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Prospects and Challenges for Russia: Davidson Institute Surveys 100 Leading Transition Economists

by Jan Svejnar

Russia's economic performance since the fall of communism has been dismal. Since 1989 gross domestic product has fallen almost 50 percent, foreign direct investment has remained miniscule, capital flight has reached dramatic proportions, creation and growth of new firms has been low, and income inequality has approached levels observed in Brazil and India. Yet the Russian Federation is one of the richest countries in terms of natural and human resources. With appropriate economic policies, it could become a rapidly growing economy that is attractive to foreign investors.

In view of the importance of the recent Russian presidential election for the future course of the Russian economy, the William Davidson Institute commissioned a survey of leading policy- and business-oriented academic economists working on transition economies. The survey obtained experts' views about the performance of the Russian economy and future prospects and challenges for Russia. The 100 respondents, many of whom are research fellows of the Davidson Institute, are almost equally divided among economists in North America, Western Europe, and the former Soviet Union. Their views, summarized below, thus constitute a balanced cross-section of opinions and expertise.

• **The dismal performance of the Russian economy during the 1990s was worse than expected.** Almost two-thirds of the respondents state that economic reform has proceeded worse or much worse than expected. For the vast majority of analysts surveyed, Russia's transition from plan to market has not fulfilled its potential.

• **In five years Russia's economy is expected to perform better than (or at least as well as) it is currently perform-**

ing. The experts are cautiously optimistic about Russia's future economic performance. About 53 percent of them expect

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the Russian economy to be stronger in five years, while about 40 percent expect performance to be the same as it currently is.

● **Moderate economic growth is likely over the next 10 years.** In contrast to the short run, respondents are relatively sanguine about Russia's economic growth over a 10-year horizon. Very few expect past declines to continue, two-thirds expect the average rate of growth to be about 1–3 percent a year, and 21 percent expect the annual rate of growth to reach 3–6 percent. The experts polled thus predict that Russia is likely to resume moderate to respectable economic growth in the next decade.

● **Putin may be good for Russia's economic growth.** Fully 60 percent of the respondents believe that Vladimir Putin will be a positive change agent for Russian economic growth. This is a strong but not unanimous endorsement by the experts: 30 percent of those polled hold the opposite view.

● **The new Russian president should focus on establishing the rule of law, eliminating corruption, collecting taxes, and encouraging private firms.** Most respondents identify the establishment of the rule of law as by far the most important priority. Yet 70 percent of them also indicate that it is unlikely that meaningful reform will be carried out in this area. The elimination of corruption and the institution of an effective system for collecting taxes are also deemed to be important policy initiatives by a majority of those surveyed. Interestingly, while almost all respondents indicate that the elimination of corruption is unlikely, half think that Russia will probably institute an effective system for collecting taxes.

● **Russia represents a good investment in the natural resources and telecommunications sectors.** Overall, the experts are by and large neutral on Russia as an investment opportunity. However, in the areas of natural resources and telecommunications,

they tend to view Russia as a good investment opportunity. Consumer goods production and sales are viewed as a neutral investment opportunities, while financial services and producer goods production and sales are rated as areas that represent somewhat unfavorable opportunities.

● **Increasing incentives for FDI is the most productive form of external assistance.** Almost two-thirds of the respondents identify increasing incentives for FDI as the most productive form of external assistance for Russian economic growth. More than a third are in favor of technical (but not financial) assistance, and more than 20 percent believe that maintaining financial assistance through the international financial institutions would be most fruitful. Very few experts favor direct financial assistance from the United States or significantly higher levels of financial assistance from the international financial institutions.

● **Russia will be relevant for global political stability but not for global economic stability or growth in the short and medium term.** The experts believe that during the next five years Russia's political and economic stability will be relevant, though not highly relevant, for global political stability. However, they do not see Russia's stability as being relevant for either global economic stability or global economic growth. In the short term, Russia is hence viewed as having the potential to destabilize the world politically, but its economy is considered too unimportant to affect the global economy.

● **Russian economic growth and stability should be a high priority for the next U.S. president.** Almost 60 percent of the respondents believe that Russian economic growth and stability should be a high or very high priority for the next U.S. president. This presumably reflects their belief that Russia's economic stability and well-being have global political ramifications and that the President of the United States is a key player in interaction with Russian policymakers.

Summing up, our survey indicates that Russia's transition has fallen short of expectations, but that the new president is expected to turn the country around. While only a sizeable minority of our experts believe that the president will establish a rule of law, a large number feels that he will improve the collection of taxes and encourage the development of new private firms. Russia's economy is likely to improve over the next 5 years and register moderate to possibly respectable rates of growth over a 10-year horizon. Presently, Russia represents a good investment opportunity only in natural resources and telecommunications, the number of attractive investment opportunities will presumably increase over time. Providing incentives for foreign investment is seen as the most productive form of external assistance. In the short term, Russia will be important politically but not economically on the global scene. The new U.S. president should place high priority on economic growth and stability in Russia.

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Ten Years of Transition: Lessons Drawn, New Issues Discussed During World Bank Conference in Washington

Since 1988 leading academics, policymakers, and researchers have gotten together every spring at the Annual World Bank Conference on Development Economics to discuss the latest issues in development. This year's conference—organized by Boris Pleskovic, Administrator of the Research Advisory Staff—was dominated by the new development thinking, but the new generation of transition issues received attention as well. In this issue we summarize the papers of János Kornai, who 10 years ago published the first comprehensive book on postsocialist transition; Paul Collier, who analyzes drawbacks and weaknesses of conditional aid and urges true partnership between donors and borrowing governments; and a paper of Joel S. Hellman, Geraint Jones, and Daniel Kaufmann, who analyze the roots and outcome of corruption and kickbacks in the transition economies based on survey data. These papers can be downloaded from http://www.worldbank.org/research/abcde/washington_12/agenda_12.html. As a follow-up to the Washington conference, the Second Annual Bank Conference on Development Economics in Europe will take stock of "Development Thinking at the Millennium." That conference will be held in Paris June 26–28, 2000.

The Road to a Free Economy—Ten Years After

By János Kornai

Ten years have passed since the publication of my book *The Road to a Free Economy: Shifting from a Socialist System—The Example of Hungary*. It was the first book in the international literature to put forward comprehensive proposals for the postsocialist transition. In this article I examine two issues I addressed in my book—ownership reform and macroeconomic stability—in light of 10 years of experience with transition.

Ownership Reform

The Road to a Free Economy supported creation of an economic system in which private ownership would dominate. In this respect, its views did not differ from many proposals originating in the West. This broad agreement on the need for private ownership left open the question of which is the best road to creating such a system, however.

Strategy A: Organic Privatization

Strategy A is based on four main tenets. First, the most important task is to create favorable conditions for bottom-up devel-

opment of the private sector. The main impetus behind the growth of the private sector is mass de novo entry. Creation of new firms has to be facilitated by breaking down barriers to entry, ensuring the security of private ownership, establishing institutions to enforce private contracts, and, cautiously, promoting the development of the private sector (through tax and credit policy, for instance).

Second, most state-owned companies must be privatized. The basic technique for doing so is sale. State assets must be sold mainly to outsiders, with preference given to those who offer a fair price and make a commitment to invest in the company. If the buyer is an insider, a genuine price must still be paid: insider privatization cannot be allowed to degenerate into a disguised form of give-away. Give-away distribution of state property must be avoided.

Third, preference must be given to sales schemes that produce an ownership structure with a majority owner. The majority shareholder may be a businessperson, a group of owners, or a privately owned com-

pany (owned by nationals or foreigners). A particularly desirable type of owner is a strategic investor who is prepared to inject a significant amount of new capital into the company. If the company is held publicly, there is no need to prevent the shares from being dispersed across a large number of shareholders. Where possible, however, it is desirable to have a core owner.

Fourth, the budget constraint on companies has to be hardened. This is key to ensuring the financial discipline essential to operating in a market economy. A set of new laws must be passed, including bankruptcy, accounting, and banking laws. Following the legislative phase all these laws should be consistently enforced.

Strategy B: Accelerated Privatization

Strategy B focuses on the rapid liquidation of the state sector. It stresses eliminating state ownership as quickly as possible. The main technique for privatization is some form of give-away, such as a voucher scheme, in which property rights in state-owned companies are distributed free and equally among the country's citizens. This

approach may be linked with toleration or even encouragement of takeovers by managers. In many cases this kind of privatization turns out to be a pseudo management buy-out, as the managers pay a very low price, almost tantamount to receiving the property rights in the company free of charge. Under Strategy B, dispersed ownership may actually be preferred to ownership by a dominant owner. All citizens share in the property rights of the formerly state-owned companies, so that "people's capitalism" develops.

What Lessons Can Be Learned from Experience?

Ten years after the onset of transition, I am convinced that strategy A, which promoted organic growth of the private sector, was the correct position to take. Strategy B proved inferior at best and harmful at worst.

The state socialist system left behind a legacy of mass unemployment on the job. Strategy A is prepared to reverse this legacy, even if it means taking painful and unpopular measures. Strategy B shrinks from doing so.

Hungary and Poland followed strategy A. In Hungary hundreds of thousands of small and medium-sized firms were created. Tightening of the budget constraint in the first half of the 1990s allowed a process of natural selection to sweep over the corporate sphere. This coincided with a strengthening of financial discipline. The chains of mutual debt among companies were broken and the standing of private contracts improved. A start was made to consolidate the banking sector. All these developments helped attract foreign capital. The strong inflow of capital was one of the main factors responsible for the improvement in Hungary's productivity and export performance.

At the beginning of the 1990s Václav Klaus, economist-prime minister of what became the Czech Republic, championed the voucher scheme (strategy B), arguing

for its adoption in the international arena. The program was applied energetically in Czechoslovakia. In the first phase the assets of state-owned enterprises were dispersed among millions of voucher owners, but they were soon concentrated among investment funds. These funds lacked the capital to develop the backward companies. Moreover, the funds were closely linked to the large commercial banks, which were dominated or owned by the state.

Such an ownership structure was incapable of building up strong corporate governance. Restructuring dragged on. Despite the strident Chicago-style free enterprise rhetoric directed at the outside world, budget constraints remained soft. Whereas privatization by sale engenders natural selection, the transfer of property rights by give-away distribution conserves the existing structure. Performance has been disappointing. Adoption of Strategy B seems to have been a significant factor behind the privatized companies' poor performance.

Perhaps the saddest example of the failure of strategy B is provided by the Russian Federation. There every feature of the strategy appeared in extreme form: a voucher scheme was imposed on the country, coupled with mass manipulated transfers of property into the hands of management and privileged bureaucrats. In the unprecedented ownership reform that occurred, ownership of natural resources, especially oil and gas, was expropriated by the "oligarchs."

All these failures are closely connected with the survival of the syndrome of the soft budget constraint, which has infiltrated and done damage to every cell of the economy and body politic. Russia has become a nonpayment society. Companies do not pay their suppliers, employers do not pay their employees, borrowers do not repay their loans. All of this is tolerated by the executive and the judiciary. In fact, the state sets a bad example by often falling behind with wages and insurance contributions owed to state employees and pensioners.

Labor productivity in Russia in 1998 was 33 percent lower than in 1989. In the Czech Republic productivity was just 6 percent higher than in 1989, the last year of socialism. In contrast, labor productivity in Hungary in 1998 was 36 percent higher than in 1989, and Poland's productivity had risen 29 percent.

Macroeconomic Stability

My book recommended immediate macroeconomic adjustment in Hungary (that is, adjustment within the next year or two). I still think that position was correct. In the event, adjustment was postponed several years. Most experts agree that if postponed, macroeconomic stabilization costs more. There is an ethical and political dilemma posed here by the intertemporal distribution of pain and gain and the acceptance of the political price of unpopular measures.

I did not predict the deep recession that followed the system change; I was too optimistic in my expectations of future growth. The socialist system left a badly distorted structure of input and output. Correcting this structure called for creative destruction. Because destruction is rapid, whereas creation proceeds much more slowly, the two processes led to a deep recession.

My book recommended implementing a radical action program by one stroke. In retrospect, I do not reject the notion of a radical adjustment package, in which several measures are taken simultaneously. Such a policy is appropriate if it will restore equilibrium in several important dimensions of the economy at once—or at least bring the economy closer to a tolerable degree of disequilibrium (by reducing the deficit on the current account or the budget deficit to a sustainable level, for example). But I paid too little attention to how to consolidate this quick fix and produce lasting improvement.

Sustainable growth requires not just one macroeconomic intervention but a deep,

comprehensive program of institutional reforms. It is easy to improve the budget balance at a single stroke by raising the rates of existing taxes. But lasting improvement requires radical tax reforms: broadening the tax base, introducing new taxes, and improving the tax collection system. And that is just one element, perhaps the easiest, of the fiscal reform. More difficult is reducing state expenditure, which could involve reorganizing the state apparatus and reforming the education, health care, and other welfare systems. It is relatively easy to declare that the currency is convertible. It is much harder to organize an effective system of international payments, develop well-functioning connections between the domestic and international banking systems, and guarantee that international payment agreements will be observed.

Macroeconomic stabilization is not a battle but an endless war. Stabilization cannot be achieved by a blitzkrieg. Institutional reforms can be obtained only step by step, by a series of larger and smaller blocks of reforms. I see that now and regret that I did not feature this idea in *The Road to a Free Economy*.

Gradualism? Shock Therapy?—Wrong Question

The polemics of the early 1990s concerned the choice between “gradualism” and “shock therapy.” In those days that was one of the favorite topics of classroom discussion in courses on comparative economics. That was what many students had to write about in their exam papers.

In my view, the question was badly put, and so I am not going to try to answer it. The question itself implies a yardstick: speed. I am convinced that speed, while important, is not the primary measure of success. The transformation of society is not a horse race. The main indicator of success is not who passes the winning post first. Excessive emphasis on speed leads to impatience, aggressiveness, and arrogance.

Ironically, the expression “mass privatization,” used as a synonym for give-away and voucher schemes, is the inverse of the mass collectivization imposed by Stalin. Stalin did not want to waste time with voluntary collectivization. Using brutal, merciless violence, he imposed collective ownership on the peasantry in a matter of two or three years. I do not want to exaggerate the comparison; luckily, no gulags were required and no brutality occurred in the 1990s. Change was forced by milder means. Nonetheless, there were similarities: the subordination of the ownership reform to political and power purposes, the horror of gradual change, the impatience, and the obsession with speed.

Transition from socialism to capitalism has to be an organic development. Transition

is a curious amalgam of revolution and evolution, a trial-and-error process in which old institutions are either retained or liquidated, new ones tested and accepted or rejected. Different elements in the process may be very rapid, fairly rapid, or slow. Each has its own appropriate speed. Some changes call for a one-stroke intervention; many others advance by incremental changes. The emphasis has to be placed on consolidation, stability, and sustainability of growth.

Excerpted from Janos Kornai's paper: "Ten Years After the Road to a Free Economy—the Author's Self Evaluation." The author is professor of economics at Harvard University and Collegium Budapest.



From the Hungarian daily *Népszabdság*.

For a New Relationship between Donors and Recipients: The End of Conditionality?

by Paul Collier

Thirty years ago donors tried to reduce poverty by delivering projects with high rates of return. This approach encountered three fundamental problems:

- Some projects were good but not widely replicable (they could not be “scaled up”). Such projects were irrelevant in the larger context of economic growth.
- Projects were fungible—that is, donor support for a project the government would otherwise have financed freed up resources for the government to do something else. Donors thus financed not the project they appeared to pay for but the marginal project the government chose to undertake. Donor care in selecting among intramarginal projects thus made no difference to the overall portfolio of implemented projects.
- Success of a project depended less on the design of the project than on the environment in which the project took place. Like other investments, donor-funded projects failed in hostile environments.

Weaknesses of Aid for Reform

Good project design being insufficient to achieve donor objectives of reducing poverty, a new approach was developed in the 1980s, namely, conditionality. Aid was provided in return for explicit negotiated commitments to policy reform.

The theory underlying this new approach was that aid could be an incentive to policy change. However, an implication of this theory was that governments would be undertaking policy change against what they considered to be their interests, except for the receipt of aid. Policy change was the

price governments would have to pay for aid—or equivalently, policy change would be what donors bought with their aid.

The implications of using aid as an inducement for reform were uncomfortable: if donors “bought” the reforms, it was clear who “owned” them. Indeed, when one African head of state became annoyed with donors who had complained about the lack of political rights in his country, he threatened to reverse the reforms unless they desisted. The notion that the reversal of a reform program could be a threat is intelligible only if it was understood by both parties that the reforms belonged to the donors and not to the government.

Indeed, the implications of using aid as an incentive were so uncomfortable that a fig leaf alternative theoretical underpinning emerged: the notion of costs of adjustment. Under this theory, policy change was initially costly and so was like an investment. Aid could finance these upfront costs.

Neither of these theories was completely wrong. Sometimes the incentive of aid was sufficient to induce a government to implement policies it otherwise would not have undertaken. Sometimes such policy changes had upfront costs. However, as general propositions these theories were dysfunctional.

The lure of aid led governments to promise more than they intended to deliver and to implement more than they could sustain. The government of Kenya, for example, sold the same agricultural reform to the Bank five times in 15 years. The same conditionality has appeared in seven of the past eight Policy Framework Papers for Malawi. Cumulatively, such behavior destroyed the

credibility of governments, not just with donors but with private investors as well.

Costs of adjustment are largely mythical. Most reforms, if they are sensible, lead to rapid improvement in the economy. The emphasis on costs of adjustment encouraged governments to exaggerate the difficulties of policy reform. The negotiating framework was such that the rational government would exaggerate the costs of policy change in order to maximize its price. Furthermore, since donor negotiating teams saw their role as extracting the maximum reform for a given amount of aid, at the margin the government was always a reluctant reformer, refusing to implement reforms urged on it by donors.

Studies find that aid has not, on average, sped policy change. David Dollar and Jacob Svensson of the World Bank studied 220 reform programs. They show that the success of reform is systematically related to domestic political economy factors, such as how long the government has been in power, but unrelated to donor behavior. They find no overall relationship between aid flows and policy change.

This result is not as surprising as it might seem. The incentives argument is indeed elementary economics: the offer of aid for reform should induce a supply response. However, it misses four offsetting effects.

- The provision of aid alleviates fiscal and payments crisis and so reduces the urgency for a government to change policy. Economists would say that the income effect of aid offsets the substitution effect. In poor policy environments, aid for reform paradoxically tends to delay reform: the income effect dominates the substitution effect. As the reform process proceeds,

the reforms become more complex and need a wider constituency of support to be implemented effectively. By this stage conditionality serves no purpose, because the substitution effect cannot be translated into effective incentives for such a large group of actors.

- Aid for reform faces what economists call a time consistency problem. Unless the government actually wants the reform, it has little incentive to maintain it once the aid has been delivered. If it supports the reform, it normally does not need aid to implement it.
- Aid for reform faces a moral hazard problem. The agencies that should enforce the conditionality also have an interest in seeing their loans repaid. Enforcing the conditionality will reduce the probability of repayment.
- While the development agencies may have wanted to use conditionality to induce policy reform, other OECD interest groups had their own agendas and so could be expected to try to subvert conditionality to induce different behavioral change. The possibility that the economic objectives of conditionality were subverted by political goals should not be dismissed out of hand.

While aid for reform was not very effective in achieving sustained policy improvement, it was effective in undermining the credibility of governments. Bad governments destroyed their reputations by reneging on the spirit of agreements, but even good governments faced a problem: when a government implemented and sustained policy reform, donors claimed the credit.

Allocating Aid Efficiently

Aid for reform also diverted aid from those countries in which it could be most effective in reducing poverty. We now know what a poverty-efficient allocation of aid would look like. It would take three factors into account: the level of poverty, the level of policy, and diminishing returns. For a

given level of policy and institutions, the greater the poverty, the larger should be the aid program. The better is the policy and institutional environment, the more effective aid is in raising growth and reducing poverty. But even in environments with good policies and severe poverty, there is a limit to how much aid can be effectively absorbed. This limit is about 20 percent of GDP. Conversely, even in environments with poor policies, the first few million dollars of aid are worthwhile.

Conditioning aid on policy change instead of policy levels not only leads to inefficient allocations between countries but to inefficient allocations over time. Consider a democratic government that periodically faces elections. Typically, such a government will be more reluctant to change policies the year before an election than the year after an election. The cycle of elections thus creates a cycle of policy change. If aid flows are conditioned on the rate of policy change, they tend to destabilize the macroeconomy: in the run-up to an election, just when a government is increasing its expenditures, its aid will tend to get squeezed.

Finally, aid for reform may have weakened governments' capacity to work out and communicate their own strategies. Governments were often little involved in the preparation of the documents they signed. The documents were sometimes prepared in Washington even before missions arrived in the United States. Governments knew that donor negotiators were going to attempt to coerce them to agree to more than they appeared to want to do. Hence rational governments should appear to want to do even less than they really wanted. The incentive was thus to impede rather than assist even those reforms in which governments believed.

Governments also had little incentive to sell reform policies to their electorates. Indeed, a whole doctrine was evolved in Washington about the efficacy of the international financial institutions as scape-

goats: governments could blame the international financial institutions for unpopular but necessary policy changes.

A final possible effect of the attempt to coerce reform is that it might have given rise to the psychological phenomenon known as "reactance." According to clinical psychologists, if someone tries to force you to do something, your natural reaction is to do the opposite (unless the other person has total power over you). Only by doing the opposite can you reestablish your freedom of action. Governments may have found the reversal of reforms attractive because it reestablished this freedom. Electorates may have gone along because they had often been told that the reforms had not been a national choice.

Improving Policies and Institutions

Aid for reform was well intentioned, but it was based on a misunderstanding of how policies and institutions are changed on a sustainable basis. At the risk of oversimplification, I suggest that within reason we now know what constitutes a good macroeconomic policy environment but we have rather less idea as to what constitutes good institutions. We know, for example, that the design of legal institutions is much less important than how they are operated in practice. This suggests that the processes by which institutions and macroeconomic policy are reformed may be different.

Policies depend largely on the balance among domestic political constituencies. In countries with very poor policies, there are large latent constituencies for policy change because poor policies inflict poor outcomes. The process of policy reform depends on strengthening these constituencies. Constituencies for reform are those that suffer from poor policies. During the 1990s there was greater empowerment of these constituencies. The visible failure of the Soviet model stimulated a wave of democratization and provided a massive injection of information into the

debate on development policy. Governments were pressured into improving the economic environment, albeit fitfully. We now know that pressure from civil society is effective in improving government performance. Civil liberties, such as freedom of the press, for example, increase the return on public investment.

Creating an effective reform process is thus essentially synonymous with creating an effective knowledge discovery process. The core of such a process is experiment and competition. There needs to be sufficient institutional variation and institutional choice that some institutions are revealed to be better than others.

What Role Can Donors Play?

What does this imply for the donor role? Donors can do much to assist both policy reform and institutional reform. In terms of policy reform, they can help pro-reform constituencies, within the constraints of appropriate conduct. The international community can encourage standards of good practice for information disclosure. It can provide the analysis that shows the true effects of policy.

With respect to institutional reform, donors can show governments that there are a wide range of potentially viable options and stress that diversity and experiment are legitimate responses to uncertainty. They can finance pilot institutional reforms that, if successful, can be scaled up through imitation. However, the international community cannot supplant the role of the government. The government cannot abdicate responsibility for working out a development strategy. There are good reasons why this process should be a partnership between the government and the international community rather than an activity undertaken entirely by the government

Paul Collier is director of DECRG at the World Bank. This article is excerpted from his paper "Consensus-Building, Knowledge, and Conditionality."

How Profitable Is Buying State Officials in Transition Economies?

by Joel S. Hellman, Geraint Jones, and Daniel Kaufmann

Most studies of corruption focus on the role of politicians and bureaucrats inherent in the conventional definition of corruption by looking at the abuse of public office for private gain. We shift attention to the role of firms, suggesting that some firms possess sufficient freedom to choose a strategy of corrupt interactions with the state that maximizes their rents. We attempt to measure the costs and benefits to the firm of alternative strategies of corrupt and noncorrupt interactions with the state in different environments, focusing on state capture and corruption of public procurement.

We define state capture as the capacity to influence the formation of the basic rules of the game (laws, rules, decrees, regulation) through private payments to public officials. An index of state capture (table 1) can be constructed based on firms' responses on the extent to which the following forms of corruption have had a direct impact on their business:

- Sale of Parliamentary votes on laws to private interests.
- Sale of presidential decrees to private interests.
- Mishandling of funds by the central bank.
- Sale of court decisions in criminal cases.
- Contributions paid by private interests to political parties and election campaigns.

Public procurement corruption is defined as efforts to secure public contracts through payment of kickbacks to high-level officials.

High Capture and Low Capture

To identify the costs and benefits of alternative strategies for both individual firms and the broader economic environment, we use data from the 1999 Business Environment and Enterprise Performance Survey (BEEPS).¹ That survey, commis-

sioned jointly by the European Bank for Reconstruction and Development and the World Bank, provides firm-level data on obstacles in the business environment in 22 transition economies.

The transition economies can be divided into high capture and low capture countries, based on scores on the state capture index. The low capture group includes Albania, Armenia, Belarus, the Czech Republic, Estonia, Hungary, Kazakhstan, Lithuania, Poland, Slovenia, and Uzbekistan. This is an unusual group because it includes some of the most reformist and least reformist countries in the sample in terms of both political and economic transition. In countries such as Belarus and Uzbekistan—where there has been only minimal privatization, the private sector remains small, and important elements of the command system are still in operation—the capacity of private sector interests to capture the state might be expected to be low (and indeed the concept may have little meaning in this context). In contrast, the most reform-minded countries (such as Hungary and Poland) have achieved the most progress in liberalizing the economy, strengthening bureaucratic accountability, and promoting political contestation—all factors that might be expected to place limits on the capacity of powerful firms to capture the state.

The high capture group includes Azerbaijan, Bulgaria, Croatia, Georgia, Kyrgyzstan, Latvia, Moldova, Romania, the Russian Federation, the Slovak Republic, and Ukraine. Most of these countries could be considered partial reformers in both political and economic transition. Most have made significant advances in liberalization and privatization, with much less progress in concomitant institutional reforms to support a legal and regulatory framework for the emerging market. Although most have

adopted the basic rules of democratic elections, there remain concerns in nearly all of these countries regarding the concentration of political power and limitations on political competition. Capture might be expected to thrive in an environment of partial economic reforms and concentrated political power.

Kickbacks: Benefits and Costs

In countries in which there is a market for state capture—that is, where firms can purchase laws, regulations, or decrees from politicians and bureaucrats—“captor” firms perform substantially better than other firms in terms of sales growth. But engaging in state capture entails costs in terms of greater insecurity of property rights among captor firms, and firms do not expect these performance advantages to be maintained over time.

In contrast, in countries in which the market for state capture is restricted, captor

Table 1: Share of Firms (% of sample) that Believe Other Firms' Corrupt Practices Influence Rules of the Game

Country	Parliamentary legislation	Presidential decrees	Central Bank	Criminal Courts' Decisions	Party finance	Capture index (avg. of firms)	Classification
Albania	12	7	8	22	25	16	Lo
Armenia	10	7	14	5	1	7	Lo
Azerbaijan	41	48	39	44	35	41	High
Belarus	9	5	25	0	4	8	Lo
Bulgaria	28	26	28	28	42	28	High
Croatia	18	24	30	29	30	27	High
Czech Rep.	18	11	12	9	6	11	Lo
Estonia	14	7	8	8	17	10	Lo
Georgia	29	24	32	18	21	24	High
Hungary	12	7	8	5	4	7	Lo
Kazakhstan	13	10	19	14	6	12	Lo
Kyrgyzstan	18	16	59	26	27	29	High
Latvia	40	49	8	21	35	30	High
Lithuania	15	7	9	11	13	11	Lo
Moldova	43	30	40	33	42	37	High
Poland	13	10	6	12	10	12	Lo
Romania	22	20	26	14	27	21	High
Russia	35	32	47	24	24	32	High
Slovakia	20	12	37	29	20	24	High
Slovenia	8	5	4	6	11	7	Lo
Ukraine	44	37	37	21	29	32	High
Uzbekistan	5	4	8	5	4	6	Lo
Overall	24	21	25	18	20	22	

Source: author's survey.

Table 2. Average Bribery Payments as Share of Gross Firm Revenues

Country	Level of bribery (% of firm revenues)
Albania	4.0
Armenia	4.6
Azerbaijan	5.7
Belarus	1.3
Bulgaria	2.1
Croatia	1.1
Czech Rep.	2.5
Estonia	1.6
Georgia	4.3
Hungary	1.7
Kazakhstan	3.1
Kyrgyzstan	5.3
Latvia	1.4
Lithuania	2.8
Moldova	4.0
Poland	1.6
Romania	3.2
Russia	2.8
Slovakia	2.5
Slovenia	1.4
Ukraine	4.4
Uzbekistan	4.4
Overall	3.0

Source: author's survey.

firms perform worse than other firms. In these environments, firms that choose rent-seeking strategies in dealing with the state based on kickbacks for public procurement show substantially greater gains than other firms. There are, however, costs in terms of time spent dealing with state officials.

We also find that there are significant social costs of state capture. Partial political and economic reforms generate the highest levels of state capture. Yet there is a threshold beyond which enhancing civil liberties and advancing economic reforms systematically lowers the level of state capture in transition economies.

The most general measure of corruption in the survey is the proportion of annual revenues paid to public officials to “get things done” (table 2). The results reveal considerable variation in the level of unofficial payments across transition economies, ranging from 1.1 percent of gross firm rev-

enues in Croatia to more than 5.7 percent in Azerbaijan.

The percentage of firms that are captors or provide kickbacks also varies across countries (table 3). Belarus has the lowest percentage of captor firms (2 percent), while Azerbaijan has the highest percentage (24 percent). Among firms that trade with the state, only 4 percent pay kickbacks in Belarus, while nearly half do so in Azerbaijan.

Where there is a market for state capture (that is, a market in which state actors engage in “selling” laws, rules, and regulations), a strategy of seeking to influence the basic rules of the game may be most effective for extracting rents from the state. Where the market for state capture is constrained, a strategy of distorting the implementation of government policy might generate greater gains to the firm. In high capture countries, firms appear to realize gains from trading with the state only if they are willing to pay

kickbacks to public officials. Firms that do not pay kickbacks in such countries underperform corrupt firms in terms of investment and employment growth.

The survey results allow us to calculate both the direct costs in terms of higher bribery payments and time spent dealing with government officials and the indirect and less tangible costs to the firm potentially associated with greater uncertainty and insecurity. Across the entire sample, captor firms pay more than twice as much of their annual revenues in bribes than noncaptor firms. In high capture countries the gap is even wider. Captor firms report paying 6.6 percent of their annual revenues in bribes. On top of the already high tax obligations of firms in this region, this constitutes a considerable financial burden. Although captor firms in low capture countries appear to gain few benefits from capture in terms of improved performance, their bribery burden is still considerably higher than that of noncaptor firms.

In addition to higher bribes paid, captor firms also spend substantially more senior management time dealing with government officials. In high capture countries, captor firms spend nearly 50 percent more of their management time dealing with the government than noncaptor firms. This "time tax" tends to be lower in low capture countries, although even there captor firms spend more time with government officials than noncaptor firms. These results suggest that capturing the state does not appear to buy firms greater protection from government incursions on management time. In fact, it could well be that we are measuring a proxy for a deliberate corporate strategy of investing in time with politicians and high-ranking officials in order to effect state capture (in contrast with the time wasted by firms due to arbitrary red tape harassment by bureaucrats).

Public procurement corruption has a similar pattern of costs to the firm across different firm types and environments,

although the contrast between kickback and nonkickback firms is somewhat less stark. Kickback firms pay more than twice as much of their annual revenues in bribes than nonkickback firms. Although large, this difference is smaller than the difference between captor and noncaptor firms. In high capture environments, kickback firms spend nearly 20 percent more of their time than nonkickback firms dealing with government officials. In low capture environments, paying kickbacks appears to be associated with a minor reduction in this time tax. Capture generates more costs to the firm in terms of bribe payments and time than public procurement corruption. Whatever the private costs and benefits to these different forms of corruption, the social costs are significant

How to Fight Corruption

Policymakers need to focus on strategies for addressing state capture and corruption in large-scale procurement. Doing so implies implementing national-level measures that deepen economic and sociopolitical liberalization.

Regarding economic liberalization, demonopolization, deregulation, fuller trade liberalization, and facilitating entry to the enterprise sector are conventional recommendations that, where feasible, need to be supported. In some countries, where state capture has led to entrenched interests, breaking up monopolistic structures will represent a particularly daunting challenge, the success of which will depend on the role of the political leadership. Where this is not feasible in the short term, strategies need to be formulated that combine a more gradual demonopolization strategy with an activist stance on competition (and entry) policy. At the same time, societal "voice" needs to be mobilized, and the social cost of state capture needs to be made transparent to the population, proreform groups, and NGOs. Policymakers could also consider introducing innovations already prevalent in Latin America, such as public hearings to determine the rules of the game

Table 3. Share of Firms that are 'Captors' and Pay Kickbacks

Country	Full sample		Firms that trade with state	
	Captors (% of sample)	Pay Kickbacks (% of sample)	Trade with state (% of sample)	Pay Kickbacks (% of firms trading with state)
Albania	11	21	45	48
Armenia	7	6	23	26
Azerbaijan	24	11	23	49
Belarus	2	3	74	4
Bulgaria	11	5	46	11
Croatia	10	16	63	25
Czech Rep.	7	18	46	38
Estonia	5	20	71	28
Georgia	8	8	47	17
Hungary	4	5	38	14
Kazakhstan	6	7	40	18
Kyrgyzstan	7	7	43	16
Latvia	14	11	50	21
Lithuania	14	2	24	9
Moldova	12	5	65	8
Poland	9	17	58	30
Romania	13	14	41	35
Russia	9	12	56	22
Slovakia	12	17	54	31
Slovenia	10	15	58	25
Ukraine	12	20	67	30
Uzbekistan	2	19	79	24
Overall	9	12	52	24

Source: author's survey.

in large procurement contracts and public audiences and NGO monitoring of the public procurement bidding itself. In a country in which a handful of oligarchs has come to exercise control through state capture of the lion's share of productive assets, a multiyear strategy of competition, privatization of remaining state assets, and foreign direct investment policies could be aimed at strategically empowering a second and third tier of domestic industrial and financial groups and enterprises that would become more prominent over time.

The ongoing revolution in Internet and knowledge-based services can foster the emergence of a new cadre of potentially powerful entrepreneurs. The Internet revolution also allows for the wide dissemination of data on corruption and state capture, helping to expose the extent of the problem and mobilizing public opinion. The Internet also offers revolutionary

new ways to increase transparency and reduce corruption and costs in public procurement. Local NGOs (possibly in collaboration with external donors) could conduct and disseminate periodic in-depth diagnostic surveys on state capture and public procurement corruption, detailing the extent and manifestations of such practices in different institutions and by different industrial groups.

Recognition of the serious problem of state capture and public procurement corruption suggests that given the reality of state capture in some settings, the strategy of economic liberalization may need to be more complex than merely promoting fair competition and demonopolization per se. The potential gains from promoting activist citizen voice, political liberalization, and transparency reforms (including support of an independent and well-informed media) can be substantial. Introduction of periodic mandatory public declarations of assets

and income sources by government officials and their dependents can help reduce corruption.

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1 Survey data were collected through face-to-face interviews with firm managers or owners in site visits conducted between June and August 1999. In all but three countries, 125–150 firms were interviewed. Larger samples were used in Poland (250), the Russian Federation (550), and Ukraine (250). The sample was structured to be representative of the domestic economies, with quotas placed on size, sector, location, and export orientation (see *Transition*, December 1999, p. 6).

China's Future Depends on Further Reforms

by Chi Fulin

Today, as China's economy struggles and social conflicts are on the rise, system innovation through reform is becoming vital and urgent. In fact, with its accession to the WTO likely, China has no alternative to reform if it wants to reap the benefits of economic globalization. Benefiting from globalization will demand that China relinquish administrative control, phase out sectoral monopoly, and provide enough leeway for the effective functioning of market mechanisms while creating a level playing field for all market participants. Consequently, if we want China to meet the challenges of WTO accession, we should encourage the involvement of the nonstate economy in such sectors as finance, telecommunications, civil aviation, and education. Accelerating reform is necessary to facilitate economic growth and maintain social stability.

China's economic reform has come to a critical crossroad; now is the time for substantial breakthroughs. China was supposed to establish a socialist market system by the end of the 20th century. It is fair to say that significant breakthroughs in the strategic restructuring of the state economy, in the establishment of a new income distribution system, and in the shift in the government's role are yet to come.

Relative surpluses and relative shortages coexist in China. The supply of commodities and manufactured products exceeds demand, while financial, housing, educa-

tion, and health care services—sectors considered off limits to nonstate investors—are unable to keep up with demand. As a result, in recent years prices of many industrial products continued to fall, while service fees increased more than 10 percent a year on average.

Stimulating Demand

The government's efforts to counter deflation in the past two years by invigorating the economy were less than successful, because of fundamental systemic constraints and barriers. As I pointed out in an

earlier article (*Transition*, February 2000, p. 13), China has great investment potential, with savings deposits of enterprises and the public amounting to nearly 7,000 billion yuan. This huge pool, however, has remained practically frozen, as the government's expansive fiscal policy has failed to stimulate investments by enterprises or individuals. In 1998 fixed asset investment by the state grew 19.6 percent, while private investment increased only 6.1 percent and fixed asset investment by town and village enterprises dropped 3.5 percent. The situation remained much the same in the first quarter of 2000.

As a solution, nonstate investment in banking, insurance, telecommunications, public utilities, and infrastructure (including civil aviation, water conservation, power generation and distribution, railways, and road construction) should get the green light. Entry barriers should be lowered or eliminated, state monopolies should be removed, and joint stock companies should be established. These steps would contribute significantly to the improvement of China's macroeconomic situation. Through increased involvement of private investments and financing, the nonstate sector could gradually switch into high gear.

Shifting the Government's Role

Strategic restructuring of the state sector should take place, based on the principle of selective withdrawal in some areas and reinforcement in others. The government should not and cannot be the major source of investment, and it should not be the direct manager of state assets.

The government's input in competitive sectors has long been much higher than its spending on social security. The Chinese government is still weak in providing effective public goods. Its role in public administration has weakened, and its responsibility to coordinate conflicts of interests and guarantee social stability cannot be brought into full play.

Both economic growth and social stability urgently call for a change in the government's role. To date, the government's social spending—although increased in recent years—has accounted for only a fraction of total public finance. Providing social security should be an important task. Social security should receive a greater share of public finance.

Restructuring State-Owned Enterprises and Banks Together

In my earlier article I pointed out that reform of state-owned enterprises must be implemented hand-in-hand with reform of

state-owned banks. Well-to-do large and medium-size state-owned enterprises should be transformed into joint stock companies without delay (a step that would not preclude the state retaining a controlling interest in some companies). In small and medium-size state-owned enterprises, stock ownership by employees or a change to shareholding cooperatives should be encouraged. The ownership reform could help persuade private and other nonstate investors to put their money into these companies, which would diversify their equity structure.

Reform of the banking sector should also be accelerated. China's accession to the WTO is imminent. Once it joins the WTO, it will have to open up its financial sector to foreign competition. Collective and private capital should therefore be allowed to invest in commercial banks, and establishment of nonstate financial institutions should be encouraged.

A way has to be found to resolve the bad debt problem of state banks. The four major state banks have established separate asset management companies to deal with their nonperforming loans, but they are moving too slowly. Five years ago CIRD suggested the creation of debt trustee-ships. It is time to move in this direction.

Maintaining Social Stability

In recent years social conflicts have intensified, as more and more workers have been laid off from state-owned enterprises, long-term income and job security have been shaken, and the income gap has widened. In this situation, it is especially important to establish a general social security system. In order to increase awareness by the general public of the direction and trend of future reform, transparency should be enhanced and the cost of reform should be evenly distributed, with special consideration given to the less affluent members of society.

Accelerated reform of the income distribution system should be combined with the

notion that employees should own shares of their companies. The state should provide legal guarantees for the status of employee stock ownership and support it with tax benefits and preferential bank loans. Capitalization of farmers' land use rights should be legally ensured, with farmers provided with long-term and secure land use rights. China has already accumulated some experience in guaranteeing the long-term security of land tenure. Under certain conditions, farmers should be allowed to receive shares in an investment project by contributing their land or using their land to receive bank loans. Such a move would stimulate farmers' investment in land, raising their incomes and developing the rural economy.

Residents should be able to own their apartments. The government should encourage home buying through tax cuts and provision of low-interest or interest-free loans. In the current deflationary situation, the state should subsidize banks to provide employees with preferential housing loans.

Implementing Political Reforms

To deal with the problems caused by economic reform, China needs to combine economic reform with political reform. Political reform helps guarantee economic reform. Rural economic reform, for instance, calls for the development of grassroots democracy. Accelerating the rural democratization process has become important for advancing the rural economic reform. A similar need exists in urban economic reform. Political reform is also needed to help prevent corruption. Finally, political reform is needed to help China adjust to the knowledge-based hi-tech industries that will play an extremely important role in 21st century China. These sectors are based on human capital. It is therefore imperative to foster market competition and drastically change human resource management. In the face of economic globalization, system innovation and input are more important than ever. Making the necessary changes will require both economic and political reform.

Only with flexible reform strategies and the removal of systemic barriers hindering China's economic growth and social stability can China's integration into the

world economy be effectively carried ahead. Reforms are the guarantees that China's sustained economic growth and long-term social stability will be preserved.

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China at the Gates of the World Trade Organization

WTO membership will increase China's annual GDP by 2–3 percent, and each additional percentage point of growth will provide 5 million jobs, predict Chinese economists. Assuming China is admitted to the WTO this year, the government forecasts that China's foreign trade will increase from \$320 billion in 1998 to \$600 billion in 2005, with foreign investment rising from \$45 billion to \$100 billion.

A recent study by the U.S. International Trade Commission (USITC) comes to a similar forecast. According to USITC, the short-term net trade benefits to China would be relatively small, adding 0.9 percent to annual GDP, and the trade balance would deteriorate, as exports rise 10.1 percent and imports 11.9 percent. However, a much more efficient allocation of capital and resources within China would add about 4 percent to annual GDP growth, with import and export growth accelerating in response.

Domestic Impact of WTO Membership

The domestic impact of membership would vary across sectors:

- The goods-producing sectors, which are dominated by state-owned enterprises and capital-intensive firms (in practice, inefficient users of capital) are the most vulnerable to increased competition. These firms will face not merely lower tariffs under the WTO regime but the reduction of nontariff barriers, such as preferential treatment for national industries and nontransparent tendering procedures.
- More recently established automobile and consumer durables manufacturers will face highly increased competition and will have to undertake fundamental corporate reforms, radical reorganizations that could even include factory closures. Some of their foreign sales will be adversely affected by WTO membership, although lower input prices for some imported intermediate goods will benefit certain export industries.

- The need to level the playing field will ensure the phasing out of incentives for foreign capital and exporting industries in the country's privileged special economic zones.

- The main efficiency gains from WTO membership will not be in the export sectors but in the protected and nontraded sectors, which will feel the impact of import competition or the arrival of new foreign-backed competitors. Currently virtual state monopolies, the telecommunications, banking, and insurance sectors can be expected to grow much more rapidly than the economy as a whole. Foreign access to distribution and import-export activities currently dominated by state-owned enterprises should also increase rapidly. While the government has sought to remove formal monopolies and has transformed ministry-controlled enterprises into stand-alone corporations in the past two years, it has not allowed or encouraged full and free competition.

- More open trade and internal market liberalization will accelerate technology transfer. Foreign firms will be more willing to use modern technology because of greater confidence that intellectual property rights and trademarks will be respected.

Agriculture

Dramatic upheavals will confront the farming sector once China joins the WTO. The government has made no secret of the fact that increased imports of wheat, soybeans, and vegetable oils will have a ma-

ior impact on farmers in the northeast, where many of these products are grown for sale to the rest of the country. One major consequence will be the tendency of southern provinces to import grain fodder rather than buy it from the northeast. To meet these challenges the government has pledged to provide funds so that farmers can restructure their planting operations, improve the flow of market information, and establish quality standards for agricultural products with a view to boosting exports.

Banking and Financial Services

Under the terms of the bilateral agreement reached in November 1999 on the terms of U.S. support for China's accession to the WTO, foreign banks will be allowed full access to the banking sector within five years of China's membership in the WTO. China's domestic securities industry will be significantly liberalized. Foreign firms will be allowed to own 33 percent of Chinese securities brokerage and fund management companies, rising to 49 percent three years after China's WTO accession. The government estimates that within three years of WTO membership, the number of foreign banks operating in China will increase from 179 to 279 and there will be a threefold increase in the domestic foreign exchange deposits held by these banks, which currently stand at \$4.6 billion. Currently, just 25 foreign banks are licensed to conduct local currency business. Within a few years all will be able to.

Domestic banks will be confronted with new challenges, as foreign banks compete

in low-risk, high-profit areas, such as international clearance transactions, enterprise loans, personal loans, and credit cards. Greater competition will put pressure on the authorities to commercialize state-owned banks (by converting them to shareholding institutions), improve regulatory oversight, and resolve the large amount of bad debt.

Telecommunications

The Sino-U.S. deal reached November 15, 1999, allows U.S. firms to own up to 49 percent of Chinese telecoms companies immediately upon China's WTO entry, increasing to 50 percent within two years of that date. Last year the Ministry of Information Industry banned foreign investment in China Unicom, a competitor of the country's dominant, state-controlled carrier, China Telecom. Earlier some 40 Western companies had invested a total of \$1.4 billion in Unicom. The WTO deal retrospectively legitimizes these investments and allows investors to retain their current holdings. It should clear the way for foreign companies to take stakes up to the agreed limits of 49 percent and then 50 percent in Internet content providers (ICPs)—ownership that was also declared illegal last year. In November 1999 the Ministry of Information Industry threatened to impose annual quotas on the sale of mobile phones made (in China or abroad) by Nokia, Ericsson, and Motorola, which together control 85 percent of this market. Under the WTO rules, this plan will have to be abandoned.

External Impact of WTO Membership

The external economic impact of China's accession to the WTO would be mixed. Some East Asian economies could benefit significantly from China's membership. Japan, the Republic of Korea, and Taiwan (China) provide intermediate goods and quality consumer durables that could gain market share in China at the expense of some local products. In addition to gaining a larger market for capital

goods, these countries would have the added advantage of proximity to China's low-cost labor.

The United States could have less to gain from WTO-related trade liberalization than China's other major trading partners. According to USITC, WTO membership could cause U.S. exports to China to increase faster than imports in percentage terms. However, as U.S. imports from China are now three to four times greater than exports, the absolute trade gap would widen.

The largest U.S. merchandise trade beneficiaries of Chinese WTO membership would probably be the agricultural sector. It is anticipated that exporters of wheat, cotton, and oil seed will benefit from a reduction in quotas, licensing, and other nontariff barriers.

How Long Will the Accession Process Last?

Although China's accession to the WTO is getting closer, negotiators still need to complete multilateral and bilateral talks and finalize working party formalities. Matters of common concern are negotiated on a multilateral basis in the China working party, open to all members of the WTO. China has agreed that anyone should have the right to trade (an early and significant commitment) and that administrative decisions affecting trade should be subject to judicial review.

However, on a number of issues China's proposed commitments remain undefined or not yet acceptable to other WTO members. These include products that may be reserved for state trading, the timetable for removing quantitative restrictions on imports, maintenance of price controls on some goods and services, the phasing out of subsidies, the use of export duties, and inspection requirements for imports and exports. Other unresolved multilateral issues include the form and duration of safeguard arrangements that other WTO

members will be allowed to maintain against surges in Chinese exports (particularly in the textiles and clothing sectors), China's commitments on agricultural liberalization (particularly tariff rate quotas) and arrangements for reviewing China's progress in implementing its WTO obligations.

Members seek specific market access commitments from China in bilateral talks. The bilateral market access agreement between the United States and China—which includes undertakings for a far-reaching liberalization of China's domestic markets—covers a large proportion of the export interests and concerns of other WTO members.

China has reached bilateral agreements with at least 17 WTO members, including Australia, Hungary, Indonesia, Japan, the Republic of Korea, Pakistan, Singapore, and Turkey. Recent market access discussions in Geneva between China and about 20 other WTO members (including Argentina, Brazil, Malaysia, and Venezuela) have also reportedly made progress. Some important issues that need to be negotiated with the European Union include tariff barriers facing machinery exports, farm products, and other goods; restrictions on the sale of life insurance; and joint venture requirements for telecommunications services.

If both sets of negotiations are completed, the results are recorded in the China working party's report. If the report is approved by both the WTO General Council and the Chinese government, China will be able to join the WTO within 30 days. This will happen once bilateral negotiations with the European Union are completed and the U.S. Congress grants China most-favored-nation trading status privileges on a permanent basis.

(Excerpted from Oxford Analytica Reports. Oxford Analytica is an Oxford (UK)-based international research group. Their Web site is <http://www.oxan.com/>.)

Growth is Good for the Poor

by David Dollar and Aart Kraay

While the macroeconomic indicators have often looked good, real wages in many countries have declined, and wage inequality has increased both within and between countries.

Lori Wallach, leader of the anti-WTO protests in Seattle, on the impact of globalization

The global economy governed by international financial institutions, the World Trade Organization, and multinational corporations proposes structural adjustment for countries in the South in the name of fiscal health. The result is increasing poverty, debt, and unemployment.

NGO declaration at the UN Conference on Women

Globalization has dramatically increased inequality between and within nations.

Jay Mazur, in *Foreign Affairs*

We have to reaffirm unambiguously that open markets are the best engine we know of to lift living standards and build shared prosperity.

President Bill Clinton, speaking at the World Economic Forum

An intense debate is going on over the extent to which the poor are benefiting from the growth the world economy experienced during the 1990s. At one end of the spectrum are those—including some of the NGOs that disrupted the WTO meetings in Seattle and tried unsuccessfully to disrupt the World Bank/IMF meetings in Washington—who argue that in general the poor do not benefit from global growth and that all of the benefits accrue to the middle and upper classes. A slightly different view is that the poor may benefit somewhat in absolute terms but that they benefit proportionally less than the average household, so that inequality within countries rises. Finally, there is the view (echoed by Bill Clinton) that countries and households that participate in the global economy will share in prosperity.

In this article we investigate the link between income of the poor (defined as the bottom fifth of the income distribution) and overall income (per capita GDP). We combine data on income of the poor and mean income in 80 countries over four decades, giving us 236 episodes in which we can link growth in the two measures over a period of at least five years. We use these data to investigate some of the hypotheses about the growth-poverty nexus:

- What is the general relation between

growth in income of the poor and overall economic growth? Does the relation differ depending on the level of development, the presence of a crisis, or the time period?

- Does policy-induced growth (through, for example, increased openness to international trade) benefit the poor proportionally, more than proportionally, or less than proportionally?
- Are there policies that are not necessarily pro-growth but that are still important for increasing income of the poor?

Growth Increases Income of the Poor

Our analysis indicates that income of the poor rises one-for-one with overall growth. Although there is a fair amount of variation, this general relation between income of the bottom fifth of the population and per capita GDP holds in a sample of 80 countries covering four decades.

A number of popular views about the poverty-growth relation are not true. First, a well-known idea in the development literature is the Kuznets hypothesis that inequality tends to increase during the early stages of development and decrease later on. We find no tendency for growth to be biased against poor households during the early stages of development: the effect of growth

on income of the poor is no different in poor countries (or countries in the early stage of development) than in rich ones (or countries in later stages of development).

Second, we find no evidence that income of the poor falls more than proportionately during economic crises. Of course, the same proportional decline in income has a greater impact on the poor if social safety nets are weak, suggesting that crises may well be harder for the poor to bear. The greater hardship crises impose on poor people does not occur because their income falls more than that of other segments of society, however.

Third, we find no evidence that growth has become less pro-poor than it was in the past. The poverty-growth relation has not changed in recent years.

A Package of Policies Benefits the Poor

We next turn to the second set of hypotheses, concerning the role of institutions and policies in explaining deviations from this basic relation between growth and income of the poor. A core set of institutions and policies (macroeconomic stability, fiscal discipline, openness to trade, establishment of the rule of law) has been identified as pro-growth in the vast empirical

literature on growth. It is possible that these policies have a systematically different impact on income of the poor. The popular idea that globalization increases inequality within countries can be tested by determining whether openness can help explain negative deviations in the relation between income of the poor and average income in individual countries. Alternatively, there may be institutions and policies that have not been established as robust determinants of growth but that are often thought to be good for the poor (notably democracy and social spending). The hypothesis that these institutions and policies are good for the poor can be tested by determining whether they explain positive deviations in the relation between income of the poor and mean income.

We find that openness to international trade raises income of the poor by raising overall income, with insignificant effects on the distribution of income. The same is true for improved rule of law and reduced government size, which raise overall per capita GDP but do not significantly influence the distribution of income. Stabilizing inflation is a super-pro-poor policy: not only does it raise overall income, it appears to have an additional positive effect on the distribution of income.

From this we conclude that the basic package of private property right discipline, macroeconomic stability, openness to trade increases income of the poor to the same extent that it increases income of other households. This is not the result of a "trickle-down" process in which the rich get richer first and then eventually benefits trickle down to the poor. Instead, the evidence suggests that property rights, stability, and openness directly create a good environment in which poor households can increase their income and income.

We also examine a number of institutions and policies for which the evidence on their growth impact is less robust but which may

nevertheless have an impact on the well-being of the poor by improving the distribution of income. Most notable among these are government social spending, formal democratic institutions (voice and accountability), and primary school enrollment rates. Voice has a small, statistically insignificant effect on growth and offsetting distribution effects, suggesting that income of the poor is not influenced directly by formal democratic institutions. Primary education has a beneficial effect on growth but no perceptible effect on income distribution. Public social expenditure shows little effect on either growth or distribution. This reminds us that in many countries public expenditure on social services often fails to target the poor effectively.

Standard Pro-Growth Policies Are Good for the Poor

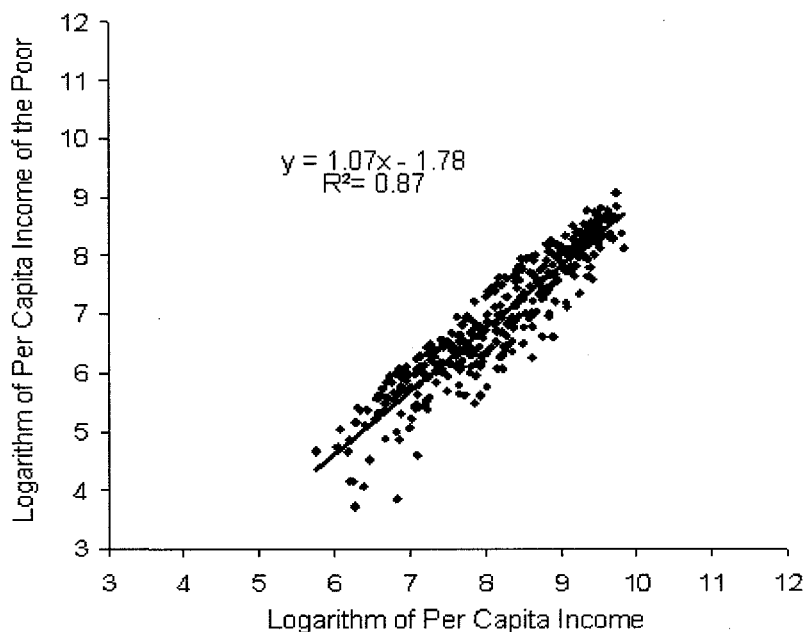
Contrary to popular myths, standard pro-growth macroeconomic policies are good for the poor, raising mean income without significantly affecting the distribution of income. In fact, macroeconomic stability (proxied in our analysis by stabilization of

high inflation) tends to improve income distribution, increasing income of the poor by more than mean income. Other policies, such as establishing the rule of law and openness to trade, benefit the poor and the rest of the economy equally. We find no evidence that formal democratic institutions or heavy government spending on social services has any effect on income of the poor. The growth-poverty relation has not changed over time, does not vary during crises, and is generally the same in rich countries and poor ones.

We do not want to be misinterpreted as arguing that growth is all that is needed to improve the lives of the poor. But we do want to get the message out that growth generally benefits the poor and that anyone who cares about the poor should favor the growth-enhancing policies of good rule of law, fiscal discipline, and openness to international trade.

David Dollar is team leader and Aart Kraay senior economist at DECRG-MG. The original article can be downloaded from <http://www.worldbank.org/research/growth/>

Figure. Income of the poor increases one-for-one with average income



Source: authors compilation.

Surveys Help Improve the Business Climate in Estonia

by Terri L. Ziacik

The Estonian Investment Agency regularly makes use of survey methods to assess the Estonian investment climate and study the inflows of foreign direct investment (FDI) into Estonia (box). It has used the results of these surveys to successfully recommend policy changes to the government.

While poor in natural resources and small in size, Estonia has attracted a great deal of investment from Europe and North America, especially from Finland and Sweden. It has received the most FDI of any former Soviet state in cumulative per capita terms; among the transition economies, only Hungary and the Czech Republic have received more FDI per capita. Estonia's success is attributed to the adoption of strict and credible economic reforms from the beginning of its transition process.

The Estonian Foreign Investor survey series, sponsored by the Estonian Investment Agency, is now in its fourth year. It evaluates investors' perceptions of Estonia, covering a wide range of investment issues in questionnaire form. Because it samples only investors who have already invested in Estonia, it cannot be used to determine why investors chose Estonia over other countries. It can, however, be used to determine how certain groups of investors evaluate different aspects of the Estonian investment climate and identify what difficulties investors are experiencing.

Results from the 1997 and 1998 surveys were analyzed to determine whether investor characteristics can explain their motivation and problems. Previous surveys indicated that export orientation, the spe-

cific area targeted for investment, the mode of entry, the size of the company, the proportion of foreign participation, and earlier links to Estonia (or the lack of such links) affect investors' motivation and their

Problem cited differed across the two surveys. This should not be surprising, since perceptions of problems should change as long as the host country is actively pursuing solutions. Several policy changes—in areas such as work and residence permits, VAT payments, and customs procedures—went into effect after the 1997 survey was conducted.

Bureaucracy and corruption, the two top-scoring problems in 1998, are considered serious problems for all investors; they do not affect one type of investor more than any other. Policies to remedy these problems should thus target all investors rather than a particular subset.

This type of analysis can serve as a useful tool to governments of countries wishing to attract more FDI. Lack of FDI can indicate perceived riskiness of the host country; surveys of this sort can pinpoint where the greatest obstacles lie. The results for Estonia show that no group of investors is having significantly more difficulty than others. This probably reflects the fact that Estonia has already made great

progress in its transition to a market economy. Results might be different in countries still undergoing major transition reforms. Thus there is a need for more research in transition countries not yet receiving large amounts of FDI.

Terri L. Ziacik is a Ph.D. candidate in the Department of Economics at Indiana University. This article is based on her article "An Assessment of the Estonian Investment Climate: Results of a Survey of Foreign Investors and Policy Implications." BOFIT's Discussion Paper 3/2000.

The Use of Surveys to Assess Investment Climate

The uneven distribution of FDI has prompted empirical research into the determinants of investment location that often include an assessment of the host country investment climate. This research frequently takes the form of investor surveys, which provide firm-specific information. Because surveys generally address FDI issues from the perspective of foreign investors in a given set of host countries or from a given set of home countries, their scope is limited. Nevertheless, surveys can yield an abundance of information to host country governments.

Surveys can be conducted through the use of in-depth interviews or questionnaires. Interviews provide lengthy, detailed information on such issues as investment motivation and difficulties, and they allow for clarification by the interviewer. The tradeoff is a smaller number of respondents than a questionnaire survey would yield because of the time and resources involved in administering an interview survey. Questionnaires are easier and less expensive to distribute to a large number of respondents, and the responses need little adjustment for comparison and analysis. However, the researcher has less control over the quality of the responses, since the questionnaires are often not completed in the presence of the researcher. Because of time constraints or misunderstandings of certain questions, questionnaires are often returned incomplete. Any misinterpretation of an answered question is likely to remain undetected.

attitudes toward problems. The first three factors are of primary interest, because they represent specific areas that can be targeted more easily through policy.

The results indicate that investor characteristics explain the evaluation of certain aspects of the Estonian investment climate. Exporters, for example, rank the importance of "entry into a new market" and "potential for market growth" much lower than do nonexporters. They are much more influenced by cost factors than are nonexporters.

Improving Latvia's Business Environment

by Lars N. Grava and Sanda Putnina

The Latvian government, in cooperation with the business community, is making broad-based efforts to create an investment-friendly environment. It is reducing administrative barriers to investment, creating effective public-private consultative mechanisms, providing access to up-to-date information (for example, placing draft legislation on the government's Web site), and ensuring that appeals procedures are effective.

Latvia's Action Plan

The job of attracting foreign investment, promoting exports, and "marketing" the

country is handled by the Latvian Development Agency, which is supervised by the Ministry of Economy. A comprehensive action plan that the agency drafted for improving the business environment contains more than 50 targets the government should implement within the next three years.

The action plan, available on the Internet at <http://www.lda.gov.lv/foreigninvestors/businessenvironment>, identifies the barriers to conducting business cited by entrepreneurs. These complaints—which cover employment, immigration, taxation, cus-

toms, and real property acquisition, construction, and inspection—were included in a report by the Foreign Investment Advisory Service (FIAS) of the World Bank. Recommendations of the FIAS experts, based on international experience, were presented to the Latvian government and the business community in 1999. Simultaneously, the Foreign Investors' Council in Latvia, made up of the country's foreign businesses, formed several ad hoc groups composed of foreign and local entrepreneurs to discuss these and other topics (including training of the work force, crime, and corruption).

Baltic Outlook: Currencies Remain Stable Despite Worsening Current Accounts

Economic recovery in the Baltic states and the Russian Federation, as well as strong growth in the European Union, will boost exports from the region, although the depressed value of the ruble will limit the ability of Baltic producers to recover markets in Russia. Imports should rise even faster, fueled by pent-up consumer demand and dependence on imported energy and other raw materials—predicts Oxford Analytica.

The trade and current accounts in all three Baltic states improved considerably in 1999, as a consequence of the regionwide economic downturn prompted by the 1998 Russian financial crisis. Imports fell dramatically as the demand for capital goods in all three states declined. Falling consumer confidence and tighter state budgets reduced the demand for consumer goods. Exports also fell, although not to the same extent, as opportunities in the Russian market contracted following the devaluation of the ruble.

Despite improvement last year, the current account deficit in the Baltic states will probably remain high for several years. Exports of food products, textiles, and wood cannot balance imports of high value-added products, such as transport equipment and electronics. The need for foreign capital equipment to modernize industrial production is likely to grow rather than diminish, as will the demand for oil and gas. Demand for computers, mobile phones, and electronic and telecommunication equipment is also increasing. Despite the sizable current account and trade deficits, however, the currencies of all three countries should remain stable:

- Latvia is the only country without a currency board. The lat is pegged to the SDR. Latvia has retained its favorable credit rat-

ings with Fitch IBCA and Moody's, allowing it to borrow on international markets at acceptable rates. The reduction of the budget deficit and a new standby agreement with the IMF should further strengthen the lat. A sharp increase in imports is not expected this year, as economic growth is projected to be about 2 percent and the government has adopted an austerity budget. However, export recovery could be even more modest, as efforts to increase penetration of European Union markets as a substitute for Russian markets have not been too successful so far.

- Estonia intends to retain its currency board until it joins the European Monetary Union, no earlier than two years after it joins the European Union. The peg that tied the kroon to the deutsche mark in 1992 at a rate of 8:1 remains unchanged. Estonia's return to growth this year will help stabilize the currency further. In an ominous sign, Estonia's trade deficit rose to 1.5 billion kroons (\$91.9 million) in February. Exports totaled 3.6 billion kroons and imports 5.1 billion.

- Lithuania's litas is still pegged to the dollar, despite severe economic difficulties last year and frequent calls by exporters for a competitive devaluation. In the second half of 2001, the dollar peg will be replaced by the euro peg. Like Latvia, Lithuania has begun to reduce its sizable budget deficit. The government has signed a standby agreement with the IMF and retained its favorable credit rating. Although the Russian economy is expected to grow in 2000, the demand for Lithuanian exports and construction services is unlikely to return to earlier levels. Imports are expected to pick up, placing further strain on the current account.

Using Surveys to Identify Problems

Surveys proved useful for identifying problems and priorities. The 1999 Survey on Latvia's Business Environment focused on various aspects of doing business in Latvia, including difficult to quantify but important factors such as the availability of information on government procedures, trust in appeals mechanisms, transparency of government action, helpfulness of civil servants, and adequacy of border crossing and immigration procedures. (Results of the survey are available on the Internet, at <http://www.lida.gov.lv/foreigninvestors/businessenvironment>. Excerpts from the Latvian Development Agency's Web site appear in the box.)

To involve interested parties—civil servants, representatives of the domestic, British, German, Swedish, and U.S. Chambers of Commerce in Latvia—in implementing measures to improve the business environment, a working group was established. Business associations are gradually becoming aware that they can become part of the decisionmaking process; government officials, in turn, have learned to consult with their private sector counterparts. To provide feedback once the recommendations are implemented, the Latvian Development Agency continuously consults with government officials and business representatives. If necessary, it provides legal assistance and intervenes in deadlocks.

A risk is that the government appears to show partiality to foreigners at the expense of domestic entrepreneurs. The most persuasive counterargument is that improvements in the business climate are not focused on a single group but benefit the whole economy. Latvia's efforts to improve business environment have found overall acknowledgement by Nordic and Baltic business leaders. During their recent meeting they proposed that other countries of the region adopt the Latvian model.

The authors are legal consultants for the European Union PHARE/Latvian Development Agency Project, aimed at improving the business environment in Latvia.

Why Invest in Latvia? Excerpts from the Latvian Development Agency's Website

(<http://www.lida.gov.lv/foreigninvestors/reasonsforinvesting/why.htm>)

In 1998 by reaching a level of \$1.5 billion, Latvia ranked among the top Central and Eastern Europe countries in terms of foreign direct investment (FDI) inflow per capita. In 1998 the growth rate of FDI slowed down as compared to the increase in 1997, which had happened due to the accelerated privatization of state property. It is expected that the inflow accelerated in 1999. The European Union countries with which Latvia has the highest trade turnover contribute in excess of 50 percent of all FDI in Latvia. The largest inflows originate from Denmark, the United States, and Russia followed by Germany and the United Kingdom. Transport and telecommunications has been the most attractive sector, receiving nearly a third of the total stock of FDI. Wood- and food-processing have been the most popular sectors in manufacturing. Latvia promotes high-tech industries in particular since it can provide an abundant reserve of high-skilled workers.

Today about 50 percent of university graduates in Latvia are educated in the field of information technologies, highlighting the commitment of both the education system and Latvians to next-generation industries. Knowledge of foreign languages is widespread in Latvia and is on the constant increase. Today Latvia has one of the highest percentages of scientists and engineers in Europe, and this is contributing to the country's development as a successful high technology and R&D center.

Latvia's BBB credit rating awarded by IBCA and Standard & Poor's places Latvia among the top investment locations in Eastern Europe. At the end of 1998 the average monthly wage was \$238, more than 10 times lower than in Finland and over 20 times lower than in Germany. Latvia's wage level will reach

Spain's wage level only in 2010. The average monthly salary of a software engineer is just over \$400, making one tenth of the rate for a comparable post in the United States.

Latvia's corporate tax rate is 25 percent, which is one of the lowest rates in Europe. Foreign-owned companies are eligible for a range of discounts and allowances: substantial depreciation rates on fixed assets and the possibility to transfer losses within a five-year period, exemption from VAT and custom duties, and exemption from import duties and VAT on goods imported on a temporary basis for processing. Foreign investors can settle in special economic zones with unique incentives: 80–100 percent rebate on property corporate income, zero percent VAT on services, exemption from customs duty and excise tax on imports and exports, 100 percent depreciation and transfer of losses within a 10-year period.

The Latvian Development Agency offers foreign partners "one-stop shopping" services that include:

- Information about the business environment and business opportunities in Latvia.
- Help in establishing contacts with potential domestic partners.
- Organization of business visits, as well as tours of companies and locations throughout Latvia as requested.
- Assistance in locating real estate, manufacturing facilities, offices, or land for investment needs.
- Assistance in handling the legal and bureaucratic requirements that are involved in a business launch.
- Postinvestment assistance.

Currency Substitution: A Latvian Puzzle?

by Vadims Sarajevs

If macroeconomic uncertainty is high (high and volatile inflation, large budget and current account deficits) and the political environment unstable for prolonged periods of time, foreign currency can take over the basic functions of domestic money, becoming a store of value, a unit of account, and even a medium of exchange. This is the phenomenon of currency substitution/dollarization. If it becomes widespread, the economic environment in which government, producers, and consumers operate will drastically change.

Initial conditions were similar in most transition economies: a period of high inflation caused by price liberalization at the onset of reforms was coupled with high economic uncertainty and the absence of developed financial markets. In many countries these conditions triggered currency substitution and dollarization. This development can seriously hinder the effectiveness of monetary policy—setting money supply targets, safeguarding the stability of the exchange rate, ensuring that the state receives the revenue from the “inflation tax” (seigniorage)—on which governments in transition economies rely heavily to achieve macroeconomic stabilization. In the presence of currency substitution, households can easily switch between domestic and foreign currencies. This, in turn, can make the money supply process endogenous and increase the instability of money demand, impairing the ability of the monetary authorities to conduct effective policies and destabilizing the domestic banking system.

How can the degree of currency substitution be measured? Ideally, one would include the value of foreign currency notes circulating in the economy as a means of payment and a store of value and all checking accounts and short-term deposits in foreign currency held by residents in domestic banks and abroad. Such data are not available even for industrial countries, however, let alone transition economies. Most studies therefore generally employ CS1, the ratio of foreign currency deposits to M2 (broad domestic monetary aggregates). Another measure, CS2, the ratio of foreign currency deposits to broad monetary aggregates including foreign currency, is also used.

In Latvia both measures have moved together (except during the banking crisis of May–June 1995, when CS1 averaged about 45 percent and CS2 about 31 percent). Currency substitution fell during 1993, as a consequence of the introduction of the lat, a strong national currency fully backed by foreign reserves. Public confidence in the new money increased as macroeconomic stabilization accelerated. Since February 1994 the lat has been pegged to the SDR rate, and monetary policy has given priority to stabilizing the exchange rate. The level of CS1, however, remained extraordinarily high, even by the standards of Latin American countries.

What explains this surprisingly and stubbornly high level of currency substitution in Latvia? A number of competing explanations can be suggested:

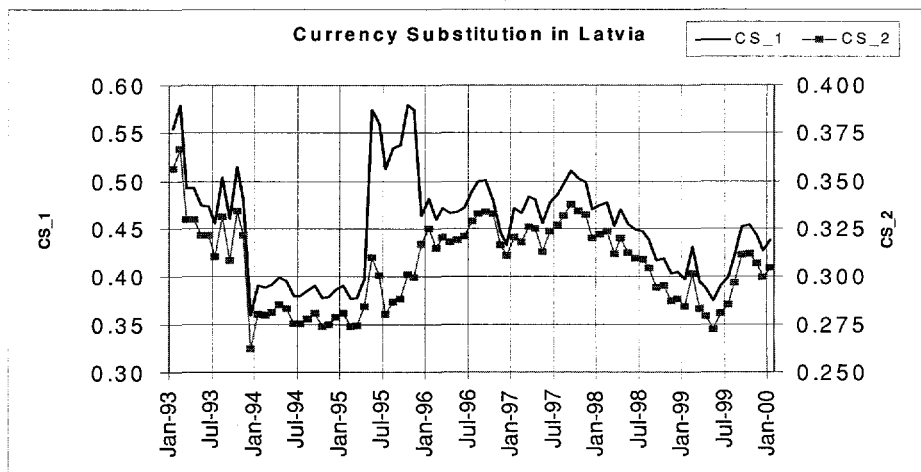
- Latvia is a safe haven for foreign exchange dealers from the former Soviet republics. The lack of restrictions on capital flows means that a significant share of foreign currency deposits in Latvian banks probably belongs to nonresidents.
- A lag occurs as financial markets and economic agents adapt to an economic

environment with large foreign exchange flows (as individuals and banks get used to dealing with high levels of currency substitution, there are extra costs of turning the situation back).

- A sharp increase in the openness of the Latvian economy increased foreign exchange balances.

Apart from its negative and potentially destabilizing effects, currency substitution can act as a disciplinary device by making it more difficult for the government to renege on its economic stabilization program and fall back on the use of the inflation tax. However, in the presence of both inflation and currency substitution, poor people suffer more than others from inflationary taxation, because they cannot afford to use financial markets instruments (including foreign currency) to avoid the inflation tax.

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Pension Reform in Ukraine: How Extensive? How Soon?

by David Snelbecker and Marta Dekhtiarchuk

Ukraine's pension system, like those in many countries of the former Soviet Union and Central Europe, is facing immediate financial crisis and is not sustainable in the long run, given an aging population. Progress has been made in planning reforms to address the short- and long-term problems through downsizing the pay-as-you-go (PAYG) pillar and introducing mandatory capitalized individual pension accounts. Most experts recognize the necessity of gradually raising pension ages from 55 for women and 60 for men and of eliminating early retirement privileges for many professions. Implementation of these changes would require considerable political commitment.

Ukraine differs from most of its Central European neighbors in several important respects:

- Pensions are quite low relative to wages. The average pension in Ukraine is roughly one-third the average wage. (In Poland this "replacement ratio" is roughly 60–70 percent.)
- Ukraine's informal sector is huge: it is generally assumed to be roughly the same size as the formal sector. One of the main challenges is persuading enterprises and individuals to contribute to the mandatory pension system.
- The level of outstanding pension liability is relatively low by international standards. It is 85–105 percent of GDP, about half the level in Poland and below that in many countries that have undertaken comprehensive pension reform. It lessens Ukraine's cost of changing to a more comprehensive, fully funded pension system.

Of the several reform proposals being considered in Ukraine, the one that is most

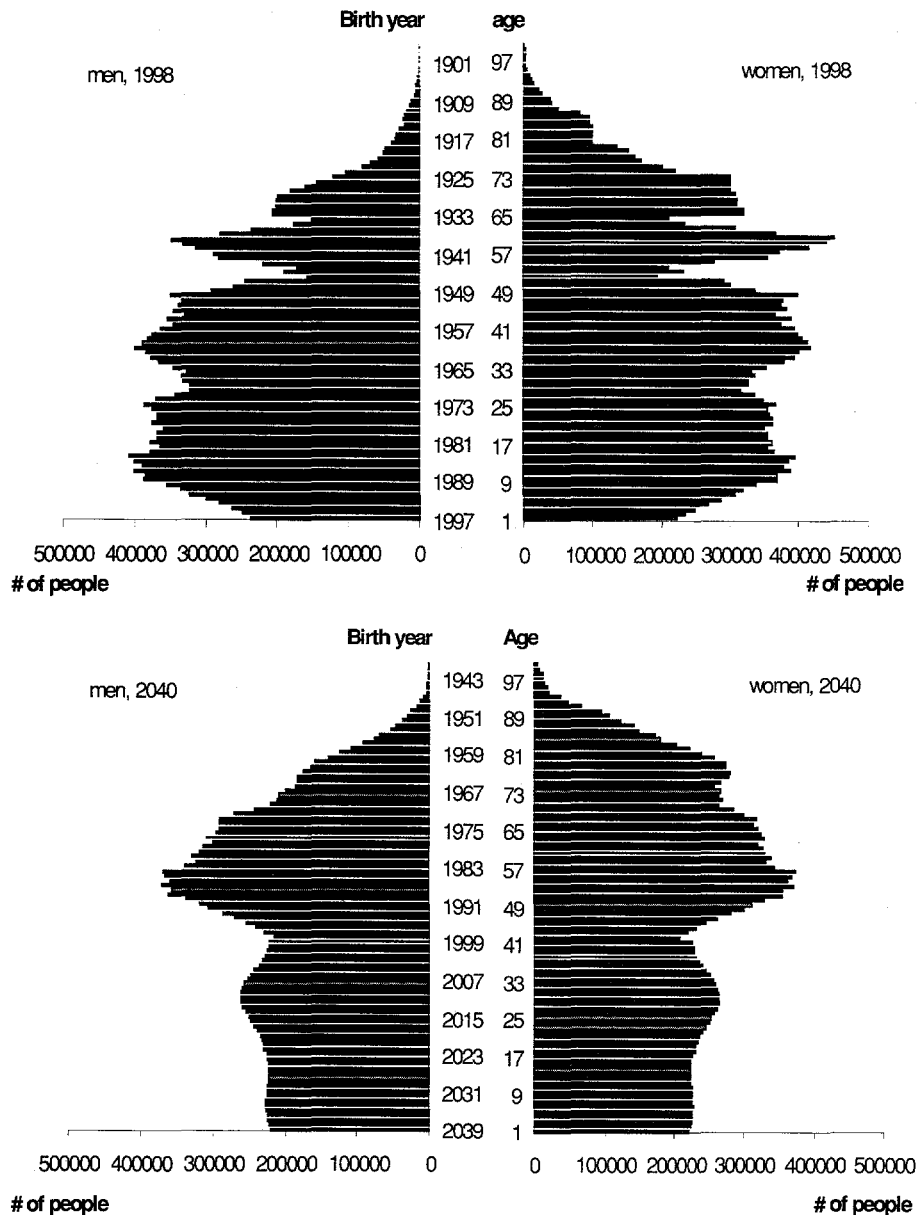
popular at the moment envisions a slight reduction in the mandatory PAYG pillar from the current contribution rate of 33 percent of wages to about 26 percent. In parallel, a mandatory fully funded pillar would be created, with contributions starting from 1 to 3 percent of wages and gradually increasing to about 7 percent. This

proposal, however, raises several questions that merit careful consideration:

Long-term Fiscal Sustainability of a Large PAYG Pillar

To maintain fiscal balance in the proposed PAYG pillar, pensions would have to be

Figure 1. Ukraine's Population by Age and Gender, 1998 and 2040



Source: authors compilation.

Table 1. Administrative Fees in Latin America's Fully Funded Systems, 1999, and Projections for Ukraine

Country	Fee as a percent of wages	Percent reduction in final capital and pension
Argentina	2.30	23.0
Bolivia	0.50	9.5
Colombia	1.64	14.1
Chile	1.84	15.6
El Salvador	2.13	17.6
Peru	2.36	19.0
Mexico	1.92	22.1
Uruguay	2.06	14.3
Average	1.84	16.9
Ukraine—small scheme	1.84	27
Ukraine—large scheme	1.84	12

Source: James, E., Smalhout, J., Vittas, D. *Administrative Costs and the Organization of Individual Account System: A Comparative Perspective*, p.38. Numbers for Ukraine are HIID projections.

reduced substantially as a share of wages, to a replacement rate of roughly 20–25 percent, even assuming a universal increase in retirement age to 65. That is, the average individual would be expected to contribute 26 percent of wages to the PAYG system during working years, in exchange for a pension amounting to only a fourth or a fifth of the average wage. For an average full-time worker (working from age 20 to 65 and living to 80), this would be equivalent to setting aside savings for many years with a real effective rate of return of minus 1–2 percent.

Most modeling of the long-term trends of the pension system show that any substantial PAYG pillar in Ukraine will result either in a considerable deficit of the system, if pensions of reasonable size are paid, or in a poor return on contributions for individuals. And with such a poor return on contributions—that is, with such a high implicit tax in the mandatory PAYG system—a substantial shift in wage payment from the informal to the formal sector seems unlikely.

These results are driven by demographic trends. In our calculations, we assume (optimistically) that fertility rates will increase from the current crude level of 1.3 children per woman to 1.8 (the level of several decades ago). If rates stay at the current level or even fall (rates in Kyiv, the capi-

tal, are only 1.0, suggesting the possibility of a worsening trend as the country develops and urbanizes), then a large PAYG pillar would be even less feasible than we have calculated. The current population and a projection for the future are given in figure 1.

Size of the Fully Funded System

Setting up such a system requires tracking each person's contributions, reporting regularly to all account holders, and managing and investing assets securely for long periods of time—all of which entail certain fixed administrative costs—whatever the size of assets of the system. If these assets are relatively small, as would be the case with

low contribution rates in an economy with low wages, administrative costs may be so high relative to the level of capital that the system is not cost effective. Table 1 shows some projections for Ukraine under two scenarios: a small fully funded system (7 percent contribution rate of wages) and a large fully funded system (15 percent rate)—with comparison to administrative expenses in Latin American countries.

Thus a small fully funded pillar with a 7 percent contribution rate in Ukraine (increased gradually from an initial 2 percent) would lead to quite high administrative costs relative to the level of capital—far higher than in any Latin American system.

For individuals, we can calculate the effective rate of return of contributions to the funded system, which can be defined as the actual return earned on contributions after administrative costs are factored in.

As shown in table 2, if the funded pillar is too small, these rates will be quite low compared to the market interest rate. Looking at the results from the first 10 years of the reforms, the return on contributions will be negative. If contributors have to expect negative real return from the PAYG system and a similarly negative return from the fully funded system, at least for the important first 10 years of transition, then this reform alternative is not presenting a credible incentive for a shift in wage payment out of the informal sector.

Table 2. Effective Rate of Return of the Fully Funded System (percent)

	Small fully funded pillar (Contribution rates: 2 % in 2003, 3 % in 2004, 5 % in 2005 and 7 % thereafter)		Large fully funded pillar (Contribution rate 15 %)	
	Administrative costs as percent of wage	1.84	1.00	1.84
Effective rate of return (Market interest rate=5 percent)				
• At retirement	3.32	4.24	4.35	4.69
• After 10 years of contributions	-6.52	-0.06	1.74	3.44

Source: authors compilation.

Timing of the Reform

The main arguments in favor of a later introduction of a fully funded system are:

- Capital markets may not be sufficiently developed for pension assets to be safely invested.
- Government policymaking and regulatory capacity may still be insufficient for establishing and overseeing a fully funded system.
- A fully funded system should be introduced only after there is a surplus in the PAYG system with which to pay transition costs.

Arguments in favor of a rapid introduction of a fully funded system are:

- Ukraine's pension system is already in deep crisis, so the sooner reforms are introduced, the sooner fundamental problems will be fixed.
- The costs of transition may be much lower now than later. The low birth rate during the Second World War means that relatively small numbers will retire over the next 10 years.
- The risks of exposure to poorly developed capital markets might be reduced by investing initially in safe assets: government bonds and high-grade foreign instruments. The costs of transition perhaps could be passed partially to future generations by issuing debt, so a surplus in the PAYG system may not be a prerequisite for beginning reforms.

Also, a simple organizational structure, for instance a centralized government asset management agency—cooperating with an international management company—could initially be preferable to many private pension funds. (Kazakhstan has pressed ahead with a bold reform to shift to a fully funded system and to phase out the PAYG system at a time when arguably it did not

have sufficiently developed capital markets, regulatory bodies, or institutions of civic society. This speed of reform has high risks if contributions are accumulated in poorly regulated private pension funds, tracking of contributions is inadequate, and the new system threatens with general collapse.)

The conflicting need for and danger of a speedy reform might be addressed by a debt-financed pension reform, in which some of the benefits—due to linking contributions with future pension payouts—are achieved early, but the gains, coming from paying off the outstanding pension liability, are deferred to a future time

when better developed capital markets can support more comprehensive reforms.

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The calculations and projections presented in this article are generated by an HIID overlapping-generations accounting model of Ukraine's pension system.

Details and assumptions of the model are available from the authors.



From the Moscow based magazine *Business in Russia*

Ukraine's State Pension Fund is Cash-Strapped

The pensions awarded to Ukraine's 14 million pensioners fail to reflect their employment history. Everyone is paid the same monthly rate of 59 hryvni (\$15), whatever the pre-retirement salary or number of years worked. Even this is far from guaranteed to be disbursed by the cash-strapped state Pension Fund. Created specifically to manage the inflow of pension contributions and redistribute them among eligible recipients, the Pension Fund has experienced severe budget problems in recent years.

The Problem

The pension system in Ukraine is pay-as-you-go, with today's workers financing the pensions of retired workers. Almost three-quarters of Pension Fund revenues derive from compulsory payments to the Pension Fund by enterprises—state and private—of 32 percent of the overall salary fund of each company. The remainder is raised from direct support from state and local budgets (10 percent) and other state-run, specialized, nonpension funds (including the Chernobyl Fund and Employment Fund), as well as compulsory contributions from individual salaries (3 percent).

Pension Fund revenues are further strained by demographic trends. The population is aging (the workforce is shrinking irrelative to the number of pensioners)—reducing contributions to the Pension Fund just when needs are growing.

Recent efforts have been made to increase Pension Fund revenues through new taxes. However, the results are mixed:

- Adopted late last year, a combination of sales taxes—1 percent on the sale of foreign currency, 5 percent on luxury goods, and 3 percent on cars—will at best bring an additional 345 million hryvni, only about 3 percent of the fund's total revenues this year.
- Neither the recent introduction of a 1 percent tax on the sale of real estate nor a flat fee of 10 hryvni for each cellular phone sale to the public is expected to have much effect.
- The most significant development is the introduction of a new fixed-rate agricultural tax, which is expected to raise almost 1 billion hryvni for the Pension Fund. The new taxes are unlikely to reverse the decline in Pension Fund contributions.

Several factors contribute to the lack of Pension Fund resources:

- **Wage arrears.** Chronic delays in wage payments throughout the country have meant that the fund regularly receives only 88–90 percent of planned revenues from salaries. The first four months of 1999 alone reportedly brought only 85.2 percent. The total wage debt across Ukraine amounts to around 11 billion

hryvni. Pension Fund contributions from corporate payers were short 3 billion hryvni at the beginning of the year. The fund's debt to pensioners was just over 2 billion hryvni.

- **Barterization.** Increasing barterization of the economy has left enterprises with little or no cash revenue to make compulsory payments to the fund. A recent analysis of Pension Fund debtors by industry revealed that the biggest debt was in the energy sector, where barter reached almost 100 percent.

- **Taxation.** High rates of taxation have driven many businesses, as well as individuals, to hide their real income by understating it or failing to report it at all. Manipulation of labor and payroll statistics is widespread. The extent of the problem is further revealed by the size of Ukraine's shadow economy, which accounts for 30–45 percent of GDP.

- **Subsidization.** Increasingly irregular and incomplete subsidies from state and local budgets exacerbate the fund's deficit. Moreover, the Pension Fund often finds itself financing some programs that are not necessarily related to pensions, such as special benefits for civil servants. By early 1999 the state budget owed the Pension Fund more than 500 million hryvni, while the local budget owed around 50 million.

Reform Imperative

Based on international experience, three approaches to pension reform are available to Ukrainian regulators:

- A minimalist solution that seeks to improve the existing system by raising the retirement age, increasing contributions, or lowering benefits.
- Creation of private pension funds to complement the existing system. Participation would be compulsory, and the funds would be engaged in investment activities.
- The introduction of a three-pillar system in which the state-run element is scaled down to deal solely with redistribution and complemented by a mandatory, fully funded private system. Both pillars would be financed from payroll taxes and supplemented by a third, voluntary pillar of private funds for those wishing to receive larger pensions. This option is still largely academic to the government, although it is actively advocated by the National Bank of Ukraine, based on guidelines issued by the World Bank in 1994. The government introduced a personalized pension contribution accounting system in 110 districts in mid-1999.

(Excerpted from a report of Oxford Analytica, the international research group based in Oxford, England.)



THE WILLIAM DAVIDSON INSTITUTE
AT THE UNIVERSITY OF MICHIGAN BUSINESS SCHOOL

Conference on Accounting in Transition and Emerging Economies

by William N. Lanen

The first Conference on Accounting in Transition and Emerging Economies was held at the William Davidson Institute in Ann Arbor, Michigan, April 13–15, 2000. The conference attracted 25 accounting researchers from Asia, Europe, and the United States. The purpose of the conference was to identify researchers from around the world working on accounting issues in transition economies and to bring those researchers together to develop potential research partnerships. The initial call for papers attracted 25 submissions, 7 of which were selected for presentation.

Accounting research is often (sometimes arbitrarily) divided into two areas, financial and managerial. Financial accounting research typically examines financial reporting and disclosure, while managerial accounting analyzes internal accounting systems. One reason for the separation is that financial accounting systems are generally subject to disclosure policies dictated by a central agency, while internal accounting systems are not.

The papers and the discussion at the conference confirmed that research on accounting issues is important in transition and emerging economies and that these economies present some unique opportunities for researchers. Many transition and emerging economies are in the process of developing securities markets, and financial disclosure policies are important in determining investor assessment of the offerings. As state-owned enterprises are privatized, internal accounting systems,

especially those associated with product or service costing and performance measurement, are essential for effective management. At the same time, firms and markets in these economies offer researchers the opportunities to study events of interest as “exogenous” from the perspective of the individual firm—something that is not possible in more developed environments.

Seven researchers delivered talks. Anil Makhija, of Ohio State University, presented “The Impact of Firm Ownership Structure on Voluntary Disclosure: Empirical Evidence from the Czech Republic,” coauthored with James Patton, of the University of Pittsburgh. Makhija and Patton analyze the impact of ownership structure on the disclosure practices of newly privatized firms on the Prague exchange. Classifying firms by the extent of investment fund ownership, they hypothesize that the extent of voluntary disclosure in financial statements depends on the magnitude of investment fund ownership but that the relation is not monotonic. The reason is that there is a tradeoff between the benefits of increased disclosure (lower capital costs) and the private benefits available from control. They find evidence consistent with this hypothesis.

The issue of complex ownership structure—and the information content of accounting earnings for firms with complex ownership structures—is considered in “Corporate Ownership Structure and the Informativeness of Accounting Earnings in East Asia,” presented by T. J. Wong of Hong Kong University of Science and Technology

(HKUST) and coauthored by Joseph Fan, also of HKUST. The concern with complex ownership structures is that voting rights (which measure the ability to control the firm) may exceed cash flow rights (the extent of investment in the firm). Earnings may be “less informative,” in the sense that the link between accounting earnings and share returns is weaker in firms in which voting rights exceed cash flow rights because of the potential for expropriation of wealth from minority shareholders. Wong and Fan find evidence consistent with their hypothesis for firms in East Asia, excluding Japan. They speculate that the reason Japanese firms may be different is that financial institutions are the ultimate owners of many Japanese firms.

In a report on an ongoing comparative study, Carol Frost, of Dartmouth College, presented some descriptive results on disclosure requirements of 50 stock exchanges, including many in transition and emerging economies. The data collected from this study will be a valuable source of information for financial accounting researchers interested in reporting and disclosure issues within and among countries.

Anne Wu of National Chengchi University in Taipei, presented “The Increased Adoption of Formal/Explicit Management Controls in Chinese Enterprises,” coauthored with Neale O’Conner, of City University of Hong Kong, and Chee Chow, of San Diego State University. The paper analyzes the factors associated with the adoption of formal management control systems. Using both case studies and survey data,

the authors find that joint venture arrangements as well as market conditions, especially increased competition, affect the adoption of formal control systems.

In related papers, Prem Lal Joshi, of the University of Bahrain, and Robert Luther, of the University of Exeter, analyze the diffusion of management accounting techniques in transition and emerging economies. Joshi's paper, "The International Diffusion of New Management Accounting Practices: The Case of India," compares experiences in India and Australia. Using survey data on past, present, and expected adoption and use of management accounting practices, Joshi finds significant differences in use and perception of benefits. He attributes these differences, at least in part, to cultural differences.

Luther's paper, "Management Accounting in a Society Undergoing Structural Change: A South African Study," coauthored with Stephen Longden, of the University of Derby, uses both interviews and survey data to analyze differences between South Africa and the United Kingdom. Luther and Longden find significant differences in the adoption and use of several management accounting practices, many of which they attribute to the more volatile business climate in South Africa and to the costs of implementation and use.

Drawing on a different theoretical framework, Trevor Hopper, of the University of Manchester, presented "A Bangladeshi Soap Opera: Privatization, Accounting, and Regimes of Control in a Less-Developed Country," coauthored with Shahzad Uddin, of the University of Belfast. The paper, based on an intensive field study at a single firm, analyzes the transformation of a company as it is privatized. While the accounting analysis is concerned with the transformation of the accounting system during the process, the paper also describes other changes, especially those dealing with labor relations in the firm during the process.

For copies of the papers, contact Sharon Nakapirat at shronch@umich.edu. For other research on accounting in transition and emerging economies, contact William Lanen at the Institute.

William N. Lanen is area director for accounting research at the William Davidson Institute and associate professor of accounting at the University of Michigan Business School.

Markets, Human Capital, Inequality: Evidence from Rural China

by Dwayne Benjamin, Loren Brandt, Paul Glewwe, and Guo Li

Market reforms are generally credited with the rapid growth enjoyed by China's rural sector. This growth has not been without some cost, however, as inequality has also significantly increased. Estimates suggest that the Gini coefficient for per capita income rose from less than 0.20 in the late 1970s to more than 0.40 by the late 1990s. Little work has been done on the causes of this increased inequality and the mechanisms through which it increased. This article examines these questions, drawing on several unusually rich household-level data sets.

We begin by reviewing a number of conceptual issues linking the transition from planned to market-based determination of income to inequality. We highlight the potentially crucial roles that human capital, such as formal education, and market institutions might play in affecting the degree of inequality associated with the transition process. After providing a brief review of the literature on inequality in China, we turn to our empirical results.

We use two key sources of household-level data. The first is the 1995 North and Northeast China Living Standards Survey (NNCLSS), carried out by the authors and Chinese colleagues in 1995. That data set covers 780 households in 6 counties, 18 townships, and 30 villages in the provinces of Liaoning and Hebei. We also use data on rural households collected in 1993 as part of the China Health and Nutrition Survey (CHNS). The CHNS survey, which covers 8 provinces, 32 counties, and 96

villages, is more nationally representative than our 1995 data. All together 1,920 rural households were surveyed.

Our empirical work confirms some of the findings in the literature—namely, that nonagricultural income has been the driving force in increases in inequality and that the educated have been most able to take advantage of economic transition. However, we also show that the literature has neglected a number of important points.

Spatial Dimensions of Inequality

Contrary to much of the conventional wisdom, most of the inequality we observe is the product of within-village differences between households rather than differences in income between villages. This is especially true of the role of nonagricultural income. For both data sets, decomposition exercises suggest that less than a third of the differences in per capita income across households can be explained by differences in per capita income across villages. An even lower percentage can be explained by differences across counties or provinces. In other words, while differences in such factors as the level of rural industrial development, soil quality, and proximity to urban centers affect mean income across localities, most of the inequality still comes from differences among households within these localities. The basic insight to be gained from these exercises is that explaining inequality in rural China requires explaining income determination within villages.

Human Capital and Its Interactions with Market Development

The role of human capital is paramount in determining the evolution of inequality. Human capital is unequally distributed in rural China. Interestingly, much of this inequality is the product of within-cohort differences rather than differences among cohorts or villages. One of the effects of economic reform has been to increase the returns to human capital, which were estimated to have been negligible under the collectives. Aggregating all types of noncrop income, we estimate a rate of return to education in nonfarm activity of 10 percent. There are significant differences across localities, however.

In looking at the effect of human capital on inequality, it is not just the return to human capital or its distribution that matters. Equally important is the way in which these factors interact with unevenly developed market opportunities, which are a central feature of economic transition. Here we find that commercialization, market integration, and economic opportunity can have a powerful equalizing effect on income. The effects are less benign when accompanied by an unequal distribution of education, as these opportunities will presumably be taken advantage of most by the more educated, increasing income inequality.

Differences in Savings Contribute to Income Inequality

Our research suggests that differences in capital accumulation (savings) across households will contribute to even greater inequality in the future. Our data are consistent with a long-run savings rate of nearly 30 percent in China. Higher-income households, however, are saving more, and they control a disproportionate share of total wealth. As long as these assets yield future income, the incomes of high-income earners will rise, thus further increasing inequality. These effects may be further magnified because of imperfectly developed capital markets.

Conclusion

Our research yields a number of suggestive results linking economic transition to income inequality in China. Two important themes emerge. First, "economic opportunity" appears to play an important role in determining the position of winners and losers in transition. Second, human capital plays an important role in allowing households to access these opportunities. Inequality of economic development interacts with the unequal distribution of human capital, leading to more inequality within villages than across villages. One relatively pessimistic implication of our analysis is that rural inequality in China is likely to worsen before it improves. The distribution of human capital is likely to change only slowly, while market institutions and

opportunities can change rapidly. Given the current distribution of education, many of these institutional developments will disproportionately benefit the better educated. Compounding this, current patterns of capital accumulation suggest that the rich will be better positioned to increase their income and thus future wealth.

Dwayne Benjamin and Loren Brandt are in the Department of Economics at the University of Toronto. Paul Glewwe is at the University of Minnesota. Guo Li is at the World Bank. This article was prepared for the IEA World Congress panel session on "Global Inequality: Where Are We and Where Are We Headed?" Buenos Aires, August 23–27, 1999. It will be published as William Davidson Institute Working Paper 298.

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September 25–26, 2000, London Business School, Sussex Place, Regent's Park, London

This conference will focus on the evolution of financial markets and corporate finance practices in emerging and transition economies. Like last year's workshop in Amsterdam (<http://www.fee.uva.nl/fm/Cifra/CIFRA.htm>), this year's conference will be a small gathering of an elite group of researchers. The conference is sponsored by the Centre for New and Emerging Markets at the London Business School, the William Davidson Institute of the University of Michigan Business School, the Amsterdam Center for International Finance Research (CIFRA), and the International Review of Finance. As last year, the conference committee is composed of Prof. Enrico Perotti, the University of Amsterdam; Dr. Anna Meyendorff, the Davidson Institute; and Prof. Sheridan Titman, the University of Texas at Austin and editor of the *Review of International Finance*.

Call for papers:

Submissions of theoretical or empirical papers are welcome. Topics may include market development, the effects of the legal environment, privatization, corporate governance and financing, corporate groups, political risk, and the impact of reform policy on financial markets. Travel and accommodation for invited speakers will be paid by the sponsors. Papers should be submitted by June 15, 2000, to Professor Enrico Perotti, Department of Financial Management Universiteit van Amsterdam, Roeterstraat 11, 1018 WB Amsterdam, Netherlands (enrico@fee.uva.nl), or Dr. Anna Meyendorff, William Davidson Institute, University of Michigan Business School, Ann Arbor, MI 48109 (ameyen@umich.edu). If you would also like your paper to be considered for publication in the *International Review of Finance*, please send three copies to Professor Sheridan Titman, Department of Finance, College of Business Administration, University of Texas, Austin, Texas 78712-1179 (titman@mail.utexas.edu).

The Fifth Annual International Conference in Transition Economies

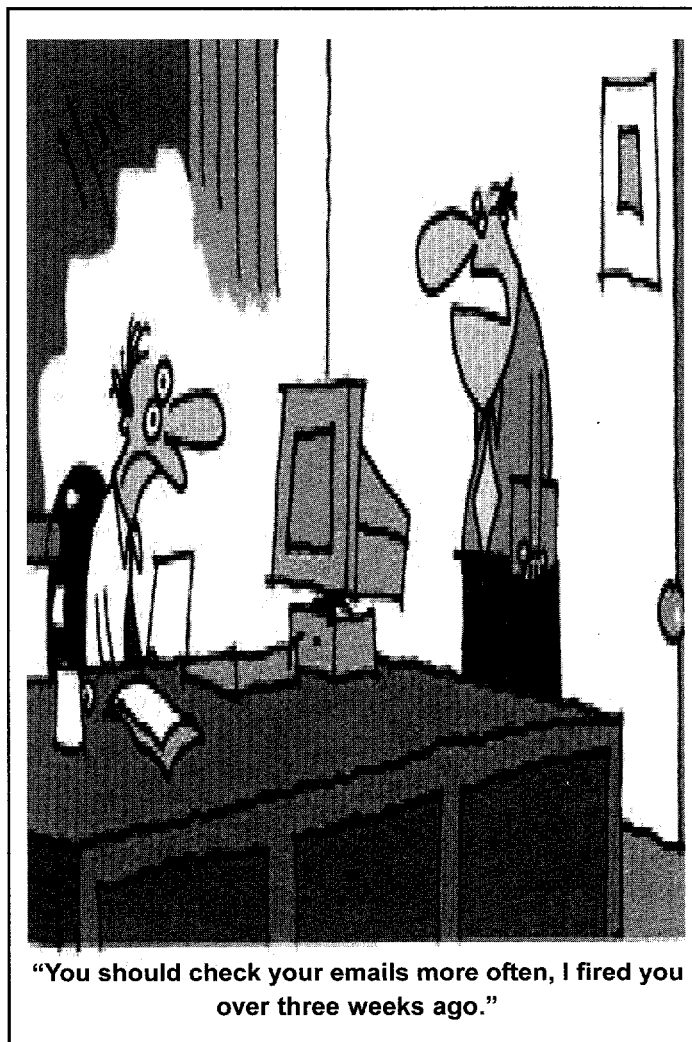
Moscow, July 2–5, 2000

This conference intends to create a forum in which leading transition economists from different universities and countries can present new research, meet and develop long-term collaborative relationships, and complete ongoing research. It

will also bring together key policymakers in the region with conference participants, facilitating discussion and the exchange of ideas. The conference is sponsored by the Center for Economic Policy and Research and the William Davidson Institute, in cooperation with the Economics Education and Research Consortium, the New Economic School, and the Russian European Centre for Economic Policy.

The meeting will bring together about 50 participants for a period of four days. Both plenary and parallel sessions will be held to allow longer time for paper presentations. Papers will be presented seminar style to allow for interaction among participants.

Information: Ms. Monique Muldoon, the Centre for Economic Policy and Research, email: mmuldoon@cepr.org.



From Cyberspace.

Don't Eliminate the Welfare State, Redesign It: Social Policy Lessons for Transition Economies

by Michael Ellman

Social policy choices in Central and Eastern Europe should take account of ongoing policy debates both at home and in countries that have already developed market economies. It would clearly be undesirable and unsustainable to introduce social programs that in the medium term may be unsustainable.

Unfortunately, the neoliberal bias of much initial discussion of the policies to be followed in the transition economies put social policy in the shade. This was largely a result of the traditional doctrine that saw an inevitable tradeoff between equity and growth. This doctrine ignores the fact that welfare programs can function as a watering can. People who benefit from adequate nutrition and medical care as babies—and adequate housing and education as young adults—have a good chance of turning into productive members of society. Hence appropriate welfare programs can contribute to both equity and growth.

The False Dichotomy between Equity and Growth

The discussion of the “crisis of the welfare state” in the OECD countries has shown the need not to abolish the welfare state but to modernize it. The need is to focus on providing social insurance against risks that incomplete markets or lack of information make difficult to insure on an individual basis.

The fundamental task of social policy in transition economies is to balance the need for redistribution of income that underpins human dignity and equality of opportunity, high labor market participation and low unemployment, and the dynamism of the market economy. The best social policy is full employment. However, the kind

of full employment that existed under the old regime—and that still exists today in some transition economies—is incompatible with the goals of the transformation process. The challenge to policymakers is to recognize their responsibility to devise policies that generate sufficient numbers of real jobs to combine low unemployment with transformation. This necessitates continuing the transformation process and implementing job creation on both the demand and supply side.

Changes Are Needed in Education, Health, and Housing

On the supply side, education and training; active labor market policies (that include job counseling, training and retraining, and public works); and attention to social cohesion are particularly important. The decline in school enrollment, the widespread cuts in education funding, and the deterioration of the quality of education in some countries are alarming and may lead to a decline in the quality of human capital in the future. The provision of good primary and secondary education for all is a basic public responsibility.

The transition economies inherited a daunting set of health policy challenges. A decade after transition began, overall progress is unsatisfactory. Priority should be given to the question of what kind of health care is needed. As far as the efficient use of financial resources is concerned, there is no advantage in social insurance or “Bismarck” systems over the Swedish or British system of funding through taxation. The most important challenge is increasing the efficiency of the existing system. Creating a group of well-trained health professionals with high morale is central to this process.

The quality and affordability of housing contributes a great deal to welfare. Caution should be exercised in rushing to adopt a system of high “market” rents sustained by housing allowances, which may deepen the poverty trap. Improvements in targeting in this area may be especially damaging if they encourage further geographical segregation of different social and economic groups. Allowances must be tapered, and efforts must be made to minimize housing segregation. There is a clear need to improve the capacity of young families to enter the housing market and to increase the ability of the unemployed to move to places where there are job opportunities. A good, if limited, social housing program can address these issues. Such a program is more effective than a program of higher rents coupled with housing benefits.

Unsustainable Pay-As-You-Go Pensions Need to Be Reformed

For countries that inherited unsustainable pay-as-you-go systems, the best way to proceed is to first scale down the generosity of the system (by indexing benefits to prices rather than wages, for example) and increase contributions (by improving collection of mandated contributions or mandating a longer working life). In addition, if there is a positive political assessment of the net advantages of a fully funded system, it should be introduced by transforming that part of the pay-as-you-go system that is not financed by contributions (but is paid for out of general taxation) into individual accounts within the new funded pension scheme. At the same time, the government should promote a third pillar of voluntary private savings. If the advantages of a funded system are deemed overwhelming, such a system should be gradually extended on a partial basis (that is, coexisting with a reformed

pay-as-you-go system) to new employees if the cost of switching from a pay-as-you-go to a funded system can be borne by the government budget.

Pay-as-you-go schemes are often criticized for being essentially Ponzi schemes. This misses the point, since they are viable Ponzi schemes run by governments with the power to compel participation and levy taxation. For given numbers of pensioners and given levels of contributions, there will always be some level of pensions that will be affordable. Furthermore, administrative costs of pay-as-you-go schemes are low, and coverage is universal.

The idea that fully funded schemes generate extra resources for pensions is an illusion. Extra resources are generated only if a fully funded scheme leads to additional investment and higher growth, lower taxes lead to higher growth, or pension funds lead to a net inflow of property income from abroad.

Universal Child and Family Benefits Need to Be Restored

The inefficiencies of means-tested benefits suggest that an effective policy option is to restore universal child benefit and family allowances. The fact that children have been hardest hit by transition is an unacceptable long-term risk. Moreover, the very low transactions costs of universal child benefits make it one of the most cost-effective ways of tackling poverty. Benefits in kind (housing, nutrition) can play a useful role in combating poverty. In countries with significant Roma populations, protecting them from persecution and cooperating with Roma organizations to raise their income and provide them with jobs, medical care, education, and transfer payments (where appropriate) must form part of effective antipoverty programs.

Social policy is a matter not just of adopting the right policies but of public debate and support for those policies and their implementation. In countries

in which the state is primarily a source of loot for the rich, powerful, or well connected, it would be naive to expect governments to implement effective social programs.

The author is professor of economics at Amsterdam University. He is a coauthor of the recently published book Hard Bud-

gets, *Soft States: Social Policy Choices in Central and Eastern Europe*, edited by J. Eatwell, M. Ellman, M. Karlsson, D. M. Nuti, and J. Shapiro (London: Institute for Public Policy Research). To order, contact Central Books, 99 Wallis Road, London E9 5LN, United Kingdom, tel.: 4420-8986-5488; fax.: 4420-8533-5281; email: ippr@centralbooks.com.

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The Road to Stability and Prosperity in Southeastern Europe: A Regional Strategy Paper, March 2000, 184 pp.

This report—prepared in response to the mandate given to the World Bank and the European Commission to coordinate a regional approach to Southeastern Europe—outlines four broad thrusts for action: moving rapidly toward trade integration with the EU and within the region, fostering social inclusion and social change to reduce tensions, improving institutional capacity and governance structures, and investing in regional infrastructure to integrate the region physically within Europe.

Dominique Dwor-Frécaut, Francis X. Colaço, and Mary Hallward-Dreimeier, (eds.), **Asian Corporate Recovery: Findings from Firm-Level Surveys in Five Countries**, 2000, 250 pp.

Jose I. dos R. Furtado, Tamara Belt, and Ramachandra Jammi, (eds.), **Economic Development and Environmental Sustainability: Policies and Principles for a Durable Equilibrium**, World Bank Institute Learning Resources Series, March 2000, 128 pp.

Winners and Losers of EU Integration: Policy Issues for Central and Eastern Europe, 2000, 340 pp.

Ten accession countries in Central and Eastern Europe could gain from exchanging lessons of experiences and best practices with one another. The EU integration network of research institutes in the 10 countries provides a valuable forum for such exchanges. This volume contains the papers presented at the first meeting of the network, as well as some background papers, identifying the main economic, social, and political groups that would gain or lose from accession.

Technical Papers

Csaba Csaki and Zvi Lerman, (eds.), **Structural Change in the Farming Sectors in Central and Eastern Europe: Lessons for EU Accession**, Second World Bank-Food and Agriculture Organization Workshop, June 27–29, 1999, TP 465, 2000, 272 pp.

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EU Standards: Political Anchor for Russia?



by Pekka Sutela

Why have the economic transitions of the postsocialist countries of Central Europe, including the Baltic states, been success stories, while the countries of the former Soviet Union continue to lag? A growing body of econometric research suggests that it is necessary not only to achieve macroeconomic stability and establish appropriate prices but also to implement structural reforms and institutional development. Moreover, the relative importance of structural reforms and institutional development seems to grow over time.

Central European nations wanted to return to Europe to become "normal European countries" again. Reintegration with Europe meant plunging into the Euro-Atlantic alphabet soup of organizations—EU, NATO, OECD, WTO, and so forth—as quickly as possible. Joining a group of clubs, all with the same underlying mentality, imposed a high degree of policy conditionality on these countries. It obliged consistency and far-sightedness in decisionmaking.

In contrast, the Russian Federation lacks a clear goal and has little wish to make a clean break with the past. This does not mean that Russia is willing to choose any road. Few would seriously argue for a return to the old regime. After a decade-long learning process, Russians generally support a market economy, openness, and democracy of some sort. But the lack of a binding conditionality has tended to render policies captive to vested interests, rent-seeking, and no-holds-barred struggles for power.

Several conclusions follow:

- Russian policies and their support by the international community have been overly influenced by an exaggerated fear of a Communist comeback.
- The partial, weak conditionality that international financial institutions offer is, at best, a poor substitute for the conditionality of a return to Europe.
- It is impossible to define a return-to-Europe path for Russia.

Unfortunately, the EU's approach to Russia has been less than accommodating. Members regularly point out that Russia

will never become a member of the Union. For reasons that remain unclear, Russia's size is often invoked—a strikingly peculiar argument. Some assert that the possibility of Russian membership is so distant that even mentioning it raises unjustifiable hopes—and perhaps claims for premembership privileges and resource flows. Such claims for resources should not be accepted. The aim of offering the prospect of EU membership is to provide a clear and demanding goal, not to provide additional soft finance. There has

been too much of that already. A precedent has been created with the reaffirmation of the membership prospects for Turkey, another country whose membership might be distant but for which prospects of accession may offer a goal and thus a policy anchor.

Vladimir Mau, one of Russia's cleverest policy experts, recently proposed that all national economic policies should be aimed at facilitating membership in the EU. Whether Russia actually becomes a

Visiting Researchers Program for 2001

The Bank of Finland Institute for Economies in Transition (BOFIT) conducts high-level research on transition economies and monitors economic developments in the Russian Federation and the Baltic states. Research focuses on (but is not limited to) issues related to macroeconomic performance, the public sector, and financial markets in transition economies. The Institute publishes two research-oriented discussion paper series and regular economic reviews.

BOFIT welcomes applications for posts in its Visiting Researchers Program. Two- to six-month scholarships are available for scholars undertaking high-level research projects in areas pertinent to the Institute's research objectives. The deadline for application for the 2001 program is June 15, 2000.

Visiting scholars will be expected to conduct research based on a mutually agreed on research plan. Articles stemming from the research are expected to be included in the BOFIT Discussion Papers Series and may be published elsewhere as well. Visiting scholars are expected to give a lecture in the Institute's seminar series on their research topic and to interact with other researchers engaged in projects in the same area.

BOFIT offers an active but relaxed research environment, excellent library facilities, and support from other research facilities. Remuneration is commensurate with the researcher's experience. To apply for a scholarship, send a brief research proposal, a curriculum vitae describing your academic and research background, two or three references, and a copy of a research article to: Bank of Finland Institute for Economies in Transition P.O. Box 160 Helsinki, Finland 00101 fax.: 358 9 183 2294, Email: bofit@bof.fi. Applications should reach BOFIT no later than June 15, 2000.

For more information about the program, contact Pekka Sutela, Head of Institute, tel.: 358 9 183 2297 or Pekka.Sutela@bof.fi, or Jukka Pirttilä, Research Supervisor, tel.: 358 9 183 2986 or Jukka.Pirttila@bof.fi.

member is a political issue, he stresses, adding that in any case the country is not ready to discuss the matter. In the long term, Russia's position could be similar to that of Norway, which meets membership requirements but is not an EU member.

A parallel approach was recently taken by Leif Pagrotsky, Sweden's Minister for Foreign Trade, who will play a central role

once Sweden takes over the EU Presidency next year. Sweden has declared that relations with Russia will be a priority under its presidency. According to Pagrotsky, the EU needs a concrete long-term program for Russia's inclusion in European cooperation structures. He is pushing for Russia's gradual entrance into internal markets, with possible fast-tracking for Kaliningrad. It may also be high time for

the rest of us to start rethinking Russia's possible role in Europe.

The author is head of BOFIT. email: Pekka.Sutela@BOF.Fi. This article is a slightly shortened version of his article published in the BOFIT's Russian Economy, the Month in Review.

World Bank/IMF Agenda

Ukraine Seeks World Bank Help to Fight Corruption

During his visit to Washington in May, Ukrainian Prime Minister Victor Yushchenko sought World Bank assistance to fight corruption and strengthen the rule of law in Ukraine. "I was particularly pleased by the prime minister's request and conveyed our readiness to offer the World Bank Group's support in this critical area," World Bank President James Wolfensohn said in a statement May 9, following talks with Yushchenko in Washington. The Bank is currently discussing with the Ukrainian government, the Ukrainian Parliament, and NGOs an assistance package that will be used to shore up social services and improve official administration. A country assistance strategy is also being prepared that would underpin future Bank assistance and lending to Ukraine.

Yushchenko also met with executive directors of the IMF and officials of the U.S. Treasury. The IMF froze installments of a \$2.23 billion loan program to Ukraine last September, after Ukraine failed to meet economic targets. There were also some accusations that the Ukrainian central bank had misled the IMF over the size of its foreign exchange reserves between 1996 and 1998. Ukraine's central bank was supposed to transfer almost \$1 billion of foreign exchange through various third parties, often double-counting its reserves. At the time, the government was receiv-

ing IMF loan payments totaling \$675 million. One of the factors on which the payments were based was the level of the country's monetary reserves. Although reserves were overstated, there were no signs of illegal use of the funds during this period, auditors of PricewaterhouseCoopers confirmed. Yushchenko headed the central bank from 1993 to 1999. U.S. Treasury Secretary Lawrence Summers said he supports the IMF's recommendation that central banks of countries that receive IMF funds be subject to "appropriate external audits."

World Bank, IMF Working Out New Financial Program for Moldova

The World Bank and Moldova will start working out a new financing program aimed at eliminating poverty there, but loans will hinge on the pace of privatization, Roger Grawe, World Bank director for Moldova, told a news conference in Chisinau, Moldova's capital, in early May. The new three-year strategy will be implemented in close contact with the IMF, which plans to start work on its own poverty reduction program.

In mid-April the World Bank suspended a \$20 million loan to Moldova under a \$40 million loan program, after Parliament rejected draft laws on fair and transparent privatization of the lucrative wine and tobacco industries. (The IMF suspended a \$35 million installment of its loan under the Extended Fund Facility). The Bank will

continue to support its 10 projects under implementation, including the social investment fund and projects on social protection management, education, private sector development, energy, rural finance, and land registration. It will also continue to fund its technical assistance program. Preparation of new operations (health, public sector reforms, agricultural services, energy) will not be suspended. Since Moldova joined the bank in 1992, the Bank has committed more than \$400 million to the country, more than \$160 million of which has yet to be disbursed.

New Environmental Strategy

The World Bank Group is preparing a new environmental strategy aimed at integrating environmental concerns into its mainstream poverty alleviation and economic development efforts. The draft strategy was presented to the Council of the Global Environment Facility May 8. Over the next six months, consultations will be held with client country governments, NGOs, and other partners around the world.

The Bank's discussion draft report, *Toward an Environment Strategy for the World Bank Group*, released in April, summarizes the emerging strategy framework that should be finalized by December 2000. Its three main objectives are to:

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SITE

Stockholm Institute of Transition Economics

STOCKHOLM SCHOOL OF ECONOMICS

Flexing BICEPS: Bringing Home the Best and the Brightest by Building a Centre of Excellence for Economic Research in the Baltics

The Baltic International Centre for Economic Policy Studies (BICEPS) project is making a groundbreaking contribution to the renewal of the economics profession in the Baltic states. The aim is to build a full-fledged research institute and think tank with a broad program of world-class research and a strong and active presence in the policy debate in the Baltic countries and the EU. Initiatives such as EuroFaculty, established in 1993 by the Council of Baltic Sea States, have helped induce the first Baltic students with Ph.d.s earned abroad to return home. This is a promising start, but additional action and resources are needed to achieve the critical mass necessary for the long-run sustainability of economics in the Baltic states.

The BICEPS project supports the initial return of talented young researchers and encourages others to follow by building an attractive environment for research. The project brings together Baltic economists with strong training in economics and local knowledge and EU-based research institutes with experience with capacity building in transition economies. Led by the Stockholm Institute of Transition Economics (SITE), the consortium of European institutes includes the Bank of Finland Institute for Economies in Transition (BOFIT), in Helsinki, and the Centre for Integration Studies (ZEI), in Bonn, both of which have expertise in transition economics, as well as Europe's largest economics research network, the London-based Centre for Economic Policy Research (CEPR). Members of the core network in the Baltic states include EuroFaculty, the University of Latvia, the Stockholm School of Economics in Riga, Tallinn Technical University, Tartu University, and the University of Vilnius.

Building a Sustainable Institution

In spearheading BICEPS, SITE is drawing on the experience it gained creating the Russian-European Centre for Economic Policy (RECEP), funded by the EU's Tacis. CEPR has been instrumental in attracting leading European academics to participate in RECEP's research; it has also contributed its experience in dissemination and policy outreach.

The aim of the project is to develop a sustainable institution whose academic staff teach at local universities and advise local governments on policy. Creating a sustainable institution will require long-term financial and institutional commitment from Western institutions. An important task is to build a broad stakeholder base and diversify the sources of funding over the next three years.

Strengthening Economic Research Capacity

BICEPS' "virtual faculty" are already participating in research projects and advising Baltic graduate students. Seminar series, conferences, and workshops will be organized to strengthen research ties and increase the center's visibility. Based on the experience of local institutions, talented young people in the three Baltic countries will be recruited to participate in research, distribution, and information networks. The networks will be modeled after the National Bureau of Economic Research (NBER) in the United States and CEPR in Europe. Affiliates and fellows of these networks will be invited to participate in training programs, at BICEPS and at the institutions in the consortium. Through its interaction with policymakers in government and business, BICEPS will promote capacity building of economics in those institutions.

Contributing to the Policy Process

Through interaction with policymakers, BICEPS wants to participate in formulating economic reform policies in the Baltic nations. To be sustainable, reforms must be homegrown and command political support. This can be achieved only by developing a vigorous public policy process and creating a deep-rooted, indigenous capacity to carry out high-quality research and policy analysis. Analysis of and advice on economic policies will be offered to core government agencies, national parliaments, and the central banks.

Developing an Institutional Network

The project will link institutions, integrating the new center into the international research community in economics and establishing closer ties with other institutions in preaccession and EU

member states. The core network in the Baltic states will help BICEPS attract leading researchers for joint appointments and research projects, and it will give students in the region the opportunity to participate in research.

Supporting the Accession Process

The BICEPS initiative aims to play an important role in supporting the Baltic states' accession to the EU. Research findings related to developments in the Baltic economies will be communicated promptly to key audiences in the region and beyond, through publications, discussion meetings, workshops, and conferences.

Disseminating Research Results

The quarterly *Baltic Economic Trends* will be BICEPS' first formal channel for disseminating its research. SITE will launch the new publication, modeled on RECEP's *Russian Economic Trends*, in mid-2000. The journal will feature macroeconomic overviews, feature articles, special reports, and statistics on the three Baltic states. It will eventually include other countries in the Baltic rim.

For additional information about the BICEPS project, visit our Web site, at www.hhs.se/site; contact SITE, tel.: 468-736-9672; or send an Email to Erik.Berglof@hhs.se or Jody.Lanfrey@hhs.se.

SITE/RECEP Research

Club Enlargement and Financial Constraints: Early Versus Late Admittance

by Mike Burkart and Klaus Wallner

This research project analyzes the enlargement strategy of a club facing applicants that differ in wealth and reform status. Much economic activity revolves around clubs, such as free trade associations and trade unions, which exercise the right to choose their members. Supranational organizations (such as NATO, the EU, the WTO, the G-7, and the UN Security Council) also function as clubs, as do many bilateral and multilateral international treaties.

A topical application for our framework is the enlargement of the EU. Applicants from Central and Eastern Europe are severely constrained financially. Adopting EU standards in order to join a group of highly developed and rich countries may require these countries to undertake actions that do not coincide with their preferred course of development. A club's incumbent members hold a monopoly on membership decisions. In the case of the EU, the dual roles of financier and enlargement monopolist give incumbents strong influence over applicants' reform agendas.

The analysis of club enlargement decisions centers on a basic conflict of incentives: the club benefits more if an applicant takes a costly action, while the applicant desires membership at the smallest possible cost. The club can induce the applicant to perform an action by making club admission contingent on it. In the EU enlargement context, the EU can make admittance contingent on implementation of reforms. It can admit an applicant before it implements reform and attempt to bring about reform within the club, or it can pursue a strategy of late conditional admittance.

Our research yields two main results. First, an optimal strategy is to admit more advanced applicants only after conditions have been met while admitting less advanced applicants early. The EU, for example, has an incentive to admit less advanced applicants before they implement reform. Greece, for example, was admitted without having to institute reforms, while more advanced applicants, such as Poland and Hungary, were offered conditional admittance based on their meeting EU standards and implementing reforms.

The second finding is related to the financing of desired reforms. Poorer applicants are overfunded. In addition to providing money for reform, the club finances some additional consumption. All but the most advanced applicants (in terms of reforms) retain rents from the enlargement process.

Overfunding can be avoided if the club engages in staged financing, which conditions the disbursement of funds on the implementation of reforms. The article devotes much attention to the problem of opportunism in the dynamic game. In the EU enlargement context, release of funds by the EU generates requests for more funds from still unreformed applicants in the next stage of negotiations.

Mike Burkart and Klaus Wallner are associate professors. Their article can be downloaded at www.hhs.se/personal/klauswallner/papers.htm. For more information, email the authors, at mike.burkart@hhs.se or klaus.wallner@hhs.se.

Dynamism and Inertia in the Russian Labor Market: A Model of Segmentation

by Irena Grosfeld, Claudia Sénik-Leygonie, Thierry Verdier, Stanislav Kolenikov, and Elena Paltseva

From the rich empirical literature devoted to the Russian labor market, four major features emerge as essential: pervasive labor hoarding, the importance of social assets, mounting wage arrears, and the mobility of some workers. The first two features can be considered as forces of inertia, the last two as forces of flexibility.

This article proposes a model of segmentation based on uncertainty, worker heterogeneity, and risk aversion. To test some of the model's predictions, the authors use a panel of 13,410 firms extracted from the Russian Enterprise Registry database. The results show that firms react to shocks by adjusting the number of blue collar workers rather than the number of white collar workers. Moreover, local labor market conditions have significantly more influence on the wages of blue collar workers than on the wages of white collar workers.

The implications of this segmentation on restructuring are ambiguous. On the one hand, it reflects some adjustment of the industrial sector—namely, the dynamic employment policy of some firms and the efficient reallocation of the most productive workers. On the other hand, if restructuring means reducing overstaffing, the process is far from being completed in Russia. There is a risk that the stagnant segment exerts an eviction effect on the dynamic sector, particularly if it receives state subsidies in order to perform its role of social protection. The presence of social

assets in former state-owned firms also increases the entry cost of new firms. Many new private firms do propose social services to their employees. The need to do so slows development of the new private sector.

This peculiar segmentation of the labor market reflects the weakness of the institutional structure. It is above all linked to the high level of uncertainty faced by workers and firms. Russian workers face greater uncertainty associated with leaving the firm than do workers in other transition or market economies. Uncertainty is greater in Russia because institutions are weaker and macroeconomic policy fluctuates more than elsewhere. The weakness of the state and the rule of law and the slow pace of institution building in Russia shorten the time horizon of agents and weaken the quality of their expectations. Reducing uncertainty thus constitutes a key condition of the normalization of the situation in Russia and of the separation of low productivity employees from their firm.

Irena Grosfeld (DELTA, ENS, RECEP); Claudia Sénik-Leygonie (DELTA, ENS, RECEP); Thierry Verdier (DELTA, ENS); Stanislav Kolenikov (RECEP); and Elena Paltseva (RECEP). This article appeared as CEPR Discussion Paper 2224. For more information, contact the authors at grosfeld@delta.ens.fr, senik@delta.ens.fr, verdier@delta.ens.fr, skolenik@recep.glasnet.ru, or epaltseva@recep.glasnet.ru.

Stuck in Transit: Rethinking Russian Economic Reform

A RECEP-CEPR-SITE publication

In August 1998 Russian policymakers finally had to face the consequences of the delays in reforms, lack of fiscal discipline, and overvalued exchange rate when the government was forced to devalue the ruble and default on its debt obligations. This report identifies the underlying causes and the deep flaws these events exposed in the process of reform and discusses the policy options for rebuilding the Russian economy. The report explores the long-term policy challenges in key areas of the Russian economy, including fiscal and monetary policy, the labor market, the financial sector, industrial restructuring, and the barter economy.

Stuck in Transit: Rethinking Russian Economic Reform draws on work by economists at the Russian-European Centre for Economic Policy (RECEP) and top international scholars. Chapters include Russia's Crisis and Beyond, Macroeconomic Policy and the Problem of Arrears, Tax Collection and Fiscal Federalism,

Banking and Financial-Industrial Groups, Industrial Restructuring, Labor Market Reform, and The Barter Economy.

Special offer: New subscribers to Russian Economic Trends—the leading publication of analysis and statistics on the Russian economy, published by RECEP—will receive a complimentary copy of Stuck in Transit. For subscription information, visit www.blackwellpublishers.co.uk/journals/ruet. Please mention Transition in your order.

To order *Stuck in Transit* within North America, contact the Brookings Institution, Dept 029, Washington DC 20042-0029, United States; tel.: 202-797-6258; fax.: 202-797-6004. Outside North America, contact CEPR, 0-98 Goswell Road, London EC1V 7RR, United Kingdom; Email: orders@cepr.org; tel.: 4420-7878-2900; fax.: 4420-7878 2999.

European Corporate Governance Network

The European Corporate Governance Network (ECGN) is a nonprofit research network that brings together scholars and practitioners residing in Europe and elsewhere who take an active interest in European and comparative corporate governance issues. SITE is the base for Sweden's ECGN country team.

Lack of data has been a major impediment to comparative corporate governance research in Europe and beyond. The ECGN brings together individuals and institutions familiar with the language and corporate culture of their own country to enhance mutual understanding of the functioning of corporate governance systems and institutions. The ECGN provides an umbrella for a variety of comparative research projects and a platform for exchange (through its Web site, conferences, general membership, and the ECGN list). The ECGN Web site is becoming a focal point for up-to-date information on corporate governance in Europe. Academics can find information on real world governance; policy practitioners can find information on what academics think and know about the subject.

Corporate governance is a key issue facing EU members and the associated countries of Central and Eastern Europe as they undergo the transition to market economies and the process of EU accession. The network is extending its data collection to the associated countries of the EU, as envisaged in the project Corporate Governance and Disclosure in the Accession Process. Enlargement of the ECGN database will permit wider international com-

parisons. Even more important, it will improve understanding of the emerging patterns of ownership and control in Central and Eastern Europe and their implications for corporate performance, economic growth, and these countries' eventual accession to the EU.

The ECGN has close links with the Centre for Economic Policy Research (CEPR) in London and cooperates with other institutions active in the field, including the World Bank, the International Corporate Governance Network (ICGN), and the Center for European Policy Studies (CEPS) in Brussels. Bureau van Dijk, an electronic publisher of company reports and statistical databases, is supporting the network's empirical projects by supplying data on companies.

The ECGN was started in 1996 by Fabrizio Barca, Erik Bergl f, Francesco Brioschi, and Colin Mayer. Financial and organizational support was provided by Stefano Micossi, Director General of the European Commission's Directorate for Industry (DGIII), and Domenico Siniscalco, Director of Fondazione Eni Enrico Mattei, Milano, a nonprofit foundation endowed by ENI, the Italian oil and gas company. The network is based in Brussels, at the Universit  Libre de Bruxelles, the Solvay Business School, and the European Centre for Advanced Studies in Economics and Statistics (ECARES).

For information on ECGN projects, activities, data, and registration information, visit its Web site at www.ecgn.ulb.ac.be.

Conference Diary

Second Annual Bank Conference on Development Economics in Europe — Development Thinking at the Millennium

June 26, 27, and 28, 2000

<http://www.worldbank.org/research/abcde/>

Opening addresses by Lionel Jospin, Prime Minister, France and James D. Wolfensohn, President, World Bank. Welcoming addresses will be given by Laurent Fabius, Minister of Economy, Finance and Industry, France; Pierre-Alain Muet, Chairman, Conseil d'Analyse  conomique; and Jean-Fran ois Rischard, World Bank. Keynote addresses by Amartya Sen, Nobel Economics Laureate; Lawrence H. Summers, Secretary of the Treasury,

United States; and Robert Mundell, Nobel Economics Laureate. Joseph E. Stiglitz will give the dinner speech, *Development Theory at the Crossroads*. There will be one roundtable discussion on *Openness and Development* (Dani Rodrik, Alan Winters). Eight papers will be presented on five topics. Topic one: *50 Years of Development Economics: What Have We Learned?* (Nicholas Stern, Irma Adelman). Topic two: *Growth, Poverty Reduction, and Inequality: Lessons Learned* (T.N. Srinivasan, Francois Bourguignon). Topic three: *Knowledge, Innovation, and Development* (Paul David, Philippe Aghion). Topic four: *Social Capital, Governance, and Institutions* (Jozef Ritzen, Jean

Philippe Platteau). Topic five: *Global Governance: In Search of a New Framework* (Jean-Fran ois Rischard, and others). There will be parallel workshop sessions the first two days of the conference. The wrap-up and concluding remarks will be given by Laurent Fabius, Minister of Economy, Finance and Industry; Jean-Fran ois Rischard, World Bank; and Pierre-Alain Muet, Chairman, Conseil d'Analyse  conomique. Participation is by invitation only. The conference is sponsored by the World Bank and Conseil d'Analyse  conomique, France. Information: Jean-Christophe Bas (e-mail: jbas@worldbank.org), External Affairs Counsellor, The World Bank, 66

avenue d'Iéna, 75116 Paris, France tel 33-1-40 69 30 35, fax 33-1-47 23 74 36 or Boris Pleskovic (email: bpleskovic@worldbank.org), Research Administrator, World Bank, 1818 H Street, N.W., Room MC4-385, Washington DC 20433, tel 1-202-473-1062, fax 1-202-522-0304.

Economics Research Competition: Focus on Policy

Request for Proposals Research Workshop
July 7–11, 2000

Economics Education and Research Consortium (EERC) is organizing Focus on Policy competition, to support medium-term economic policy-related research by teams of Russian scholars. Grants are awarded for two years, with possible extension to three years. Two grant awards of up to \$25,000 per project per year may be awarded at each round (competition rounds will be held annually). Members of a research team must be academic or professional economists, CIS nationals, living and working in Russia.

Applications must be received no later than May 15, 2000, at the EERC Moscow-based secretariat.

Information: Economic Education and Research Consortium, 18, Malaya Pirogovskaya, Suite 101, Moscow, 119 435, Russian Federation. Tel./fax: 7095-248-2728, 246-3439, or 232- 3349, fax: 1202-478-1968, email: eerc@eerc.ru, We site: <http://www.eerc.ru>.

Ten Years of the Special Period: Retrospective and Perspectives

August 3–5, 2000, Biltmore Hotel, Coral Gables, Florida, United States

Organizer: The Association for the Study of the Cuban Economy (ASCE).

Papers on the following topics are welcome: developments in Cuba during the last decade and future prospects; developments in a comparative framework, the former Soviet Bloc, China or Vietnam; macroeconomic and sectoral issues; developments in social sectors; international relations; civil society; legal issues; environmental mat-

ters; gender issues; governance; and infrastructure and civil-military relations.

Information: Jorge Pérez-López, Chair, Program Committee, 5881 6th Street, Falls Church, VA 22041, United States, tel.: 703-379-8812, email: perezlop@erols.

Marketing Strategies for Central and Eastern Europe

December 13–15, 2000, Arcotel Hotel, Wimberger, Vienna, Austria

Organizers: Kellstadt Center for Marketing Analysis and Planning, DePaul University, Chicago, and the Department of International Business, University of Economics and Business Administration, Vienna.

Topics: comparative analysis of conditions of market entry in Central and Eastern Europe; market entry through exports versus market entry via capital investment; acquisitions as opposed to joint ventures; marketing strategies to reach Central and Eastern European consumers; marketing-mix decisions for markets; financial strategies for opening markets; case studies of Western firms' experiences.

Abstracts of the papers, in English, should be received by September 15, 2000. The final papers must be ready by November 15, 2000. For more information or to send abstracts contact either of the conference sponsors.

Information: Prof. Dr. Reiner Springer, Wirtschaftsuniversität Wien, Althanstr. 51, 1090 Wien, Austria, tel.: 43-1-313 36/4371, fax: 43-1-313 36/751, email: Reiner.Springer@wu-wien.ac.at, or Prof. Dr. Petr Chadraba Kellstadt, Center for Marketing Analysis and Planning, De Paul University, 1 East Jackson Boulevard, Chicago, Illinois 60604, United States, tel.: 312-362-6200, fax: 312-362-5647, email: pcha_drab@wppost.de paul.edu.

Enterprise in Transition: Competitiveness, Restructuring, and Growth

May 24–26, 2001

Organizer: Faculty of Economics, University of Split.

Call for papers: The last decade has been marked by the process of transition in the former socialist countries—a process that has involved the complex task of socioeconomic restructuring, reestablishing the interrupted flow of history, and developing modern social, economic, and political structures. The most advanced among these countries have now passed the first stages of transition, but there is still a long way ahead. Many countries are still struggling with fundamental issues and problems, trying to find their way toward economic and social progress.

The experience of living with the transition to democracy and the market economy has motivated the Faculty of Economics at the University of Split to organize a global forum that brings together scholars and practitioners in search of solutions to the problems faced by enterprises in transition economies. In previous years the Enterprise in Transition conference has highlighted the need for scholarly consideration of many issues and problems facing enterprises in transition economies. More than 300 conference presentations by 500 authors from 40 different countries have been published, and many new links have been forged among scholars interested in these issues—indications of the important contribution this conference has made to advancement in the field. To further this advancement, we believe it is necessary to focus attention on some pressing transitional issues that will prove very important in the 21st century.

In addition to discussion of the transition from a socialist to a market economy, we encourage and invite authors to consider issues relating to the growth and development of enterprises and economies in transition, such as competitiveness, restructuring, and growth. The range of issues to be covered reflects the comprehensive approach to transitional problems that has been a key feature of the conference from its very beginning. This concept preserves the breadth of our approach to the problems of transition, but at the same time it directs researchers' efforts toward a seri-

ous and relevant discussion of issues and dilemmas related to the development of enterprises in transition economies. We especially encourage the case study method, which has the potential to provide deeper insights into the underlying processes of enterprises in transitional economies. Together with more theoretical papers, these studies could significantly enhance the quality of the conference and its proceedings.

Prospective authors are invited to submit an abstract of up to 250 words in English, including the author's name, affiliation, and contact details, by August 30, 2000. Notification of abstract acceptance will be sent by September 30, 2000, along with detailed instructions on submitting papers. Two hard copies of the paper, printed on a high-quality printer, and a computer file of the paper in Word for Windows format should

be received by December 31, 2000, in order to be included in the review process. Paper acceptance notification will be February 20, 2001.

For information: Faculty of Economics Split, Radovanova 13, HR 21000 Split, Croatia, tel.: 385 21 362 465, 385 21 366 033, fax: 385 21 366 026, e-mail: eitconf@efst.hr, Web site: <http://www.efst.hr/eitconf>.

Milestones of Transition

EBRD

Jean Lemierre to head EBRD. The EU put forward French Treasury Director Jean Lemierre to serve as EBRD president, a post left vacant when Horst Koehler was named Managing Director of the IMF. The EU controls a majority of votes in the selection process, making Lemierre's appointment a certainty at the Bank's annual meeting May 21–22. Earlier, Austria proposed a representative from Central Europe. The United States supported Leszek Balcerowicz, the architect of the reforms that transformed Poland into a market economy.

European Union

EU expansion not a serious threat to jobs, according to Employment Commissioner. The European Union's Employment Commissioner played down fears that cheap labor from post-Communist countries would flood the EU when it expands. Following Austria's call for immigration curbs on future EU members, Employment Commissioner Anna Diamantopoulou said that the impact of expansion on labor migration should be slight, although transition periods may be imposed [meaning temporary restrictions, the editor]. When Greece, Portugal, and Spain joined the EU "we had exactly the opposite, the movement of immigrants back to the new member states," she noted. The 15-member European Union is currently discussing accession

with 10 countries. Six of those countries—the Czech Republic, Cyprus, Estonia, Hungary, Poland, and Slovenia—are well along in the process and aim to join the Union by the middle of the decade. The EU is scheduled to open negotiations with the six countries May 25 on the sensitive issue of the free movement of labor.

Substantive membership negotiations started with five "second-wave" nations. Negotiations between the EU Commission and Bulgaria, Latvia, Lithuania, Romania, and the Slovak Republic began March 28. The EU divides accession negotiations into 31 subject areas, or "chapters." It has proposed initially discussing five chapters with the group of Eastern European countries: small business, education, science, external relations, and common security policy. The EU has also offered to negotiate cultural and audio-visual policy with Bulgaria. Latvia, Lithuania, and the Slovak Republic have been offered two more areas each, competition policy and statistics.

Eight of the 10 Eastern European countries negotiating for EU membership fell below EU poverty threshold in 1995–97, according to Eurostat data released April 18. Only the regions of Prague and Bratislava registered per capita GDP of more than 75 percent of the EU average. The lowest figure, in the Polish region of Swietokryskie, was 24 percent of the average EU per capita GDP.

The 10 poorest regions include 5 of Poland's 16 regions, 3 regions in Bulgaria, the northwestern region of Romania, and 1 region in Latvia.

Baltics

Baltic countries seek to reduce budget deficits by reining in public spending growth in the wake of last year's record budget deficits. Pension increases and public sector wages have been frozen. Lithuania has also reduced subsidies to agriculture and state-owned firms.

According to preliminary figures, budget deficits in Estonia and Latvia for the first quarter of this year fell below the upper limits set in the economic programs agreed on with the IMF. In contrast, state revenues in Lithuania were below budget, causing a larger than expected shortfall in the first quarter. Public sector deficit targets for this year are 1.3 percent of GDP in Estonia, 1.9 percent in Latvia, and 2.8 percent in Lithuania.

Central and Eastern Europe

Bulgaria

Nearly half of Bulgaria's state assets had been privatized by the end of March, according to Bulgaria's Privatization

Agency. Contracted revenues from privatization in the first quarter of 2000 amounted to 32.9 million leva (\$15.3 million), with 13.5 million leva (\$6.2 million) paid in cash. Of the 195 privatization deals concluded in the first quarter, 120 were handled through direct sales, 56 through auctions, 15 through tenders, and 4 through mass privatization.

Currency Board issue politicized. Martin Zaimov, the chief of Bulgaria's currency board, refuted press reports that the board mechanism will be drastically changed in the near future. The Bulgarian public supports current monetary policy and would not consent to any changes, he pointed out. Opposition leader Alexander Tomov claims that the currency board model is "destroying production and causing a drop in exports and a surge in unemployment." His party is proposing a new model that would involve a floating rather than fixed exchange rate. Tomov concedes that the currency board is not threatened at the moment, because the central bank holds sizable currency reserves. "Floating of the currency rate led to catastrophic consequences in the 1990s" government officials pointed out categorically rejecting Tomov's suggestion.

Croatia

Cautious tax incentives offered. The government will exempt reinvested profits and wages from the 35 percent corporation tax, Finance Minister Mato Crkvenac announced in early May. Other taxes, including the 22 percent value-added tax, will remain unchanged. The government has been criticized by corporate leaders for failing to encourage business, but Zagreb's room for maneuver is limited by the need to pay wage arrears and meet debt obligations

Czech Republic

Largest bank entangled in scandal. In the Czech Republic's biggest banking scandal since the fall of communism, po-

lice this week charged 11 top managers of the country's largest commercial bank with mismanagement of entrusted property and violation of their duties. An investigation in December confirmed that Komerční Banka made an unsecured loan of more than \$175 million (7 billion crowns to the Austrian commodities—trading company BCL. The Austrian company has since gone bankrupt. The BCL loan was the state-run bank's largest default, but it was by no means the only one. Since the early 1990s, when Komerční Banka became the government-designated motor of Czech privatization, the bank made scores of unsecured loans to various businesses. Many were never repaid. Recent audits have shown that even when loans were supposedly secured, the real estate, industrial plants, and other collateral the bank counted on was highly overvalued. The current Czech government now wants to privatize Komerční. So far, it has spent some \$1.5 billion of the taxpayers money to cover debts resulting from the bank's bad loans. (RFL/RL's Jeremy Bransten)

Inflation remains lower than expected.

Prices in April remained unchanged from April 1999, and inflation in 2000 is forecast to fall below the 3.5–5.5 percent target. The low projected inflation rate reflects lackluster growth and lack of domestic demand. The central bank, which seeks to counteract upward pressures on the koruna, may ease interest rates in the near future. IMF officials praised current policies but warned that monetary policy needs to be backed by more sustainable fiscal tightening in order to offset the impact of rising capital inflows.

Hungary

Preliminary first quarter current account deficit figures were better than expected, the National Bank of Hungary announced May 2. The deficit fell to 370 million euros (\$330 million) from 538 million euros during the same period last year. The deficit had been expected to reach 489 million euros.

Hungarian cabinet approves employment program. The government approved a National Employment Action Plan May 9, aimed at creating full employment. The plan proposes reducing social contributions paid by employers from 33 percent to 30 percent in 2001 and to 27 percent in 2002. The plan also includes infrastructure projects, investment incentives, and job creation subsidies and gives priority to employment opportunities for Roma, the long-term unemployed, and the disabled.

Slovak Republic

Government approves draft law on incentives for foreign investors.

The law, approved May 10, is aimed at boosting direct foreign investment and helping underdeveloped regions. A 10 percent tax break will be granted to those who invest at least 100 million crowns (\$2.12 million). Those investing 50 million crowns in regions in which unemployment exceeds 10 percent will also be eligible for the concession. Investors will be paid 40,000–160,000 crowns for every new job created in the country. The Parliament must still approve the bill, which will require some changes in existing legislation.

Slovenia

Slovenia will accelerate EU membership preparations.

According to Prime Minister Andrej Bajuk, the government will reduce state intervention, abolish monopolies, and encourage foreign direct investment, which has lagged other leading EU candidates.

Poland

First quarter GDP grows 6.2–6.3 percent over same period last year.

Based on industrial production figures, growth was unchanged from the last quarter of 1999, Polish Deputy Finance Minister Jarosław Bauc estimated. Unemployment stood at 13.9 percent in March, the highest level in years and it is likely to reach

15 percent by the end of the year, according to Polish Labor Minister Longin Komolowski. Inflation rose to an annualized rate of 10.4 percent in February, up from 8.6 percent in 1998 and 9.8 percent last December.

New efforts made to reform tax system.

The center-right ruling coalition plans to make another attempt to simplify the tax system in the coming weeks. Last year President Aleksander Kwasniewski, former head of the biggest opposition party, vetoed some of the government's tax proposals.

The first part of the tax reform program of Finance Minister Balcerowicz, approved in 1999, cut the Polish corporate tax from 34 percent to 30 percent in 2000. The rate will gradually be lowered to 22 percent in 2004. This year's proposals envisage lowering personal income tax rates to 19, 28, and 36 percent in 2001, depending on income. The current rates are 19, 30, and 40 percent. Tax rates would fall to 19, 28, and 35 percent in 2002 and to 18 and 28 percent in 2003. The bill would also scrap tax relief for real estate investors and private medical care users and introduce a 5 percent tax on capital gains for individual investors, beginning in 2003.

CIS

Russian Federation

Russian economic program almost ready. The Russian government's economic program will be ready by the end of May, according to Acting Prime Minister Mikhail Kasyanov. The Russian cabinet will discuss the document, make adjustments, and implement the program in June.

Kasyanov's appointment as prime minister was seen as confirmation that the government would continue economic liberalization. Kasyanov, who served as finance minister and a deputy premier, has called for greater freedom for business and the overhaul of the tangled tax system. Kasyanov's appointment must still be approved by Parliament, but he is not expected to face major opposition.

Exports rise. The Economics Ministry announced that Russian exports jumped 41 percent in the first quarter of this year. Exports were \$17.8 billion, up from \$12.6 billion in the first quarter of last year. The increase was due partly to rising prices for oil, the country's largest export commodity.

Russia must create a privately funded pension system covering all citizens, according to Andrei Illarionov, economic adviser to President Vladimir Putin. Pensioners make up about 27 percent of Russia's population. The state spends about 8 percent of GDP on pensions, which fall short of covering basic needs and are often paid late.

Rich and Poor. The percentage of the population earning more than 2,000 rubles (about \$70) a month rose from 13.2 percent in the first quarter of 1999 to 27.4 percent in the first quarter of this year, while the percentage of those earning less than 400 rubles (about \$14) dropped from 6.9 percent to 4.0 percent, according to a preliminary report released by the State Statistics Committee. Per capita income in March was 1,876 rubles (about \$66), up 8.6 percent from February 2000 and 39.8 percent from March 1999. The top 10 percent of the population earned 33.7 percent of the country's cash income in the first quarter, while the bottom 10 percent received just 2.4 percent.

Russians fear rising unemployment most, according to a recent survey by the Russian National Public Opinion Research Center (VCIOM). The survey polled 1,580 people over the age of 18. The percentage of people who fear increases in unemployment rose from 30 percent in 1996 to 35 percent in 2000. Other problems that worry Russians include price rises and impoverishment of the population (30 percent in 1996, 33 percent in 2000); disintegration of the economy and the country's bankruptcy (30 percent in 1996, 32 percent in 2000); and the increase in crime (26 percent in 1996, 29 percent in 2000). The number of people who consider the plundering of national wealth by foreign states

and companies to be a national threat rose from 16 percent in 1996 to 28 percent this year. Nineteen percent of those polled fear Russia's growing dependence on the West and its turning into a third world country—up from just 11 percent in 1996.

Only a minority of Russians trust democracy. Just 9.1 percent of the 1,500 Russians polled in April by the Russian Public Opinion and Market Independent Research Center (ROMIR) believe that democracy is the best form of rule despite certain problems it poses. This view is shared to some degree by 38.7 percent of those polled. As many as 23.7 percent disagree to some extent with this opinion, 4.2 percent reject it outright, and 24.3 percent are undecided. The poll covered 94 urban and rural areas in Russia's 40 regions.

Turkmenistan

EBRD would ban all loans to Turkmenistan's public sector, although it will continue lending to the private sector where viable. The move follows President Saparmyrat Niyazov's refusal to discuss political reform with an EBRD delegation. Although grounded in the Bank's mandate, the formal ban is unprecedented in the post-Soviet period; even Belarus remains nominally eligible for EBRD loans. Niyazov was made President for life in December, and the EBRD sees little prospect of political or economic liberalization.

China

China's dynamic private sector contributes almost as much to GDP as state enterprises. Private businesses generated 33 percent of China's GDP in 1998, while the state sector contributed 37 percent, according to a new report by the International Finance Corporation (IFC), the private sector arm of the World Bank. The balance came from agricultural companies and businesses.

We appreciate the contributions from Radio Free Europe/Radio Liberty.

World Bank/IMF Agenda

Continued from page 32

- Improve health by reducing exposure to environmental factors, such as urban air pollution, waterborne diseases, and toxic substances.
- Enhance the livelihoods of poor people who depend on land, water, forests, and biodiversity by helping to manage natural resources sustainably.
- Reduce people's vulnerability to natural disasters, severe weather fluctuations, and the impacts of climate change.

For more information, visit the Web site: <http://www.worldbank.org/environment>.

Free Education for Every Child: A New Education Initiative

At the end of April the World Bank announced a fast track plan to jumpstart governments into providing all children with free basic education by 2015. World Bank President James D. Wolfensohn told an international conference on education that if a country has a viable and sustainable plan, it should be able to achieve the "education for all" target even if it lacks resources. Donors must be ready to respond quickly and help countries that are ready to move to meet these goals, Wolfensohn said at the World Education Forum, held in Dakar, Senegal.

The Bank has doubled its lending for education from \$920 million to \$1.9 billion. Only 3 percent of the \$120–\$130 billion spent worldwide on education comes from overseas development assistance. Half of that aid comes from the World Bank. Almost 75 percent of education funding comes from governments, with most of the remainder contributed by the private sector and communities.

World Bank Designs New Forest Strategy

Forestry experts, environmental activists, industry representatives, and government

policymakers from across Central Asia, Eastern Europe, and the Russian Federation met in Finland in early April to examine the World Bank's forest policy and develop ideas for its future strategy in the region. The strategy is important because 28 percent of the world's forests are located in the region.

Far-reaching economic and political reforms in the region have profoundly changed the incentives for maintaining the region's forest cover and biodiversity. A recent report by the Bank's Operations Evaluation Department found that the Bank's forest strategy, formulated in 1991, has a mixed record and needs to be adapted to the changing dynamics of the forest sector and the aspirations of developing countries.

Funding Target Exceeded for "Quick-Start" Package

As a result of the regional funding conference for Southeast Europe held in late March, 47 countries and 36 international organizations surpassed their goal of fully financing the comprehensive "Quick-Start" package for Southeast Europe. The package will finance regional projects and initiatives in Southeast Europe over the next 12 months. More than 2.4 billion euros was pledged or committed for promoting private sector development, supporting policy and institutional reforms, and encouraging democratization, reconciliation, and security. Conference participants pledged support for specific regional projects, including the Albania Water Project, the Montenegro Transport Rehabilitation Project, the Bosnia and Herzegovina Power Interconnection Project, the Blace Border Crossing (Kosovo/FYR Macedonia), the Bosnia and Herzegovina Demobilization Project, and the Feasibility Study for the Development of a Regional TV Network.

World Bank Pledges Assistance for Bosnia-Herzegovina and Kosovo

The World Bank plans to allocate up to \$300 million for war-torn Bosnia and Herzegovina through mid-2002. More than half of the funds will be used for the reform of public finances and social services and for development of the private sector.

The Bank and the United Nations Interim Administration in Kosovo (UNMIK) signed a \$5 million Economic Assistance Grant for Kosovo March 20. The grant will be used to pay salaries, help the Central Fiscal Agency set up a budget management system, and help the Banking and Payments Authority improve its bank licensing and supervision capability. Through the creation of a Special Trust Fund for Kosovo, financed from World Bank net income, the Bank intends to support an agriculture restart operation—a credit line to help dynamic small and medium-size private enterprises—and support activities in the energy, water and waste, and social sectors. Total Bank assistance to Kosovo is expected to amount to \$50–\$60 million over the next 18 months.

For more information, visit the World Bank-European Commission Web site, <http://www.seerecon.org>.

IMF Sees World Bank Playing Greater Role in the Russian Federation

The IMF is likely to take a back seat to the World Bank in future dealings with the Russian Federation, according to IMF Deputy Managing Director Stanley Fischer. Much of what needs to be done is World Bank-related, he notes, adding that the European Bank for Reconstruction and Development (EBRD) could also play a more prominent role.

IMF payments to Moscow under a \$4.5 billion facility were halted after only one installment last year, and those funds had

been earmarked solely for repayment of Russian debts to the IMF. Few expect the Fund to go beyond such arrangements until it is confident its funds will not leave the country. As the Fund suggests, the Russian government needs to restore the rule of law, particularly in the bankruptcy field, and make corporate management more accountable to their shareholders.

World Bank Helps Develop Mongolia's Financial Sector . . .

A \$32 million International Development Association (IDA) credit, approved April 20, will help Mongolia reform and develop its financial sector. The Mongolia Financial Sector Adjustment Credit will help establish basic financial infrastructure (banking skills, accounting standards, enforcement of financial contracts); consolidate the country's banking system; develop effective regulation and supervision; and improve the payment system in rural areas.

. . . China Construct Key Interprovincial Highway . . .

A \$200 million loan to China for construction of a 238-kilometer interprovincial highway was approved March 28. The new road—which will connect Nanning, the provincial capital of Guangxi, to Shui ren, in the north—will be a key section of China's national trunk highway system. Guangxi province has three coastal sea ports in its southern tip, providing the shortest route to the sea for landlocked provinces, including Guizho, Yunnan, Sichuan, and Chongqing. In addition to the Bank loan, the \$566.8 million project will be financed with \$106.7 million from the central government and \$256.7 from the Guangxi provincial government.

. . . Albania Build Institutions. . .

Two credits to Albania—a \$9 million loan for a legal and judicial reform project and an \$8.5 million loan for a public administration reform project—were approved March 21. Both credits will be disbursed on stan-

dard IDA terms and will be repayable in 40 years, with a 10-year grace period. Albania joined the World Bank in 1991. Since 1992 the Bank has committed \$522.9 million to the country for 38 projects.

. . . Latvia Continue Reforms. . .

A \$40.41 million Programmatic Structural Adjustment Loan (PSAL) to support Latvia's reform program was approved in mid-March. The loan will help correct macroeconomic imbalances, strengthen the credibility of the public sector, improve institutional capacity to deliver services, and rationalize a transparent relationship with the private sector. The loan will be a fixed-spread loan denominated in U.S. dollars, with a maturity of 17 years and a 5-year grace period. Since Latvia joined the World Bank in 1992, Bank commitments to the country have totaled \$355 million for 17 operations.

. . . and Estonia Improve Traffic Flow

A \$25 million loan for a transport project in Estonia was approved in mid-March. The loan will help reduce traffic along the Tallinn-Tartu-Luhamaa road and address road safety problems by providing assistance for seminars, training programs, education, public campaigns, and technical assistance for the development of systems and technology. The loan has a maturity of 15 years, with a 5-year grace period, at the standard interest rate for fixed-spread loans. Since Estonia joined the Bank in 1992, commitments to the country have totaled \$138 million for eight projects.

Romania, IMF Agree on Preliminary Standby Loan

The Romanian government has committed itself to stringent austerity measures and strict monitoring of spending in a preliminary agreement with the IMF for extension of a \$540 million standby loan. The loan will support economic stabilization and reform. "The Board is expected to consider the Romanian program by the end of May, provided that some remaining policy actions

are taken," IMF Mission Chief Emmanuel Zervoudakis said. The Romanian Parliament approved a strict new budget for 2000 that envisages a consolidated budget deficit of 3 per cent of GDP.

So far Romania has received just \$73 million from the IMF. It expects to receive about \$300 million from the World Bank and some 200 million euros (\$182 million) from the EU this year.

Loans for North Korea?

North Korea could receive aid from the Fund once it becomes an IMF member, according to David T. Coe, Senior Resident Representative of the IMF in South Korea. If such loans were made, the IMF—together with other international organizations, such as the World Bank—would offer to train officials there, he noted. Last month Kim Dae-jung, President of South Korea, said he hoped North Korea would be able to receive financial assistance from international organizations, including the World Bank.

NGOs Form Regional Working Group

Representatives of 67 NGOs met in Vilnius, Lithuania, in early May, for the first assembly of the Europe and Central Asia Region NGO Working Group of the World Bank. NGO delegates elected nine of their peers to represent them for two-year terms. The group will "seek to catalyze NGO efforts to influence and monitor World Bank operations in the Europe and Central Asia region and facilitate communication between interested parties," according to the mission statement adopted by the assembly. Discussion centered on Bank-NGO relations; the Bank's operational role in the region; environmental and social impacts of Bank operations, particularly structural adjustment operations; the Bank's policy for disclosure of information; and the role of NGOs in the development of country assistance and poverty reduction strategies.

New Books and Working Papers

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

Continued from page 30

Farm structures in Central and Eastern Europe today include small subsistence-oriented household plots, medium-size commercial family farms, and large corporations. Contrary to the earlier expectations of Western experts, the agricultural sector in the region has not embraced the family farm as the dominant farming structure. This volume contains papers presented at a workshop held in Warsaw, Poland, in June 1999. It is organized around three topics: evolving farm structures and competitiveness in agriculture, land laws and legal institutions for development of land markets and farm restructuring, and development of farm services for improved competitiveness.

Ayse Kudat, Stan Peabody, and Caglar Keyder, (eds.), **Social Assessment and Agricultural Reform in Central Asia and Turkey** TP 461, March 2000, 328 pp.

John A. Gray, **Kazakhstan: A Review of Farm Restructuring**, TP 458, March 2000, 71 pp.

Agriculture in Kazakhstan is in crisis: the majority of farms are insolvent, and production has fallen to the lowest level in 30 years. Initial restructuring efforts yielded disappointing results and mostly failed to lead to new patterns of ownership or management. Since 1998 the government has pursued a more aggressive approach to farm restructuring based on increased reliance on farm bankruptcy. This report reviews the experience of the farm restructuring policies and programs pursued in 1998 and 1999.

Bartlomiej Kaminski and Michelle Riboud, **Foreign Investment and Restructuring: The Evidence from Hungary**, TP 453, 2000, 48 pp.

Although the official rhetoric in most transition economies has supported foreign direct investment (FDI), few countries have succeeded in attracting sizable inflows. Hungary stands out among those countries that have done so effectively. Several factors helped Hungary get ahead of other transition economies in attracting FDI. This volume analyzes Hungary's achievement, identifying the scope and depth of FDI and assessing the effect of FDI on Hungary's economy and foreign trade.

Discussion Papers

John R. Hansen and Diana Cook, **Economic Growth with Equity: Which Strategy for Ukraine?** DP 408, 2000, 67 pp.

What strategy should Ukraine follow? This report identifies and evaluates alternative strategies in terms of their probable impact on fiscal balances, inflation, the current account deficit, economic growth, employment, and equity.

Country Studies

Ukraine: Restoring Growth with Equity: A Participatory Country Economic Memorandum, World Bank Country Studies, 2000, 233 pp.

Since independence Ukraine has suffered one of the most severe economic declines of any country in this century. While other transition economies in the region successfully replaced their old command economies with market economies, Ukraine continued to protect unprofitable enterprises to preserve employment and income levels. To support this strategy, the government has borrowed more money than it takes in, competing with private enterprise domestically for credit. In this

report a team of experts from the government, the World Bank, and the International Center for Policy Studies (ICPS) in Kyiv examine the issues surrounding the crisis and formulate recommendations for strategies.

Working Papers

Mitchell A. Orenstein, **How Politics and Institutions Affect Pension Reform in Three Postcommunist Countries**, WPS 2310, March 2000, 75 pp.

Hungary, Kazakhstan, and Poland implemented mandatory funded pension systems as part of reform. The extent and configuration of changes differed greatly in the three countries. Countries with more "veto actors"—social and institutional actors with an effective veto over reform—engaged in less radical reform, as theory predicts. Poland and Hungary generated less radical change than Kazakhstan, partly because they have more representative political systems, to which more associations, interest groups, and "proposal actors" (who shape the reform agenda and influence the positions of key veto actors) have access.

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Michael Lokshin, Kathleen Mullan Harris, and Barry Popkin, **Single Mothers in Russia: Household Strategies for Coping with Poverty**, WPS 2300, March 2000, 27 pp.

In the Soviet Union single mothers and their children received government income support, subsidized child care, and full employment guarantees. Economic reform in

the Russian Federation has reduced government transfers, eliminated publicly subsidized preschool care programs, and limited job opportunities for women. Single-parent families now represent nearly a quarter of all Russian households. Half of all single mothers in Russia live with their parents, their adult siblings, or other adult relatives. The other half live in independent residences and face increased risk of poverty.

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Cevdet Denizer, Holger C. Wolf, and Yvonne Ying, **Household Savings in Transition Economies**, WPS 2299, March 2000, 14 pp.

To order: Ala Cubukcu, Room H4-347, tel.: 202-473-8449, fax: 202-522-2754, e-mail acubukcu@worldbank.org. Cevdet Denizer may be contacted at cdenizer@worldbank.org.

Nina Budina and Sweder van Wijnbergen, **Fiscal Deficits, Monetary Reform, and Inflation Stabilization in Romania**, WPS 2298, March 2000, 33 pp.

Unsustainable fiscal deficits have been the chief reason for the inflation that has persisted in Eastern Europe since 1989. Deficits need to be cut back, but by how much for a given inflation target? The authors develop a simple framework for debt, the deficit, and inflation to study the interactions between fiscal and monetary policy in Romania, which has a history of unsuccessful stabilization attempts. This framework can be used to determine the required deficit reduction for a given rate of output growth, inflation rate, and target for debt-output ratios and to find the inflation rate for which no fiscal adjustment is needed.

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bank.org. The authors may be contacted at Nina Budina/Washington/Imf@Imf or svw.heas@wxs.nl.

Dominique van de Walle and Dileni Gunewardena, **Sources of Ethnic Inequality in Vietnam**, WPS 2297, March 2000, 31 pp.

Vietnam's ethnic minorities, who live mostly in remote rural areas, typically have lower living standards than the ethnic majority. What are the most important factors affecting this trend—economic characteristics, such as education or quality of land, or the low returns to these characteristics? Is there a self-reinforcing culture of poverty in minority groups, reflecting patterns of past discrimination? Minorities live in less productive areas, with poor infrastructure; they have less access to off-farm work and the market economy; and they have less access to education.

But the authors find differences in returns to productive characteristics to be the most important explanation for ethnic inequality. Policies must be designed to reach minority households in poor areas and to explicitly recognize behavior patterns (including compensating behavior) that have served minorities well in the short term but intensify ethnic inequalities in the longer term. It will be important to open up options for minority groups by ensuring that they are not disadvantaged (in labor markets, for example) and by changing the conditions that have caused their isolation and social exclusion.

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Oleh Havrylyshyn and Ron van Rooden, **Institutions Matter in Transition, But So Do Policies**, WP/00/70, March 2000.

Christoph B. Rosenbert and Maarten de Zeeuw, **Welfare Effects of Uzbekistan's Foreign Exchange Regime**, WP/00/61, March 2000.

Mark De Broeck and Vincent R. Koen, **The Great Contractions in Russia, the Baltics, and the Other Countries of the Former Soviet Union: A View from the Supply Side**, WP/00/32, March 2000.

Stanley Fischer and Ratna Sahay, **The Transition Economies after Ten Years**, WP/00/wo, February 2000.

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To order: CSPP, University of Strathclyde, Livingstone Tower, 26 Richmond Street, Glasgow G1 1XH, Scotland, tel.: 44-141-548-3217, fax: 44-141-552-4711.

Marc Morjé Howard, **Free Not to Participate: The Weakness of Civil Society in Post-Communist Europe**, SPP 325, 2000.

This study seeks to explain why civil society is extremely weak in postcommunist Europe. Analysis of the 1997 World Values Survey shows that organizational membership is much lower in postcommunist countries than in either the older democracies of the West or the postauthoritarian countries of Southern Europe, Latin America, Asia, and Africa. The analysis demonstrates that, controlling for other country-level factors (economic, political, and "societal"), a country's prior communist experience has a strong negative effect on contemporary organizational membership, including mistrust of organizations and disappointment with the new democratic and capitalist systems.

Richard Rose, **Modern, Pre-Modern and Anti-Modern Social Capital in Russia**, SPP 324, 1999.

In Soviet times social capital networks were widespread, but they were inconsistent with a modern society. A specially designed 1998 New Russia Barometer survey shows that some social capital networks do still help Russians obtain food and provide income security, but conventional human capital measures, such as education and socioeconomic status, are also significant. Russians should use social capital networks consistent with a modern society to cope with problems of transition to a modern society.

Greenwood Publishing Group, Inc. Publications

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Donald M. Hancock and John Logue, **Transition to Capitalism and Democracy in Russia and Central Europe: Achievements, Problems, Prospects**, Praeger Publishers, April 2000, 352 pp. Internet: <http://info.greenwood.com/cgi-bin/eupdget.pl?S=RV&I=0275962148>.

Demetrius S. Iatridis, **Social Justice and the Welfare State in Central and Eastern Europe: The Impact of Privatization**, Praeger Publishers, April 2000, 272 pp. Internet: <http://info.greenwood.com/cgi-bin/eupdget.pl?S=RV&I=0275967913>.

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Bulgaria's Capital Markets in the Context of EU Accession: A Status Report, November 1999, 42 pp.

Bulgaria's Participation in EU Structural Funds, May 1999, 79 pp.

Preparing for Bulgaria's EU Accession Negotiations, September 1999, 42 pp.

The Role of Political Parties in Accession to the EU, October 1999, 40 pp.

Social Policy Aspects of Bulgaria's EU Accession, June 1999, 44 pp.

Interstate Statistical Committee of the CIS Publications

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Economy of the CIS States in 1999, (in Russian), January 2000, 96 pp. **CD-ROM, 1999-4** (in Russian and English).

This updated version of a previously released CD-ROM of statistics for the CIS states includes data through 1998 for most data series. More than 3,500 indicators are indicated, starting with 1980. The data can be exported to a variety of formats, including Excel.

Russian Statistical Yearbook 1999: Statistical Handbook, 1999 (in Russian; table of contents in English), 621 pp.

Economics Education and Research Consortium (EERC) Publications

Free subscription to EERC Working Paper Series. To order: Uliana Sharina, 3 Kochnovsky Proezd, Suite 418, 125319, Moscow, Russian Federation, tel./fax: 7095-152-0601/0121, email: www.eerc.ru.

Yuri Perevalov, Ilya Gimadi, and Vladimir Dobrodey, **The Impact of Privatization on the Performance of Medium and Large Industrial Enterprises**, 2K/01E, 2000, 84 pp.

This study, based on panel data from 198 industrial enterprises in the Sverdlovsk

Oblast during 1992–96, shows that on average privatization produces performance improvements only in operating profit margins and, to some extent, the productivity of labor. Results suggest that both full privatization and majority state ownership is preferable to a state minority stakeholding. If the state has minority stakes, there is no effective monitoring of managers' activity, and the enterprise's performance deteriorates.

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Miroslav Gronicki and Katarzyna Pietka, **Macroeconomic Model for Ukraine**, 190, 1999, 51 pp.

Wojciech Maliszewski, **VAR-ing Monetary Policy in Poland**, 188, 1999, 23 pp.

Barbara Liberda, **Household Saving in Poland**, 187, 1999, 43 pp.

Malgorzata Jakubiak and others, **Public and Foreign Savings**, 186, 1999, 77 pp.

Stanislav Gomulka, **Comparative Notes on Pension Developments and Reforms in the Czech Republic, Hungary, Poland, and Romania**, 182, 1999.

Pavel Stepanek and Ondrej Schneider, **Present and Future Fiscal Policy Problems in the Czech Republic**, 180, 1999, 30 pp.

Katarzyna Zawalinska, **Agriculture of the Czech Republic, Hungary, and Poland in Perspective of Joining Common Agricultural Policy—with Some Fiscal Remarks**, 178, 84 pp.

Preaccession agricultural policies in the Czech Republic, Hungary, and Poland

should focus on investing in rural development and reducing employment, creating new jobs opportunities (especially in Poland), restructuring the collective farms, speeding up the privatization of state farms (especially in Hungary and the Czech Republic), and changing patterns of settlement inherited from the socialist period. Further investment targets include building up technical and social infrastructure, providing better access to education, creating well-functioning land markets, improving access to financial markets, and developing agroindustry. Accession countries can count on preaccession agricultural aid from the EU.

Mirosław Gronicki and others, **Polish Economic Outlook: Trends, Analyses, Forecasts**, 2/2000, May 2000.

GDP growth can reach 5.4 percent in 2000 in Poland, but given the anticipated net increase in the labor market (of about 160,000) and the continued process of restructuring of some branches of industry, the unemployment rate may reach 13.4 percent by the end of 2000, higher than it was at the end of 1999. Reducing the current account deficit should be a top priority for Polish economic policy, since any further rise in the deficit could cause a currency crisis and a substantial drop in foreign direct investment in the case of a portfolio capital outflow. Monetary policy is excessively restrictive given continued portfolio capital inflows and tightening of budgetary policy. By maintaining high interest rates (much higher than those in EU countries) and eliminating a crawling peg, further inflows of portfolio capital may be spurred, leading to the strengthening of the zloty.

Centre for Economic Policy Research (CEPR) Discussion Papers

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Daniel Kaufmann and Dalia Marin, **Barter in Transition Economies: Competing Explanations Confront Ukrainian Data**, 2432, April 2000.

Jennifer Hunt, **Why Do People Still Live in East Germany?** 2431, April 2000, 53 pp.

Kaspar Richter, **Government Cash Transfers, Household Consumption, and Poverty Alleviation: The Case of Russia**, 2422, April 2000.

At least 30 percent of the rise in poverty in Russia between 1994 and 1998 was due to the changes in cash transfer policy. Had benefits been maintained at the 1994 level, poverty would have been about 20 percent lower in 1998.

Gianmarco Ottaviano and Stefano Manzocchi, **Outsiders in Economic Integration: The Case of a Transition Economy**, 2385, February 2000.

Jürgen von Hagen and Rolf Strauch, **East Germany: Transition With Unification—Experiments and Experiences**, 2386, February 2000.

The Kohl government's policy toward East German transition focused almost entirely on financing a high standard of consumption, with too little emphasis on fostering investment and economic restructuring. There is considerable risk that East Germany will remain a transfer-dependent economy for the foreseeable future.

Other Publications

Grzegorz W. Kolodko, **From Shock to Therapy: The Political Economy of Postsocialist Transformation**, Oxford University Press, April 2000.

From the acknowledgment by former Director of UNU/WIDER Giovanni Andrea Cornia:

The transition to the market economy of the former socialist countries of Europe

and Asia is certainly the most momentous event of the last two decades of this millennium. Its onset has been unpredictable, and most of its outcomes contrast sharply with the initial expectations. While generating an extensive—and still rapidly growing—literature on it, many aspects of the transition process—such as the huge cross-country differences in economic and social performance—remain broadly unexplained. Until recently, debates over transition have been more focused on rapid macroeconomic stabilization, liberalization, and privatization and less on the role of initial institutional conditions, the political economy of transition, and the role of external advice in this process.

In this highly original single-authored study on the economics of postsocialism, Grzegorz W. Kolodko attempts to fill this gap. He recognizes the need for sound economic fundamentals but, at the same time, emphasizes the long-term multifaceted nature of the transition process, the influence of historical factors on the outcomes of the reform process, and the crucial need for developing gradually but steadily those institutional arrangements that are the best guarantees of successful transition.

While all readers may not agree with his interpretation of the transition or his policy approach, they will no doubt benefit from this well-researched and provocative analysis that challenges many of the simplicities of the "Washington consensus." Kolodko places his analysis of the transition in a broader social and political-economic context and strongly emphasizes the need for a gradual build up of institutions. This book has been written by a scholar who played a key role in the formulation of the successful policies adopted in Poland over 1994–97.

Rose Brady, **Kapitalizm: Russia's Struggle to Free Its Economy**, Paperback, Yale University Press, April 2000, 336 pp.

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