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Hong Kong Will Remain a Free Market after 1997
by Andrew Sheng

In 1997 the world will witness a major historic event in Asia. On July 1, 1997, Hong Kong, with 6 million people the world's eighth largest trading economy and fourth largest international financial center, will return to China, the world's most populous nation and one of its most dynamic economies.

But under the agreed principle of "one country, two systems," or "one country, two currencies, two monetary policies, and two credit ratings," Hong Kong will enjoy a high degree of autonomy, except in such areas as foreign affairs and defense. Hong Kong will formulate and implement its own monetary and exchange rate policy, and will safeguard and regulate financial transactions undertaken on the Hong Kong market. Under the Basic Law (see box), Hong Kong's capitalist system will exist for fifty more years, and the extremely successful monetary system—a currency board where the currency is pegged to the U.S. dollar—will continue. Backing the currency, Hong Kong will manage the world's seventh-largest foreign exchange reserves, totaling US$66 billion. These reserves are five times larger than Hong Kong's monetary base. And Hong Kong has no external debt. (To compare: Taiwan's [China] reserves are about the same and China's reserves are about US$100 billion.) Hong Kong will use its financial resources for its own benefit. The central government will not tax Hong Kong.

For the very reasons that people are skeptical about monetary integration in Europe, there will be monetary segregation between mainland China and Hong Kong. The Heritage Foundation in the United States found Hong Kong the freest economy in the world. Hong Kong will record a budget surplus of HK$15 billion (US$1.95 billion) for the fiscal year ending March 31, and HK$31.7 billion in the next fiscal year. China still has a budget deficit to cut. Interest rates in Hong Kong are totally market-driven; China is going through a transitional phase in which some interest rates are still set administratively. [See Transition, November-December 1996, p. 22] (China has brought inflation down into the single digits, but it is still higher than in Hong Kong.) The Hong Kong dollar is fully convertible with no exchange controls whatsoever; China's currency is convertible on the current account but not yet on the capital account. So China is going through a major transition. Monetary segregation makes sense.

Seven principles have been agreed between Hong Kong and China on monetary relations:

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1. The Hong Kong dollar will be the only legal tender in Hong Kong, and the renminbi remains the only legal tender in China.

2. The two monetary authorities are mutually independent and are not subsidiary to one another. They may consult one another and closely cooperate. The People’s Bank of China will not set up an office in Hong Kong after 1997 and will not replace the Hong Kong Monetary Authority. The two independent monetary systems will have their own credit ratings.

3. The mainland China offices of the Hong Kong-based financial institutions will continue to be treated as any other (U.S., Japanese, and so on) financial institutions. Similarly, the mainland’s financial institutions in Hong Kong will not receive any special privileges. They will be subject to all the rules and regulations in Hong Kong.

4. At the request of the Hong Kong Monetary Authority, the People’s Bank of China will support the Hong Kong dollar, if necessary with its own reserves, but in no circumstances will draw on the Hong Kong exchange fund or any other financial resource.

5. Financial transactions between China and Hong Kong will be treated as if they are external business—and practically as international business. Trade and liabilities between the two will be regarded as external trade and liabilities.

6. Some raise the question: After unification will Shanghai replace Hong Kong as a major international banking center? The Hong Kong Monetary Authority, as recently agreed, will participate in the New Arrangements to Borrow within the IMF.

Hong Kong in 1997—The Basic Law

China’s policies of maintaining Hong Kong’s status as an international financial center and preserving its autonomy in monetary and financial affairs after 1997 are clearly enshrined in the Joint Declaration of 1984 and the Basic Law of 1990. The Basic Law has the following provisions:

“109. The Government of the Hong Kong Special Administrative Region [HK S.A.R.] shall provide an appropriate economic and legal environment for the maintenance of the status of Hong Kong as an international financial center.

“110. ... The Government of the HK S.A.R. shall, on its own, formulate monetary and financial policies, safeguard the free operation of financial business and financial markets, and regulate and supervise them in accordance with law.

“111. The Hong Kong dollar, as the legal tender in the HK S.A.R., shall continue to circulate. The authority to issue Hong Kong currency shall be vested in the Government of the HK S.A.R. The issue of Hong Kong currency must be backed by a 100 percent reserve fund.... The Government of the HK S.A.R. may authorize designated banks to issue or continue to issue Hong Kong currency under statutory authority, after satisfying itself that any issue of currency will be soundly based and the arrangements for such issue are consistent with the object of maintaining the stability of the currency.

“112. No foreign exchange control policies shall be applied in the HK S.A.R. The Hong Kong dollar shall be freely convertible. Markets for foreign exchange, gold, securities, futures, and the like shall continue. The Government of the HK S.A.R. shall safeguard the free flow of capital within, into and out of the Region.

“113. The Exchange Fund of the HK S.A.R. shall be managed and controlled by the Government of the Region, primarily for regulating the exchange value of the Hong Kong dollar.”

Hong Kong’s success as a prominent international and regional financial services center is no miracle. Hong Kong is highly competitive. This is confirmed by the World Economic Forum’s 1996 Global Competitiveness Report, which ranks Hong Kong as the second most competitive economy in the world, just after Singapore. Hong Kong has long been a leading financial services center in Asia and globally. It enjoys optimum conditions for success:

- Hong Kong benefits from its strategic geographical location—it is at the center of the fastest-growing region in the world and it is the gateway to China. Located within the Asian time zone, Hong Kong complements New York and London to form a global network in providing financial services.

- Hong Kong has a clear, fair, and predictable legal system. The government has provided the rule of law to protect the interests of depositors, investors,
shareholders, insurance policy holders, and members of occupational retirement schemes. It also makes every effort to ensure that all market participants compete on equal terms.

- The tax system is renowned for its simplicity and low rates. Companies are free to enter and to do business in Hong Kong as long as they meet some minor requirements and observe Hong Kong laws. And ancillary institutions, such as accounting and legal firms and information suppliers, provide world-class support services.

- Hong Kong enjoys an excellent physical and financial infrastructure. In 1998 it will complete one of the most modern airports in the world. It has one of the most advanced and competitive telecommunication systems. It is currently advocating the buildup of AsiaClear, a regional network of bond clearing and settlement systems in Asia.

- The workforce is highly educated, flexible, and proficient in English. There are few barriers to the entry of foreign specialists. And the quality of life is conducive to attracting and retaining experienced staff.

- Milton Friedman on the Renminbi-HK Dollar Relationship

Milton Friedman on the Renminbi-HK Dollar Relationship

"I’ve tried to look at economic history for examples of a sovereign country which permitted two currencies to exist simultaneously, at a floating, free exchange rate between them, the one currency linked to a foreign currency and the other a national currency—the renminbi and the Hong Kong dollar. And I only know one example in history that comes close: that’s the United States during the period of the Civil War and immediately after, when gold and greenbacks circulated simultaneously.

...It is in the Chinese self-interest to let the Hong Kong dollar remain what it is, because it’s been a tremendous value to them to have a Hong Kong dollar that stimulated the investments in China itself."

From an Asian Wall Street Journal interview with the Nobel Prize-winning economist during his recent visit in Hong Kong

Andrew Sheng is Deputy Chief Executive of the Hong Kong Monetary Authority. This article is based on his recent presentation at the World Bank, Washington, D.C.

1997 Annual Meetings in Hong Kong

The 1997 Annual Meetings of the World Bank and the International Monetary Fund will be held September 23-25, 1997, at the Hong Kong Convention and Exhibition Center and its Extension. Some 3,000 formal and informal meetings will be held throughout the period.

More than 13,000 people, including international bankers, media representatives, and over 300 finance ministers and central bank governors, are expected to attend the Annual Meetings. Some 6,000 hotel rooms have been reserved. The staging of this event so soon after the transfer of sovereignty will be a timely affirmation of Hong Kong’s continuing status as an international financial center. It will also boost international and local confidence in the territory, and bring substantial benefits in terms of additional tourism and related business.

The Hong Kong Monetary Authority (HKMA) is the agency responsible for coordinating the provision of services and facilities for the Meetings.

Selected Reforms on China’s Agenda

As unification with Hong Kong approaches, the “mainland” is cautiously preparing to further streamline the economy. At the recent annual session of the National People’s Congress, held in early March, state-owned enterprises emerged at the top of the country’s reform agenda. Moderate yet stable growth and reform of the agricultural and state industrial sectors were emphasized in Prime Minister Li Peng’s annual state-of-the-union work report, Finance Minister Liu Zhongli’s draft budget for fiscal 1997, and the economic plan for 1997, which was presented by State Planning Minister Chen Jinhua.

Liu announced a planned 1997 budget deficit of 57 billion renminbi (US$6.9 billion), down from 61 billion renminbi in 1996. Total government expenditures for the year were put at 896.7 billion renminbi, up 13 percent from last year, against revenues of 839.7 billion renminbi, up 14 percent. The deficit will be met by the issuing of a record 248.6 billion renminbi in domestic and foreign bonds this year, up from 196.7 billion last year. Of this, 57 billion renminbi will go to finance the deficit, and the remainder to service domestic and foreign debt. Despite the increase in revenue, Liu highlighted continued deficiencies in collection owing to widespread tax evasion, fraud, and arbitrary tax reductions and exemption. He also said that expenditures were “not effectively controlled,” leading to serious waste and extravagance, notably among state-owned enterprises.

Two other key areas received promises of significant extra money:

- **Agriculture.** China had record grain harvests of 480 million tons in 1996, and average annual rural incomes rose 9 percent over 1995, to 1,926 renminbi. Further output increases could minimize import dependence as domestic demand rises. But local governments lack funds to pay farmers, who account for most of the workforce and are suffering from rising local taxes and fees. To support farmers and output, Liu proposed a 14.2 percent increase in agricultural expenditures in 1997, up from a 13.3 percent hike in 1996.

- **Defense.** Military spending is set to rise by 12.7 percent in 1997, to 80.6 billion renminbi, after an increase of 11.3 percent in 1996. (Some military sources claim that actual Chinese defense spending is at least 2.5 times that stated in the budget, as the military has access to other sources of revenue, for example, its industrial activities.) Nonetheless, as Beijing argues, the base figure is not excessive by international standards, especially given the People’s Liberation Army’s current technological deficiencies.

The economy grew by 9.7 percent last year, lifting total GNP to about 6.8 trillion renminbi (US$820 billion). And government economists have predicted that GDP growth will be as high as 10.5 percent this year. However, as happened last year, as much as two percentage points of this growth may go into expanding stockpiles of state-produced goods that no one wants. The growth of stockpiles to 530 billion renminbi (7.8 percent of GNP) last year highlights an inherent contradiction in China’s otherwise strong macroeconomic performance. In order to prevent a financial crisis in the state sector, authorities last year sharply increased loans to state-owned enterprises (SOEs). The way out of this dilemma is to accelerate the restructuring of SOEs, so as to allow a distribution of credit according to efficiency criteria.

Li’s report singled out SOE reform for the first time as the leading economic and political challenge (even though, owing to the rapid growth of private and foreign-invested sectors, the economy’s dependence on the state sector has fallen to around 40 percent). Such reform produces its own set of undesirable side effects, such as unemployment and elimination of wide-ranging social benefits for workers. According to Li the government’s immediate priorities are to standardize bankruptcy practices, encourage mergers and promote employment of people released from state enterprises. The State Council had set aside 30 billion renminbi to support these objectives. The government’s long-term objective is to concentrate state resources on building a core group of 1,000 companies that will dominate China’s major economic sectors and, it is hoped, compete on a global scale. Meanwhile, Li’s speech clearly implied that the country’s 240,000 smaller SOEs will be released to the private sector.

The government has succeeded in curbing price increases: retail prices rose by just 6.1 percent last year, down from 14.8 percent in 1995 and 21.4 percent in 1994. Inflation is expected to be less than 6 percent this year, despite 32 percent growth in fixed asset investments, to 2.53 trillion renminbi, down from 34.6 percent growth in 1996. Beijing’s financial position is respectable; its fiscal deficit is manageable and it has amassed record foreign reserves in excess of US$100 billion. The challenge for policymakers is to find a sustainable balance between the long-term economic need for SOE reform and the short-term political need for subsidies.

*Based on reports of Oxford Analytica, the U.K.-based research group and news agencies*
Desperately Seeking Economic Recovery

Why are some of the transition economies, including Russia and Ukraine, unable to embark on a path to recovery even though their macroeconomic fundamentals are in place, with budget deficits cut, inflation brought down, and exchange rates stabilized? In the following roundup we try to find answers to this question. According to Daniel Kaufmann, these economies still lack micro-level liberalization; excessive taxation, suffocating regulations, and omnipresent bribery are paralyzing business activity. In our forum for discussion, economist Stanislav Menshikov claims that the Russian economy is suffering from unnecessarily restrictive policies and suggests a well-targeted industrial policy for revitalization. David Gisselquist's therapy differs; he recommends actions on the local level and believes that the World Bank should support a long-term growth strategy in the transition economies.

Why Is Ukraine's Economy—and Russia's—Not Growing?
by Daniel Kaufmann

Ukraine's economy contracted by about 10 percent during 1996, experiencing another year of sharp decline. Even accounting for the unofficial economy—the unreported value added—a continuing contraction in overall GDP is clear. Russia and a number of (non-Baltic) newly independent states are experiencing similar trends. Stabilization was attained in some countries, including Ukraine and Russia, but they are still missing economic growth. That suggests that macro-stabilization is a necessary but not sufficient condition for growth.

Unhappy Enterprises

Almost three years ago Ukraine initiated a major economic reform program. It has made significant progress in conquering inflation, introducing a new and relatively stable currency (the hryvna), and liberalizing trade and prices on a macro level (top-down). But liberalization at the micro level (bottom-up) has not taken place, and accordingly, the cost of operating enterprises legally is still extremely high. In 1996 enterprise surveys were conducted in Ukraine and—with a smaller sample—in Russia. The vast majority of the participating firms denied that they had benefited from the reforms (while declaring them irreversible).

Newly established private enterprises especially continue to see excessive taxation, unstable legislation, and trade and regulatory constraints as serious impediments. The practice of greasing the palms of officials—tax, health, or fire inspectors, for example—to obtain a license or avoid or reduce a tax is widespread, and payments are sizeable. These payments have not declined since the reform started in 1994. (The magnitude of these payments is the same order as in Russia.)

A panel sample of about fifty firms in Kiev and Lviv—compiled last year through the Ukraine Rapid Enterprise Survey by the Soros International Economic Advisory Group—also reported a rising tax burden and increasing administrative, policy, and regulatory controls. Throughout 1996, the government continuously strengthened its regulation of production, pricing, bank credit, and foreign trade. Foreign businesses felt the heat of such constraints as discretionary application of licensing rules, spreading corruption, a fragile banking system, and legal and regulatory instability. A recent report detailing Ukraine-based U.S. bilateral agencies’ experiences listed other barriers as well:

- Commercial, tax, and land codes are lacking. As a consequence, few business contracts are regarded as final or binding.
- Tax laws, customs regulations, and specialized licensing procedures are cumbersome and ambiguous. This leads to arbitrary implementation of regulations and corruption.
- Bankruptcy law permits companies to accumulate debts and then simply close down, but prevents restructuring.
- Resident or nonresident companies can withdraw only a limited amount of cash from bank accounts (most enterprises are allowed to keep only a single account). Bank accounts are arbitrarily frozen.
- Corporate profit taxes vary extensively. Tax exemptions are significant and discriminatory. Local tax offices exercise considerable discretion, resulting in abuses and corruption.
- The payroll tax which includes social security contributions, the Chernobyl fund, and withholding taxes, is prohibitively high. Personal income taxes are also high.
- Company registrations are not transparent, and are time-consuming.
- Foreign currency purchases and private foreign currency loans are under administrative control, and are subject to discretionary and bureaucratic licensing procedures.
- The Antimonopoly Committee is authorized to intervene in broad and unwarranted areas of the economy.
Barriers also impede progress in the agricultural sector. About 14 percent of arable land is held as private subsidiary plots, but it is not tradable. (This private land produces about half of agricultural output; the 86 percent in collective and state hands produces the other half.) No clear policy has yet been formulated for land privatization and ownership.

It is no surprise that foreign direct investment (FDI) to Ukraine has averaged less than $5 per capita per year. (Comparable data for Hungary show annual per capita FDI of $1,200.) Large, promising foreign investments that were at advanced stages of preparation have recently become mired in bureaucratic red tape. And some large foreign investors are leaving the country.

**Business Underground**

In many transition economies politicians and bureaucrats try to control the enterprise sector through administrative measures and regulations. This gives rise to side payments, directly raising the cost of doing business within the official economy. But as taxes or other administrative barriers are raised, the illicit rents extracted from an enterprise (to evade taxes and official impediments) increase as well. Given the degree of oversight bureaucrats and politicians have over the enterprise sector in many newly independent states, an endorsement is required to operate unofficially. That "nod" comes at a private price, probably less than the extra cost of operating in the official economy. Thus the overall cost of doing business (whether officially or unofficially) increases when a tax or regulation is imposed. But operating officially becomes relatively more costly than operating unofficially.

The absence of micro liberalization has two effects on the economy:

- It slows overall output recovery because higher operating costs deter some firms from starting businesses; others may get started but then stagnate or go bankrupt.

**Table 1. Evolution of the unofficial economy in countries of Eastern Europe and the former Soviet Union and possible determinants, 1989-94**

<table>
<thead>
<tr>
<th>Country, by degree of change in unofficial economy</th>
<th>Change in unofficial economy's share 1989-94 (percentage of total)</th>
<th>Unofficial economy's share 1994</th>
<th>Private sector development and liberalization index (0-100)</th>
<th>Average annual inflation rate (percentage)</th>
<th>Bureaucratic discretion index (0-100)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Extremely high increase (war)</td>
<td></td>
<td></td>
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<td></td>
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<tr>
<td>Georgia</td>
<td>52</td>
<td>64</td>
<td>22</td>
<td>309</td>
<td>36</td>
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<tr>
<td>Azerbaijan</td>
<td>46</td>
<td>58</td>
<td>17</td>
<td>208</td>
<td>32</td>
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<tr>
<td>Average</td>
<td>49</td>
<td>61</td>
<td>20</td>
<td>259</td>
<td>34</td>
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<tr>
<td>Very high increase</td>
<td></td>
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<tr>
<td>Ukraine</td>
<td>34</td>
<td>46</td>
<td>13</td>
<td>393</td>
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<tr>
<td>Russia</td>
<td>28</td>
<td>40</td>
<td>32</td>
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<td>Moldova</td>
<td>28</td>
<td>40</td>
<td>27</td>
<td>299</td>
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<tr>
<td>Average</td>
<td>30</td>
<td>42</td>
<td>24</td>
<td>307</td>
<td>41</td>
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<tr>
<td>Medium increase</td>
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<td>22</td>
<td>414</td>
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<td>40</td>
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<td>60</td>
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<tr>
<td>Average</td>
<td>17</td>
<td>28</td>
<td>43</td>
<td>165</td>
<td>49</td>
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<tr>
<td>Low increase</td>
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<td>Belarus</td>
<td>7</td>
<td>19</td>
<td>18</td>
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<td>29</td>
<td>49</td>
<td>79</td>
<td>49</td>
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<td>29</td>
<td>69</td>
<td>23</td>
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<td>Poland</td>
<td>0</td>
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<tr>
<td>Average</td>
<td>3</td>
<td>23</td>
<td>51</td>
<td>145</td>
<td>58</td>
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<tr>
<td>Decline (repressed politics)</td>
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<td>Uzbekistan</td>
<td>-2</td>
<td>10</td>
<td>19</td>
<td>177</td>
<td>28</td>
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<td>Romania</td>
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<td>Average</td>
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<td>Overall average</td>
<td>17</td>
<td>32</td>
<td>37</td>
<td>195</td>
<td>45</td>
</tr>
</tbody>
</table>

* a. Calculations based on main conservative scenario of aggregate electricity consumption (Kaufmann and Kaliberda 1996).

**Note:** The private sector development (PSD) and liberalization index ranges from zero (anti-PSD and liberalization) to 100 (maximum pro-PSD and liberalization). Annual inflation rates are based on geometric averages. The bureaucratic discretion index has been standardized to range from 0 to 100 (maximum discretion) based on annual Freedom House indices of civil and political liberalization.

**Source:** From Plan to Market, M. De Melo, C. Denizer, and A. Gelb (1996), Freedom House.
It encourages businesses to operate in the unofficial economy, where the added operating cost is relatively less than in the official economy. (The trend was different elsewhere: following liberalization, the share of the unofficial economy declined in Poland, in some other Central and East European countries, and in the Baltics; [see table 1].)

Prior to the transition, the share of the unofficial economy in overall GDP in the Soviet Union was estimated to be 10-15 percent. In Ukraine the unofficial segment of the economy had grown to more than 40 percent of overall GDP by 1994, and by mid-1996 it was estimated to be about one-half of overall GDP. The increase was due partly to the significant decline of the official economy during the period and partly to the tripling in the absolute size of the unofficial economy.

Although some new businesses are altogether unregistered, having entered directly into the unofficial economy, others register the visible part of their operations. They receive some state support (social protection), and hide the rest of their business. The ratio of reported to unreported activities depends largely on the costs and benefits of operating in each economy.

Most firms surveyed in Ukraine admitted paying bribes to lower their official tax burden and to secure various licenses; [see table 2]. Senior management in the new private enterprises must spend a lot of time with public officials "securing" licenses and permits and "negotiating" taxes and penalties. In 1995 they spent about 30 percent of their working hours with officials, and almost 40 percent in 1996. (Managers in Russia—as our small sample indicates—need to spend about 30 percent of their working hours with officials, compared with 15 percent in Lithuania and 8 percent in El Salvador, for instance. During a recent visit to Moscow IMF Managing Director Michel Camdessus, while praising the strong commitment of Russia's reformers to stabilization, warned them to face the realities of the enterprise sector. He was surprised to see so many entrepreneurs waiting in the ministers' offices. "You cannot build a market economy on this basis," (he cautioned.)

Enterprises in Ukraine are hit hard by taxes and regulations. Thus, in order to survive, they are willing to pay significant sums in bribes and consequently misreport large shares of their value added. This is why many firms are forced to submerge their operations at least partly. At the national level, the unofficial economy reduces the country's tax base and official foreign exchange holdings (thus fostering capital flight) and in so doing lessens the state's ability to manage the economy. But the costs are also significant on the enterprise level; besides the high extralegal payments required, operating in the underground economy undermines entrepreneurial

| Table 2. "Unofficial" payments by enterprises for official permits, licences, and other "favors" in Ukraine and Russia, 1994 and 1996 |
|--------------------------------------------------|--------------------------------------------------|--------------------------------------------------|--------------------------------------------------|
| **Ukraine** | **Percentage of enterprises admitting need to pay "unofficially"** | **Russia** | **Percentage of enterprises admitting need to pay "unofficially"** |
| **Type of licence or "favor"** | **Average "unofficial" fee required for "favor"** | **1996** | **1994** | **1996** | **1994** | **1996** | **1994** |
| Enterprise registration | $176 | $186 | 66 | 64 | $288 | 44 |
| Each visit by fire or health inspector | $42 | $40 | 81 | 72 | $67 | 23 |
| Each regular visit by tax inspector | $87 | $91 | 51 | 56 | $250 | 21 |
| Each phone line installation | $894 | $550 | 78 | 95 | $1,071 | 100 |
| Lease in state space (sq. meter per month) | $7 | ... | 66 | 88 | $26 | 39 |
| Each export license or registration | $123 | $217 | 61 | 96 | $643 | 43 |
| Each import license or registration | $278 | $108 | 71 | 93 | $133 | 50 |
| Each border crossing (lump sum) | $211 | $194 | 100 | 90 | ... | ... |
| Domestic currency preferential loan (percentage of value) | 4 | ... | 81 | ... | 8 | 38 |
| Hard currency preferential loan (percentage of value) | 4 | ... | 85 | ... | 23 | 53 |

a. Average among those who admit making unofficial payments. Preliminary data based on March 1996 survey of 150 state or private enterprises in five large Ukrainian cities, and 50 enterprises in three large Russian cities. Caution should be exercised in interpretation of the data, which are not representative of the whole country (particularly in Russia, where the sample is small). The mid-1994 survey results for Ukraine are based on a similar survey instrument. 

Source: The survey.
confidence, preventing longer term investment.

According to estimates based on our survey, in both Ukraine and Russia registered firms that are responsible for about 80-85 percent of unreported economic activities are prepared to return to the legal sphere over time; only an entrenched, hard-core 15-20 percent want to stay, no matter what. Thus the unofficial economy is still relatively shallow, and with appropriate economic and institutional reforms its size could be cut.

**State Restructuring**

What could be those "appropriate economic and institutional reforms"?

- A major deregulation program should be launched. Such a program could level the playing field for new enterprises, eliminating most enterprise licenses and permits while keeping those that are absolutely necessary (health, environment, and safety), according to simple and transparent rules. Abuses of discretionary government powers should be eliminated (including forced delays at customs, arbitrary cancellations of import permits, and levying of steep penalties). Export registration requirements and indicative export pricing should be eliminated, along with inter-oblast trading restrictions and oblast-specific export barriers (for grain, coal, or any other commodity). Restrictions on domestic agricultural trade should be lifted, and the discretionary enforcement of state contracts terminated. The remaining price controls for artificial monopolies should be abolished, and the price inspectorate offices closed. At the sectoral level, deregulation of the energy and power sectors should be carried out, exposing gas and other subsectors to competition. More generally, the large industrial structures need to be demonopolized. This is urgent in Russia.

Privatization should be accelerated. To date, less than one-third of medium-size and large enterprises have been privatized, with about 70 percent of their shares sold. Many of the privatized assets have been transferred to earlier managers, who are in full control of the enterprises. This trend, coupled with the absence of deregulation, has worked against enterprise restructuring. Land privatization is also urgent.

- Tax rates should be reduced and the tax regime simplified. The excessively high payroll tax needs to be cut. Tax payments should be credibly enforced, and special privileges and exemptions need to be eliminated. An improved tax administration should oversee a new tax regime that is simple, moderate, and transparent.

- The financial sector should be streamlined.

- The public sector needs to be restructured. The legions of bureaucrats, currently setting and monitoring prices, authorizing licenses and permits, and otherwise regulating enterprise activity would be more productive collecting corporate taxes, teaching, or starting their own businesses. Similarly, accelerated privatization in the agricultural and enterprise sectors would substantially relieve the overstretched civil servants, enabling them to focus their activity where public sector involvement is really needed, such as reforming local governments (particularly in Russia) and the relations between local and central governments.

A window of opportunity is now open to take bolder measures not only in Ukraine (despite the delay in reforms in recent months) but also in Russia. With the support of the international community, these governments, working in cooperation with the reformers, may be able to carry out a bold reform program. If the historic opportunity is seized, both countries could look forward to vigorous and sustained growth, exceeding 4 to 5 percent a year. The key is to create a pro-business and pro-investment climate by implementing deregulation and government reform.

Daniel Kaufmann is a visiting scholar at the Harvard Institute of International Development, on secondment from the World Bank. Earlier he was the head of the World Bank’s Kiev (Ukraine) office. This article is based on his recent study, "The Missing Pillar of a Growth Strategy for Ukraine: Reforms for Private Sector Development," forthcoming in Cornelius and Lenain, editors, Ukraine: Accelerating the Transition to Market, IMF, Washington, D.C.

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Russia’s New Dream Team Confronts Nightmares

On March 17 a reinvigorated Boris Yeltsin announced a complete overhaul of the Russian government. Leading figures among the newly appointed reformers include:

- **Anatoli Chubais**, who has moved back into the government (after serving as presidential chief of staff) as first deputy prime minister and economic policy overlord, replacing former Oneksimbank chief Vladimir Potanin. Chubais has also become finance minister, taking over from Aleksandr Livshits, who returns to the presidential administration as deputy chief of staff. Chubais’s major assignment is to reform Russia’s grossly inefficient tax collection system, raise revenues for empty budget coffers, and initiate banking reforms. (Aleksandr Morozov, an economist with the World Bank, explained that the first step could be the establishment of a nationwide federal treasury system to coordinate banking operations using state budget funds. This would lead to a gradual cut in the number of currently authorized commercial banks. They may be replaced with a network of regional treasury branches working directly with Russia’s central bank.)
- **Boris Nemtsov**, the liberal reformist governor of Nizhni Novgorod, who has come in as another first deputy prime minister. Nemtsov’s job will include restructuring state monopolies, such as the electricity, railroad, and gas sectors. Another of his main goals will be the creation of a social safety net that will allow companies to restructure and form new relationships with regional governments.
- **Yakov Urinson**, who has taken over as economy minister from Yevgenii Yasin (he was Yasin’s first deputy) and has also become a deputy prime minister. The economy ministry has absorbed the industry and defense industry ministries. The construction ministry has been abolished. Yasin, in turn, has become a minister without portfolio engaged in policy analysis.
- **Alfred Kokh**, who continues to head the State Property Committee (GKI) and has become deputy prime minister.
- **Oleg Sysuev**, mayor of Samara, who has also become deputy prime minister with responsibility for housing and utilities reform.

**On the Downside**

The new team takes over an economy that is drifting, in which many reform issues are unresolved (including regulation of state monopolies and of bankruptcy procedures, codification of land privatization and legislation of security markets) and social tension is high.

**Budget Crisis**

The bottom-line problem remains the government’s failure to meet budget obligations and collect planned taxes. Moscow’s failure to pay millions of government workers and pensioners and to pay its bills to private contractors has deepened the anger of the Russian populace. Wage and salary arrears at the end of March 1997 amounted to more than 50 trillion rubles ($8.8 billion) in back wages, of which the state owes 10 trillion or around 6 percent of the officially recorded annual wage and salary bill. Budget revenue was only 55 percent, and spending 50 percent, of planned levels in January-February 1997.

By the end of 1996 interfirm debts topped 490 trillion rubles, or 25 percent of GDP (against 15 percent in 1995), and federal tax arrears another 61 trillion. Barter has become common, accounting for perhaps 80 percent of payments to energy producers. Most firms have learned not to ship goods unless their clients pay cash up front. The IMF has refused to release the February 1997 tranche of its $10 billion extended fund facility loan because of doubts about the credibility of the 1997 budget. The budget crisis delays the decline in interest rates that is vital to private investment.

**Shrinking Economy**

Russian GDP has been falling for the past seven years; in 1996 the decline was 6 percent, steeper than the 4 percent fall in 1995. The World Bank predicts that the fall will cease this year, but does not expect much positive growth until 1998. The State Statistical Committee (Goskomstat) reported on March 17, that year-on-year, Russia’s GDP increased by 0.1 percent in January and 0.9 percent in February. But this encouraging upturn was “produced” by the statisticians of Goskomstat, according to “Russian Economic Trend,” a monthly report of the EU-funded, Moscow-based Institute for Macroeconomic Research. Goskomstat boosted its 1997 estimate of the size of the black economy to 25 percent compared with last year’s 20 percent, but did not adjust the 1996 figures upward. Without this “data massage,” the reported GDP would have fallen by 6 percent in January. The new methodology would have produced 5 percent growth for February. That was too much even for the statistical office, so they adjusted the figure downward.

Other new figures should be evaluated in the light of these manipulations. In January-February the coal and electrical energy output declined by 4 percent each. The population’s real disposable income increased by 5 percent, and the average monthly wage went up to 885,000 rubles ($155). The number of people living below the minimum subsistence level (404,000 rubles at the end of February) fell from 31.9 million in January to 31.5 million in February.
Social Tensions

A new industrial and financial elite has grown and gained importance (see the following article). Heads of leading Soviet-era monopolies, as well as representatives of an aggressive banking and financial community, have accumulated enormous power and wealth, taking advantage of political connections, weak rules, and lack of legislation. Many Russians say the concentration of wealth and influence in the hands of a few, well-connected industrialists and bankers has discredited reform. Nemtsov and Chubais have been charged with reviving reforms and making sure that wealth starts circulating among ordinary Russian citizens. (Boris Nemtsov declared shortly after his appointment that Russia must now choose between "bandit-capitalism and capitalism with a human face." He declared himself in support of the latter.)

Insiders’ Privatization

On paper Russia has 15,000 joint stock companies with 40 million shareholders, the world’s largest on both counts. But insider owners continue to dominate, and the expected shakeout of loss-making plants has failed to materialize. Seven leading firms that paid less than 20 percent of their taxes were warned and issued bankruptcy papers late last year. The Togliatti auto giant AvtoVAZ was forced to agree to sell 51 percent of its shares because of tax debts. But the Tatarstan truck giant KamAZ, which was initially on the bankruptcy list, suddenly was taken off.

FDI Down

Foreign direct investment in 1996 reached an estimated $800 million, down from $1.5 billion in 1995. Corruption, taxation, red tape, and legal uncertainty are still major barriers. Only a handful of new manufacturing projects started in 1996, such as a $140 million Snickers chocolate bar plant. An auto assembly plant was inaugurated by GM in Tatarstan, and South Korean automaker KIA Motors, plans another in Kaliningrad. Still, the energy sector urgently needs an injection of foreign capital and technology: oil production has fallen by 40 percent since 1987 and contracted another 2 percent in 1996. However, the Duma refused to sign off on the list of approved oil and gas sites and without this the 1995 Law on Production Sharing cannot go into effect. The government has made no progress with the privatization of the telecom company Svyazinvest, which was canceled at the last minute in December 1995.

On the Brighter Side: Export Booms...

Reasons for optimism can be found in Russia’s rise in exports and increasing fiscal stability. Exports in 1996 rose 8.3 percent to $86.5 billion and imports were little changed at $46.6 billion, giving Russia a trade surplus of $40 billion. From this should be subtracted the estimated $8 billion of goods brought in by individual "shuttle" traders. Oil and gas accounted for 45 percent of the exports. Russia’s arms exporters probably earned $3 billion, with fighter sales to China and India. Imports were mainly machinery, meat, sugar, and alcohol. Last year saw a modest revival of trade with the Commonwealth of Independent States (CIS). CIS countries took 20 percent of exports and provided 30 percent of imports—a rise of 12.5 percent and 8.3 percent, respectively. As part of the IMF agreement, export duties were lifted from all goods except oil in April, and from oil in July, although the revenue loss was compensated by an increase in oil excise duties (paid by domestic consumers). Import tariffs were rearranged in May, although the tariff average stayed at 14 to 15 percent.

...And a Stable Ruble and a Good Standing

In 1996 the ruble held its value against the dollar in real terms, ending the year at 5,550 rubles to the dollar. The 20 percent nominal depreciation was roughly equal to the domestic inflation rate. The central bank kept the ruble within the "corridor" introduced in July 1995, and in July 1996 switched to an inclined corridor (akin to a crawling peg), with parameters announced six months in advance. In May 1996 Russia announced its intention to conform to Article 8 of the IMF Charter, meaning current account convertibility for the ruble. Official reserves declined slightly to around $16 billion by November, while capital outflow amounted to about $12 billion over the year. Russian individuals and firms now hold a total of $40 billion to $50 billion abroad. In addition to the $10.1 billion IMF loan, the World Bank approved eight loans in 1996, totaling $1.8 billion, for enterprise restructuring and social infrastructure. Late last year Russian state bonds were ranked as investment-grade by international rating agencies. Gazprom shares are quoted on the London Stock Exchange, and Vimpel-Communications, a mobile phone company, became the first Russian company listed on the New York Stock Exchange.

Based on reports of Reuters News Agency, Open Media Research Institute, and Oxford Analytica. Contributions from Johnson’s Russia List are highly appreciated.
Russia's New Robber Barons Act Up

The Russian polling service Vox Populi published in early 1997 the latest list of Russia's fifty most influential businessmen. Number 1 on the list is Rem Vyakhirev, chief of Gazprom, the natural gas monopoly. Numbers 2, 3, and 4 are top bankers who control huge and rapidly expanding retail, media, and industrial empires: Alexander Smolensky of Stolichny Savings Bank, Vladimir Gusinsky of Most Group, and Mikhail Khodorkovsky of Rosprom, an investment group spun off last year from Menatep Bank. Also among the top ten are Vagit Alekperov, head of the oil conglomerate Lukoil; Anatoly Dyakov, head of a major utility, United Energy Systems; and the heads of four top banks—including Sberbank, the state savings bank.

Behind these men are "money, relatives, friendship with top government officials, mass media and many other things," according to a commentary in the weekly newspaper Interfax—Argumenty i Fakty. The majority of these businessmen will most likely exercise considerable influence on the state's economic policy in 1997.

Just how much of the political and economic process do these men control? Financier Boris Berezovsky reported late last year that a "magnificent seven" group of bankers and businessmen (including him) controls 50 percent of the Russian economy. Nervous about the social consequences of closing down insolvent behemoths, the government strikes deals with tax debtors for long-term payment or investment credits—schemes that don't necessarily enforce financial discipline.

Some of the most influential Russian entrepreneurs, in alphabetical order:

- Boris Berezovsky, 50, owns the national Lada car dealership network as well as the All-Russia Automobile Alliance. (The company raised $50 million in a public offering in 1993 on the so-far-unfulfilled promise to build a Russian people's car.) Berezovsky and allies bought the no. 9 oil concern Sibneft for a mere $100 million. Berezovsky owns 16 percent of Russian Public Television, the largest national network; 20 percent of Moscow's TV-6; and 50 percent of the weekly magazine Ogonyok.

- Vladimir Goussinsky, 44, founder of Most Bank and Russia's leading press czar. A former engineer and theater director, he controls the country's first independent TV station NTV, the daily newspaper Sevodnya, the NTV-Plus pay entertainment network, and other media holdings.

- Mikhail Khodorkovsky, 33, is president of Rosprom, (earlier called president of Bank Menatep, Russia's sixth largest bank. The former chemist and Communist Youth League activist recently bought 75 percent of Yukos, the no. 2 oil giant, whose annual revenues are around $3 billion, for a mere $168 million and became chairman. Khodorkovsky owns Literaturnaya Gazeta newspaper, and 10 percent of Independent Media and is publisher of Russian Cosmopolitan and various other papers.

- Vladimir Potanin, 36, is a former foreign trade ministry bureaucrat who founded the country's biggest private bank, Uneximbank, and the eighth largest, International Finance Corp. He also owns Russia's biggest ferrous metals producer, Norilsk Nickel, and its no. 4 oil company, Sidanco. (Potanin bought the voting stock of Norilsk Nickel, which produces 20 percent of the world's nickel supply and more than 40 percent of its platinum-group metals, for a mere $170 million. He paid just $130 million for 51 percent of the oil giant Sidanco.) In all, seven of Russia's twenty largest companies are considered members of the Potanin clan, tied by equity or credit relationships. (These twenty companies account for 56 percent of Russia's industrial production and a much higher proportion of its annual exports, according to the Moscow economics journal Expert.)
Alexander Smolensky, 42, is president of Stolichny Savings Bank (Russia's eighth largest), which recently swallowed up the state-owned agricultural lender Agropropbank (fifth largest). Smolensky is a former construction manager.

V. Vinogradov owns Inkombank (Russia's fourth largest), which has a huge branch network and interests in metals as well as a stake in the oil pipeline monopoly Transneft. Rem Vyakhirev, chairman of Gazprom, owns 30 percent of NTV and 3 percent of Russian Public Television.

These "latter-day robber barons" are forming new power centers—built mostly around commercial banks and natural resource companies—that control huge swaths of the Russian economy. They dominate the country's trade in arms and precious metals, as well as its production of copper, nickel, and a quarter of its oil. They control the no. 1 and no. 3 television networks, the Visa bankcard network, a big chunk of the pulp and paper industry, and an increasing portion of the food processing industry and the short-term bond market.

That is only one side of the story. Russia's new fat cats are also providing essential financial services—including loans—to the burgeoning small and medium-size businesses visible in any big Russian city. These cottage industries support millions of ordinary Russians who are earning a decent, legitimate living. This middle class is also buying a large quantity of Western products, including $10 billion of imported foodstuffs alone last year. Optimism about this growth helped make Russia's stock market the hottest in the world last year despite the country's political troubles.

From news agency and press reports and the Moscow-based Interfax—Argumenty i Fakty.

Kremlin Capitalism

Russian privatization was rapid, extensive, and unprecedented in world history. Almost 90 percent of industrial output and 80 percent of industrial enterprises passed mainly into private hands. State ownership in 60 percent of the firms covered by the 1996 Russian National Survey was zero.

Privatization was a seed that fell on hard, dry ground. After four years of reform, the nation was still struggling to jump-start national and regional stock markets and bank loan to enterprises. Any future "reform" government will confront a budget crisis of daunting proportions. It will not be able to fund social programs for the needy and at the same time bestow its largess on corporations and cronies. The government must start to extend aid to weak citizens directly through health, welfare, unemployment, and training programs and let firms stand or fall on their own.

Our evaluation of the Russian National Survey of corporations in 1995 and 1996 leads to a shocking conclusion: No more than a quarter of Russian companies are clear winners (financially sound firms with well-established domestic or export markets), although even of these firms, only a small number will be able to finance modernization out of their profits. Three-quarters of Russian corporations are in need of radical and far-reaching restructuring. At least a quarter of those firms should be bankrupt.

How much capital investment is necessary to modernize all 18,000 privatized corporations? When estimates by the top managers in the Russian National Survey in 1995 are telescoped to all privatized corporations, the amount is between $150 billion and $300 billion, depending on the method of estimate. (The size of the entire 1995 Russian government budget was approximately $50 billion.) These estimates include only the costs of capital investment. They do not include the costs of subsidizing wages to maintain full employment or supporting the many social services provided to employees. With foreign investment in Russia amounting to no more than $1 billion to $2 billion a year since the beginning of reform (in 1995 half of Russia's foreign investment went to the energy sector, which accounts for less than 6 percent of all employment), the capital that privatized corporations need represents a capital investment crisis of astounding proportions.

Russia's only choice is to develop capital markets—stock markets and bond markets that efficiently put capital in the hands of corporations and banks that believe they can make money by lending it to companies. Banks must be regulated so that citizens can view them as safe havens for their funds. Mutual funds need to be developed to attract Russian and foreign capital and direct it to productive investment. Capital markets must be developed in all of the country's eighty-nine regions and they must be relatively free of crime and corruption. This is a tall order.

Rather than thinking of subsidies, the Russian government should be stimulating the training and education of thousands of young Russians in the skills of restructuring, turnaround management, and bankruptcy workouts, by sending them as apprentices to the regions of the major industrial powers that have faced these crises. It should use foreign assistance to contract with the best universities in those countries to offer eighteen-month MBA programs.

Forum for Discussion

Russia's Economic Policy—Suggestions for an Alternative
by Stanislav Menshikov

The Russian economy is not in the process of turning around toward recovery, nor will it be in the foreseeable future. In 1996 GDP fell another 6 percent. Our suggestions for alternative policies are specifically aimed at getting an economic recovery under way as soon as possible and not waiting for the necessary long-term structural changes and adjustments, assuming that:

• The inflation in Russia is now caused mainly by supply-side factors.
• The budget deficit is caused not by overspending but by the eroding tax base due to the prolonged general depression.

Roots of Inflation

While in the first year of price liberalization (1992) inflation was largely a demand-pull phenomenon rooted in preceding goods shortages and money overhang accumulated in the Soviet period, inflation very quickly developed into a multi-factor phenomenon with the two underlying main factors being supply-side pressures and the “catching up with world energy and material prices” effect. Consumer goods shortages were largely eliminated by 1993 due to skyrocketing prices, falling real incomes, eliminated savings and increased imports. The money overhang all but disappeared. By 1994 there was no appreciable demand-pull to talk about. While falling output in 1992 and 1993 was largely explained by a sharp reduction in military production and the resulting macroeconomic fallout, the further contraction in 1994-96 was due mostly to inadequate aggregate demand, particularly in capital investment and personal consumption.

By early 1996 prices of electric power rose 2.4 times faster than average wholesale industrial prices, prices of fuel 1.9 times the initial gap between the prices of imports and domestic goods. Supply-side inflation subsided only in 1996, when most domestic prices came close to or partly overshot the ceiling of world prices and could not rise much further without destroying exports completely.

<table>
<thead>
<tr>
<th>Table 1. Russian federal budget deficit and money aggregates, 1992-96 (trillion rubles)</th>
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<tr>
<td>Federal deficit</td>
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<tr>
<td>Financed by:</td>
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<tr>
<td>Sale of government bonds</td>
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<tr>
<td>Foreign credit</td>
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<tr>
<td>Net deficit</td>
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<tr>
<td>Increase in money supply:</td>
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<tr>
<td>M0</td>
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<tr>
<td>Ratio to net deficit</td>
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<tr>
<td>M2</td>
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<td>Ratio to net deficit</td>
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Neither was this latter-day inflation caused by net deficits in the government budget or excessive money supply. Table 1 summarizes the relevant data for 1991-96, which shows that there is no correlation between net budget deficits and increases in money supply, particularly in 1995-96 when practically the whole gross deficit was financed by the sale of government bonds and by foreign credits. The ratios of M0 and M2 to the net deficit (i.e. gross deficit minus sales of government short-term paper and IMF credits) fluctuated wildly from year to year. The figures for 1994-96, are particularly interesting. In 1994 both ratios fell sharply, but they exploded in 1995, when the net deficit was practically eliminated. Considering that inflation in 1995-96 was down compared with 1994, one would expect the opposite to have happened.

Effective aggregate demand deteriorated sharply. Money supply in real terms (M2) fell by 51 percent between February 1992 and 1996. The Russian economy, by all accounts, is severely undermonetized. There is simply no evidence to claim that the Russian government or Central Bank...
Table 2. Russian federal budget and GDP, 1992-97

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<td></td>
<td>(trillion rubles)</td>
<td>(preliminary)</td>
<td>(plan)</td>
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<tr>
<td><strong>Current prices</strong></td>
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<tr>
<td>Federal revenue</td>
<td>2.7</td>
<td>17.2</td>
<td>81.1</td>
<td>241.4</td>
<td>269.5</td>
<td>434.4</td>
</tr>
<tr>
<td>Federal expenditure</td>
<td>3.9</td>
<td>34.1</td>
<td>146.4</td>
<td>290.1</td>
<td>354.5</td>
<td>529.8</td>
</tr>
<tr>
<td>Deficit</td>
<td>1.2</td>
<td>16.9</td>
<td>65.3</td>
<td>48.7</td>
<td>85.0</td>
<td>95.4</td>
</tr>
<tr>
<td>GDP</td>
<td>18.1</td>
<td>171.5</td>
<td>611.0</td>
<td>1,659.0</td>
<td>2,209.0</td>
<td>2,730.0</td>
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<tr>
<td><strong>GDP deflator,</strong></td>
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<tr>
<td>1992=100</td>
<td>100</td>
<td>1,037.8</td>
<td>4,230.2</td>
<td>11,965.7</td>
<td>17,141.0</td>
<td>20,746.7</td>
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<tr>
<td><strong>Real terms,</strong></td>
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<tr>
<td>1992=100</td>
<td>100</td>
<td>61.4</td>
<td>71.0</td>
<td>74.7</td>
<td>58.2</td>
<td>77.5</td>
</tr>
<tr>
<td>Federal revenue</td>
<td>100</td>
<td>84.2</td>
<td>88.7</td>
<td>62.2</td>
<td>53.0</td>
<td>65.5</td>
</tr>
<tr>
<td>Federal expenditure</td>
<td>100</td>
<td>91.3</td>
<td>79.8</td>
<td>76.6</td>
<td>71.2</td>
<td>72.7</td>
</tr>
<tr>
<td>GDP</td>
<td>100</td>
<td>91.3</td>
<td>79.8</td>
<td>76.6</td>
<td>71.2</td>
<td>72.7</td>
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</tbody>
</table>

Source: Author's calculations.

were issuing money in excess of the needs for the circulation of goods and services. Quite the opposite is true. The shortage of money in today's Russia is a well known phenomenon from which the population, business firms, and the government suffer the most. The only exceptions are the banks and the newly rich.

The above analysis indicates that the restrictive fiscal and monetary policies of the Russian government, particularly in 1995 and 1996, were unnecessary as a means of fighting the nonexistent demand-pull inflation. By restricting aggregate demand, the government helped prolong depression in the real sector while failing to restrain supply-side inflation. The analysis also suggests that fiscal and monetary restriction are no longer needed as the principal instrument of economic policy. In the present conditions they are doing more harm than good.

Once we accept a predominantly supply-side explanation of Russian inflation, the budget deficit can be seen in a more realistic light. Table 2 shows that the deficit is the result not of excessive government spending but of inadequate revenues. (Therefore it is a "passive deficit.") Government expenditure has fallen substantially both in real terms and relative to GDP. Government revenue in real terms fell steeply in 1996, usually explained by the particularly weak tax collection due to the election year. A more relevant long term explanation is the eroding tax base, a phenomenon that is natural in a depression of such magnitude. One cannot expect government revenues to keep up with income when the latter is falling below 60 to 70 percent of its normal level. (The intention to somewhat restore revenue in 1997 is considered unrealistic by most experts.

Thus some increase in the real amount of government spending is possible without running the risk of more inflation. As a first step, we suggest that the government should start paying its own arrears accumulated in 1995 and 1996 both to firms (for goods and services ordered and received by the government) and to individuals (government employees and pensioners) as provided by the approved budgets of those years, even though such payments would exceed government revenues. (Total arrears in the economy are now conservatively estimated to be in excess of 300 trillion rubles, equivalent to 150 percent of monthly nominal GDP. It is normal for companies to be in arrears on wages for three to four months or more, and in some cases wages have not been paid for more than six months. Some companies are paying employees in products instead of cash, and municipalities are forced, where possible, to distribute basic food supplies directly—via food coupons and otherwise—on an emergency basis.) This would immediately give a boost to the economy in terms of larger aggregate demand and at least help stop the current reduction in GDP and industrial production.

As an accompanying step, the possible increase in the federal deficit should be financed by low-interest loans from the Central Bank, not by additional sales of government securities or new loans from the international institutions. The reason is that the current market in government securities is oversold and is effectively crowding out investment in the real sector.

This boost in demand would result in an adequate expansion in supply. The economy is working well below capacity, and a modest addition to aggregate demand should not create inflationary pressure. On the contrary, if inflation is mainly supply-side, as we have argued above, then an increase in output should lead to falling fixed unit costs and also to some decrease in variable unit costs due to increased labor productivity and the spread of energy costs over a wider product range.

The savings rate in the higher income brackets and the profits generated in the banks and some "small", (unregistered and weakly monitored) private business remain high. But capital investment in the economy fell drastically in real terms and as a share of GDP, due to the deep depression, the virtual disappearance of net profits, and the disastrously high interest rates. (The contribution of foreign firms and joint ventures to capital
### Table 3. Capital investment, 1989-96

(gross fixed capital formation)

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<tr>
<td>Real terms, 1990 = 100</td>
<td>104</td>
<td>100</td>
<td>51</td>
<td>45</td>
<td>34</td>
<td>30</td>
<td>25</td>
</tr>
<tr>
<td>Share of GDP (percent)</td>
<td>23</td>
<td>19</td>
<td>14</td>
<td>16</td>
<td>18</td>
<td>15</td>
<td>13</td>
</tr>
<tr>
<td>Net of depreciation and depletion</td>
<td>..</td>
<td>37</td>
<td>30</td>
<td>38</td>
<td>32</td>
<td>32</td>
<td>20</td>
</tr>
<tr>
<td>Real terms, 1990 = 100</td>
<td>150</td>
<td>100</td>
<td>23</td>
<td>30</td>
<td>30</td>
<td>17</td>
<td>8</td>
</tr>
<tr>
<td>Share of GDP (percent)</td>
<td>13</td>
<td>9</td>
<td>4</td>
<td>6</td>
<td>8</td>
<td>5</td>
<td>3</td>
</tr>
</tbody>
</table>

**Share (percent) in capital investment of:**

| Centralized investment from federal and local budgets and from preferential bank credits | .. | .. | .. | .. | .. | .. | .. |
| Internal sources and borrowed funds of firms | .. | .. | .. | .. | .. | .. | .. |
| Foreign capital and joint ventures | .. | .. | .. | .. | .. | .. | .. |

**Gross profits**

| Real terms, 1990 = 100 | .. | 100 | 89 | 63 | 25 | 26 | 13 |
| Share of GDP (percent) | .. | 24 | 30 | 24 | 11 | 13 | 7 |

**Net profits**

| Real terms, 1990 =100 | .. | 100 | 123 | 75 | 16 | 25 | 14 |
| Share of GDP, (percent) | .. | 11 | 20 | 14 | 3 | 6 | 4 |

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**a. Calculated assuming a conservative uniform share of depreciation and depletion (10 percent of GDP). In fact, this share tends to rise when GDP falls. In 1990 it was to be reported as high as 15 percent. If that share was extrapolated, net investment would be negative starting in 1992.**

**Source: Russian Economic Trends, various years, and calculations based on that source.**

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**The Bank Should Prioritize Recovery**

by David Gisselquist

Mr. Menshikov addresses a serious issue: Why has the Russian economy declined so badly, and what can be done about it? In any situation with great gains and losses at stake, opinions are going to be strong on many sides. While I don't agree with some of the details of his argument and some of his recommendations for resolution, I think that the basic thesis—that fiscal austerity has gone too far and is also not the way to promote economic growth—can be sustained.

I found the discussion of falling investment to be particularly revealing—and alarming. This is similar to what happened in the United States during the Depression. Investment fell drastically, and with multiplier effects brought down demand for consumer goods, employment, and GDP. Keynes General Theory described insufficient aggregate demand as the cause of GDP decline and unemployment during the Depression. The facts presented in table 3 tell the same story. (Note: During the Depression falling prices created incentives for investors to wait, which cut investment; as Keynes described, the eventual impact on aggregate demand and employment was several times the initial investment shortfall. In 1990s Russia, the cause of falling investment has more to do with political disagreements, but the impact on aggregate demand is similar.) If I were still teaching, I could put data from table 3 into a test question for a college intro course; any student who did not work out that a 75 percent fall in real aggregate investment during 1990-96 would result in a 25 to 40 percent fall in GDP would not do well on the test.

Data in table 1 strongly support the argument that budget deficits have not

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been the cause of Russian inflation. That makes political-economic sense: the corrupt rich can get money more easily from bank loans than budgetary allocations; without putting expenditures on budget, the ruling elite can channel money to buddies through banks. We see money supply and credit expanding much more than required to cover budget deficits (see table 1, especially data for 1995 and 1996). A similar argument is workable in many other countries where the IMF and the World Bank have gone overboard to press for fiscal austerity, but where budget deficits do not explain monetary expansion and hence inflation.

Aside from monetary expansion, supply-side price increases no doubt go a long way to explain inflation in Russia.

What is the solution? I do not agree with suggestions in the article that focus on changes in macroeconomic policy by the central government. Yes, some relaxation of spending limits and deficit targets is reasonable; deficit spending is part of the solution. Who can invest for expansion when demand is weak? However, the core of a workable solution may have more to do with changing government-business arrangements for long-range planning so that private investment can increase. How to create more trust and stronger partnerships among economic players (government, people, labor, businesses)? How to help small and medium-size businesses invest? How to help people invest in new houses and apartments?

I think an important part of the answer is to shift taxes and regulatory authority out of Moscow into oblast and local governments, so that business and government can work together and plan at that level. This is also an answer to corruption; putting power closer to the people, and breaking up large power concentrations at the center, exposes criminals to closer legal and democratic oversight. Responsibility for remaining privatization can also be shifted down, so that power does not continue to mass in a small group of corrupt people in Moscow.

The basic economic problem in Russia is that there is not a consensus in favor of recovery and growth among political-economic factions. Many in the World Bank are in favor of killing off a large share of the institutions that guided the Russian economy through 1990, and call it "reform." This negative agenda is commonly presented as a growth strategy, with the linking argument that destruction is necessary before healthy growth can take place. A similar (and equally false) argument supported Hoover's do-nothing approach to the Depression.

However, if we are in favor of destruction, that means that we are not willing to accommodate, work, and live with important economic facts; if that is the case, then within the Russian economy long-range planning is difficult; if long-range planning is hostage to conflict, then investment lags; and low investment largely explains low demand, falling GDP, and increasing unemployment. The basic change necessary to turn the corner in Russia is to prioritize growth rather than reform, and then to work with whomever and agree to whatever unpalatable measures we have to, so that recovery takes place.

As long as Bank staff don't prioritize recovery, we are part of the problem. If we do not change our position, I expect that we will sooner (rather than later) see a drastic falloff in influence and access to economic policymakers in Russia.

David Gisselquist, a consultant at the World Bank, is the author of The Political Economics of International Bank Lending.
Retraining Economics Lecturers in Russia

by Lan Wu

Although economics is taught to almost every college student in Russia, Russia badly needs more economists, but economics education programs currently are unable to adequately train these professionals. The overall quality of higher-level economics instruction remains poor. The key to improving the quality is to retrain current economics faculty.

Four years after the removal of Marxist-Leninist theory as the principal component of economics curricula, the quality of teaching of higher-level economics in Russia is still not up to the requirements. Most lecturers had no formal training in market economics and have had little opportunity for systematic retraining in programs supported by the West. Only a few lecturers are competent in teaching market economics, even at the introductory level. Most lecturers are in the midst of a professional transition, retooling by reading translated Western textbooks—some can be found reading the appropriate chapters before the class bell rings.

During our survey—conducted in the last quarter of 1996 in four Russian cities, Perm, Rostov-on-Don, Vologda, and Cherepovets, as part of the project "Teaching Economics in Russia" by the Global Development and Environment Institute at Tufts University—we often heard comments like "microeconomics is only about practical matters and not qualified as general theory by our Russian tradition" and "macroeconomics is just about a set of abstract and mystic hypotheses." The lack of understanding of market economics has negative consequences: undergraduate courses in economics are relatively few, and their quality is poor.

The shortage of qualified lecturers to train roughly 3 million students within a relatively short period is a daunting task by any measure. A few hundred Russians (many are not lecturers) are earning masters degrees in economics in programs run by Westerners in Russia, or at American or European universities. A lesser number are earning Ph.D. degrees. These programs will undoubtedly produce qualified economists, but training one Ph.D. will cost well over $100,000 and take at least five years. Moreover, training people in Western degree programs can be a risky investment because of "brain drain" and retention problems. Given that Russian university salaries are at the bottom of the income ladder, few people with a Western degree and good knowledge of English will choose to teach if they return home at all.

Under such circumstances retraining the current economics faculty is a far more viable option for quickly improving the skills of economics lecturers. Retraining:

- Should be intensive (at a minimum it should be at the level of a three-credit course at an American university).
- Should be held on site where the trainees are, not concentrated in central cities. Most current economics lecturers under the age of 50 are women, and for cultural and economic reasons women in Russia today bear most of the family responsibilities. It is thus very difficult for them to be away from home for an extended period. This was a major reason given by survey respondents for not being willing to attend a retraining program.
- Should be able to generate a critical mass for change. A locally held program will make possible the training of a large number of lecturers in a given institution. These lecturers can then form a critical mass for initiating and sustaining changes in their respective institutions. This is particularly important because the content of every course must be approved by the department head and the academic dean, who may be resistant to change.

Has retraining mattered so far? Perm was chosen as a target city for a retraining program financed by the European Union's TACIS. Two-thirds of the thirty lecturers sampled from the three institutions in Perm have attended some kind of retraining program, whereas only two of a total of twenty-nine lecturers sampled in the three other survey cities (Rostov-on-Don, Vologda and Cherepovets) attended retraining.

According to the survey, a lecturer in Perm teaches on average 2.22 and 2.26 hours per week in introductory micro- and macroeconomics, respectively, versus 1.09 and 2.09 hours per week for a lecturer in the other cities.

The study materials of the old political economy are dogmatic, inherently unsuited to open discussion and debate, and do not lend themselves easily to numerical application in the real economy. Partly for these reasons mechanical methods of teaching were common. Survey results show that in the surveyed cities other than Perm 96 percent of the lecturers rely on the traditional oral exam as the only way of testing for finals, while in Perm 30 percent of the lecturers also use other means to supplement the oral exam.

To conclude, the only viable and practical way to improve, on a large scale, the teaching of higher-level economics in Russia over the next decade, is to retrain the current economics faculty. The retraining conducted so far, although infrequent and insufficient, has made a difference. We have found strong support for the hypothesis that the most effective retraining should be intensive, locally held, and able to generate a critical mass for change.

Lan Wu is codirector of the Eurasia Economics Education Nonprofit Institute. Dr. Neva R. Goodwin contributed to this article. Email: EEEI@aol.com.
The World Bank Should Facilitate, Not Provide Proposals of an “Outsider” Research Team

What will the World Bank’s role be in the twenty-first century? The Bank was originally conceived as a public sector development agency lending to developing country governments or against government guarantees. Its brief was to augment deficient capital flows to developing countries in a culture where governments were seen as the main agencies for growth. It must now adapt to a world in which:

• Private capital flows to developing countries are at an all-time high.
• The private sector is the dominant engine of growth in developing countries.
• Environmental issues are creating new demands.
• The Bank’s own resources are becoming increasingly stretched as a consequence of cuts in its administrative budget.

The World Bank combines banking (financial intermediation) and development assistance functions, with the performance of each function benefiting from the other. Policy conditionality cements the two functions, enabling the Bank to lend with greater security than private banks can, and allowing it to reward governments that pursue successful development strategies. A privatized World Bank would lack the authority to apply policy conditionality. The world would gain one more large international bank but lose its leading development agency.

If fostering private sector investment in developing countries is to become the World Bank’s main objective, it will entail a substantial reorganization of the World Bank group. The group currently comprises four separate entities with economic functions:

• The IBRD borrows from financial markets against member government guarantees and onlends against client government guarantees.
• The IFC borrows in its own name without member government guarantees, and lends to private sector projects without client government guarantees. The IFC should be recapitalized by an injection of private-sector funding, perhaps with private sector banks becoming minority shareholders.
• MIGA is financed via the IBRD. Refinancing does not present major problems since this can be through direct transfer of resources from the IBRD. It is urgent that governments agree to the refinancing of the IFC and MIGA. (The Bank should lend less and guarantee more, with the consequence that borrowing countries may be encouraged back to the private capital market. This shift, which implies increased prominence for MIGA, may be helped by an examination of Bank procedures for pricing guarantees, and for provisioning against potential default.)
• The IDA is financed from group net income and by direct grants from member governments. The IBRD and IDA have historically been the largest components in the World Bank group, but the shift toward lending to the private sector requires a major shift of resources toward the IFC and MIGA and away from the IBRD. The poorest countries will continue to rely on IDA funding. This should remain the priority for investment of World Bank group profits.

The proposed injection of private sector finance into the IFC would amount to partial privatization. It would simultaneously increase the World Bank group’s capacity to lend to the private sector, while subjecting it to the discipline of producing an adequate return to equity holders. Placement of shareholdings with private banks would reinforce the principle of complementarity with the private sector. The proposal will put the IFC in a position to become the lead development agency in the opening decades of the new century, while maintaining the development assistance capability of the whole World Bank group with regard to the entire range of developing countries, including the least developed countries.

The World Bank should become a facilitator instead of a provider, seeing itself as augmenting rather than substituting for private sector investment. The Bank should concentrate its lending in two areas: the least developed countries, many of which are in Africa; and reconstruction activities in Eastern Europe and the former Soviet Union (perhaps shortly also in Cuba) where there are major capital and institutional infrastructure deficiencies. In other regions the World Bank should move from direct provision to facilitation, either through increased use of IBRD or MIGA guarantees, or, where appropriate, through a shift from IBRD loans to IFC loan participation in conjunction with private sector banks.

[President James D. Wolfensohn has launched a major strategic review to respond to these challenges. He has proposed a Strategic Compact under which member governments will grant the Bank additional resources over the next three years. This will allow the Bank to improve its performance and release resources for development assistance. The Board of Directors approved the Compact on March 31, 1997.]

Letters to the Editor

So Far...Could Be Better

Though we say so far so good with regard to privatization ("So Far So Good? A Privatization Update," by John Nellis, Transition, November-December 1996, p. 6), we should recognize certain problems.

First, privatization has been accompanied by serious corruption; it is, in fact, by far the most important area of corruption in most transition countries. Second, and related, crony privatization has skewed the wealth distribution in favor of the haves in a way that will last for a hundred years. Furthermore, most of the haves are former communist functionaries. Third, and again related, it has been accompanied by asset stripping, by shell companies being left with liabilities they could not pay, which in turn bankrupted banks. And last, in the mind of the public, it has been accompanied by the collapse of once-great companies, by increased unemployment, by a decline in the social services provided by enterprises, and so on. One can argue that the last has little to do with privatization, but that is not how it is perceived by many local people.

Privatization has brought a social and economic transformation of mammoth proportions. There is no way it could have been done without creating large-scale problems. We must not close our eyes to those problems.

Millard Long, Resident Representative, World Bank Budapest Regional Office

The Ethics of Privatization

Every single thing Mr. Long says about the pitfalls and costs of privatization in transition countries is true. But the sad reality is that in those countries that have avoided, postponed, or tried to conduct slow privatization in order to evade these problems, the outcomes have been even worse. I cite the cases of Belarus, Bulgaria, and, until recently, Ukraine. In Bulgaria the lack of privatization over five years has resulted in the near-total destruction of the industrial base. It is awful for assets to be stolen and for the nomenklatura to become the bourgeoisie, I agree; but it is worse when the asset base is degraded to the point of being worthless. Mismanagement under incompetent state ownership can mean that there is little left to privatize.

Some thus conclude that it is wrong and indeed counterproductive to wring one's hands over the legality or injustices of privatization; the important thing is to get the property into the hands of those capable of putting it to good use, those with the incentives to watch over the longer-run health of the capital. Foreigners, if you can find them, but there won't be many, so you have to look inward—and all you will find are the former managers, the former elites, the nomenklatura.

But claiming that one should ignore the injustices for the sake of restructuring and efficiency gains, ignoring the political-economy issues, can be dangerously naive. It is possible and indeed likely (as democratic processes become more the norm) that electorates in transition countries, fed up with the fraud and excesses of the divestiture process, will vote in populists or leftists who will delay and modify, if not reverse, reform. It really hasn't happened yet (showing the strength of the public's revulsion toward many aspects of the old system), but it could.

What does this mean for us in the Bank? We should espouse privatization but we should equally espouse that it be done right—that standards of transparency are promulgated and maintained, that mechanisms exist for the wide distribution of shares outside the elites; that safeguards are enforced for minority shareholders; that regulatory systems are in place before the sale of an infrastructure monopoly, and so on. Will our insistence on these measures always work? No, but we should continue to do it anyway, and uphold the correct standards even when it is unpopular. We are not a private bank, interested only in the financial return. Our job is not simply to push for privatization; it is to push for privatization being done in a manner that is mutually beneficial to the buyer and the seller—and has a reasonable chance of adding to consumer welfare as well.

John Nellis, Private Sector Development Department, World Bank

All I wanted to say is let us not be a Pollyanna in describing privatization. It has been a necessary but crude medicine, in practice a rough-and-tumble process. Amputation of your leg with a hacksaw may save your life but is not fun. It leaves a nasty scar. So will privatization. We in the World Bank should not pretend that we know how to redistribute nicely a large segment of a country's capital, in real time. Or that only morally inferior countries let managers make off with so much of the goodies. Perhaps we can do a little better than just say "hold your nose and go ahead." But not much better.

Millard Long

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Are Currency Boards Helpful? Consider Bulgaria and Bosnia

Professor Steve H. Hanke is thrilled because the IMF has changed its [formerly hostile] attitude toward the currency board and has been forcing Bosnians and Bulgarians to accede to pressures to use this exotic measure ("New Currency Boards Come to the Balkans," Transition,
Estonia’s experiences with a currency board are, at least in part, relevant for Bulgaria and Bosnia and Herzegovina, too. (The experiences of Hong Kong and Singapore, usually cited as successful cases by advocates of the currency board arrangement, are less relevant.) Estonia has had a currency board with a fixed exchange rate (8 Estonian kroon = 1 deutsche mark) since June 1992; inflation nonetheless runs at 25 to 30 percent annually, and the trade deficit has been increasing, from $100 million in 1993 to $700 million in 1995 to $900 million in 1996—and is expected to reach $1,200 million in 1997. The current account deficit was $185 million in 1995, increased to $250 million in 1996, and is expected to reach $400 million in 1997. The inflow of direct or portfolio investments, however, is sufficient to conceal the problem. Thus inflation and a current account deficit can coexist with a currency board.

(Slovenia, with a normal central bank and a flexible exchange rate system, reduced an annual inflation rate of 1,000 percent—as measured in October 1991, when the new Slovene currency was introduced—to single-digit levels by 1995 and 1996. The country has no current account deficit, and the foreign exchange reserves, which started from scratch as the new monetary system was established in 1991, are now twice as much as the M1 money supply.) Bosnia and Herzegovina and Bulgaria are among those former socialist countries that would have suffered severely from transition, even without the devastation of war (Bosnia) and prolonged financial crisis (Bulgaria).

Crisis in Bulgaria

The crisis in Bulgaria was not caused by the national bank’s financing of the budget deficit. Rather, it began with the so-called consolidation of the banking sector, which triggered a vicious circle in which interest payments have absorbed a rapidly growing share of budget revenues. This share equaled 17 percent of budget revenues in 1992, 66 percent in 1996, and 88 percent in the last quarter of 1996. Meanwhile, the shares of public revenues in GDP (ranging from 38.8 percent in 1992 to 30 percent in 1996) and of noninterest expenditures (ranging from 38.8 percent in 1993 to 21.2 percent in 1996) have been much lower than in other transition economies. The primary budget surplus reached an astonishing 9 percent of GDP in both 1995 and 1996.

It is a matter of theoretical debate whether Bulgaria should target a balanced budget or a noninflationary financing of the budget deficit. Fiscal revenues are, and will remain, insufficient as long as economic activity is squeezed, particularly in the former state sector, where a predominant part of tax revenues was generated and collected. An increase in tax rates would simply further compress the tax base and lessen, rather than increase, tax revenues. The social distress, meanwhile, requires enormous social transfers—a large part of the population is starving. The pros and cons for more or less restrictive fiscal policies are irrelevant because there are no sources to finance the deficit.

The IMF, which has acknowledged that Bulgaria faces a fiscal deficit this year, is ready to provide financing before the creation of a currency board through a “drawing fund.” It seems that no new sources of revenue will be available to bridge the fiscal gap. Consolidating the cash balances of other extrabudgetary funds and cashing in additional privatization revenues can bring in only marginal revenues. Thus external borrowing appears the only available way to bridge the gap. Will the drawing fund of this highly indebted country increase the confidence of foreign investors? I doubt it.

Prospects for Bosnia and Herzegovina

The creation of a currency board, envisaged in the Dayton-Paris Agreement for Bosnia and Herzegovina, is supposed to create stable money and promote gradual economic reintegration of the country. As in Bulgaria, however, setting up a currency board in Bosnia and Herzegovina can hardly solve the most acute problems. If it is not clear who is collecting taxes and who is paying teachers, it makes no sense to argue whether the fiscal policy should be more restrictive or not, or whether the government should run a budget deficit or not. Fiscal revenues remain very low because of the destroyed tax base and weak tax collection. War victims, pensioners, and the unemployed require enormous social transfers. The government(s) of Bosnia and Herzegovina cannot afford to run budget deficits because there is no one to finance them.

As to the functioning of a currency board, another question emerges: What are the prospects of generating surplus in the current account? The economy is performing at only 10 percent of its 1991 level and cannot count on surpluses in trade or services. Individuals receive remittances from abroad, but most of this foreign currency is held, not traded in for domestic currency. The deutsche mark, which serves as an accounting unit, is also used for transactions, especially in the informal sector, and with this alternative available, only a small portion of remittances is likely to be converted into the new domestic currency. Also slowing currency conversion will be the likely parallel circulation of Yugoslav dinars in Republika Srpska and of Croat kunas in the parts of the Federation that will remain controlled by Croats. Administrative measures—to increase the current account—say, by placing restrictions on the inflow or holding of foreign currency—would fuel
resentment in the population. Finally, large foreign private capital flows into such a high-risk economy cannot be expected. Thus, official financial assistance might be the only way to achieve a surplus on current account, the only source of the reserve currency that is a prerequisite for a functioning currency board.

Profile for a Currency Board?

What will the currency boards in these countries look like? What will be the initial currency reserves required? Who will provide the reserves and under what conditions? The starting reserve can be quite modest. For example, in Bulgaria, on the basis of the current exchange rate of 2,000 lev = 1 U.S. dollar, less than $100 million would suffice for establishing a currency board. However, at such an exchange rate last year's GDP is calculated as a mere $1 billion, consistent with a $10 monthly average wage. (On the basis of the 1996 average exchange rate, the 1996 GDP rises to $3.6 billion, and the required reserve currency to $300 million; on the basis of the leva's average exchange rate in 1991-94, more than $700 million is needed.)

Currency boards cannot solve the problems in these two countries. The problems can only be solved by foreign assistance focused on building production, creating employment, preserving subsistence agricultural production, controlling public expenditures, protecting domestic production, and imposing lasting administrative price controls on many nontradable goods. These might all be considered as steps in the wrong direction, away from a market economy and world economic trends. They are, however, also steps away from an economy where a dinner for one foreign expert costs the equivalent of a worker's monthly wage.

Joze Mencinger, Professor of Economics, Economic Institute of Slovenia and University of Ljubljana

North Korea's Economy Under Multiple Severe Stresses

by Nicholas Eberstadt

By the mid-1980s the North Korean economy had reached the limits of classical socialist extensive growth, and had probably entered into stagnation or even decline. With the end of Soviet aid and subsidized trade at the start of 1991, an already faltering economy suffered a heavy blow. Although North Korea has so far succeeded in managing the stresses that have accompanied its economic crises, a variety of indications suggest that the system is approaching a breaking point as economic conditions continuously worsen.

In May 1994—months before the death of Kim II Song—Chinese food sources were drying up, producing a food crisis unprecedented in North Korea's history. A year later Pyongyang officially launched a diplomatic appeal for emergency food aid. In the summer of 1995, following the emergency appeal, North Korea suffered unusually heavy flood damage. In the following months reports and rumors about dire hardships in North Korea proliferated in the international media. Stories spoke of people swarming into Pyongyang in search of food; of North Korean families foraging for sustenance across the Chinese border; of outbreaks of cholera (a deadly disease for the severely malnourished) that carried off hundreds; and even of starvation in the industrial center of Hamhung.

There can be little doubt that North Korea is under severe and rising economic stress. If the rudimentary food balance sheets constructed by outside observers are correct, North Korea is currently experiencing an annual deficit of roughly two million tons of cereal. In the absence of detailed information, outsiders can attempt to assess the North Korean system's ability to cope with the growing economic pressures, through historical analogies. "Socialism with North Korean characteristics" may only be found in the northern half of the North Korean Peninsula, but some of the economic predicaments emerging in North Korea today have been seen and studied elsewhere in the past.

In 1944 the war effort absorbed more than 40 percent of the United States' and Japan's national output; in Germany and the United Kingdom it absorbed over 50 percent; and in the Soviet Union it may have absorbed an astonishing 60 percent or more. In North Korea, by contrast, defense expenditures in the early 1990s accounted for only about 20 to 25 percent of GNP, according to U.S. government estimates. But whereas for the major World War II adversaries the period of maximal exertion lasted about three years, North Korea's economy has been on something approaching a full-out war footing for more than a generation, certainly since 1970 and arguably since the mid-1960s.

As Pyongyang's leadership has repeatedly emphasized, the unexpected loss of Soviet aid and trade in 1990 and 1991 constituted a serious setback to the national economy. If so, it was a setback from which North Korean trade performance has yet to recover: trade (calculated in current dollars and at official exchange rates) is believed to have declined almost continuously between 1990 and 1994, and may have fallen still further since then. North Korea's imports per capita average perhaps $50 a year. North Korea has a limited endowment of natural resources (energy products being perhaps the most critical constraint). With-
out securing access to such resources through imports, North Korea's socialist economy, as currently structured, can be expected to undergo further decline. To date, no turnaround in North Korean trade performance is evident.

North Korea is certainly not the first centrally planned economy to confront domestic food shortages. Mongolia in the early 1930s and North Vietnam in 1955 and 1956 each experienced serious food shortages. Outright famine erupted in the Soviet Union on several occasions, perhaps the most devastating being in 1933; and famine held China in its grip between 1959 and 1961. Virtually all these food crises were policy-induced—or at the very least, policy-intensified.

The 1933 Soviet famine in Ukraine (causing "excess mortality" of about 7 million) was largely brought on by sharp increases in stipulated procurement quotas in 1932; the great Chinese famine followed the communization of farms, as well as a drastic increase in procurement, in 1958 and 1959 ("excess mortality" of about 30 million); the Cambodian famine ("excess mortality" of about 1 million) was triggered by an indigenous and perhaps even more radical application of the same Great Leap Forward techniques that had been used in China. Because severe food shortages under communist governments were typically policy-induced, the states in question were commonly able to solve their food crises simply by relaxing or moderating harsh and destructive innovations.

What does the historical experience of severe food shortages under communist regimes suggest about the current North Korean situation?

• All previous severe food shortages took place in countries that were overwhelmingly rural and agrarian (Cambodia, China, Mongolia, North Vietnam, and Ukraine were all at least 80 percent rural at the time). North Korea, by contrast, had become a predominantly nonagricultural and urbanized economy by the late 1980s. This means that household-level food self-sufficiency is simply not an option for most North Koreans.

• Virtually all previous food crises occurred within a decade of the establishment of the communist regime. Those crises may be seen as part of the process of system consolidation. But in North Korea the current food crisis has emerged in a fully mature Marxist-Leninist polity, in which a vanguard party has held power for nearly half a century.

• In the earlier food crises the policy interventions at fault were both newly introduced and self-evident, thus lending themselves to relief through policy reversal. There is little information about North Korea's contemporary agrarian policies and their implementation. North Korean media extolled the virtues of a "transition to all-people's ownership in agriculture" in 1994 and early 1995. Later in 1995, however, the media fell silent, after the official appeal for international food aid and the official announcement of massive damage from flooding.

To sum up, the economic pressures and problems confronting North Korea's socialist system today appear to have no precise analogy in recent historical experience. Although the country enforces an exceptional degree of social control over its people, and reinforces this control by a to-date singularly successful policy of obstructing communication and contact with the outside world, it is well to remember that economies under severe stress can in fact collapse. One incontestable indicator of a potential collapse is a hunger crisis precipitated by a breakdown of the national food system.

Nicholas Eberstadt is a researcher at the American Enterprise Institute, Washington, D.C., and Harvard University. This article is based on a longer forthcoming study, "Communist Economies and Economic Transition."

Wise Planning

"Our kid finally appreciates the extra Russian language classes, now that he has an excellent job with the mafia."

From the Hungarian daily Nepszabadsag
North Korea Is Starving for Reform

North Korea, detailing its food shortage for the first time, has announced that it is short 2.3 million tons of grains needed to feed its people this year. The country harvested only 2.5 million tons in 1996 because of devastating floods. North Korea appealed to world governments for food. The Rome-based U.N. World Food Program estimates that North Korea has only enough food to last until late spring or early summer.

Easing the forty-seven-year U.S. trade embargo on North Korea, the Clinton administration allowed nongovernmental organizations to provide humanitarian food aid to the country. U.N. officials said that the North Korean government a few months ago reduced the amount of food provided by the state-run ration system from about 14 ounces daily per person to 3 1/2 ounces. (Refugees in U.N.-supported camps in Africa and elsewhere receive 22 ounces of rations a day.)

Karen Elliott House, president of Dow Jones International, in the Wall Street Journal calls on the U.S. administration "to stop extending the death throes [of the dying North Korean regime] with pills of promised aid and placebos of diplomatic dialogue." She points out that North Korea’s economy has been shrinking for seven years, its people are now limited to one bowl of rice a day, and the regime is warning of impending starvation. U.S. intelligence sources claim that North Korea’s fuel shortages have required its air force to curtail exercises, stalled the army’s tanks, and left industry operating at 20 percent of capacity. An Oregon state senator who recently visited Pyongyang reported blackouts in the government guest house, a sign that things are so tough even pretenses can’t be maintained.

Thus far, Pyongyang has steadfastly refused to embrace reform, despite negative economic growth every year since 1990 and a largely nonfunctioning formal economy. The latest upheavals in the top leadership—the rise of military generals at the expense of technocrats who have made some efforts at reform—bode ill for the prospects of change. Leading ideologist Hwang Jang-yop, who defected in Beijing on February 12, largely shaped Pyongyang’s official philosophy of juche (self-reliance), but even he appears to have concluded that the ascendant military hawks are harmful, both to the country and to himself. His flight is bound to render other would-be “reformers” vulnerable.

On February 21 Hong Song-nam, 73, one of several deputy premiers, was appointed acting prime minister. He is a Czech-trained engineer who has held mainly economic posts, and was chief planner in 1986-88. It is not clear whether he favors economic reform. His predecessor, Kang Song-san, had been out of action owing to ill health for over a year. At 65, Kang was younger than most Korean leaders. He was regarded as proreform; during his earlier premiership, from 1984 to 1986, Kang oversaw the first joint venture law and a partial repayment of Western bank debts. Thereafter, as governor of North Hamgyong Province, he laid the groundwork for the country’s only free economic zone, Rajin-Sonbong, promulgated in 1991. Expectations of further reform were thus high when Kang was reappointed premier in late 1992. These were not fulfilled.

The funeral committee for the late defense minister, Choe Gwang, who died of a heart attack on February 21, strongly suggests that soldiers are displacing civilian technocrats at the center of power. (In the absence of due process in North Korea, funeral committees offer valuable pointers on the rise and fall of individuals and groups.) Real power now lies with a trio of marshals who have shot up in the ranks: the head of the secret service, the head of the air force and political director of the Korean People’s Army (KPA), and the chief of the general staff. Several leading technocrats with reformist leanings were not on the funeral list, and have therefore presumably lost their party rank. In general, North Korea’s military leaders can be assumed to be even more narrow-minded than the Pyongyang norm (few have ever traveled abroad), and are likely suspicious of reform, since peace would threaten the huge military budget.

This is why many pundits react cautiously to suggestions that 1997 could be the year that Pyongyang finally allows some degree of marketization and opening of its economy. Rumors that de facto family farming will be tolerated owing to the agricultural crisis do little to support such predictions.

Based on news agency reports and reports of the international research group, Oxford Analytica, U.K.
Milestones of Transition

Regional

Foreign direct investment in the former communist world topped $46 billion in mid-1996, up 60 percent from a year earlier, with countries that are reforming faster getting the lion's share. Hungary ranked number one in foreign direct investment in transition economies with a cumulative $13.9 billion, followed by Poland with $9.1 billion, a report by the U.N. Economic Commission for Europe (ECE) said. Hungary now accounts for 30 percent of total foreign direct investment in the ex-communist world, followed by Poland with a 17 percent share. Russia is third with a 13 percent share, pushing the Czech Republic into fourth place with 12 percent. Overall, Hungary, the Czech Republic, Poland, the Slovak Republic, and Slovenia receive nearly 70 percent of the total.

Although tiny by Western standards, the per capita foreign direct investment in transition economies more than doubled to $135 at the start of 1996 from $60 at the start of 1994, the ECE said. This is way below the $1,800 or so in per capita foreign direct investment in the United States but is more than Brazil's $130 and China's some $110. At the bottom of the heap, per capita foreign investment in 1996 was just $17 in Ukraine and $20 in Moldova.

In the former Soviet Union, Russia led in foreign direct investment with $6.6 billion, according to the report. In contrast, Moldova and Belarus received just $104 million and $350 million, respectively. Western Europe accounted for the bulk of foreign direct investment in the former Soviet Union, with a share of 80 percent in Belarus, 70 percent in Russia, and up to 60 percent in Estonia, Latvia, and Ukraine, but reaching only 17 percent in oil-rich Kazakhstan.

Central and Eastern Europe

The European Investment Bank (EIB), the European Union's (EU) main financing arm, posted record results in 1996 with total lending of $27.26 billion, EIB President Brian Unwin announced. Lending to Central and Eastern Europe reached an all-time high.

The EU invited Central and East European leaders to a special summit in June to discuss the EU's preparations to admit new members from among the former communist countries. The meeting, scheduled for June 27 in Amsterdam, will follow EU approval of a package of reforms designed to prepare for an eastward expansion over the coming years. The Czech Republic, Hungary, and Poland are seen as the leading contenders for early EU membership, with Bulgaria, Estonia, Latvia, Lithuania, Romania, and Slovenia also hoping to join.

The European Commission is completely revamping its multibillion dollar Phare program aimed at getting the ten former communist countries ready for EU membership. Commission officials said the program to date has been driven by requests from the countries, resulting in a plethora of small projects, many run by outside consultants and not all run efficiently. Under the new system the fragmented aid programs will be merged into a superfund, and decisionmaking on development spending will be shifted from the region to Brussels. The EU will draw up national programs with the countries being offered membership, and the money will be targeted directly at preparing the countries to join the EU.

Albania

Albania needs at least $300 million to prevent economic collapse, Albania's new finance minister, Arben Malaj, told an EU fact-finding mission in mid-March. The country faces a food crisis because looters have stolen government food reserves. The EU should act in Albania by sending an elite brigade of accountants and economists, according to a recent Times of London editorial.

Bulgaria

Caretaker Prime Minister Stefan Sofiyansky on March 17 presented on national television the main features of the stabilization program, admitting it could cost as many as 58,000 people their jobs. (Unemployment reached 13.4 percent in January, the highest level since July 1994.) All prices would be fully liberalized except for temporary continuation of subsidies for bread, milk, white cheese, and chicken. Earlier the government announced a 257 percent increase in the prices for heating, electricity, and coal. Services offered by the Bulgarian Telecommunications Company are to be raised eightfold.

Wages would be increased by 70 percent starting April 1, and a new social security system would be created by the end of June. The average monthly wage is to reach $72 in April and $112 in December, the average pension $22.5 in April and $34 in December. The government will try to find ways to compensate the country's poorest citizens. Some 20 million ECU provided by the EU will be distributed among 150,000 families. Eighty-nine percent of Bulgarians say that they are poorer than they were last year. The number of those who are living off their savings has doubled since 1995. Almost every fourth Bulgarian has run up debts reported the National Statistics Institute (NSI).

Harvard Institute for International Development Director and Bulgarian presi-
Resident adviser Jeffrey Sachs said the Bulgarian government should seek ways to restructure its heavy debt burden over both the short and the long term. He told a news conference in early March that a country with hyperinflation could not be expected to make net payments to the outside world to any significant extent. Sachs also warned Bulgaria against long-term implementation of a currency board, as proposed by the IMF, to help stabilize the economy. The country’s small foreign reserves (about $400 million) cast doubt on the efficacy of a currency board, he claimed. Noting that annual debt service is about 10 percent of GDP, he lambasted the West for being more concerned about the welfare of Western creditors than about that of the Bulgarian people.

Meanwhile, Steve Hanke, the world’s best-known advocate of currency boards, has become an adviser to Bulgarian President Petar Stoyanov. (See Steve Hanke’s article on new currency boards, Transition, February 1997, p. 8.)

Czech Republic

An economic slowdown—and the consequent shrinkage of the tax base—was largely responsible for the deficit in the state budget after only two months of 1997. In January-February the budget deficit reached 6.7 billion crowns ($231 million). The finance ministry attributes much of the current year’s deficit to a fall of 3.3 billion crowns in revenues from taxes. In addition to the economic downturn, Czech firms have become smarter at avoiding taxes, according to Evzen Kocenda, deputy director of research at Charles University’s Center for Economic Research and Graduate Education.

Economists blame the slowdown on three factors: the incomplete privatization of large companies, the growing trade deficit, and the Czech National Bank’s inflation-conscious and restrictive monetary policy.

Finance Minister Ivan Kocsmárik has announced an across-the-board cut in state spending of 2 percent, (that is, 11 billion crowns). Proposed government measures also include increasing consumption taxes (for example, on gasoline, cigarettes, and beer) and lowering the corporate tax rate from the current 39 percent to 35 percent.

The strong crown, as well as Czech industry’s failing export performance, is driving the country’s trade deficit—$5.9 billion in 1996, compared with $3.7 billion the previous year. The national bank reported that the current account deficit for all of 1996 was $4.5 billion, compared with $1.4 billion in 1995. This year’s trade deficit could top 200 billion crowns (about $7 billion). The trade deficit in January was 13.6 billion crowns ($477 million), compared with 7.9 billion crowns in January 1996.

Hungary

The foreign trade balance is expected to deteriorate by $500 million in 1997 compared with last year, because of a 10 to 12 percent projected increase in imports, Hungarian officials predict. To preserve the balance of payments the tourism sector must produce a surplus of $1 billion to $1.2 billion. Industrial production must grow by 4 percent and investments by 8 to 10 percent, along with stagnant export and domestic consumption levels, in order to achieve GDP growth of 2 to 3 percent. In accordance with the EU association agreement, Hungary will lift import quotas on EU goods. Hungary must also abolish import duties by the turn of the century, with only temporary duties to be imposed on products important to the Hungarian economy.

The gap between the rich and the poor in Hungary continues to widen: the 20 percent of people with the highest incomes earn four times as much as the poorest 20 percent, according to a recent report by the Central Statistical Office.

About 25 to 30 percent of the nation lives under the poverty line, defined last year at earnings of 15,172 forints (Ft), or $87, a month. A typical family of four spends 45.3 percent of its income on food. Hungary’s 3 million pensioners received an average Ft 17,300 (about $100) a month last year.

The Budapest-based Economic Research Institute (GKI) forecasts a 2.5 percent rise in real GDP in 1997 with 6 percent growth in industrial production and a 1 percent increase in agricultural output. Capital investment is expected to grow by 10 percent next year. GKI forecasts 8 percent growth in exports and a 10 percent increase in imports next year. This will result in a $2.8 billion $3 billion trade deficit, including the turnover of duty-free zones, but GKI expects the current account deficit to remain at $1.8 billion in 1997. The conditions for economic growth are expected to emerge in the next few months, and falling inflation and higher wages are likely to boost domestic demand.

Hungary on April 1 reduced the monthly crawling-peg depreciation of the forint to 1.1 percent from 1.2 percent. The government is to reduce Hungary’s special surcharge on imports to 3 percent effective May 15. The country’s improving economic fundamentals have allowed the government to take these steps as part of an effort to force down inflation in 1997.

Poland

According to estimates by the economy ministry, the foreign trade deficit reached $12.6 billion in 1996, almost double the figure for the previous year. Export revenues totaled $24.35 billion (a 6.3 percent increase over 1995) and import revenues $36.94 billion (27.2 percent). Economy ministry official Janusz Kaczurba said the shortfall was caused mainly by the limited export capacity of the Polish economy and the slowing down
of global foreign trade. He added that the improvement of the German economy (Germany is the biggest importer of Polish goods) and the increase in foreign investment in Poland should mean that the foreign trade deficit will be lower this year. Exports are projected to grow by 15 percent and imports by 22 percent.

Polish authorities are weighing controls on some foreign investment as part of their effort to reduce inflation by reining in money supply growth. The national bank wants foreign investors who buy Polish government bonds and corporate debt securities to deposit a portion of their investments in non-interest-bearing accounts. Critics are concerned that the national bank’s intended measure would slow down investments by foreigners, who have already invested an estimated $1 billion in Polish government debt.

**Romania**

Prime Minister Victor Ciorbea presented the government’s long-awaited shock therapy program. About 3,600 state companies will be privatized in 1997; unprofitable companies will be closed or auctioned off, exchange controls are to be lifted, tariffs and price controls cut, and an inflated exchange rate abandoned. (The price of fuel, electricity, public transport, and telecommunications already surged in February following the government’s decision to withdraw subsidies for them. As a result, consumer prices rose 18.8 percent in February, after a 16.2 percent rise in January.)

The government expects a rise in unemployment to about 8 percent from the current 6 percent. A social program will compensate those most affected by the measures—over 10 percent of GDP will be channeled into this program. The average monthly wage will increase by more than 30 percent, from 329,000 lei ($53) to 430,000 lei ($70). The government hopes that the wage increase will compensate for some 75 percent of the price hikes. The minimum taxable salary will double from the present 97,000 lei (about $16).

Within the next two months the government will introduce or revise up to eighty laws in order to attract direct and portfolio investments from the West, Prime Minister Ciorbea said. Bureaucratic procedures are to be cut back. Romanian authorities plan to allow foreign banks to acquire up to about 95 percent of state banks’ capital and to develop capital markets. All five state-controlled commercial banks will be included in the bill. Mr. Ciorbea also invited foreign companies to buy stakes in state utilities, communications groups, and oil companies that are to be privatized. Foreign investors in Romania, whether their interest is in partially or entirely foreign-owned businesses, will be entitled to own the land required for their activities.

Romania’s GDP will contract by 1 to 2 percent this year amid sweeping free market reforms. Romania’s annual foreign debt servicing will total about $900 million this year but will grow to $1.6 billion between 1999 and 2001 due to recent short-term borrowing, IMF Resident Representative John Hill told an investors conference in Bucharest in early March. Most of the country’s resources for debt servicing in 1997 will come from foreign loans. The budget and current account deficits should steadily improve, and the state could pay for the higher debt servicing in the near future with little borrowing. Modest GDP growth is expected in 1998 following the free market reforms.

The leu has stabilized at rates of 8,500 to 9,000 to the dollar after a six-week depreciation of 46 percent. The National Bank of Romania has set an official reference rate of 6,822 lei to the dollar in order to hold the leu’s depreciation to 39 percent so far this year. The bank will set minimum and maximum rates for the leu by the end of this year if foreign reserves total at least $2.5 billion and inflation drops to an annualized rate of 30 percent, national bank officials predicted.

**Federal Republic of Yugoslavia**

The Yugoslav economy is on the verge of collapse and the government is facing stark economic options—recession or rampant inflation—the Belgrade-based Institute for Market Research (IZIT) said on March 4. IZIT director Jovan Todorovic said Yugoslavia urgently needs to rejoin international financial institutions but must also embark on privatization, economic restructuring, and reform of the expensive state apparatus. The West has made any recourse to such bodies as the IMF conditional on political as well as economic change by the government.

**CIS and the Baltics**

**Baltics**

The Baltic states of Estonia, Latvia, and Lithuania are all moving ahead with legislation to introduce private pensions, which experts say will provide a major boost to both local markets and the economy. "This is really important for economic growth," said Louise Fox of the World Bank, who is advising the Latvian and Lithuanian authorities on pension fund legislation. Fox said that once private pension are introduced, around 1 percent of Latvia’s 2.7 million population will likely take part in some form of private pension scheme in the first year, with participation rising to around 20 percent after ten years. An underground pipeline to smuggle vodka between Estonia and Latvia has been discovered by the countries’ customs officials. The 300-meter pipeline ran between two border villages alongside the main Riga-Tallinn road. The pipeline was discovered before it began operating. The price of vodka in Estonia is 60 percent higher than in Latvia.
In February monthly inflation in Estonia was 0.9 percent, in Latvia 0.4 percent, and in Lithuania 0.6 percent, in each case sharply down from January levels. The combined rates for the first two months (2.3 percent in both Estonia and Latvia and 3.4 percent in Lithuania) are considerably lower than for the same period over the past six years.

Russia

In January Russians purchased $5.2 billion worth of foreign currency, a recent Russian State Statistical Committee report said. This amounts to 18.5 percent of total earned income. The monthly flight of Russian capital abroad totals between $1.5 billion and $2 billion, according to the Russian Academy of Sciences’ Institute of Economics. The most widespread scheme is to sell raw materials at lower than world prices and then share the difference between the participants in the deal.

Russia’s 17 million jobless constitute 22 percent of the labor force, the International Labor Organization claims. The ministry of labor in Moscow, however, cites data that put unemployment at just 7.5 million (9.7 percent) at the end of 1996: 2.5 million registered unemployed, plus 3 million engaged in part-time work and 2 million on unpaid leave. Arrears of unemployment benefits total 1.2 trillion rubles ($210 million). Currently, an unemployed worker receives 75 percent of the last earned wage. A new law would cap the benefit at the subsistence minimum for the region in which the applicant resides.

Only six of Russia’s eighty-nine regions met their 1996 tax obligations to the federal budget, according to Deputy General Procurator Vladimir Davidov. The main reasons for tax arrears are falling industrial output and the inefficient fiscal system, he admitted. Barter deals and the mass issuance of bills of ex-change (vekselya) represent major channels for tax evasion. Russian commercial banks alone issued 114 trillion rubles (some $20 billion) worth of vekselya, according to the central bank. At any one time 11 trillion rubles in tax payments are being held by commercial banks, which delay passing the funds on to the federal authorities. (On March 14 the Duma imposed higher fines for each day that commercial banks delay transferring tax payments to the budget.)

The 1997 budget, signed into law, plans expenditure of 530 trillion rubles ($76 billion), including 104 trillion on defense, 47 trillion on internal security, 18.5 trillion on education, and 10 trillion on social policy. With income of 434 trillion rubles and a deficit of 95 trillion (3.5 percent of GDP), the budget formally complies with the deficit guidelines agreed with the IMF. Prime Minister Viktor Chernomyrdin admitted that 40 trillion rubles of expenditure carried over from 1996 are not covered by revenues at present.

The volume of domestic investment in the Russian economy in January totaled 18 trillion rubles, a 9 percent decline over the same period a year earlier. The fall is largely due to drastic cuts in federal investment programs, high interest rates for banking credits, and the higher returns possible from state short-term securities.

In the fuel and energy sector investment in 1996 fell 16 percent compared with the previous year, amounting to 104 trillion rubles ($18.4 billion). Investment in the gas industry fell 5.5 percent, and in the oil sector the decline was 25.7 percent. Oil production dropped 2 percent in 1996, and has fallen 40 percent overall since its peak in 1987. Major foreign investors are staying away pending the approval of a list of sites authorized under the production-sharing law. Half of the oil pipelines are more than twenty years old, and 2 percent of the oil is lost through leaks due to corrosion and accidents.

The average monthly salary in Russia was 870,000 rubles ($155) in January, 10 percent higher than a year earlier after adjustment for inflation. As of January 27, Russian workers were owed 48.6 trillion rubles in delayed wages, up 3 percent from 47.2 trillion in December 1996; late payments from the budget accounted for about 20 percent of the arrears.

Russia’s population will decline by up to 25 million people during the next three decades if current demographic trends continue, Carl Haub of the Washington-based Population Reference Bureau predicts in a recent study. The population will decrease from the present 148 million to 123 million by 2030, and after that the decline will be even faster. The drop in population is related to the low birth rate (in 1996 the rate was just 9 births per 1,000 population) and the high death rate among Russian males, which now equals that of war-ravaged Liberia. This high mortality rate is attributed primarily to cardiovascular diseases, industrial accidents, and alcoholism. Soon, almost one-third of Russia’s population will be people who are dependent on pensions.

Ukraine

Ukraine owes 1.36 billion hryvnias ($750 million) in wage arrears and 1.2 billion (more than $700 million) in unpaid pensions, Prime Minister Pavlo Lazarenko told the parliament on March 11. He said the debts have accrued because budget revenues were smaller than predicted, unforeseen wage increases were being financed from the budget, and local budgets were higher than envisaged. He hoped that 35 percent of all wage arrears would be paid by May and all pensions dating from December 1996 by the end of March.
Ukraine wants to promote foreign investment. Prime Minister Lazarenko announced in mid-February that the tax burden will be reduced, and the state's share in privatized enterprises will not exceed 26 percent (except for strategic facilities, in which the government will retain 51 percent ownership). Ukraine has so far attracted only $1.5 billion in foreign direct investment.

Ukrainian lawmakers have voted to increase the minimum monthly wage from 15 hryvnyas ($8) to 70.9 hryvnyas. Labor Minister Mykola Biloblotsky warned that the move would cost the state budget 32 billion hryvnyas this year. The average monthly wage for Ukraine's industrial workers is now 157 hryvnyas.

Central Asia

The presidents of the Kyrgyz Republic, Tajikistan, and Turkmenistan have pledged aid totaling 0.3 percent of their annual fiscal budgets to the International Fund for Saving the Aral Sea.

Under a major government reorganization in Kazakhstan, two new state agencies directly responsible to the president have been created to control strategic resources and planning. The economy ministry, the trade and industry ministry, and the antimonopoly committee have been merged into a new economy superministry. The state property and state privatization committees have been abolished, and their powers transferred to the finance ministry and the state investment committee. The energy sector ministries were amalgamated into a new energy and natural resources ministry. The changes seem likely to concentrate more power in the hands of the president and to strengthen the hand of the oil and gas lobby.

U.S. investors at the start of 1996 had a 66 percent share, worth $1.8 billion, in Kazakhstan's foreign direct investment, mainly in the oil industry. More than 27,000 Kazaks now work for foreign companies or joint ventures, compared with around 6,400 in early 1993. (A U.S. firm, CCL, has recently invested in Kazakhstan, having a three-year concession to run the Pavlodar oil refinery. The plant previously produced more than half of Kazakhstan's gasoline needs.)

Kyrgyzstan's GNP increased by 5.6 percent, industrial output by 10.8 percent, and agricultural output by 13.1 percent in 1996, President Askar Akayev announced to parliament on March 26. One of the country's goals for 1997 is to reduce the trade deficit. In 1996 Kyrgyzstan imported 1.7 times more than it exported. Another goal is to bring inflation down to 17 percent and to cut unemployment, which is running at 20 percent.

Uzbek President Islam Karimov called 1996 the year of economic and financial stabilization. The budget deficit did not exceed 3.5 percent, inflation was cut in half, the national currency was strengthened, and foreign trade was more than $9.3 billion. Mr. Karimov called for 1997 to be a year of social security for all. (The EBRD has granted a credit line of $120 million to develop the Uzbek banking sector, and OPIC has provided $200 million worth of political risk insurance and financing for U.S. projects in the country.)

In Turkmenistan inflation in 1996 was 100.1 percent. Some 4.4 million metric tons of oil and 35.2 billion cubic meters of gas were extracted during the year. Over 90 percent of industrial production came from state enterprises but some 66 percent of retail trade is reportedly outside state control. GDP exceeded 6.6 billion manats ($1.6 billion) in 1996.

Turkmen President Saparmurat Niyazov signed a $580 million agreement with three Japanese concerns—Itochi, JGC, and Nissho Iwai—to build Turkmenistan's first polypropylene plant in Turkmenbashy (formerly Krasnovodsk). The Japanese government will extend a $400 million credit to the plant, which will produce 90,000 tons of polypropylene annually.

Asian Economies

Cambodia

Cambodia is laying plans to set up its first stock market, and finance ministry officials are aiming for a 1998 start-up. Capital market laws have already been drafted and are awaiting submission to the National Assembly for approval. The government also needs to pass company laws and legislation affecting withholding tax and foreign exchange. Cambodia's economic growth for 1996 has been revised upward to 6.5 percent from an original 6 percent, Finance Minister Keat Chhon said in early March.

Vietnam

Vietnam is expected to record a $945 million trade deficit for the first three months of this year. That level would represent a 6.5 percent decline from the shortfall in the same period in 1996, and would signal that government efforts to tame the deficit were paying off.

Nearly one-fifth of Vietnamese state-owned enterprises (SOEs) are operating at a loss, a Vietnamese newspaper reported. However, experts say that given the nature of accounting at most state-owned enterprises, the figure could be much higher.

We appreciate the contributions from the Open Media Research Institute's Daily Digest.
World Bank/IMF Agenda

Wolfensohn: World Bank and IMF Prepared to Aid Albania

The World Bank and IMF are prepared to provide financial aid to Albania to help it out of the present crisis, World Bank President James Wolfensohn said during a March 6 press conference in Madrid. The EU regards reestablishing relations with the IMF, introducing strict financial discipline, and clarifying events that led to the collapse of the country's pyramid schemes as conditions for support.

Pyramid Schemes and the Limits of Conditionality

International institutions cannot be accused of keeping their eyes shut to the dangers of the pyramid schemes to Albania but they did underestimate the consequences, writes French commentator Francoise Lazare. Both the IMF and the World Bank warned the authorities several times and urged them in vain to eliminate these schemes. "The painful misadventure in Albania shows the limits of economic conditionality. As long as local authorities cooperate with international finance institutions (IFIs), they can manage economic policy together, but if confidence is lacking, the means available to IFIs are limited."

Albania was a master student of international economic institutions two years ago, with a healthy economy (GDP was growing at 8 to 10 percent annually), acceptable entrepreneurial structures, and stable political conditions. But the poorest economy in Europe is now shrinking to less than its size in 1990. If new credits from abroad are cut off because of the current chaos, imports could completely collapse. The economy is kept afloat only by the inflow of hundreds of millions of dollars a year from Albanians working in Italy or Greece, and through foreign aid from the EU, the World Bank, Germany, Italy, and the United States. (About a third of last year's $960 million budget revenues was provided by various foreign sources. Albania has received the highest per capita level of EU aid of any East European state.) Albania's growth was largely a mirage. (From comments in Le Monde, the Guardian, Handelsblatt, and Financial Times.)

World Bank Loans to Russia Could Expand

The World Bank expects its loans to Russia to increase by $2 billion to $3 billion a year for the next few years from the current $6 billion, Vice President Johannes Linn told a news conference in Moscow during his early-March trip to Russia. "A doubling of loans outstanding by the end of the century is not impossible," he added. Michael Carter of the Bank's Moscow office said new loans would fund a bureau for economic analysis to improve economic policymaking and would finance higher education and school textbooks. Work on a new structural adjustment loan is to be completed in the next few months.

Tentative accord was reached on a $300 million loan for the reconstruction of historic parts of St. Petersburg, as well as on a loan of similar size for renovation of the water and drainage networks of several Russian cities, Construction Minister Yefim Basin disclosed. Earlier, the Moscow Times reported that World Bank officials are discussing another loan to Russia's coal industry, just months after dispensing the second tranche of a $525 million loan targeting the battered sector.

More Satisfactory Projects in Russia

A joint Russian-World Bank review concluded in March shows that Russia's loan projects have a 65 percent satisfactory rating and that monthly disbursements are running at about $70 million. This is a far cry from early 1996, when a similar review of Russia's portfolio found that with a less than 40 percent satisfactory performance rating, Moscow was drawing an average of only $25 million a month from its loans. In 1995 Russia's loan projects were the most troubled in the Bank, with only 39 percent considered to be performing satisfactorily.

But a major joint effort launched by Russian Prime Minister Viktor Chernomyrdin and World Bank President James Wolfensohn has turned the situation around. The review's target is to reach a satisfactory rating of 80 percent of projects by June. (To get this rating, a lending project must meet all goals outlined in the Bank's country assistance strategy, must be consistent with the Bank's overall policies on poverty reduction, and must be using resources efficiently.) The Bank is now Russia's largest single foreign source of long-term financing for public sector investments.

Since August 1992 twenty-eight loans to Russia have been approved, with a total value of $6.4 billion. This makes Russia the Bank's third largest borrower after China and India. Loans have been provided for the oil industry; for the transport sector, including road and bridge repairs and improvement of bus services in more than a dozen cities; for strengthening the banking sector and developing capital markets; for the support of agricultural and land reform; for promotion of better health care, education, water supply, and sanitation; and for protection of the environment.

Reported by Robert Lyle, Radio Free Europe

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TRANITION, April 1997 29
Chubais Orders Investigation of Use of World Bank Loan

Russian First Deputy Prime Minister Anatoly Chubais has instructed the finance ministry's control department and the territorial agencies of the main department for the federal treasury to check on whether the World Bank's 1996 "coal loan" was used correctly, Chubais's aide Andrei Trapeznikov disclosed. Reports have indicated that the administrations of some coal-mining regions, rather than apply the loan as intended to improve the social conditions of coal miners endangered by mine closures, used the World Bank funds for other purposes. The investigation will affect all of Russia's twenty-four coal-mining regions. The World Bank's Moscow office welcomed the news regarding the investigation. "We hope that the ongoing verification effort will clarify the proper use of all budget resources going to the coal sector," the Bank's communiqué emphasized.

Summers Urges Greater World Bank Role in Russia

The current phase of economic reform in Russia calls for the broader expertise of the World Bank, Treasury Deputy Secretary Lawrence Summers told members of the U.S.-Russia Business Council on April 1. Summers praised the work carried out thus far by the International Monetary Fund, but said "strengthening the public sector, promoting development of the private sector, and tackling sectoral problems" are better suited to the World Bank. Its conditionality, operating through numerous projects and programs loans, is also more focused and surgical than what the IMF can do with a single program, he added. "I call on the World Bank to now take the lead and greatly increase its role in Russian reforms," he said, adding that the Bank was clearly ready to do so and should now
greatly expand" the scope of its activities to provide $2 billion in additional loans this year. He said the Bank should examine areas of fiscal management, social protection, and programs in areas such as agriculture and power.

Emergency Support to Bulgaria

The Bulgarian government reached agreement with the IMF on March 17 for an economic stabilization program to be backed by new loans totaling $660 million, mostly from a $510 million standby facility. This will be disbursed in six tranches over fourteen months, subject to the country meeting quarterly conditions. The stabilization program is to be based on a currency board system, under which the exchange rate will be fixed and the money supply fully backed by foreign currency reserves. The budget deficit is to be cut to 4 percent compared with 11 percent in 1996 and a similar level in the first half of this year, and foreign reserves are to rise sharply. In the long term the government has committed itself to accelerating structural reforms, including faster privatization, greater price and trade liberalization, and higher foreign direct investment. The World Bank is discussing loans worth about $290 million—$170 million from two financial and enterprise structural adjustment loans, $40 million for financing critical imports of grain, medicines, vaccines, and basic foodstuffs; and $80 million for social protection. In mid-April the EU and OECD will discuss additional balance of payments support, which could amount to $300 million. The Bulgarian National Bank said it had foreign exchange reserves of $445.5 million at the end of February. Bulgaria has foreign debt repayments of more than $800 million due this year.

First World Bank Guarantee to Ukraine

A partial risk guarantee of $120 million approved by the World Bank on March 18 will support a pre-export guarantee facility (PGF) established by the government of Ukraine. The PGF will encourage foreign investors to finance the working capital or fixed capital requirements of Ukrainian agricultural enterprises, agroprocessing enterprises, and private distributors. The Guarantee Administration Unit (GAIU), an independent public entity, will sell guarantee contracts against government performance and political force majeure risks, back-stopped by a World Bank guarantee. Since Ukraine joined the World Bank in September 1992, Bank commitments have totaled about $1.6 billion for ten projects. World Bank Managing Director Caio Koch-Weser said at a recent news conference in Kiev that the Bank could provide Ukraine up to $1 billion in loans this year if it quickly passed the 1997 budget and a package of tax reforms to underpin it. The budget would also pave the way for Ukraine's receipt of a $2.5 billion to $3 billion extended fund facility loan from the IMF.

Fund-raiser for Bosnia and Herzegovina Postponed Again

An international donors conference aimed at raising $1.4 billion for reconstruction in Bosnia and Herzegovina has been postponed for the second time this year. The conference should have been held in March but was postponed until April to give the Bosnian government time to adopt economic reforms and clinch a deal with the IMF. Now the April date will also be missed. Before committing funds to Bosnia and Herzegovina, foreign donors want to see it sign an agreement with the IMF, which in turn wants to see a functioning central bank,
an agreement on common currency, and finance and budget laws in place. In another development, with support from the World Bank, the government has established an Investment Guarantee Agency (IGA) to offer guarantees to foreign investors providing credits to local industries. "This ensures that a guarantee holder is fully protected by an independent and strong financial source outside Bosnia and Herzegovina," Lamija Kosaric, the agency's director, said. The World Bank group's MiGA grants guarantees for larger and longer-term investments beyond the coverage offered by IGA.

**Croatia Receives IMF Loan**

The IMF announced on March 13 that it has approved a three-year $486 million extended fund facility loan to Croatia, $158 million of which will be available this year. The credit is designed to help the government push ahead with structural reforms while meeting postwar expectations of higher living standards. Healthy growth is likely to continue this year. Croatia's Deputy Prime Minister Borislav Skegro announced that the country is close to completing an $80 million to $100 million financial and enterprise structural adjustment loan from the World Bank. The loan will be used to help overhaul Croatia's banking system and restructure and privatize large public sector firms.

**Camdessus Sees IMF Capital Account Mandate**

An agreement to give the IMF a mandate to promote capital account convertibility (progressive liberalization of capital account transactions among its members) could be reached at this year's IMF-World Bank Annual Meetings, IMF Managing Director Michel Camdessus said on March 7, at a conference on Asian financial integration in Hong Kong. Mr. Camdessus said that he would recommend that the IMF establish capital liberalization as an objective, although he added that prudence was needed in approaching the process. Stressing the risks for emerging economies in the process of globalization, he said that they should secure their macroeconomic balances and the soundness of their financial system while opening up their capital markets.

**World Bank to Pay More Attention to Environment**

In the future the World Bank will ask independent environmental NGOs for advice in the institution's credit commitments, World Bank President James Wolfensohn said at the Rio-plus-Five summit. The Bank in the past has disregarded environmental sustainability in projects it financed and has made serious mistakes, said Wolfensohn, adding that the Bank was now a reformed institution trying to give greater weight to social, cultural, and human issues alongside economic issues, when deciding on what to finance. (Of the World Bank's $25 billion in annual loans, some $7.2 billion flows to environmental projects. Since 1989, when the Bank set up an environment department, it has supported some 153 projects in 62 countries.)

**Nam Theun II Project: No Decision Yet**

"The World Bank, which initially promised to help finance Laos's Nam Theun II dam, has put the brakes on its support. Alarmed by the $1.2 billion estimated cost of the project, equal to the country's annual GNP and three times as big as the government's budget, the Bank fears the outlay could push the Lao PDR into debt," claimed a recent article in the French newspaper Le Figaro. Officials of the World Bank told the Transition newsletter that contrary to the newspaper's information, no decision has yet been made regarding the project. The World Bank considers it vital to obtain stakeholder evaluation of the projects it supports. A series of public consultations will be held in order to ensure participation at local, regional, and national levels. Only after all these public forums have taken place and several studies completed (about alternatives, economic impact, an environmental and social action plan, a resettlement action plan, an environmental assessment and management plan) will the Bank reach a decision on whether or not to support this project.

**Romania Expects IMF Standby and World Bank Loans**

Romanian Finance Minister Mircea Ciumara said that the country expects to receive about $1 billion in loans from the IMF, World Bank, and European Union. The IMF share is $400 million, with approval expected in mid-April.

**$225 Million for Reforms in Hungary**

A twelve-year, $225 million enterprise and financial sector adjustment loan approved by the World Bank on March 11 will help Hungary finalize banking sector and enterprise reforms. The loan will be used to complete the privatization of the four largest commercial banks—Savings Bank, Budapest Bank, Foreign Trade Bank, and Credit Bank. Since banking reforms began, the share of banking assets controlled by the private sector has increased to about 80 percent. The loan will also be used to strengthen banking regulation and supervision as well as to promote the further integration of Hungary's banking sector into European financial markets. Reforms in the enterprise sector include a new privatization law mandating the divestiture of 80 percent of the remaining state holdings in the enterprise sector and implementing sweeping privatization through which a major share of state holdings in gas and electricity distribution, power generation, and the Hungarian oil and telecommunications companies were divested. So far, Hungary has taken loans totaling $3.7 billion from the World Bank.
Conference Diary

Ninth Annual Bank Conference on Development Economics (ABCDE)  
April 30-May 1, 1997, Washington, D.C., United States

Inaugurated by James D. Wolfensohn, President of the World Bank, and sponsored by Joseph E. Stiglitz, Senior Vice President, Development Economics and Chief Economist. Topics include Corruption: catalysts and constraints (Michael Johnston and Susan Rose-Ackerman); Incentives and performance in public organizations (Sherwin Rosen, Bruce Weinberg, and Dilip Mookherjee); Poverty and environment (Karl Goran-Maler and Ramon Lopez); and Leaders in growth: can others follow? (Alberto Alesina and Takatoshi Ito). Participation by non-Bank and non-IMF staff is by invitation only.


Human Resources Management: Interaction of the Western and Eastern European Management Cultures  
May 22-23, 1997, Jurmala, Latvia

Organizer: LBS Exhibitions and Conferences.
Information: Latvian Business School, 1 Maza Pils Str., Riga, LV 1050 Latvia, tel. 371-721-1186, fax 371-722-4429, Email: lbs@mailbox.riga.lv.

Economic Research Conference: Market Distortions of the Shadow Economy  
June 10, 1997, Kyiv, Ukraine

Organizer: Economic Education and Research Consortium (EERC), Economics, M.A. Program, University of Kyiv-Mohyla Academy.

The purpose of the conference is to stimulate research on the functioning of markets whose operation is hampered or distorted by the shadow economy, inadequate legal foundations, secrecy, rent-seeking, and corruption. Participants will include Ukrainian and foreign scholars, government officials, members of the business community, representatives of foreign assistance organizations, and EERC faculty members and students. Four panels, including a number of invited papers, commentary, and open discussion, will be held. Paper presentations are only by invitation of the program director.

Information: email: sasha@eerc.kiev.ua; or by fax 011-38-044-417-7395.

China as a Global Economic Power: Market Reforms in the New Millennium  
June 15-18, 1997, Shanghai Hilton, China

Organizer: Cato Institute and Fudan University. This international conference features more than thirty leading experts, with sessions on China's place in the global trading order; the future of China's market economy; Hong Kong's future; social developments in China; and building China's institutional infrastructure.


Global Knowledge '97 World Bank Conference on Knowledge for Development in the Information Age  
June 22-25, 1997, Toronto, Canada

The conference will bring together 1,200 ministers and senior policymakers from countries undergoing political and economic transitions, representatives of the international development community, private industry, NGOs, academic institutions, and opinion leaders to discuss the role of knowledge in economic growth and social development; new approaches and technologies in applied learning; and benefits of the information revolution.

Information: Latifah Alsegaf, World Bank, Economic Development Institute, 1818 H Street, N.W., Room M7-075, Washington, D.C., 20433, United States, tel. 202-473-6442, fax 202-676-0858, Email: GlobalKnowledge@worldbank.org.

Investments and Priorities in Development of St. Petersburg  
September 23-28, 1997, St. Petersburg, Russia

Information: Lynn Brittingham, Regional Coordinator USA, tel. 1-800-862-5015, fax 215-862-0303.

Post-privatization Period in Eastern Europe: A Chance for Enterprises and Shareholders  
October 14-19, 1997, Chisinau, Moldova

Organizer: University of Grenoble.
Information: Ivan Samson, Chairman of Organizational Committee on EU, University of Grenoble, 1241 rue des Residences, BP 47 Grenoble, France, tel. 33-476-825-819, fax 33-476-825-862.

Banking and Finance in the Baltics '97  
October 15-17, 1997, Riga, Latvia

Organizer: LBS Exhibitions and Conferences.
Information: Latvian Business School, 1 Maza Pils str., Riga, LV 1050 Latvia, tel. 371-721-1186, fax 371-722-4429, Email: lbs@mailbox.riga.lv.

Third International Conference on Small and Medium Enterprise Development Policy in Transition Economies  
October 16-17, 1997, Wolverhampton, United Kingdom

Organizer: Dr. Milford Bateman and Dr. Will Bartlett, Local Economic Development in Transition Economies Unit, School for Policy Studies, University of Wolverhampton.
Information: Dr. Milford Bateman, Local
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Policy Research Working Papers

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The geographical distribution of foreign direct investment (FDI) within China is determined mostly by GNP, infrastructure development, level of general education, and coastal location. In the past, FDI has been biased toward speculative investment, especially the real estate sector; recently this bias has become less pronounced. Between 1978 and 1995, China received $128 billion in FDI. Recent FDI inflows account for 40 percent of combined flows of FDI to all developing countries, making China the biggest developing-country FDI recipient.
To order: Joan Grigsby, Room MC8-238, tel. 202-458-2423, fax 202-522-1556, Email: jgrigsby@worldbank.org

The authors conclude that the CEE countries at present are not on a path toward reach the income level of the European Union:

- Hungary, Slovakia, and Slovenia would converge to the 75 percent threshold in between forty and ninety years if they maintained their current growth determinants. Poland would never converge in these circumstances and the Czech Republic would converge in about fifteen years.

- Using the growth determinant values of the EU country average, none of the CEE countries would converge to the set threshold. Their high investment level—relative to the EU country average—would enable them to compensate for other shortcomings.

- Assuming an investment level of 25 to 30 percent of GDP would significantly reduce the years required for convergence—for the Czech Republic: 10 to 11 years; Poland: 20 to 22 years; the others: 10 to 20 years. The CEE countries should provide an environment that promotes investment and education.

To order: Luca Barbone, Room H11-079, tel. 202-473-2556, fax 202-477-1034, Email: lbarbone@worldbank.org

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Ukraine's pension system requires radical reforms to restore credibility to the system.
and remove distorted incentives that make it unsustainable. Raising the retirement age to 65 and introducing a funded pillar have to be considered.
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The threat of bankruptcy, internal controls imposed by shareholders, and external disciplines, such as the threat of hostile takeover, can maximize the pressure on privatized infrastructure companies to be more efficient.
To order: Randee Schneiderman, Room G4-040, tel. 202-473-0191, fax 202-522-3481, Email: rschneiderman@worldbank.org


For a cross-section of 706 firms for the period 1992–95, the authors find that the mass-privatization scheme improved the management of privatized enterprises by concentrating ownership. Banks with an (indirect) equity stake in a privatized firm have a positive influence on the firm’s corporate governance.
To order: Faten Hatab, Room H8-087, tel. 202-473-5835, fax 202-477-8772, Email: fhatab@worldbank.org


The authors investigate the optimal boundary between public and private production.
To order: Paulina Sintim-Aboagye, Room N9-030, tel. 202-473-8526, fax 202-522-1155, Email: psintimaboagye@worldbank.org


The government is risk-neutral and the enterprise manager is risk-averse; the government’s goal is to increase revenue (or profitability), to retain maximum control of the firms, and to reduce the inequality of income across firms, by bailing out firms in financial trouble and collecting heavier taxes from high-performing firms. Efficient firms therefore pretend to be inefficient by slacking, so they can get more transfers. The enterprise manager and employees, on the other hand, have an informational advantage over the government that allows them to earn a rent; that advantage leads to suboptimal efforts.
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Foreign direct investment can promote economic development by helping to improve productivity growth and exports in the host countries. But multinationals’ entry into developing countries may replace local production and force local firms out of business, rather than force them to become more efficient.
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Discussion Papers


Eastern German (former GDR) agriculture is competitive, and has ample capacity to rapidly adjust to policy changes. The paper examines in detail particular factors such as land reform and farm restructuring.


China’s Trust and Investment Companies (TICs) are the most numerous nonbanking financial institutions to emerge in China. The paper describes their role in the financial sector, together with their balance sheets, assets, deposits and loans, and financial statements.

Technical Papers


Other World Bank Publications


Bond, equity, and direct investment in the developing countries continued to rise for the sixth consecutive year in 1996. Private capital now accounts for more than 80 percent of net long-term flows to developing countries, totaling $285 billion last year. Nearly 75 percent of foreign private investment last year went to 12 core countries. But that share is down from 84 percent of total investment in 1990. China again is the leading destination of net private investment among emerging-market countries at an estimated $52 billion, up from $44.3 billion a year earlier. (China is followed by Mexico in this “top 12 league”;

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Russia is ninth with $2.5 billion, and Hungary is twelfth with $1.2 billion.) On a regional basis, Europe and Central Asia, with $31.2 billion in FDI, was the third-largest destination for private capital after East Asia and the Pacific ($108.7 billion), and Latin America and the Caribbean ($74.3 billion). "Long-term development aid is a catalyst for, and complement to, private foreign investment. Private investment is not a substitute for official assistance targeted at programs which promote better health, education, and environment," the report said.


Earlier published as the statistical appendix to the World Development Report, now enlarged to include more than 80 data tables and 600 indicators for single-year observations of about 150 countries. Supplemented with a WindowsTM-based CD-ROM that contains time-series data (mostly 1970-95). Other sets of tables include Country-at-a-Glance tables, Social Indicators, and Key Economic Indicators (previously found in World Tables), as well as those from the Atlas.


Color maps, charts, and graphs representing the main social, economic, and environmental indicators for 209 countries and territories. Social data are provided on life expectancy, population growth, infant mortality, female labor, and child malnutrition. Economic data include gross national product (GNP) and the shares of exports, agriculture, and investment in gross domestic product (GDP). Population statistics are provided in absolute terms and as growth rates for 1985-95. Data for the environment are presented on deforestation, water use, energy consumption, and air pollution. A section on states and markets includes data for private investment and capital flows, money supply and government revenues, and power and telecommunications infrastructure. The text appears in English, French, and Spanish.


Altogether, seventy-nine countries—the world's poorest and home to 3.3 billion people comprising some 57 percent of the world's population, and recording average annual income of about $400—are eligible to borrow from the International Development Association (IDA), long term and with zero interest rate. The IDA is replenished by donor countries every three years. (Thirty-two countries fund about 88 percent of IDA activities.)

The total resources made available during the Tenth Replenishment (the period from July 1, 1993, to June 30, 1996) amounted to $19 billion. The IDA provides about one-sixth of net official development assistance (ODA). Out of the IDA's nine new members, six—Armenia, Azerbaijan, Bosnia and Herzegovina, FYR Macedonia, Georgia, and Tajikistan—are transition economies. The report includes summaries of the IDA's country assistance strategies for more than fifty borrowing countries.


Major compilation of macroeconomic data on the economies of the fifteen states of the former Soviet Union. The national statistical offices of each country are the source of the data, which include data (for 1990-95) on population and employment, national accounts, balance of payments and foreign trade, government finance, agriculture, industry and energy, price indexes and wages, and household incomes and expenditures.


Asif Faiz, Christopher S. Weaver, Michael Walsh, and others, Air Pollution from Motor Vehicles: Standards and Technologies for Controlling Emissions, 1996, 268 p.


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IMF Publications


Working Papers

Marta de Casstello Branco, Alfred Kammer, and L. Effie Psalida, Financial


Center for Economic Policy Research Discussion Papers

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The privatization process in Eastern Europe is not irreversible. Future governments may want to expropriate successful private firms by increasing taxation or by renationalizing them in order to subsidize unsuccessful firms. There will be less expropriation the more shares are distributed free to the population. A mass privatization scheme that includes substantial free distribution of shares may induce more investment, higher-than-expected profits, and higher privatization revenues for the government than a policy that relies exclusively on selling shares to the highest bidder.


Lorand Ambruš-Lakatos and Mark E. Schaffer (eds.), Coming to Terms with Accession, EPI Report 2, CEPR/EastWest Studies, November 1996.

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A Sustainable Land Use and Allocation Program for the USSURI/WUSULI River Watershed and Adjacent Territories [Northeastern China and the Russian Far East], Ecologically Sustainable Development, Inc., New York, November 1996, 95 p. To order: Ecologically Sustainable Development, Inc., 2 Church Street, P.O. Box 848, Elizabethtown, New York 12932, United States, tel. 518-873-3200, fax 518-873-2686, Email: esd@igc.apc.org


One of the most rapidly changing areas of municipal financial management, itself undergoing transition, is communal services. Fundamentally, new forms of ownership as well as new organizational and managerial relationships have been established in the broad area of communal services that also includes the provision of public utilities. Methods of financing have changed, the cost burden has been rearranged, and the competency of local governments has increased.
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The Social-Economic Situation in Russia in 1996, 324 p.

The Social Sector in Russia: Statistical Handbook (Sotsial’naya sfera Rossii: Statisticheskiy sbornik), 275 p. (in Russian)

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Bank of Russia in Transition, Central Bank, United Kingdom, vol. 7, no. 2, 1996, 160 p. Special issue includes Interview with Governor Dubinin; History and Organization; Monetary Policy; Exchange Rate Policy; Financial Markets and Banking; IMF and the CBR; Governors of the Bank of Russia; and Glossary.

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Russian Economic Developments, journal published by East View Publications, Inc.

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