Ukraine, harshly criticized the aid package offered to eight other Soviet republics by the G7. He claimed it was "a gross interference in domestic affairs, and Ukraine was not party to the aid package, which will block moves to protect internal markets and interfere with plans to set up a separate currency." The republics reserved the right to negotiate separately with foreign creditors, he stated. Fokin also said that free inter-republican trade, as enshrined in the agreement with the G7, would mean that the republics could not protect their internal markets or create their own currencies. Ukraine has said it would mint its own currency after a transitional period using currency coupons instead of the Soviet ruble.

The Russian Federation parliament will take control of Gosbank (the Soviet State Bank) and Vneshekonombank (the Bank for Foreign Economic Affairs) on January 1, 1992. According to a November 22 parliamentary resolution, the Central Bank of Russia will become the only agency on Russian territory responsible for state monetary, credit, and currency policy, the main aim of which is to strengthen the ruble. According to reports, the central bank will take full control of resources, organizations, and the material base of the Soviet Gosbank as they existed on November 1, 1991. The resolution was adopted after the parliament rejected a decree by Russian Republic President Boris Yeltsin that proposed making the Soviet central bank subordinate to his government. Instead, the central resolution makes the bank answerable to parliament. However, the parliament decided to leave intact a separate Yeltsin decree about taking control of the Soviet gold storage facility at Gokhran.

Leaders of the ex-USSR republics are asking for 49.7 million tons of imported grain (see box, page 3). The republics requested $2.5 billion from the U.S. in agricultural credits, in addition to the $2.5 billion already received this year, and $1 billion in humanitarian aid. In response, the U.S. is offering an additional $1.25 billion in farm credits. Agriculture Secretary Edward Madigan also announced emergency food assistance of $165 million for this winter and about $85 million in technical help to improve Soviet agriculture and food distribution. The administration would offer further assistance next spring if the central government and the republics meet repayment schedules for existing loans. EC finance ministers have agreed to disburse $625 million in food credits; the Union and the republics can spend a quarter of that amount on food purchases from their former COMECON allies, Poland, Hungary, and Czechoslovakia.

Viet Nam is tightening foreign exchange controls to stabilize its currency against overseas currencies. The tightened controls include a ban on the use of foreign currencies within the country and an increase in tariffs on imports other than those needed for economic development. In another development, a Viet Nam Growth Fund has been set up in connection with a campaign to sell state-owned companies. Fund managers hope to raise between $50 million and $75 million by mid-December and make the first investments when companies are sold in March 1992. Hanoi is also planning to set up a stock exchange in three to five years.

The Hungarian parliament passed a banking act in early November that limits any one shareholder, the state included, to a 25 percent stake in commercial banks. At the same time the legislation set out capital requirements to fit BIS norms.

Poland's budget deficit has topped the $2.35 billion limit less than a month after it was set, according to the Central Statistical Office. The deficit reached $2.42 billion at the end of October, mostly due to falling tax revenues from collapsing state companies. A new budget must also be approved by the IMF before it will resume payment of a tranche of a three-year, $2.5 billion credit package postponed in September. The statistical office said consumer prices rose 3.2 percent in October, compared with 4.3 percent in September, while the year-to-year inflation figure was 64.8 percent, after 67.1 percent in September. October industrial production was up 9.4 percent from September but was still 21.5 percent lower than last October.

Romania has unified its currency exchange rate and introduced internal convertibility for the leu. Romanian Prime Minister Theodor Stolojanc, in his first major policy initiative since taking office last month, also told parliament in early November that the hard currency state accounts of state-owned firms would be frozen immediately and that the National Bank would buy up the cash for local currency at a rate derived from unifying the present two-tier exchange system. Romania can (continued on page 13)
Conference Diary

Disintegration of an Empire: The Soviet Economy
October 30, Washington, DC

A day-long seminar to discuss prospects in the Soviet Union. Participants included 60 World Bank staff involved in the Bank's technical assistance program to the Soviet Union and about 15 analysts from outside the Bank. Speakers included: Andris Aslund, Stuart Brown, Mario Nati, Jeffrey Sachs, Martin Weitzman, John Williamson, political scientists (Steven Meyer and Peter Reddaway), government officials (John Hardt and Paul Goble) and an investment fund manager (Dean LeBaron). Sessions focused on the current political and economic situation, the economic strategy, inter-republic relations and trade, military conversion, and the role of the West.

Attendees agreed that conditions in what was once the Soviet Union are spiraling downward, with no clear end in sight. Two revolutions are occurring simultaneously — one against the political imperialism of the former communist regime and the other against the economic system of communism itself. Hardly ever in history has there been such political and systemic upheaval simultaneously, without any clear rules of the game — not even with such basic elements as national boundaries.

In particular, the experts voiced broad consensus (although not necessarily unanimity) on the following basic points:

- Politically, the Soviet Union is on the verge of anarchy — no one is in charge. The Center Treaty and the current Union Treaty are essentially irrelevant. Union leaders could be out of their jobs within three months. Even within the Russian Republic there is evidence of bickering and little political stability.
- The economy is collapsing. Tax collections have fallen precipitously. This year's total budget deficit may reach 25 to 30 percent of GDP, and GDP will probably decline this year by 20 percent. Recorded inflation is running at 200-300 percent, and actual inflation may be higher. The system is in crisis and has lost all legitimacy. There are no incentives.
- Thorough reforms are needed, beginning with macroeconomic stabilization, price liberalization, improvisation of a social safety net, and rapid trade liberalization and privatization, with the many other elements of reform to follow. Although debt relief is not called for, debt rescheduling is needed to ameliorate the short-run liquidity crisis. According to some analysts, privatization could begin concurrently with stabilization if 20-30 percent of the shares in enterprises were given to employees; this would give workers and managers an incentive to think long-term rather than immediately to decapitalize their firms.
- Soviet industry — both military and civilian — needs extensive restructuring. Given the low technology and highly specialized nature of much military industry, military conversion will not and cannot be an engine for economic change. At best it will be a byproduct of economic change in the few cases where world-class potential exists. One thing the Soviet Union has in its favor, however, is a large cadre of capable technicians and managers. Paraphrasing one participant: "Anyone who could manage a large state-owned enterprise (with its constant crises and endless constraints) must be among the best managers in the world."
- The reform plan put forward by Boris Yeltsin on October 28 is the only glimmer of hope in the current situation. The plan, formulated by the State Council under Egor Gaidar, calls for a "big bang" price liberalization in January 1992. Although the plan is likely to be implemented — there is no other choice — it is fraught with risks, particularly because the public is unprepared for the resulting pain. The situation is dire, and the outcome is likely to be far worse than in Eastern Europe, but there is no alternative.
- The breakup of the Soviet Union can have a positive impact, both politically and economically, as long as inter-republican trade can be maintained. Politically, smaller units have a greater chance of creating some political legitimacy that would make reform possible. (However, the West should not expect all the results to be democratic. The political systems emerging in the republics vary widely — some are democratic, others clearly authoritarian.) Economically, smaller units can implement reforms more easily, and competition among republics is likely to accelerate the reform process in each. For example, as some republics liberalize prices, others will feel pressure to do the same. This phenomenon has been seen already in Central and Eastern Europe.
- A single currency and monetary and fiscal system — as envisioned in the Union Treaty — is not necessary for successful economic interaction and growth. History has shown that the size of an economy is not indicative of its success. Open trade is the only crucial economic relationship that needs to be preserved among the republics, and industrialized countries should use their leverage to ensure this.

Open trade requires a central payments-clearance mechanism, and it can be further facilitated by the credit facilities of a European-style payments union. Some participants at the seminar were against the idea of a payments union, arguing that credit facilities would allow republics to relax macroeconomic discipline, would encourage trade diversion away from international comparative advantage, could slow the drive to convertibility of the republican currencies, and would be administratively complex and politically difficult. Others (most notably John Williamson, who recently published a paper on this issue with Oleh Havrylyshyn) supported a full-fledged payments union. They argued that some relaxation of the discipline underlying macroeconomic stabilization might be helpful in the short run and that convertibility might be assisted by the general economic strengthening that a payments union could provide. According to this view, it is not the payments union — being only the vehicle of implementation — that causes trade diversion, but the trade barriers worldwide, no matter the free trade arrangements in any given region.

None of the participants disputed, however, that movement away from a single currency (i.e., currency reform) ideally should be done in a coordinated fashion. There are precedents for this, and Western technical assistance can help.
- The West should be forceful in making contacts with republican governments and, in particular, in sup-
Conference Diary (continued)

Impediments to Transition: East European Countries and the Policies of the EC
January 24-25, 1992, Florence, Italy
Conference sponsored by the European University Institute. Program will focus on debt overhang, trade obstacles, payment difficulties, investment flows, EC enlargement. Information: EUI, European Policy Unit, tel: (39) (55) 509-2235, fax: (39) (55) 509-2298.

Social Legacy of Socialism
February 21-22, Washington, DC
Sponsored by the George Washington University and the Woodrow Wilson Center. Participants will discuss social aspects of the transition process, including policies to combat unemployment, and reform of the health, education, and social security systems in the post-socialist economies. For further information: Woodrow Wilson Center, East European Program, Kristen Hunter, tel: (202) 287-3000, ext. 330.

New Dimensions in Regional Integration
April 2-3, The World Bank, Washington, DC
Sponsored by the World Bank’s CECTP. Topics will include the desirability and prospects for successful integration in Africa, Latin America, and Eastern Europe; and the likelihood of successful integration between developing and developed countries will be assessed. The issue of whether regional integration can serve as a stepping-stone to multilateralism or whether it is a barrier to the latter will also be addressed.

Attention, Advisers...

A peasant goes to a rabbi: “Please help me. My goose of geese is diminishing dangerously.”
“OK,” says the rabbi, “change their diet. Their mash is not healthy enough!”
After a couple of days the peasant returns: “They all died in mass. What shall I do?”
Rabbi: “Give them water from another well!”

Hungarian anecdote

Milestones (continued)

access foreign resources only if it proves its commitment to a market economy, Stolojanc said, adding that the central bank would merge official and interbank rates and that the new floating rate would be at an economically sustainable level somewhere between the two. (At present it is about 80 leu to the dollar.) He said the future exchange rate would be set through an enlarged daily interbank auction market. The government would give top priority to securing adequate energy and food stocks. The central bank would open credit lines to encourage exporters and would be responsible for taking measures to stabilize the leu. The prime minister said wages would be indexed to inflation after talks with trade unions at year-end.

G24 countries have agreed to extend financial assistance to Albania and the Baltics. Foreign ministers of 24 industrialized nations called for a meeting with Baltic officials before the end of the year to discuss the republics’ needs. Any help would be conditional on economic reforms approved by the IMF, they added. The G24 also announced the suspension of aid to Yugoslavia. The G24 estimated they had pledged $45 billion to Central and Eastern Europe since 1989, of which a little more than 20 percent had been disbursed. About 80 percent of the pledges had come from EC and EFTA states.

The Czech government has postponed for at least two months the start of a program to privatize its state enterprises. Privatization Minister Tomas Jezek said major privatization was now unlikely to start before March. The postponement also was expected to delay privatization plans in Slovakia. Czechoslovakia’s Finance Minister Vaclav Klaus said the delay would prove costly, adding that it would cause citizens to lose trust in the government’s ability to handle problems. The minister repeated his support for the use of a voucher system as part of the privatization program.

Western countries are resuming financial aid to Ethiopia. Aid has been blocked since the civil war that preceded the fall of President Haile Mariam’s regime. The European Community has decided to release $70 million set aside for the country. Belgium, Canada, and the Netherlands are also resuming economic aid projects, according to Ethiopian Information Minister Dina Noggo. He added that the U.S. has considered lifting the so-called Brooks amendment, which bans all economic aid, other than humanitarian or emergency, to Ethiopia.
Books and Working Papers Briefs *

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

Arvind Panagariya
UNRAVELING THE MYSTERIES OF CHINA'S FOREIGN TRADE REGIME - A VIEW FROM JIANSU PROVINCE

The author describes the evolution of China's complex foreign trade system, at the central, provincial, and city levels, starting in 1978 when China started its open-door policy. The paper illustrates those developments with specific research on Jiangsu, one of the fastest growing provinces of China and one that experienced rapid growth of exports.

Assuming that China will move only gradually toward a market economy, the paper proposes piecemeal reform of trade policy to improve efficiency and foster competition. It asserts that China’s foreign trade is still very tightly controlled (imports of most consumer goods are virtually prohibited, raw materials often require licenses, and even some exports are centrally controlled). Proposed reforms at the national level include expansion of direct export rights; allowing enterprises to retain a larger share of earned foreign exchange (retention rate); and eliminating discrepancies between domestic and export prices. At the local level, town and village enterprises (TVE) should be allowed to operate as freely as possible, with restrictions removed from inter-provincial trade and labor.


Jenny Corbett and Colin P. Mayer
Financial Reform in Eastern Europe: Progress with the Wrong Label

Eastern Europe is moving rapidly in the direction of the Anglo-American financial system, i.e., promoting the development of a stock market and participation of a large segment of the population in the privatization process, claim the authors. This is explained by the fact that most of the advice to the region comes from U.S. and U.K. experts. In the minds of many, capitalism is almost synonymous with the stock market, privatization, and wide share ownership, with these elements seen as the most effective means of breaking with the past. In most of the capitalist countries, banks, not stock markets, are the main source of financing for industry, and there is little participation by individuals in the enterprise sector, the paper argues.

In Germany and Japan, however, banks are the main actors, holding corporate equity both directly on their own account and — in the case of Germany — on behalf of investors, thus exerting considerable leverage over companies. Enterprises control each other through cross shareholding, protecting themselves from outside intervention. These “insider” systems overcome the “free-rider” problems that afflict corporate control in the U.S. and the U.K. systems — where equity is widely held by large numbers of investors (in the U.S.) and by non-bank intermediaries (in the U.K.) and where there is little incentive for any one shareholder to intervene in corporate activities. Corporate control is exerted indirectly through takeovers, in particular hostile takeovers.

Eastern Europe’s enterprise sector is in need of substantial restructuring. A large group of dispersed shareholders could hardly do the job of breaking up the large conglomerate organizations, injecting new management, and providing a significant amount of external financing. Creation of mutual funds, reliance on foreign ownership, or retention of public sector control — each has its flaws. The German-Japanese model, based on controlling groups of enterprises and banks, has to be considered in Central and Eastern Europe, say the authors, although they recognize the perils involved, such as monopolistic abuses and the close involvement of banks in industry.

Address: Centre for Economic Policy Research, 6 Duke of York Street, London, SW1Y 6LA. Tel.: (44) (71) 930-2963.

Gerlinde and Hans-Werner Sinns
Kaltstart: Volkswirtschaftliche Aspekte der Deutschen Vereinigung (Cold Start: Economic Aspects of German Unification)

The centerpiece of the book is a critical analysis of the “high wage/high technology” strategy in eastern Germany, implicitly adopted in monetary reform and subsequent wage agreements. At the start of the transformation process, western Germany's price structure has been superimposed to eliminate economic activities that are non-viable at western labor costs. An industrial structure created under these conditions would have to meet the efficiency standards of industry in the western part of Germany from the very beginning.

As for the immediate effects of this strategy — after adjustment for women's reduced participation, short-time work, and long-distance commuting to western Germany — employment in the eastern states has dropped to about half the level of 1989. The present workforce mainly produces non-tradables. Its level and structure are maintained primarily by large financial transfers to pay for the imports of tradables.

The authors focus on the evolution of the labor costs built into the existing wage contracts. The average labor cost per hour (wages plus wage-related taxes and statutory contributions) would rise from 43 percent of the west German level in early 1991 to 85 percent by 1995, or an average rate of almost 20 percent per year. Eastern Germany's average labor cost already exceeded that for Greece in mid-1990, and would pass the level of...

This strategy implies that productivity would rise extremely rapidly if a rapid absorption of the redundant labor force is achieved. In the view of the authors, such productivity growth is not a realistic prospect. Their suggestion is that a “social pact” should be concluded, by which the labor force in eastern Germany would trade off part of the already programmed wage increase for a share in the socially owned assets now being privatized. Buyers of assets — in the absence of private savings in eastern Germany — could purchase only a slight majority of the shares, with the remainder held by the Treuhand Anstalt for a number of years until the enterprises are profitable. They would gradually be distributed free of charge, in part to the workforce, in part to the eastern population at large.

The proposal is very appealing because it avoids some of the shortcomings of various other privatization schemes, including the one presently being pursued in eastern Germany. However, the time may already have passed when this alternative would be feasible, and a more painful evolution seems to be all but programmed.

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New Books and Working Papers *

Centre for Cooperation with European Economies in Transition
The Role of Tax Reform in Central and Eastern European Economies
Order: OECD Publications, 2 Rue Andre Pascal, 75775 Paris Cedex 16, tel: (331) 4524-8200.

Doing Business with the Soviet Republics
Information and free copy: (1-800) 937-5357.

U.S. General Accounting Office
Soviet Economy — Assessment: How Well the CIA Estimated the Size of the Economy.
Free copy: (202) 275-6241.

Jeff Schubert
Eastern Europe and its “Wild East”: The Financial Markets of Hungary, Poland, Czechoslovakia, and the USSR.
Contact: Nick Howard, (212) 916-3013.

Grigory Yavlinski (et al.)
500 Days: Transition to the Market
St. Martin’s Press, New York, 1991

Anthony Jones and William Moskoff (eds.)
The Great Market Debate in Soviet Economics: an Anthology

Adrian Wood
China’s Economic System — A Brief Description, with Some Suggestions for Further Reforms
Contact: Leila Alberici, China Program, The Development Economics Research Program, London School of Economics, Houghton St., London WC2A 2AE, UK, tel: (44-71) 405-7686, ext. 3290.

Laszlo Csaba (ed.)
Systemic Change and Stabilization in Eastern Europe

Sergei Shatalov
Privatization in the Soviet Union: the Beginnings of a Transition
Contact: World Bank, CECSE, tel: (202) 473-7188.

Cheryl W. Gray (et al.)
The Legal Framework for Private Sector Development in a Transitional Economy: the Case of Poland
Contact: World Bank, CECSE, tel: (202) 473-7188.

Jan Svejnar and Katherine Terrell
Reducing Labor Redundancy in State-Owned Enterprises
Contact: World Bank, Barbara Gregory, tel: (202) 473-3744.

David M. Newbery
Sequencing the Transition

Michael Burda and Michael Funke
German Trade Unions after Unification: Third Degree Wage Discriminating Monopolists?

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From the Bulgarian magazine Vek 21

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Martin Schrenk, CECSE, World Bank

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November 1991
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Sachs, Jeffrey D. Crossing the Valley of Tears in East European Reform Challenge (U.S.) 34:26-34, September-October 1991.


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