Session 6
Evaluation of Bilateral and Multilateral Cooperation

Table of Contents

Taking Stock and Challanges Ahead

Mr. Rika Ishii, EBRD
Economist
Office of the Chief Economist

1. Introduction

It is a pleasure for me to be given an opportunity to present the EBRD's activities in the 26 countries in eastern Europe and the former Soviet Union. In the past decade, the countries in the region have taken giant steps towards establishing democracies and market economies. Indeed, 11 years after the fall of the Berlin Wall, we can see clear progress in the transition. Practically all the governments in the region have been elected in free or almost free elections. Exceptions such as Belarus simply prove the rule. With the election of a new president in Yugoslavia, one of the last vestiges of communist rule in eastern Europe has been overcome. In the area of economic reforms, there have been substantial advances in trade and price liberalisation, privatisation and institutional reform. In 20 of the 26 countries, the private sector now accounts for over half of total output. This year, the regional as a whole is projected to grow by almost 5%, which constitutes its highest growth rate since the start of the transition, and the prospects for the years ahead are also good.

However, I do not wish to underestimate the structural problems that still exist in the transition countries. In the advanced countries these concern mainly the restructuring of old industries and agriculture, as well as reform of the tax and social systems. In the less advanced countries, industrial enterprises and banks still require fundamental restructuring, and the effectiveness and reliability of state institutions and of public administration need to be radically improved. Domestic and foreign investors in a number of transition countries rightly complain of the lack of certainty in the legal system, corruption, bureaucracy and arbitrary administrative acts as being the biggest obstacles to investment. For small and medium-sized enterprises in particular, this makes life difficult and spoils their appetite for investment. Therefore, in our view: significant progress has been made but the transition is far from over. And, as the Russian crisis and its impact on the neighbouring economies have shown, set-backs are possible along the way to completing the transition to a free market economy.

Within today's speech, I would like to drawn on the lessons learned from the experience of first ten years of transition and challenges of the next decade. Where appropriate, I would like to present you some of the findings from our Transition Reports, the most recent of which was published just 2 weeks ago. But first, let me briefly describe the EBRD's activities in the region.

2. EBRD's activities in the region

The EBRD is a multinational institution founded in 1991 with the specific aim of assisting the countries of central and eastern Europe and the CIS to develop into market-oriented economies. Specifically, the EBRD seeks to promote the development of the private sector within these economies through its investment operations and through the mobilisation of foreign and domestic capital. With a capital base of €20 billion, it has committed 14.5 billion for 642 projects by the end of June this year.

We are active in all countries of operations [and the portfolio by country is shown in the slide - slide 2]. It should be highlighted that the majority of investments by the Bank are in the private sector [slide 3] and the Bank uses various instruments from loans - both private and state- to equity investments and guarantees [slide 4]. We have also invested in various sectors [slide 5]. Perhaps the most important aspect with respect to the EBRD's contribution to transition is its role in mobilising investment capital. Compared to the total EBRD financing of €14.5 billion as of June 2000, the Bank has mobilised additional resources amounting to €37.4 billion [slide 6]. The Bank is the largest single direct investor in the region and by the end of this year, will have been associated with almost €14 billion of FDI representing over 9% of total cumulative FDI into the region between 1991-2000. The EBRD's medium-term business plan calls for investment in our countries of operations totalling more than 3 billion euros a year, and therefore the Bank will remain the largest direct investor in the region for some time.

Now let me turn to the lessons that we have learned from our experience so far.

3. Lessons learned

- The first lesson is that **building institutions that support markets take much longer than implementing liberalisation and privatisation.** The lack of supporting institutions hampers the functioning of markets. The governments should attach the highest priority to establishing transparent, predictable and fair rules of the game. The series of Transition Reports beginning in 1994 has been providing a detailed assessment of progress in structural reform. These assessments are made for a number of core dimensions of reform that correspond with the main elements of market economy - markets and trade, enterprises and financial institutions. Progress is measured against the standards of industrialised market economies. The measurement scale for the indicators ranges from 1 to 4+, where 1 represents little or no change from a rigidly planned economy and a 4+ represents a standard that would not look out of place in an industrialised market economy. The progress measured for each country this year and the classification system are contained within the handout. As shown in the slide [slide 7], it is clear that the development of market supporting institutions - such as governance and enterprise restructuring, competition policy, banking reforms and the development of securities markets and non-bank financial institutions - has lagged behind progress in liberalisation and privatisation. The points that correspond to countries and years in which progress in liberalisation and privatisation advanced ahead of institutional performance are mostly below the 45-degree line.

Of course, liberalisation and privatisation are easier to implement than institutional reforms, but it is also clear from the slide that the sequence of reforms has differed sharply across the region. Whereas Hungary has achieved almost perfect balance between progress in liberalisation/privatisation and institutional reform, in Lithuania, rapid progress in initial liberalisation was only followed by institutional reforms in the mid-1990s. In Georgia, institutional reforms failed to follow rapid liberalisation in the early years.

- The second lesson is that **reform choices matter.** There is a growing divergence in progress in reform and economic performance between the front-runners in EU accession and the less advanced countries in the CIS [slide 8]. To some extent this is because countries in eastern Europe had better starting positions. Indeed, the correlation between initial conditions -such as the initial level of development, trade dependence on the CMEA (Council for Mutual Economic Assistance), macroeconomic disequilibria, distance to the EU, natural resources endowments, market memory and state capacity - and progress in reform is positive [slide 9]. It should be noted however, that there are countries that have been much more successful in implementing reforms than initial conditions would otherwise suggest such as in the Baltic States, Kyrgyzstan and Poland. Further, as this slide shows, liberalisation of markets and progress in privatisation have contributed positively to growth [slide 10].
- The third lesson is that because reform choices matter, **political will and its implementation are decisive.** Reforms have tended to progress further where governments have come to power in free and fair elections. However, where democracies are young and weak, states remain at risk from "capture", that is, the efforts of firms to shape and influence the underlying rules of the game (i.e. legislation, laws, rules and decrees). Consequently, the competitive process is distorted, inefficient firms survive artificially and new firms are discouraged from entering in the market. Last year the EBRD has conducted a business survey, together with the World Bank, which has shown that "state capture" by vested interests is a serious problem in some of the countries of the region [slides 11&12].

4. Challenges ahead

From these lessons it is clear that the challenges in the years ahead are institution building, consolidating the gains made in economic liberalisation, and promoting open, democratic and accountable government. Let me now turn to some specific challenges on each of the major sub-regions.

4.1. CEE and the Baltics

Although Central and Eastern Europe and the Baltic states had better initial conditions, they have also made rapid progress in structural reforms. For the four Visegrad countries, Slovenia and the three Baltic states, EU accession is now the main policy goal and the major transition challenge, but an increasingly realistic prospect in the medium-term.

- **EU accession will require substantial investment in public infrastructure.** In the areas of environment and transport systems alone, investment requirements are expected to reach 2-3% of GDP annually over the next decade. While EU transfers pre- and post-accession may help the financing of these investments, fiscal pressures are likely to arise. Against the background of already large public sectors and high statutory tax rates, the governments will need to cut expenditures -such as public sector wages, social security and welfare services - and enhance the effectiveness of social assistance for example, through the reforms in pension systems.
- **Improvements in the implementation capacity of the governments for infrastructure investments are another challenge.** Investments in environmental improvements will naturally require municipalities to take a lead and municipalities must strengthen their financial management capabilities. Governments also need to explore the scope of public-private partnerships in the financing and management of utilities.
- EU accession will also eliminate many of the remaining trade and non-trade barriers and expose weaknesses in the corporate sector - particularly in agribusiness, financial services and heavy industry. **Managing the painful structural adjustment and the associated labour-shedding in the remaining large-scale enterprises will be a key challenge.**

4.2. South-Eastern Europe

Progress in transition in South-Eastern Europe has been considerably held back by the prolonged military conflict in former Yugoslavia. With a new democratically elected government now in place in Yugoslavia, the hope is that this region may finally put the instability of the past decade behind it. However, reform challenges remain more daunting than in Central Eastern Europe.

- Perhaps the most immediate challenge relates to the cementing of a still precarious democracy in Yugoslavia and implementing economic reforms. While the economy is in crisis, subjected to a decade of misrule, conflict and international isolation, prospects for recovery are good. We believe that the international community can have a constructive role in Yugoslavia's economic recovery - first by providing an emergency short-term assistance programme, but also by helping Yugoslavia to design a longer-term growth strategy.
- Foreign investments in the region have remained far less than in Central Eastern Europe - largely reflecting the uncertain political environment but also because of the unfavourable investment climate. It is unlikely that investor confidence will increase rapidly in the short-term. Therefore, the best hopes for economic restructuring lie with the growth of new businesses -as demonstrated by the experience in Poland where the growth of small and medium enterprises (SMEs) became the engine of reform and economic recovery early on in the transition. The governments in the region can make relatively easy improvements in the business environment for start-ups through lowering administrative barriers, streamlining taxation and ensuring equality of treatment in courts.

- Another immediate and critical challenge relates to rebuilding regional links. The revival of intra-regional trade and investment, as well as the creation of expanded markets for local producers will be crucial in increasing the attractiveness of the region to foreign investors. The Stability Pact for South-Eastern Europe will provide between €1-1.5 billion per annum for regional infrastructure projects. As in the case of EU accession, governments will have to improve their implementation capacities to deal with these large transfers.

4.3. Russia and Ukraine

The transition process in Russia and Ukraine has been slower than expected -especially in the area of institutional reforms. Administrative interference at all levels and high-level corruption are seriously undermining the business environment and growth of new businesses. Energy subsidies have also hindered much-needed enterprise restructuring. Nevertheless, developments over the past two years have defied the prophets of doom following the Russian crisis. Russia has recorded two consecutive years of growth and Ukraine is experiencing its first year of growth ever since the transition process began. Of course, this has been achieved on the back of real exchange rate depreciations and high oil prices (in the case of Russia). In both countries, this has provided a window of opportunity for new, bold reform programmes to be adopted. However, restructuring challenges remain enormous.

- First, **competition needs to work.** The loosening of public monopolies in energy and infrastructure are key. Not surprisingly, they feature high on the reform agenda of the present governments in both countries. WTO accession process in the context of Russia will further remove trade barriers and increase competitive pressure in the economy.
- Second, **corporate governance must be improved.** The EBRD as an investor, has experienced a number of cases where weak corporate governance undermined investments. A recent case in Russia has highlighted how both creditor and shareholder rights can been abused. Nevertheless, the threat to the international reputation of the company involved in the case and, by extension, Russia itself- has rectified the situation. Therefore, as large Russian and Ukrainian corporates look increasingly for private financing including from abroad, changing their corporate practices will become increasingly important. EBRD is supporting public and private policy initiatives such as the planned development of a Corporate Governance Code for Russia. The recent start by Standard and Poors to rate the corporate governance of Russian companies can also provide important institutional backing.
- Finally, **a social safety net to cushion the impact of redundancies associated with enterprise restructuring must be provided for.** Compared to Eastern Europe, social security expenditures in Russia are small. During 1993-1998, public expenditures in social security and welfare in Russia averaged only 8% of GDP compared to 13-19% in the Czech Republic, Hungary and Poland. Social reforms are rightly emphasised by the new Russian reform program. Given limited public resources, better targeting is needed and for this, great political and administrative skills are required.

4.4. Southern CIS

The countries south of Russia cover a vast territory from the Black Sea to the Chinese border and have a population of 70 million - as much as Central and Eastern Europe and the Baltics combined. However, their economy constitutes less than 5% of the total regional GDP. Whilst vast natural resource endowments may attract foreign investments, there is a real risk that the economies face problems of economic dualism. At present, markets especially in Central Asia remain highly concentrated and subject to state intervention.

- **Commitment to transparent processes involved in awarding contracts to natural resources development.** Early privatisations and private sector participations in natural resources have often been undermined by corruption. In order to attract serious foreign investors, many of which, have been discouraged by past experiences, governments must establish clarity in the process.
- **Improve the business environment for SME development.** In order to achieve more broad-based economic development, administrative barriers should be reduced, tax administration strengthened and access to financing by the SMEs should be improved.

5. Conclusion

The past decade has been one of great achievement. People in the region have demonstrated tremendous resilience and ingenuity in the face of dramatic change. It is clear that whilst there have been set-backs in reforms along the way, the principles of free markets and pluralist democracy have not been fundamentally questioned. There is no turning back. However, challenges ahead are also enormous and the EBRD hopes to continue to contribute to a successful transition through its investment activities.

The OECD and the Economic Transition in Central and Eastern Europe

Mr. Andre Barsony, OECD
Deputy Director
Centre for Co-operation with non-member Countries

1. Introduction

Since the fall of the Berlin Wall, we have seen an historic and irreversible economic and political transformation of Central and Eastern Europe. In the early 1990s, as their communist regimes collapsed one after the other, the countries of the region faced daunting challenges. There have been remarkable achievements over the last decade. However, progress has been uneven. In some countries, per capita productivity and income have started converging towards average OECD levels. And this is only part of the picture. Production is now much sounder in terms of environmental impact, the quality of goods and services has improved and life expectancy has significantly increased. The foundations of a market economy can be considered as well entrenched. Other countries, however, still face a difficult journey to an effective market economy

These differences of outcomes can perhaps be explained by the complex interaction between two main factors: the initial economic and political conditions prevailing in individual countries (i.e. the «path dependence») and the quality of the reform effort. Regarding the first factor, OECD work indicates that over the last century GDP per capita in Central and Eastern Europe was at no time ever converging to levels prevailing in Western Europe. The planned economy episode only pushed the region further away from convergence. When the transition started in the early 1990s, there was a common legacy of distortions but there were also considerable variations in the initial conditions. The Czech Republic was among the industrialised European countries before the Second World War. Hungary implemented a number of market-oriented policies for two decades under its communist regime. Poland had a private sector, especially in agriculture. In contrast, Bulgaria and Romania had stiffer communist regimes and inherited more distorted economic structures, institutions and policies. Second, as the transition unfolded, there has also been significant differences in the quality of the institutional and policy reforms implemented by governments.

The accomplishments of the first decade of transition are remarkable. However, as we enter the second decade of Central and Eastern Europe's great transformation, considerable challenges still remain for all transition countries. It might thus be useful to recall that institutions and policies matter in transition.

2. A decade of OECD engagement in the transition process

Today, the most important external "anchor" for economic policy in the countries of Central and Eastern Europe is the prospect of accession to the European Union. But it is appropriate, in the 10^{th} year anniversary of transition, to take stock of the OECD's engagement in the transition process. In particular, the **Partners in Transition Programme (PIT)** played a somewhat analogous role of external "anchor" in the uncertain and complex early stages of transition for the countries concerned. A reference to the PIT programme is all the more warranted because, on September 28, Slovakia formally committed itself to the OECD Convention.

As a result, the PIT programme has come to a successful conclusion, since the other participants -- the Czech Republic, Hungary and Poland -- became OECD Members some years ago.

Even if the PIT programme is formally over, the realities of transition are still on the OECD agenda today, not only with respect to the former PIT participants but also with respect to other countries in transition, including Russia and China as well as through OECD's contribution to the Stability Pact for South Eastern Europe. In fact, OECD engages no less than seventy transition and emerging market economies through different programmes managed by its Centre for Co-operation with Non-Members, all aimed at institutional and policy reform for effective market economies.

In that pivotal year of 1990, OECD members decided that the Organisation should engage itself to the maximum of its capacity to assist and support the great transformation already underway in the former Czechoslovak Federation, Hungary and Poland. Within a year, wide-ranging PIT programmes were established with these countries, with the important "anchor" that the ultimate, if undated, target for these programmes was OECD membership. It is, perhaps, one of the "accidents of history" that other transition countries in the region, which launched their efforts somewhat later or from different initial conditions, were not extended similar OECD programmes. The main reason which has some resonance today in the EU context -- is that the prospects of OECD enlargement have implications for internal governance of the Organisation that are extremely difficult to sort out and resolve. Nevertheless, it should be noted that the OECD's Co-operation Agreement with Russia stipulates membership as an ultimate shared goal.

A thorough assessment of the PIT programmes, for possible lessons for the future, is far beyond the scope of this statement. The question as to whether there are, in fact, any lessons to be learned is less rhetorical than it might appear. Most of what one can say is provisional. After ten years it is still difficult to draw significant and uncontroversial recommendations which could be easily applied to all economies in transition. However, there are four points that I would like to underline:

- First, even with hindsight, the policy advice provided to the transition countries through the PIT programmes was good advice although it must be recognised that in some cases it might have underestimated the difficulties related to the unique initial conditions of transition economies. The starting point was that **macroeconomic and structural policy issues are inextricably linked and that therefore the transition process needed to be seen in the broadest possible context.** Of course, the OECD has been only one of several external players providing policy advice; and OECD advice could well be characterised as "mainstream" in that it is largely coherent with the evolving orthodoxy of transition economics. What distinguishes most OECD policy advice is the related working methods: the comparative analysis of policy experiences and the lack of strict conditionality.

These methods encourage a sense of ownership by the country concerned. They also reveal clearly that OECD Members have often distinctive blends of institutional and policy frameworks in support of an effective market economy, reflecting their history and culture. Nevertheless, the real credit has to go to the Central and Eastern European governments themselves, who have faced the far more demanding tasks of translating policy advice into politically sustainable programmes and to the people for their courage and patience.

- Second, the centrality -- and the complexity - of the financial intermediation reform in the context of transition should be emphasised. In particular, **financial development impinges directly both on the nature of the budget constraints facing enterprises and the governments, and on the evolving nature of corporate governance.** In fact, the most stringent issues in the accession of PIT countries to the OECD related to the OECD Codes of Liberalisation which cover invisible transactions and capital movements. These discussions as well as others forced the pace, to some extent, of domestic policies with regard to the financial system so as to promote the restructuring or the liquidation of firms that fail to add value and the entry of efficient enterprises, as well as to assure financial robustness in the face of inevitable shocks.

- Third, and most fundamentally, the PIT programmes provided a critical catalyst to institution building and reform. A number of dimensions could be cited here. A substantial amount of direct assistance was provided to **reduce transaction costs in establishing appropriate legal frameworks in key areas.** In this respect, the active engagement of the OECD's Fiscal Affairs Committee in helping the transition countries implement fundamental tax reform and improve tax administration needs to be mentioned, as does the work of the Competition Policy Committee with respect to the drafting of basic laws on competition. Also, the SIGMA programme, mainly financed by the European Commission but carried out by OECD, provided critical assistance in the area of efficient public governance. It should be noted that most of these OECD efforts have rapidly gone well beyond the PIT countries and now engage a broad number of transition economies as well as emerging market economies.

- Finally, the PIT programmes provided wide access for the participating countries, as observers, to OECD committees. This access has been an efficient vehicle for the training, or re-training of national administration officials in the ways public administrations operate in the context of a market economy. Indeed, one of the most fundamental challenges of transition has been to **create a new culture of public service under radically new conditions of real democratic pluralism and electoral contestability.** For the officials who participated in the unique specialised networks of OECD Committees, the direct contact with OECD counterparts on both the substance of issues and on the role of policy advisers in the policy process in areas as diverse as trade, financial markets, agriculture, technology, social policy, labour markets and education may have been decisive in the emergence of "public service" ethos and pluralistic know-how in these countries' capitals.

Furthermore, the broad nature of OECD reviews, cutting across a wide range of competencies also meant that these reviews, by themselves, fostered the development of inter-agency co-ordination mechanisms that clearly impacted on the overall quality of policy advice transmitted from the bureaucracy to the politicians. It is also important to point out that training of officials through the programmes of the Joint Vienna Institute have been and will continue to be a key aspect of the OECD's support for reform in transition countries.

These are in a nutshell, the main points that can be retained from OECD's engagement in the transition process, which may then be seen as an important and successful element in the overall history of transition. After this overview, I will now turn to one of the key challenges ahead: how to promote the development of competitive enterprises in the overall effort to establish an effective market economy. This is particularly relevant because the world economy is itself going through a great transformation and the transition economies face the challenge of adapting to increasing competition in a globalising world economy.

3. A key challenge of the next phase of transition: the development of competitive enterprises

In most instances, Central and Eastern European countries have successfully liberalised trade, the exchange rate system and a large basket of prices. As a result, the pattern of both domestic and foreign demand revealed itself and relative prices adjusted to this pattern. This was accompanied by stabilisation and as a result, inflation is now basically under control in the region. Privatisation is well advanced in some countries while others still struggle to implement large-scale privatisation. However, liberalisation, stabilisation and privatisation are necessary but not sufficient. To ensure the good functioning of markets and to create the conditions for sustainable economic and social progress, it is essential to link more effectively liberalisation, stabilisation and privatisation to two other areas of institutional and policy reform: (i) first, the restructuring or the liquidation of firms that fail to add value to the economy according to market criteria and (ii) second, the entry of new enterprises which are profitable in competitive markets.

The aim of the next phase of the transition should be to strengthen the market incentives for the further release of real resources from ineffective uses -- Schumpeter's "creative destruction"-- through the continuing restructuring of enterprises and, if necessary, liquidation. In turn, these real resources are recycled in higher productivity activities. What steps should be taken to underpin the reallocation of real resources to more productive activities? There is a clear need to create a more competitive climate for enterprises and, importantly, to enhance efficiency, transparency and accountability in the allocation of real resources by firms through better corporate governance. Key institutional and policy challenges include:

- strengthening the domestic framework for trade liberalisation;
- creating a better environment for the inflow of private capital;
- promoting efficient markets;
- fighting corruption;
- improving the rules of corporate governance; and
- promoting entrepreneurship and SME development.

3.1. Strengthening the domestic framework for trade liberalisation

Trade liberalisation has intensified competitive pressures on enterprises in the region through external exposure and has led to the restructuring or liquidation of inefficient enterprises. Importantly, it has also stimulated the reallocation of real resources from unproductive to productive firms. In turn, this has led to the reorientation of the commodity structure and the direction of trade as well as a more efficient use of the country's comparative advantage.

WTO disciplines and regional integration under the auspices of the European Union will continue to play a key role in trade reforms and institution building in Central and Eastern Europe. These "anchors" set liberalisation commitments and strict deadlines for implementation for the countries in the region. They also help lock in its achievements. As WTO members, the countries of Central and Eastern Europe accepted significant trade liberalisation commitments. They have also been subject to regular monitoring and surveillance. The current trade negotiations at the WTO in Geneva on agriculture and services are of particular importance for the region because they provide new opportunities for trade reorientation and productivity enhancement. The potential to release resources from ineffective uses and for the emergence of competitive enterprises in agriculture and services is strong because these two sectors had been neglected before the transition had started.

Free trade agreements with the European Union -- the so-called Europe Agreements -- have also played a key role in trade reforms undertaken in Central and Eastern Europe. These Agreements have led to the removal of tariff barriers and continue to steer the rationalisation of trade regimes. They also have led to a considerable increase in the volume of mutual trade with EU countries. Today, exports from Central and Eastern European countries are very strongly oriented to EU markets. The share of liberalised imports is also high. Since the Central and Eastern European countries have signed other bilateral and plurilateral agreements guaranteeing preferential trade access, the bulk of industrial imports, corresponding to some 60 to 75 per cent of total trade, enter duty-free to their markets.

While most countries in the region have made substantial progress in establishing a formal legal framework for trade, several continue to face problems in building effective legal institutions and ensuring appropriate implementation of trade liberalisation commitments. In other words, while the "law on the books" has been adopted, considerable efforts still need to be deployed to ensure the "law in action".

Looking ahead, there is a clear need to improve the effectiveness of domestic institutions for trade liberalisation and their capacity to enforce the law as well as to enhance the readiness of enterprises to cope with competition and comply with the law and legal decisions. OECD co-operation with countries in the region attaches increasing attention to the legal, regulatory and institutional aspects of trade policy, especially as regards implementation.

3.2. Creating a better environment for the inflow of private capital

The relationship between foreign direct investment (FDI) and economic growth is twofold: FDI stimulates economic growth, but is also driven by economic growth. Growth is generated by FDI through imported capital, technologies and marketing capabilities. For example, Hungary has had an economic recovery strongly supported by the inflow of FDI. But the reverse causality also seems to exist: foreign investors react positively to the resumption of economic growth. Thus Poland started to receive substantial amounts of foreign capital only after economic growth became robust. Whatever the relative weight of these causalities might be, a comparison of domestic and foreign owned companies indicates the crucial effect that FDI has on the up-grading of the economic structure and technology and, as a result, on productivity and growth. As it was the case in Spain in the 1970s and in Ireland in 1990s, FDI is contributing heavily to economic growth in a number of countries in the region.

FDI regimes and various incentive schemes to foster domestic and foreign investment can influence the relative advantages of a country, region or locality. But links with macroeconomic balances should be kept in mind. The potential scope for active investment promotion schemes is limited by the budgetary situation of the countries in the region. Tight fiscal policies do not allow for much tax breaks and spending on incentives.

Some countries in the region have complex incentive schemes, ranging from tax and customs allowances to R&D and infrastructure-related subsidies. In addition, special incentives are often considered necessary to foster the start-up of new firms and greenfield investments. These may involve import duty allowances for equipment, subsidies for infrastructure, industrial parks, and special economic zones. Regional and labour market policies also have investment promotion components. Nevertheless, the transparency and the stability of investment promotion policies need to be improved. However, it should be underlined that the positive impact of tax breaks and other incentive schemes is not analytically proven. This is probably because the effects of incentives can hardly be separated from other factors determining FDI.

More than tax breaks and other incentive measures, what really matters to foreign investors is the quality of overall economic and social conditions and the assurance that their investment will be protected by a stable, predictable regime based on the rule of law. Against this background, the application of national treatment to foreign controlled enterprises and the elimination of double taxation are essential framework conditions to attract foreign direct investment.

National treatment of foreign controlled enterprises after establishment has become a pervasive principle in OECD countries and prevails also in most of Central and Eastern Europe. This means that laws and policies do not discriminate between domestic and foreign firms. However, various incentive schemes in the region still offer preferential treatment to large investments. This involves a bias in favour of large foreign investors, who are more able to launch large ventures than domestic and foreign SMEs. Small and medium-size firms often cannot meet the minimum investment and employment requirements to become eligible for tax breaks or other investment incentives.

Several OECD instruments contribute to the development of conditions conducive to FDI. The OECD Declaration and Decision on International Investment and Multinational Enterprises constitutes a policy commitment to improve the investment climate, encourage the positive contribution multinational enterprises can make to economic and social progress and minimise and resolve difficulties which may arise from their operations. All OECD Members and Argentina, Brazil and Chile have subscribed to the Declaration. Serious consideration is presently given to the possibility to open this OECD instrument to the participation of a larger number of non-Member countries. The OECD undertakes analytical and advisory work with non-Member countries from the region on FDI trends and policies.

FDI would be seriously impeded if there was a danger that the returns on such investment would be taxed twice, both where the money was invested and in the country of residence of the investors. The OECD Model Tax Convention and the worldwide network of tax treaties (over 1500) based upon it, help avoid this danger by providing clear rules for taxing income and capital. Countries in Eastern and Central Europe will continue to contribute to the development and refinement of the OECD Model through an extensive OECD outreach programme in taxation.

3.3. Promoting efficient markets

The essence of an efficient market economy is that enterprises are free to compete and can try to satisfy demand in the best way they can find. There are of course some exceptions to this rule in case of market failure. OECD work on competition law and policy in Central and Eastern Europe has focused on the identification and elimination of laws, rules and policies that unnecessarily prevent enterprises from competing in efficient ways on factor and product markets. In particular, the OECD has assisted in the design and implementation by national competition authorities of laws that prevent enterprises from engaging in cartels and laws that prevent abusing monopolies to interfere with the market by restricting output or other such harmful conduct.

The OECD competition policy activities in the region have had two main targets. First, they have focused on rules that directly impose anticompetitive restrictions on entry or expansion (e.g., into a new geographic area, a new product line, or new production or distribution processes.) Since restrictions on exit necessarily operate as impediments to entry, work has also addressed government rules or policies that prevent exit or reorganisation into a more efficient structure or new line of business. Second, OECD co-operation in the region has also focused on the manner in which countries regulate industries in which there is some natural monopoly aspect.

This work has involved opening up new markets to competition, both by observing that an activity no longer has natural monopoly attributes and by separating potentially competitive sectors from those that are natural monopolies. It has also used competition principles to improve the regulation of natural monopolies.

This competition policy work will continue to be carried out through co-operation with competition authorities in the region, sharing with them the ways in which OECD competition authorities have used "competition advocacy" to bring about reform.

3.4. Fighting corruption

The social, political and economic costs of corruption are very high. The economic costs stem from sharp distortions in the allocation of public resources and less competition in markets. First, corruption distorts the allocation of resources by governments not only because contracts do not go to the most efficient competitor but also because it tilts the composition of public spending and regulation towards areas that make it easier to collect bribes. Second, by increasing uncertainty and transaction costs, corruption reduces investment. Third, by allowing the reaping of benefits through criminal means instead of competition, corruption hinders the development of competitive enterprises. For all these reasons, fighting corruption at the national and international levels is a key component of the overall effort to promote an effective government and market economy and the development of competitive enterprises. Notwithstanding progress made, the legal and institutional anti-corruption framework needs to be strengthened in Central and Eastern Europe.

Since its creation in 1992, SIGMA -- a joint initiative of the OECD and the European Union -- co-operates with the countries in the region to strengthen public institutions in order to reduce incentives for corruption by improving accountability, efficiency and transparency in the public administration.

The OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions constitutes a major step forward in the fight against corruption. It is open to accession by any country that is willing and able to assume the obligations of the Convention. Signatories currently include all OECD Members and Argentina, Brazil, Bulgaria and Chile. The overall purpose of the Convention is to prevent bribery in international business transactions by requiring countries to establish the criminal offence of bribing a foreign public official, and to have in place adequate sanctions and reliable means for detecting and enforcing the offence. They also include non-criminal rules for prevention, overall transparency and co-operation between countries. In addition, parties are obliged to deny the tax deductibility of such bribes.

Reducing the supply of bribes requires more than criminalising the act of bribing a foreign public official. Enterprises themselves must play a role and address the practice internally by changing the corporate culture that enables corruption to continue. To provide businesses with guidance in this regard, the OECD has revised its Guidelines for Multinational Enterprises, which are open to non-Members, to include a new chapter on the measures that should be taken by enterprises to prevent the furnishing as well as the solicitation of bribes. In addition, the provisions in the OECD Principles of Corporate Governance on improving disclosure and transparency in financial as well as other matters acts as a framework for entreprises to discourage bribery. The Anti-Corruption Network for Transition Economies supported by the OECD provides a forum for the exchange of concrete, action-oriented information between anti-corruption practitioners and analysts from Central and Eastern Europe and elsewhere.

Moreover, the Financial Action Task Force on Money Laundering, which includes most OECD Members as well as some key financial centres outside the OECD area, is combating economic crime, *inter alia,* by addressing the illegal laundering of proceeds deriving from corruption.

3.5. Improving the rules of corporate governance

While appropriate legal and market disciplines described above as well as improved accounting and auditing standards, go a long way towards making firms more competititve, improved corporate governance can also greatly contribute. Corporate governance is the set of internal rules specifying the distribution of rights and responsibilities among different participants in a company such as the management, the board, the shareholders and other stakeholders. It is through these rules that the objectives of the company are set and means of attaining them and monitoring performance are determined. By enhancing efficiency, transparency and accountability in the allocation of real resources by firms, good corporate governance underpins the emergence of competitive enterprises. By building investor confidence, good corporate governance can contribute also to the inflow of private capital to a country.

Transition economies face particular challenges. Privatisation transfers the ownership of enterprises from public to private interests. But privatisation also requires a strict definition of property rights and corporate governance rules. If the manager of a privatised company does not have to give any information to his shareholders, if he does not have to answer to any board about his actions, if he can unilaterally alter the content of property rights of other parties, by shifting assets and cash flows in and out of the company at will, or by issuing new shares, then the company does not really exist as a well-defined property for its shareholders or for its creditors. It does not really represent a stable source of employment for its workers or a source of revenues for tax authorities who often cannot find anybody responsible to pay them.

The need for better corporate governance has been acknowledged worldwide as a key determinant of efficient allocation of real resources, of inflow of private capital, of the development of equity markets and of broader institutional development in the governance of our societies. In this respect, the OECD Member countries adopted a set of Corporate Governance Principles to help policy makers and corporations raise their governance standards. Since their adoption in 1999, the OECD Principles of Corporate Governance have become the main point of reference for corporate governance reform in both OECD and non-Member countries. They were also included in the Compendium of 12 global standards for financial stability, compiled by the Financial Stability Forum. As such, the OECD Principles are expected to be used increasingly by international financial institutions, namely the World Bank and the EBRD.

3.6. Promoting entrepreneurship and SME development

In the early phase of the transition, the creation of small and medium-sized enterprises (SMEs) was mainly driven by individuals facing unemployment. Progress towards privatisation was initially built upon the sale of inefficient, state owned enterprises. As a result, large enterprises still tend to dominate markets in transition economies much more than is the case in mature or emerging market economies. Often the large, privatised enterprises were able to defend their dominant position in the market by maintaining a close relationship with the state and thus creating important obstacles to entrepreneurial contenders.

At the same time, the development of SMEs has been hampered by a number of factors such as a lack of adequate legal frameworks and effective enforcement which allow enterprises to enforce contracts, collect debts and resolve disputes; overtaxation; heavy administrative burdens; and corruption. In some countries, banks remained more a vehicle for post privatisation corporate control than a primary source of finance for SMEs. The development of small and medium-sized enterprises in the next phase of the transition needs to be more fully supported.

While it is well understood that entrepreneurship and SME development lead to employment creation, the role that SMEs play in increasing competition and instilling flexibility in markets is perhaps less apparent. SMEs increase competition by giving consumers a wider choice of goods and services and employees a broader range of job opportunities. They also put new ideas more rapidly to test than large corporations. In OECD countries, SMEs are particularly dynamic: they are first to move in new economic activities and they are also the first to cut capacity in line with declining demand. Market-oriented structural adjustment in an economy is primarily driven by SMEs.

Over the years, governments in Central and Eastern Europe have become increasingly aware of their responsibility to create the conditions necessary to stimulate and support the development of SMEs. The OECD Forum for Entrepreneurship and Enterprise Development (FEED) is a policy dialogue tool on how to develop enterprises able to compete in effective market economies. It aims to identify a set of "good practice"institutions and policies that improve the environment for entrepreneurship and lead to the creation of new enterprises. The Forum has developed, through policy dialogue, practical approaches to entrepreneurship and SME development which capitalise on extensive OECD analysis and experience. It's work focuses on two main areas: first, the institutional framework, including tax policy for SMEs, institutionalisation of SME policy and rule of law and regulation; and second, support services, including financial instruments for start-ups, advisory services and enterprise promotion through business incubators. It is hoped that over the longer term, the exchange of policy experiences in the Forum will lead to significative improvements in the operating environment for SMEs as well as in a more accurate targeting of public policies and support programmes.

4. Conclusion

In conclusion, I would like to underline that productivity growth and competitiveness are no longer elusive objectives for Central and Eastern Europe. As highlighted in my intervention, governments will need however to take a number of important steps to underpin a more competitive institutional and policy framework, including better corporate governance and SME development. The OECD stands ready to continue, within the limits of its resources, its co-operation in all these areas of institutional and policy reform. Clearly, for several countries, the prospects for productivity convergence towards Western Europe and higher living standards are real. If this will be confirmed in the years ahead, we will be able to say in full confidence not only that transition in Central and Eastern Europe has proved to be a resounding success for the people in the region but also a source of new hope to people around the world.

To the International Conference on the 10-Year Review of Transitional Economies and Challanges in the Next Decade

Mr. Yo Maruno, UNIDO
Duputy Director General and Managing Director
Investment Promotion and Institutional Capacity-Building Division

1. Introduction

On behalf of the UN Industrial Development Organization, it is, indeed, an honour for me to address this part of the Conference, which is focusing on bilateral and multilateral cooperation in the transitional economies.

As the name of the Conference makes clear, we are looking back at what has been achieved since the momentous transition to a market economy began in Eastern Europe and the former Soviet Union a decade ago. We are also looking ahead to tackling the formidable challenges the region faces in its efforts to become part of the global economy.

Even before the winds of political and economic change swept through Eastern Europe and the former Soviet Union, UNIDO pioneered the promotion of investment and technology transfer in the region. In 1983, for example, UNIDO opened the first investment promotion office in a CMEA country, in Warsaw. This was followed, in 1988, by the establishment of the UNIDO Centre for International Industrial Cooperation, in Moscow.

Since then, the region has changed dramatically and so has UNIDO. The Organization began its transformation in 1998 by adopting a business plan with three aims: to build competitive economies, to create productive employment and to ensure a sound environment.

2. UNIDO

UNIDO believes that these are the elements that affect people's lives most profoundly. And, after all, human well-being must be the ultimate objective driving the forces of production and commerce.

Based on these guiding goals, the Organization has consolidated its expertise into 16 core services. These can be tailored into unique packages to meet client countries' specific industrial needs at policy, institutional and enterprise levels. Since 1998, more than 40 programmes have been developed. Eight of these, with a total value of $15.5 million, have been designed specifically for countries or areas within Eastern Europe and the newly independent states of the former Soviet Union.

Today, the transitional economies face two major challenges, which are closely interrelated: integration into the global economy and economic transformation. For them to benefit from globalization requires the continuation of internal economic transformation. But economic transformation is largely predicated on economic openness and participation in the globalization process.

Despite progress in overcoming these hurdles during the last decade, there are striking disparities between countries in the region, in terms of their pace and depth of integration into the global economy. Per capita income, for example, ranges from a low of some $179, in Tajikistan, to a high of more than $9,000, in Slovenia. Parallel to the economic transformation that has taken place, a range of environmental considerations has emerged creating a further challenge for the manufacturing sector.

Intrinsic to a lasting solution to these problems is the role of industry. Today, UNIDO is in a unique position among the various international development agencies to offer a comprehensive package of industrial services. From micro-sized projects to interregional initiatives, it is the only such organization able to

deliver the entire range of expertise essential for sustainable industrial growth in the global market of the twenty-first century. Combined with a well-established network of contacts in the public and private sectors alike, this builds a distinct value added into UNIDO's services.

The Organization's investment and technology promotion programme exemplifies this value-added approach. Investment today goes beyond mere joint ventures for manufacturing and marketing. It entails sharing technology and adapting it to local conditions so that production meets the standards demanded by international trade.

Responding to that need, UNIDO has coupled its more than 20 years' experience as an honest broker in investment promotion with its expertise in technology and quality management. The result is a new approach to fostering partnerships between investors and project sponsors. Strategic investments, tools and methodologies for project appraisal, modern technologies and internationally recognized quality standards are brought together in packages designed for success in global trade.

UNIDO has established 11 Investment and Technology Promotion Offices to deliver its services directly to investors and project promoters. As I mentioned earlier, Warsaw was the first such office to be opened in Eastern Europe. Its success in promoting $154 million worth of investments in 1999 alone speaks for its impact. Earlier this year, Bratislava became the latest office in the UNIDO investment chain. These offices are, in turn, backed up by a network of national investment promotion units working closely with UNIDO around the world.

Value-added support of this kind constitutes the building blocks that industries in transitional economies need if they are to develop and prosper in the global market. This is particularly important for small- and medium-sized enterprises in the region.

In the ten years that the transition to a market economy has been underway, the contribution of the private sector to GDP has grown tremendously. Although privatization of state-owned enterprises has proved important in this regard, new businesses–many in the small- and medium-scale sector–have also helped fuel this new-found prosperity.

But these fledgling enterprises require careful nurturing if they are to grow into tomorrow's engines of economic growth. UNIDO has a central role to play in three key areas:

- by providing policy advice and assistance in establishing support institutions for SME development
- by providing a focus for exchange of experience among transition economies on SME policies and programmes and
- by launching innovative partnership programmes with transnational corporations to enhance SME competitiveness as well as supporting SME clusters and local enterprise development initiatives.

To prosper and grow, SMEs need to increase sales, decrease costs and have access to low-cost support services, including information on financing, technology, markets, raw materials and the like. Information and communications technology can have a considerable impact given the requisite support infrastructure. One approach to ensuring success is to use the technique known as technology foresight.

UNIDO has initiated a major programme in this direction, which is currently being tested in Latin America and may soon be adapted to Eastern Europe and the former Soviet Union.

Technology foresight is the analysis of market trends and current technological developments in a coordinated fashion with the aim of assigning priorities and resources to strategic sectors of the economy.

A key aspect of UNIDO's approach to technology foresight is the strengthening of business-to-business e-commerce, with the aim of fully integrating SMEs into domestic and international production processes and supply chains. In this endeavour, UNIDO enjoys a singular advantage since it brings together the interests of the private and state sectors as an honest broker.

By assisting governments and enterprises to build B2B supply chains, the Organization can help SMEs reduce their transaction costs, increase sales and customer services and create new businesses and linkages. As a spin-off, SMEs gain a better understanding of the use and potential for information and communications technology while finding new ways to improve their businesses.

To strengthen access to e-commerce, at the end of this year, the Organization will formally launch a unique Internet-based electronic platform called UNIDO Exchange. It is designed as a one-stop shop for sharing information and fostering business partnerships between enterprises, governmental and non-governmental bodies, R+D institutes and other industrial stakeholders worldwide.

UNIDO is building a further bridge to span the communications gap, having recently joined forces with Ericsson Consulting to study emerging trends in electronic and mobile commerce for SMEs in developing countries and transition economies. The goal is to pinpoint the bottlenecks SMEs face in this respect at policy, institutional and enterprise levels as well as to map out a viable approach for them to take part in e-commerce.

In addition to networking, UNIDO is fostering information technology for the seamless management of industries, from matching supplies of components to production requirements, to operating efficiency on the shop-floor and, onward, to meeting market demands.

Hand-in-hand with the transformation of the manufacturing sector in the region have come new environmental challenges. These include not only the traditional problems associated with industry of air, soil and water pollution. A further dimension has emerged in the form of compliance with European Union and other international conventions on pollution control, which is central to countries applying for EU membership.

UNIDO's approach is, once again, based on giving value added to its services. Rather than just concentrate on costly end-of-pipe solutions to reducing effluent emissions, the Organization has introduced the concept of cleaner production to the manufacturing process. This encompasses control of the entire production cycle from more efficient use of raw materials and energy through reduction of waste to recycling of effluents.

UNIDO has established a growing network of National Cleaner Production Centres, including ones in the Czech Republic and

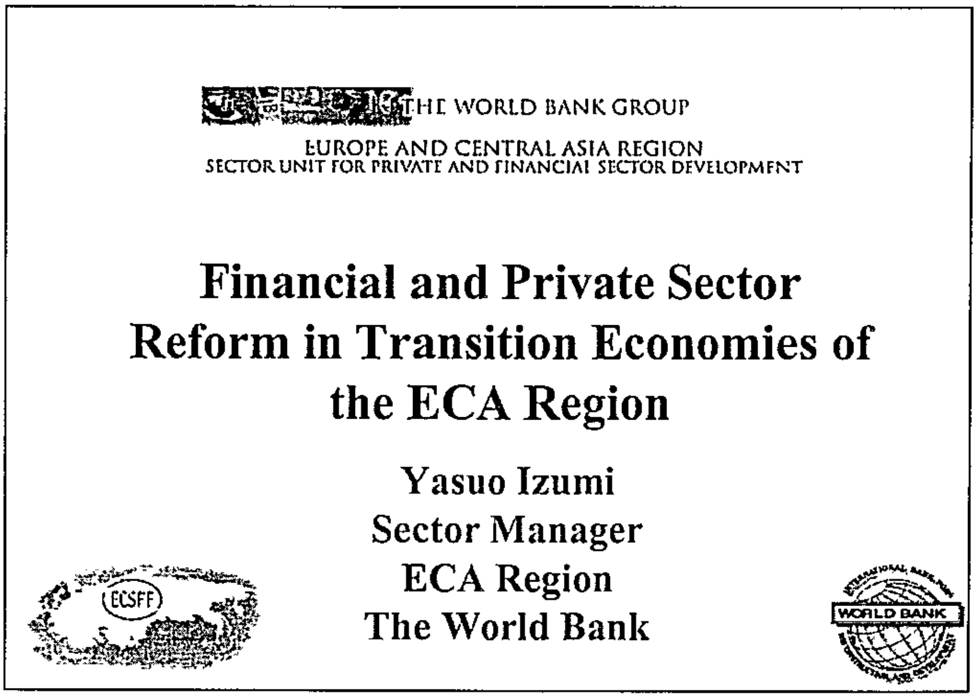
Hungary, which have, so far, provided more than 25,000 entrepreneurs, technicians, government officials, financiers and academics a new window on the latest developments in the field of cleaner technologies. They are enabling small- and medium-sized enterprises to acquire clean technologies that might, otherwise, be beyond their reach. The Centres collaborate with UNIDO's Investment and Technology Promotion Offices to ensure that the industries of tomorrow are the preservers—rather than the polluters—of the environment.

At subregional level, UNIDO's programme for transfer of environmentally sound technology in the Danube River Basin is helping local enterprises to upgrade technology and, thereby, to comply with environmental norms. The Organization is also involved in three other large-scale environmental protection programmes aimed at reducing industrial pollution in the Dniepr River Basin, Tisza River and Caspian Sea.

These represent but a few of the ways UNIDO is building value added into its services to help transition economies meet the challenge of industrialization in the new millennium. With the region's diversity of development levels, the challenge is, indeed, formidable. But UNIDO is confident that, by working with its partners in this way, the industrial challenges of today will become the economic opportunities of tomorrow.

Financial and Private Sector Reform in Transition Economies of the ECA Region

Mr. Yasuo Izumi, IBRD
Sector Manager, Private & Financial Sector Development, Europe and Central Asia
The World Bank



FSD Reforms in the ECA Region

- Reforms in the banking sector in the ECA region have been uneven
- There are a group of strong reformers that include Hungary and Poland
- There are a group of intermediate reformers that include the Slovak Republic and Slovenia
- There are also a group of weak reformers that have yet to progress on serious state owned bank reform

WORLD BANK

FSD Strong Reformers: Hungary

- On January 1, 1997 a two-tier banking system was established when thre commercial banks were spun off from the NBH
- Sectoral concentration remained high only until mid-1990's
- By the end of 1997 bank privatization was largely completed with private ownership exceeding 80%
- More than 60% of Banking Sector is Foreign Owned
- The 1991 Banking Law established a consistent framework for:
  - entry and exit for domestic and foreign banks
  - banking supervision
  - ownership and prudential regulations
- The 1996 Banking Law and its Amendment in 1997
  - required full compliance with international standards (BIS)
  - enabled foreign branching starting 1998
  - laid ground for universal banking starting January 1999

WORLD BANK

Strong Reformers: Poland

- Significant Foreign Involvement
- High Financial Intermediation Expressed by 84% of Banking Sector Assets to GDP
- Low Sectoral Concentration
- Very Strong Bank Regulatory Framework: Banking Supervision Commission established by the Law on Banking and the Law on NBP, effective January 1, 1998
- High Quality of Loan Portfolio: 89% of Loans are Rated Standard
- Openly Competitive Market Environment
- Market-Oriented Banking Culture
- Favorable Macroeconomic Environment

WORLD BANK

Intermediate reformers: Czech Republic

- **Strengths**
  - Fast Movement towards Full-Fledged Universal Banking
  - Large Service and Client Networks
  - Increasing Foreign Presence
- **Weaknesses**
  - Poor Loan Portfolio Quality: Two Thirds of Sector's Classified Loans is Rated Loss (22% of Entire Loan Portfolio)
  - Significant State Participation: Almost 70% of Deposits Concentrated in 4 Largest (State-Owned) Banks
  - Relatively Weak Regulatory Regime and Transparency
  - Slow Micro-Level Restructuring

WORLD BANK

Intermediate reformers: Slovak Republic

- **Strengths**
  - High Degree of Financial Intermediation
  - Refined Regulatory Environment
  - Clear System of Asset Classification
  - Improved Transparency and Disclosure
- **Weaknesses**
  - Insignificant Foreign Involvement
  - Poor Loan Portfolio Quality: A Third of Loan Portfolio is Rated Doubtful or Loss-Making
  - Luck of Restructuring in the Real Sector
  - Tight Monetary Policy along with Slowing Macro Growth

WORLD BANK

Intermediate reformers: Slovenia

- **Strengths**
  - Relatively Healthy Loan Portfolio: Only 12% of Loans Rated Non-Performing
  - Steps Toward Liberalization of Banking Sector in the Light of Possible EU Accession
  - Stable Macroeconomic Environment Coupled with Highest Per Capita Income in the Region
- **Weaknesses**
  - 40% of Sector Assets Remain State-Owned
  - Limited Bank Competition
  - No Foreign Branching Allowed
  - High Barriers to Domestic Entry
  - Very High Concentration

WORLD BANK

Intermediate reformers: Bulgaria

- **Strengths**
  - Improved Regulatory Framework
  - Increased Foreign Interest in the Sector
  - Somewhat Accelerated Enterprise Restructuring
  - Macro Level Stabilization Following the Currency Board Arrangement in July 1997
- **Weaknesses**
  - Significant State Involvement: Approximately Two Thirds of Banking Sector Assets Concentrated in Five State-Owned Banks
  - Slow Pace of Bank Privatization
  - Poor Quality of Loan Portfolio Inherited from Old System of Centralized Credit Allocation

WORLD BANK

Intermediate reformers: Armenia

- **Strengths**
  - Relatively Low Concentration
  - Strong Banking Supervision
  - Advanced Interbank Clearing and Settlement System
  - Insignificant State involvement: Only About 6% of Banking Sector Assets is State-Owned
- **Weaknesses**
  - Small Size of Banks
  - Low Level of Financial Intermediation with Total Assets to GDP Ratio Amounting 12%
  - Slow Enterprise-Level Restructuring Resulting in Little Credit to Real Sector

WORLD BANK

Intermediate reformers: Estonia

- **Strengths**
  - Strict Banking Regulations
  - Increasing Foreign Participation
  - Universal Banking Allowed by the 1995 Law on Credit Institutions
  - Strong Macro Performance and Structural Transformation
- **Weaknesses**
  - Deteriorating Loan Quality due to Exposure to Russia
  - Size and Structure of Foreign Liabilities: Potential Problems with Refinancing
  - Tight Monetary Policy Limited by the Currency Board Arrangement

WORLD BANK

Intermediate reformers: Latvia

- **Strengths**
  - Strong Banking Supervision
  - Insignificant State Involvement: Asset Share of State-Owned Banks is Nearly 7%, as of end-1997
  - Robust Macroeconomic Performance
- **Weaknesses**
  - Vulnerability to External Shocks: Over 55% of Banking Sector Assets is Foreign Lending. As of August 31, 1998 10.6% of Assets were invested in Russian Treasury Securities
  - Lack of Consolidated Supervision
  - (Unsustainably) High Growth of Domestic Lending Following 1995-96 Banking Crisis

WORLD BANK

Intermediate reformers: Lithuania

- **Strengths**
  - Strict Prudential Regulations and Improved Transparency
  - Foreign Branching Allowed by Amendment to 1996 Law on Banking
  - Significant Enterprise-Level Privatization and Restructuring
- **Weaknesses**
  - High Concentration with 4 Largest Banks Holding 85% of Banking Sector Assets
  - Significant Sate Involvement: Two State-Owned Banks Account for 45% of Total Banking Sector Assets
  - Largest Exposure to Russia among Baltic States: Approximately 30% of Exports is Directed to Russia
  - Large and Widening Current Account Deficit: Expected to Reach 13% in 1998 as a result of Russian Crisis and Currency Peg

WORLD BANK

Weak Reformers

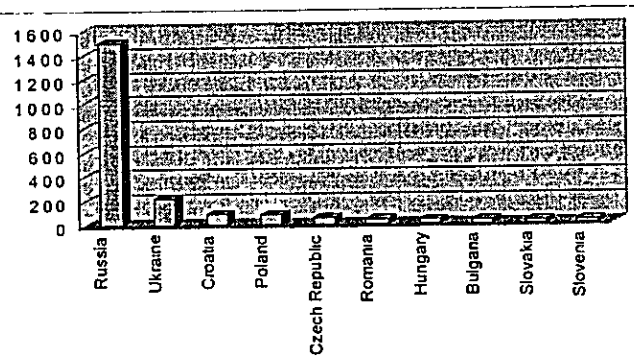
General Characteristics of Weak Reformers:

- High Concentration and Lack of Competition
- Poor Asset Quality
- Lack of Sector-Specific Expertise and Market Culture
- Significant State Ownership Leading to Poor Corporate Governance and, in Particular, Lack of Incentives to Restructure
- Low Level of Corporate Lending Partly due to Insignificant Enterprise-Level Restructuring
- Inadequate Supervision and Lack of Transparency
- Non-Compliance with Prudential Regulations
- Unstable Macroeconomic Environment

WORLD BANK

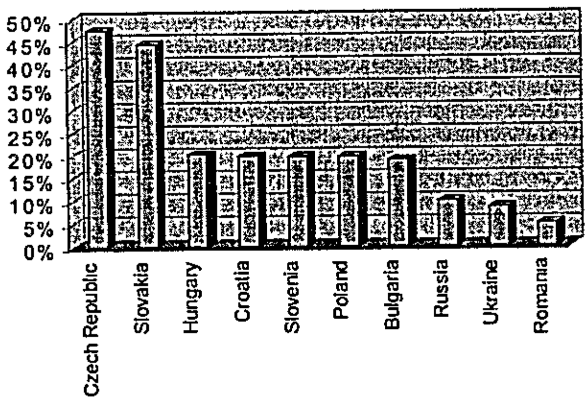
Banking Sector Statistical Annex.

Chart 1. Number of Commercial Banks



WORLD BANK

Chart 2:
Domestic Corporate Lending/GDP



WORLD BANK

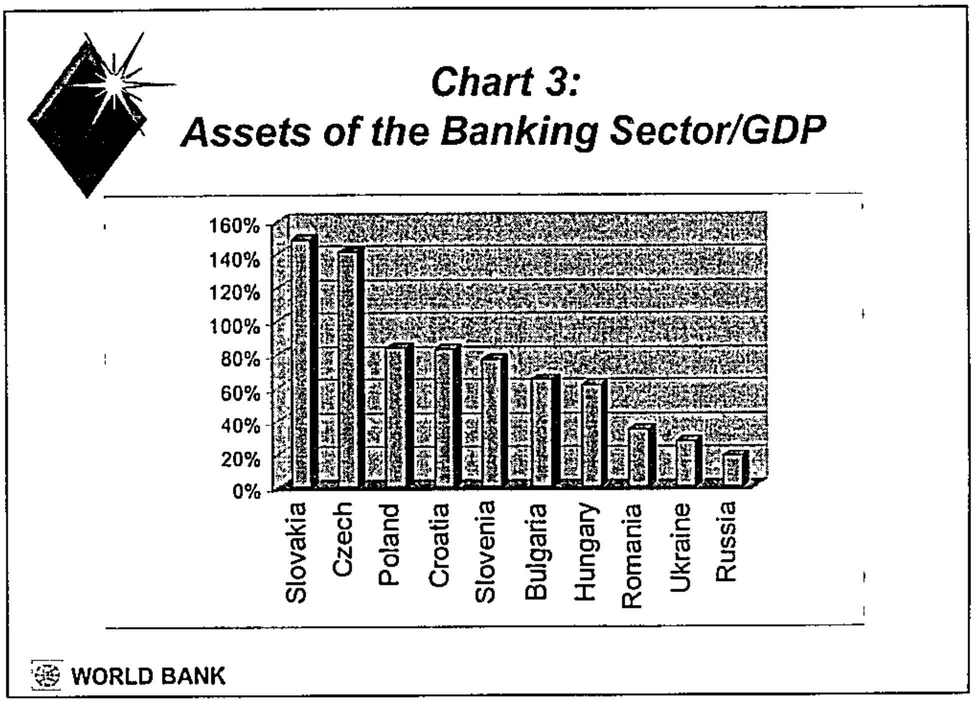


Chart 3:
Assets of the Banking Sector/GDP
160%
140%
120%
100%
80%
60%
40%
20%
0%
Slovakia
Czech
Poland
Croatia
Slovenia
Bulgaria
Hungary
Romania
Ukraine
Russia
WORLD BANK

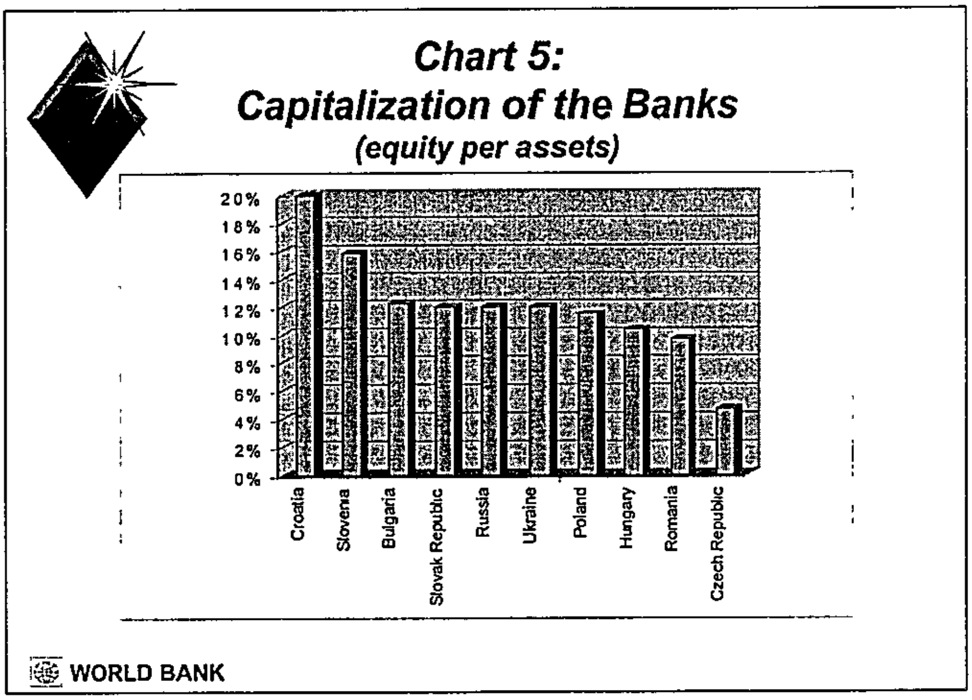
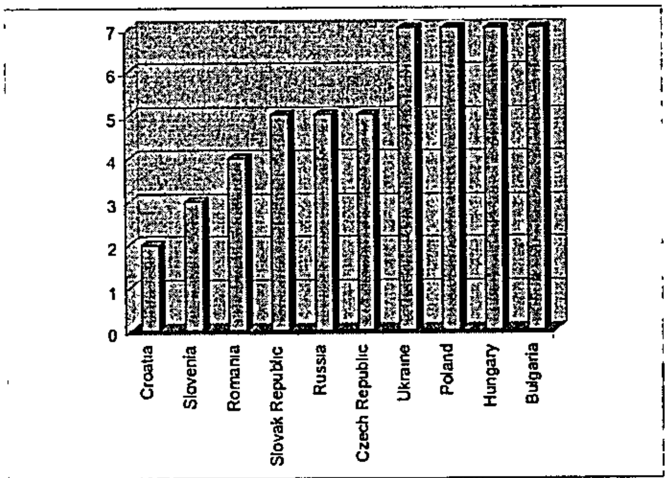


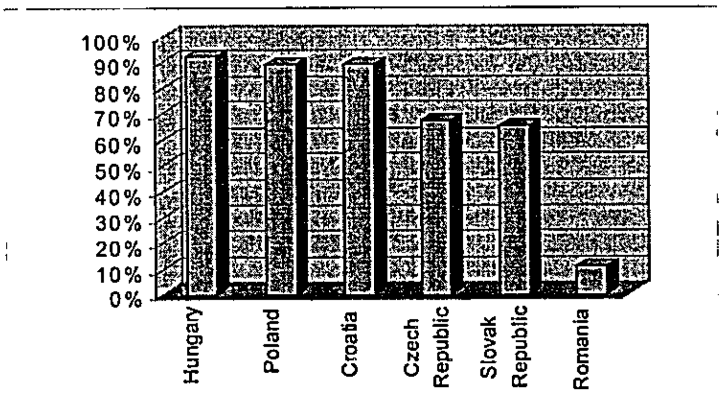
Chart 5:
Capitalization of the Banks
(equity per assets)
20%
18%
16%
14%
12%
10%
8%
6%
4%
2%
0%
Croatia
Slovenia
Bulgaria
Slovak Republic
Russia
Ukraine
Poland
Hungary
Romania
Czech Republic
WORLD BANK

Chart 7: Number of Banks with 60% of Total Assets



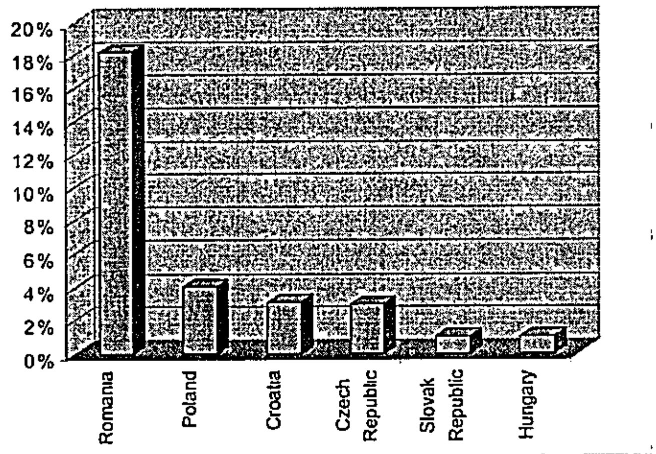
WORLD BANK

Chart 8: Quality of Bank Loans: Standard



WORLD BANK

Chart 9: Quality of Bank Loans: Sub-Standard



WORLD BANK

PSD Reforms in the ECA Region

- There are a number of countries well advanced in PSD reforms in the ECA region that include Hungary and the Czech Republic
- There are a number of countries who have attained intermediate progress in PSD reforms in the ECA region like Russia and Romania
- There are a number of countries that have been slow to move forward on PSD reforms mostly in the "stan" countries

WORLD BANK

PSD Reform: Phases of Privatization

1. **Phase 3 -- Advanced Reformers**
   - More than 50% of formerly state-owned enterprise assets in private ownership
   - Privatization of small companies with tradable ownership rights is completed
   - Significant progress on corporate governance, although some structural problems may remain

2. **Phase 2 -- Intermediate Progress**
   - More that 25% of formerly state-owned enterprise assets in private ownership
   - Nearly complete privatization of small companies

WORLD BANK

Phases of Privatization

- Major unresolved issues in corporate governance of privatized enterprises

3. **Phase 1 -- Slow Progress**
   - Less than 25% of formerly state-owned enterprise assets in private ownership
   - Comprehensive privatization scheme is still to implemented; some sales completed
   - Small-scale privatization is ongoing, although a substantial share has already been privatized
   - Little progress in corporate governance

WORLD BANK

Phase 3: Hungary

- Large-scale privatization began in 1990, small-scale - a year later
- By 1999, private sector share of GDP amounted to 80%
- By the end of 1997 small scale privatization was virtually complete
- Large-scale privatization is scheduled for completion in 2000; the state wi retain residual shares in a number of strategic companies
- Almost all infrastructure companies have been privatized
- Case-by-case sales to strategic investors were the main privatization method in Hungary, the only developed post-socialist economy without a mass privatization program
- Privatization program encouraged FDI, with foreign-owned companies accounting for about one-third of GDP and 25% of private sector investment

WORLD BANK

Phase 3: Czech Republic

- Most SOEs were privatized in two waves of equal access voucher privatization conducted in 1992-1995
- By 1999, private sector share of GDP amounted to 80%
- Small-scale privatization was largely complete by 1997
- The state has retained significant ownership shares in mines, steel mills, banks, energy and infrastructure companies
- The local investment funds collected 70%of all vouchers; only a few enterprises were sold on a case-by-case basis to foreigners
- The fragmented ownership and weak corporate governance resulted in significant problems in the industrial sector
- The government set up a Restructuring Agency in 1999 and introduced new laws to improve corporate governance

WORLD BANK

Phase 2: Russia

- Mass privatization program was launched in 1992 with significant concessions to insiders, who had majority ownership in 65% of privatized firms by 1994
- Privatization of the remaining "crown jewels" was conducted in 1995-1997 through cash-based auctions. Most deals were rigged, with assets going to the well-connected oligarchs
- By 1999, private sector share of GDP amounted to 70%
- The state retains significant share packages in many infrastructure and energy companies, including Gazprom
- The lack of transparency and weak institutional environment precluded foreign investors from active participation
- Entrenched management control provides little incentive for enterprise restructuring and improved corporate governance
- Wide-spread problems include asset-stripping, abuse of shareholders' and creditor's rights, diversion of cash flows, etc.

WORLD BANK

Phase 2 : Romania

- Conducted mainly through MEBOs and voucher scheme, privatization proceeded slowly in the first few years after 1991
- Starting in 1997, privatization accelerated, with new emphasis on cash-based sales to strategic investors
- By 1999, private sector share of GDP amounted to 60%
- With small-scale privatization virtually complete, detailed plans are ready for the future sell-offs involving the remaining large SOEs, including infrastructure and energy companies
- Under the new privatization law, investment banks are set to play a key role in upcoming strategic sales
- The power of enterprise insiders creates significant corporate governance problems; coal-mining sector typifies the need for restructuring in Romania's industry
- The new legislation aims to improve the shareholder protection, bankruptcy rules and other procedures

WORLD BANK

Phase 1: Azerbaijan

- After many delays, mass privatization started in May 1997
- In voucher and cash auctions since May 1997, 954 mainly medium-sized enterprises (10% of total SOE assets) had been offered to private investors by July 1999
- By mid 1999, private sector share of GDP amounted to 50%
- The process is slowed by the opposition of key interests within the government; only 10% of issued vouchers have been redeemed
- A new privatization program for 1999-2000 provides for the use of investment tenders in the sale of strategic state enterprises
- Although foreigners now hold the majority of vouchers, their participation have largely been limited to the energy sector
- Corporate governance remains very weak, with allegations of corruption and criminal behavior abounding

WORLD BANK

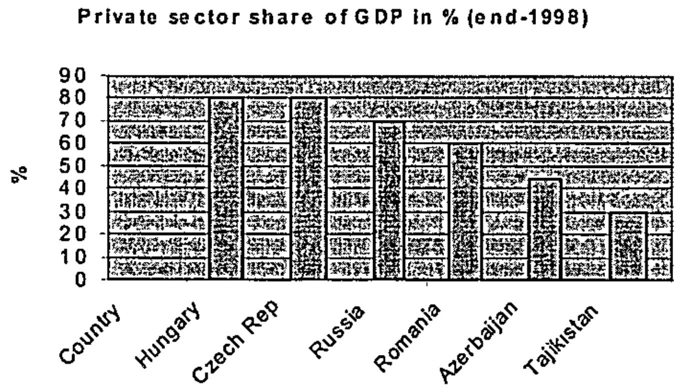
Phase 1: Tajikistan

- The revision of the privatization law in May 1997 restarted the privatization process, which has been stalled by the civil conflict
- By May 1999, 80% of small enterprises were privatized
- The government is now focusing on the privatization of medium-sized and large firms (16% were privatized by late 1998)
- By mid 1999, private sector share of GDP amounted to 30%
- Major sectors -- including heavy industry, transport and energy - remain in state ownership
- Plans to sell minority stakes in power generation plants and other strategic firms are unlikely to materialize in the short run
- Political violence and weak state capacity present a serious obstacle to private investment
- A new banking law and a new law on joint-stock companies aim to improve the weak corporate governance system

WORLD BANK

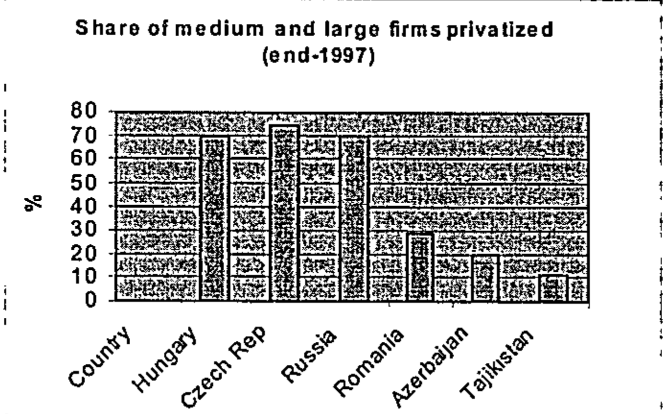
Privatization Statistical Annex.

Chart 1



WORLD BANK

Chart 2



WORLD BANK

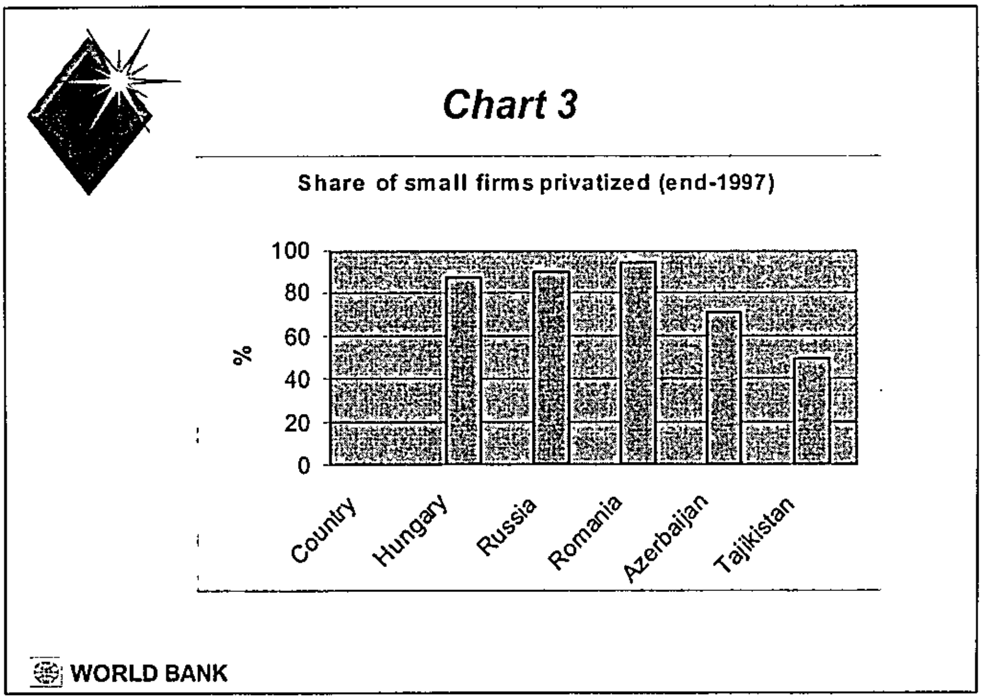


Chart 3
Share of small firms privatized (end-1997)
100
80
60
40
20
0
%
Country
Hungary
Russia
Romania
Azerbaijan
Tajikistan
WORLD BANK

Transition to Market Economy and JICA Cooperation

Mr. Yoshiaki Nishimura, Japan
Professor
Institute of Economic Research, Hitotsubashi University

1. Introduction

I don't belong to JICA, but I have been being involved in several projects for technical cooperation conducted in Central-East European countries by the Japanese governmental organizations including JICA. So I have some experiences from practice in the field of technical cooperation there, and I would like to try to explain JICA activities on behalf of JICA objectively. I will mention the following respects.

- Why does JICA wrestle with support for transition to market economy?
- What is JICA's role in cooperation with transitional countries or what has JICA been implementing in practice in Central-East European countries?
- What reputation has JICA got as to its activities there, and what are problems?

2. Components of transition to market economy

Before I explain JICA activities in the Central-East European countries, I must refer to some aspects of the transition to market economy. We can mention at least four components of transition to market economy.

2.1. Liberalization of internal and external economic activities.

This contains introduction of convertibility of the national currency. The liberalization means, first of all, deregulation of economic activities which were regulated by the state under the socialist regime. That, nevertheless, doesn't admit a lawless situation. In order to make free economic activities suitable for market economy, market-oriented institutions as normative forms or ways of action are indispensable, including sets of rules, moral and a way of thinking. And moreover, organizations such as a government, enterprises and banks etc. should be transformed into those of market economy. And lastly, market-oriented people are essential.

2.2. Privatization.

It is relatively easy to realize legal privatization and transform state enterprises into private corporations. But a problem is whether newly born private owners or managers have capacities of management adequate for market economy or not. From this point of view, it is an urgent and important task to raise due managers or entrepreneurs at the beginning of the transition.

2.3. Institution-building, and development of proper organizations and human resources.

It is obvious from the above-mentioned that the transition to market economy is a process of institution-building, and creation and development of proper organizations and human resources for market economy, which takes rather long time. People can learn market behavior from everyday practice, but it is possible as well as necessary to promote the learning process by training especially at the beginning of such a great transformation.

2.4. Economic development.

All the transitional economies are low-income economy or (upper-medium-lower) middle-income economy. And therefore the transition to market economy should entail economic development. First, it is necessary for people in the transitional countries to minimize social cost for the transition. Second, the transition to market economy contains their involvement in the world market. And accordingly they have to achieve economic development so that their national economy can survive independently, I mean, on the commercial basis in the world market, but not on the basis of financial aids from the international organizations or other foreign governments. Thirdly, Central and East European countries want to accede to EU, and as a result, they have to reach the level of economic development adequate for the accession within a certain period of time. Eventually many governments of the transitional countries have been being engaged in developmental policies since the early time of the transition(See the appendix). But it is a difficult task for economists in the governments to work out active economic policies such as industrial policies, accepting market economy as a prerequisite condition, because they didn't have experiences and knowledge for that.

To sum up, I would like to emphasize that people in the transitional countries must learn much in order to build up market-oriented institutions and organizations and to implement market-oriented economic policies.

3. Why do the Japan government and JICA want to support the transition?

The Japan government and JICA have their leading ideas to give ODA (Official development Assistance), and according to their documents, the ideas are as follows.

3.1. Humanitarian and moral consideration

This means assistance to those people suffering from poverty and misery. I don't think this idea relevant to the transitional countries especially in Central and Eastern Europe.

3.2. Recognition of interdependence of nations

National economies of all the countries on the earth including developed, developing and transitional ones are closely interdependent each other. And the developed economies themselves cannot develop smoothly without economic development of the rest of the world.

This recognition leads up to JICA efforts to support introduction and development of market economy.

3.3. Environmental consideration

Environmental deterioration due to past developmental policies is serious in the transitional countries, too. And economic development there must go in harmony with environmental preservation.

I think that the second and third recognition gives arguments for JICA assistance to transitional countries. In other words, the Japan government and JICA regard the transition to market economy as a serious challenge for the people of the transitional countries, which needs assistance from the side of the developed economy.

4. What is JICA' role in cooperation with transitional countries?

JICA was established to have charge of one aspect of ODA, that is to say, of technical cooperation. In other word, tasks of developing local human resources devolve on JICA. The Japanese government has another organization for financial assistance, such as former OECF (The Overseas Economic Cooperation Fund) and now JBIC (Japan Bank for International Cooperation). Therefore JICA is a most suitable organization to assist people in the transitional countries in learning the market economy. It is worth while to point out a fact as a background of the technical cooperation in the economic field. I mean that Japan has many experiences of quick economic development and has many experts involved in the development process.

The technical cooperation is aimed at the transfer of technology and knowledge that can serve socio-economic development of a country. And JICA has a wide range of menu of technical cooperation, but I think what is relevant to the Central-East European countries is limited to the following four forms of JICA activities. I can't show the whole picture but only the outline.

4.1. Retraining various experts to raise their market-oriented capacities.

A good many of special training courses for Central-East European experts have been being organized by JICA in Japan for 12 years. Various organizations cooperate with JICA for the training; for example, Japan Productivity Center, Economic Planning Agency, Japan Development Bank, International Development Center of Japan, Japan International Cooperation Center, Local governments, Ministry of Agriculture, Forestry and Fisheries, Ministry of Construction, Ministry of Transport, Energy Conservation Center and so forth.

I can mention the number of the trainees, the term of training courses and their contents. But topics adopted in the training courses range very widely, and it is not an easy task to make a full list of the topics. I would like to compile a list of topics of the courses held in this fiscal year.

The track record of training experts from the European transitional countries in Japan (From 1989 to 1998)

State	Number of trainee	Number of months multiplied by number of trainees
Albania	78	146,6
Bulgaria	389	442,3
Croatia	22	30,4
Czechoslovakia	139	120,5
Czech	117	119,4
Slovakia	215	223,0
Hungary	602	620,7
Poland	653	729,7
Romania	376	451,9
Slovenia	56	59,1
Macedonia	82	143,0

Table 1

List of Topics of the Training Courses for Central-East European Experts in The Fiscal Year 2000:

1) Business management for Bulgaria (27 days; 10 trainees)
2) Business management for the Slovak Republic (26; 10)
3) Business management for Romania (27; 10)
4) Support for economic reform efforts for Romania (29; 6)
5) Designing and improvement of production system (71; 6)
6) Problem solving and improvement by TQM for Polish industries (29; 7)
7) Fisheries development for Albania (14; 13)
8) Productivity management for Hungary, Slovakia and Slovenia (26; 8)
9) Production management for East European countries (40; 9)
10) Macroeconomics (Japanese development) for Central-East European countries (40; 13)
11) Energy efficiency for East European countries (26; 11)
12) Agricultural production and distribution for four countries (48; 11)
13) Development finance for Central-East European countries (22; 12)
14) Seminar on small business policy in Japan for Central-East European countries (25; 11)
15) Industrial pollution control for four countries (52; 9)
16) Industrial policy in Japan for Central-East European countries (30; 12)
17) Environmental administration for Central-East European countries (35; 10)
18) Industrial air pollution control technology Central-East European countries (43;10)
19) Foreign trade promotion for Central-East European countries (27; 11)
20) Management of medical equipment for Bosnia and Herzegovina (48; 9)
21) Business management for Bosnia and Herzegovina (about 30; 6)
22) Small business policy in Japan (about 30; 6)

Incidentally, JICA also has an experience of opening training courses in a Central Asian transitional country, that is, in Uzbekistan. "The Japan course" was set up in the Academy of State and Social Construction under the President of the Republic of Uzbekistan for three years. Its main contents were introduction and explanation of experiences of the Japanese economic development (See the appendix). The trainees and participants are from central and local governments and from the private sector. The number of the total participants was about 500. The lectures were given by Japanese short-term experts (professors, government officials, businessmen) dispatched by JICA. After closing the course the notes for lectures were translated into Russian and distributed to relevant ministries and 63 universities and colleges and so forth.

In addition to training courses JICA has organized many seminars of the similar contents in transitional countries in connection with other forms of technical cooperation. For example, JICA held a seminar on Technique of macro-economic forecasting, meeting a request from the Polish Ministry of economy.

4.2. Support for the formation of Key Government Policies on Industry

In Poland, three long term experts were dispatched to the Polish Ministry of Economy as an in-house advisor so as to help experts of the Ministry in working out industrial policies in the three fields; a. SME promotion policy; b. Regional development policy; c. Technical innovation policy. The Ministry and JICA wanted to devise proper policies for reinforcement of competitiveness of Polish industries. But their activities were limited to these three policy fields, and they could not touch upon industrial policies, such as sector approach policy and export promotion with financial and fiscal subsidies. Because EU doesn't like European transitional countries to implement other fields except the above-mentioned three.

The long-term experts as an in-house advisor in the Ministry of Economy, first of all, learned the real situation in Polish economy, and considered their own experiences in Japan, and then they synthesized the both factors and gave advices, when Polish experts worked out economic policies. And they organized about forty seminars or workshops in connection with policy making in and around the Ministry.

It was frequently said by Polish experts of the Ministry that their advices and proposals were utilized effectively. But in what meanings were they utilized? According to my interview study in the Ministry, there are four cases of the utilization.

1) Experts in the ministry could get acquainted with new knowledge or know-how in the filed of their tasks. They could extend their knowledge about what is done in the market economy.
2) Information given by JICA experts was effective or useful as reference, when Polish economists consider their own concepts of economic policies and institutions.
3) Information given by JICA experts was effective or useful, because they could serve as strong arguments for the policies which Polish experts proposed to the government or the parliament.
4) Proposals and suggestions given by Japanese experts were adopted in the governmental documents after certain modifications. I can show examples in Poland below.

Examples:

- "Program for supporting development of regional Institutions acting to promote technology transfer" (approved by the Council of Ministers in March 1997)
- "Assumption of Long-term Industrial Policy till 2000" (approved by Economic Committee of the Ministers Council, in June 1997)
- "Economic Activity Law"(its draft accepted by the Council of Ministers and sent to the Parliament)
- "The Medium-term Concept of the Country's Economic Development till 2002" (its draft sent to the Council of Ministers)
- "Assumptions of Government Policy towards Small and Medium Enterprises in the years 1998-2001"

I think that the above cases of utilization of knowledge given by the Japanese experts can be extended to other knowledge acquired by the participants in the training courses.

Except the above-mentioned cooperation, two long-term experts were dispatched to the Polish Ministry of Finance. They helped the Ministry to issue foreign bond. And moreover, Technology Information System was set up through JICA cooperation. This organization is to coordinate matching of suppliers and demanders of technology.

JICA is now conducting a new project of the same essence in Bulgaria. One expert was dispatched already, and two will be done within two months to the Bulgarian Ministry of Economy. The main policy fields are (a) SME promotion policy, (b) Export promotion policy, (c) Reinforcement of international competitiveness. Here again, developments of the export promotion policy seem to be restricted to marketing and advertisement, because Bulgaria has started the negotiation of EU accession and she has to follow the EU standard.

Incidentally, in Uzbekistan, one long-term in-house advisor was dispatched to the Cabinet office, whose activities have got a good reputation and he is required to stay in Tashkent longer.

4.3. Transfer and diffusion of know-how of enterprise management in transitional country

JICA has promoted organization of Productivity Centers by dispatching specialists in Hungary, Poland and Bulgaria. For example, in Hungary, Japanese long-term experts exercised leadership for establishing the Hungarian Productivity Center. The center has already conducted inspection and training in more than 200 companies and proposed improvements of management during 5 years. The center organized open seminars and more than two thousand people took part in them. It is very interesting that many of the customer companies are joint ventures or foreign companies; a typical case is Audi, a famous carmaker, which requested HPC to train one hundred managers of the middle class. Western companies trust effects of Japanese methods to raise productivity, and the cost of training by the local agency is low, and moreover it can avoid problems of language. But I must underline the fact that who has learned here is Hungarians. Now a stress of HPC activities is moving to development of small and medium size enterprises.

In Bulgaria, the Bulgarian Quality and Productivity Center was built up through JICA assistance about four years ago, but it worked only for about 40 companies.

In Poland, the vice premier and the Minister of Finance at that time, Mr. Balcerowvicz made an official request to JICA to cooperate in establishing the Polish Productivity Center. It was in August 1990.

I can mention another form of transfer of know-how organized by JICA in the field of enterprise management. JICA dispatched a long-term expert as an in-house advisor from 1995 to 1996 to a Hungarian producer of car seats, IMAG, which was a state enterprise at that time. The expert inspected the production line, and proposed its improvements. And he taught the IMAG managers how to produce proto-type of products and trial products and how to make a decision on investment and proposed a direction of R&D. This company was privatized later successfully and now it supplies products to Hungarian Suzuki (a carmaker from Japan). The managers say that what they learned from the Japanese experts in terms of Japanese culture and a Japanese way of thinking is very useful for them to do business with the Suzuki company.

JICA has another example in Poland. One of the long-term experts dispatched to the Polish Ministry of Economy applies HOPP Program (Human Oriented Program for Productivity Improvement) to a tool section of the URSUS factory. The managers of the section could learn the Japanese management system and succeeded in separating it from the URSUS and privatizing it as an independent SME.

4.4. Development study

The last form of JICA activities which is relevant to Central-East European countries is "Development study". Study teams are dispatched to provide assistance in formulating development plans for the public sector and other basic areas of infrastructure. The team studies projects or programs proposed by its partner government from technical and financial viewpoints and gives proposals or suggestions.

For example, in Poland, JICA conducted three studies of this kind; the study on the comprehensive traffic plan (from 1991 to 1992), the study on the privatization of the Polish national railway (PKP) (from 1996 to 1997), the study on the master plan for energy saving (from 1997 to 1999). In Hungary, one is the study on the energy saving plan and the other is the study of the productivity improvement and environmental preservation in the Borsod power station.

Here I explain only one case briefly. It is the study on the privatization of the Polish national railway (PKP). The study was implemented from 1996 to 1997 and the study team proposed a basic scheme for it. The proposal consists of the following three points.

1) The national railway company should be divided into two parts, namely the part of infrastructure and the part of management of running the transport, and then privatized.
2) The latter part should be divided into 8 companies, that is, three passenger traffic companies, two freight transport companies and two other related companies.
3) A holding company should be established to manage all the companies.

And the proposal contains procedures of the process of corporatization and privatization, which has four stages from 1997 to 2005 and further.

In this proposal, the JICA team tries to draw attention of the Polish government to a danger of overall dependence on private fund to privatize and modernize the railway business and it suggested alternative ideas. The Polish government accepted basic ideas of the JICA proposal, and it has been advancing preparation for it step by step, and now the government has made another request to JICA to conduct a study for the next stage

All the activities were implemented on the basis of requests of the partner governments. And many of necessary equipments for the implementation of the above-mentioned cooperation were granted by JICA.

5. Conclusions

As I mentioned above, so far as Central-East European countries are concerned, JICA concentrates on the technical cooperation to develop local human resources as actors in the market economy. JICA believe that the technical cooperation must lead up to promoting market-oriented institutions and organizations, and to formation of economic development policies on the basis of market economy. Since most of the actors in the economy didn't have adequate knowledge, know-how and experiences of market economy, especially on the first stage of the transition, it seems to me that this type of technical cooperation is of a great significance. I can say, therefore, that JICA makes much of what is missing or undervalued in the radical liberalistic approach. I think that JICA activities hit the mark in this respect.

The technical cooperation conducted by JICA up to now, generally speaking, has a good reputation from its partners in Central-East European countries. For example, it is said in the Prime Minister's Office in Hungary that the JICA technical cooperation is No.1 in terms of quality and quantity among the OECD member countries. So far as training courses are concerned, it is said on the partner side that the number of trainees is very big and the term of training is relatively long and the contents of training courses are rich and comprehensive. As regards the support for formation of key governmental policies on industry, it is sufficient to introduce one story. After having heard the effects of JICA cooperation for formation of key industrial policies directly from the Polish Ministry of Economy, the Bulgarian government made a formal request to JICA to apply the same scheme to Bulgaria.

With regard to transfer and diffusion of know-how of enterprise management, the cooperation with HPC has been relatively successful and the shift of its activities towards SME seems to be appropriate from the viewpoint of economic development. The assistance of long-term experts to managers of state enterprises in rationalizing management was effective itself, but it could only show a model or a good example, and consequently, the efforts at diffusion of the experiences were necessary, but they seem to be unsatisfactory.

Lastly the development study could raise realistic proposals and suggestions to reform the public sector and there are several cases in which proposals were accepted in the governmental plans. But at the same time, there is a difficult case such as the Borsod power plant in Hungary. The study was done when the plant was state-owned, and the results of the study were accepted by the Hungarian government. But then it was privatized and the private power station didn't accept the proposal for it. That is, maybe, because of financial difficulties.

As I mentioned above, there are four forms of JICA technical cooperation up to now which are relevant to Central-East European countries, but in my view, there is one remarkable common feature; the knowledge transferred from JICA experts could be utilized by partner experts in the following ways. (1) as a chance for partner experts to expand knowledge or know-how about what is done in the market economy, (2) as useful references for working out concepts of economic policies and institutions, (3) as strong arguments for policy proposals to the government or parliament, (4) as proposals and suggestions adopted in the governmental documents after certain modifications, and/or (5) as effective tools for improving enterprise management in practice. I am sure it is possible for partner experts to utilize the knowledge in one way or another, if they want to. It seems to me that especially long-term in-house advisors could get very good reputation from JICA partners and have strong influences over them.

But in my view, there is a serious shortcoming in the JICA technical cooperation. It consists in the fact that it is, in principle, separated from materialistic cooperation such as financial assistance. I think if it entailed the materialistic cooperation and if it had a close interconnection with the latter, the JICA technical cooperation could have much stronger impacts on partner experts.

Last but not least, I would like to refer to some economic problems. I think there are some fields of which JICA should make much. As I mentioned above, the transitional countries should survive in the world market without chronic financial aids from the international financial organizations and foreign governments, that is, on the commercial basis. But the perspective of economic independence is still unclear for almost all the transitional countries with some exceptions. Therefore the reinforcement of competitiveness of their industries and export-lead development are a crucial task for them, and accordingly they need promotion of export, development of industries of comparative advantage and infant industries, and promotion of SME. SME development can contribute to formation of supporting-industry attracting FDI, mitigation of unemployment, and sometimes, to regional development, too.

And what is more, Central-East European countries want to accede to EU, and therefore, they will have to reach the due level of economic development in a relatively short period of time. From this viewpoint, too, they have to pursue reinforcement of industrial competitiveness. But here I would like to draw your attention to existence of a very complicated problem. It consists in the fact that because they want to acquire membership of EU, they have to develop their economy quickly, on one hand, but that at the same time, they have to follow various EU standards of economic policies and institutions, on the other hand. Nevertheless the application of the EU standards to the countries restricts their latitude of economic policies only to the narrow sphere EU approves. Usually EU permits transitional EU applicants to implement three fields of economic policies, namely, SME promotion, technical development and regional development. EU dislikes them to do sector approach of industrial policy, export promotion with financial and fiscal subsidies and development of economic special zones. Because of that, the scope of economic policies on which Japanese experts work is limited very much, although they can serve transitional countries with its much wider policy menu. But here arises a question, whether the narrowed economic policies are rational or sufficient for their economic development or not. I am afraid that the application of the EU standards of economic policies to, for example, South-East European countries is not right. I think this question should be examined cautiously from the economic point of view.

6. Appendix

6.1. Examples of Active Economic Policies in Some Transitional Countries

Here I don't try to produce a full list of active economic policies. I only show one or two examples in Poland, in Hungary and in Bulgaria.

- In Poland: "Industrial Policy Program 1995-1997; International competitiveness of Polish industry"(adopted by the Economic Committee of the Council of Ministers December 19, 1994)
- In Hungary, "National Revival Program (Nemzeti megújhoddás programja) "(1990) "Hungary medeium-term Economic Policy Priorities"(1997), " Szécsenyii Plan"(draft, 2000)
- In Bulgaria, "Program of the Government of the Republic of Bulgaria 1997-2001"(2000). (In the Chapter VI: Financial and Economic Reform in Bulgaria, 1. financial stabilization, 2. structural reform, 3. industrial policy, 4. trade policy, 5. revival of the Bulgarian agriculture, 6.Bulgarian tourist industry, 7. Bulgarian infrastructure), "Strategy for the Development of Industry in the Republic of Bulgaria 2000-2006"

6.2. The curriculum of the Japan course in Uzbekistan

- First seminar (03.14-03.19, 1997) "Japan and Uzbekistan"
  - Theory of Japanese economic development
  - Monetary policy
  - Economic statistics compilation and its utilization for policy determination
- Second seminar (09.18-09.25, 1997) "Public Administration and National Public Service System in Japan"
  - Administration system
  - Public service system and personnel management
  - Process of public administration and human resources development systems
  - Modernization
  - Human resource development
- First Intensive course of lectures (11.13-11.24, 1997) "Industrial Policy and Human Resources Development"
  - Industrial policy after the world war II
  - Industrial policy development process
  - Financing for policies implementation
- Third seminar (03.18-03.30, 1998) "Japanese Enterprises and Their Human Resources Development"
  - Japanese method of management at enterprises in transition
  - Productivity increase movement in Japan
  - Personnel training in the company "Matsushita- Panasonic"

- Fourth seminar (09.23-10.09, 1998) "Improvement of the Service Quality"
  - From Planning to market economy
  - Service in the Japanese postal service
  - What are administration services?
  - Private sector services (tourism)
- Second intensive course of lectures (11.19-11.26, 1998) "Analysis of the Uzbek Economy"
  - Development of ASEAN countries
  - Economic situation with CIS countries and economic analysis of Uzbekistan
  - Present situation with investments from Japanese enterprises
- Fifth seminar (02.26-03.03, 1999) "Agricultural and Monetary Policy in Japan"
  - Productivity improvement in agriculture
  - System of agriculture financing in Japan
  - Irrigation system and water control
  - Monetary policy in Japan
- Sixth seminar (10.04-10.11, 1999) "Social Infrastructure Improvement in Japan"
  - Pension system
  - Medical insurance
  - Employment insurance system
  - Public health and medical service
  - Environmental protection policy
  - Labor policy
- Third intensive course of lectures (11.08-11.12, 1999) "National Public Service system"
  - Public service system and personnel training
  - Administration and personnel assignment systems
  - Service conditions: salary, service benefits, etc.
- Fourth intensive course of lectures (12.07-12.16, 1999) "Economic Development of South-East Asian Countries"
  - Economic development of South-East Asian countries
- Seventh seminar (01.31-02.04, 2000) "National Land and Regional Development"
  - Land development
  - Environment policy
  - Regional development financing
  - Regional development policy