Partners in Transition '99:
Lessons for the Next Decade

A conference for leaders of economic, political and social transition in nations emerging to open market economies.

October 3–5, 1999
Warsaw, Poland

Contents

Welcome

U.S. Agency for
International
Development

Dear Participants:

Welcome to Warsaw and the first Partners in Transition Conference, sponsored by the United States Agency for International Development (USAID) and the German Marshall Fund of the United States. Let me extend special thanks to our hosts—the Republic of Poland and the people of Warsaw—and to all of you who have taken the time to join us here.

Our goals for this conference are many: we hope to effect a better understanding of and appreciation for the steps needed for a successful transition. We hope to renew the call for cooperation among the countries and people of Europe and Eurasia. And we hope to discover new ways reform leaders can continue to share their experiences in the years to come. But mainly, we hope that every participant will be able to take back to his or her community lessons that can help them better the lives of the people there—an ambitious goal, to be sure, but a worthwhile one.

It has been ten years since the Berlin Wall fell and nearly ten since the Soviet Union collapsed; in most countries, the transition process in well under way. Over the next few days, we will look back as well as forward, and say—what have we learned, and how can we manage the challenges the new millennium has in store for us?

How appropriate, then, that this first Partners in Transition conference be held in Warsaw, whose motto is *contemnit procellas*—"it defies the storms." Let us hope the lessons we learn here will help us defy storms as well.

USAID and the German Marshall Fund of the United States wish every participant a good stay in Warsaw, and an enjoyable conference. We look forward to learning from all of you.

Sincerely,

Donald L. Pressley
Assistant Administrator
Bureau for Europe & Eurasia

Executive Summary

After ten years of experience in transition, reform leaders in the vast region covering the Baltics, Eastern Europe, and the now independent countries of the former Soviet Union have experienced many challenges in fostering the development of democratic systems of government and market economies while civil society undergoes great change. The United States Agency for International Development is providing the opportunity for the region's leaders of reform to share with each other their experiences in addressing these challenges. Through open dialogue on common concerns, lessons may be learned and partnerships between reformers strengthened, reinforcing the prospects for rapid improvement in the lives of the people of the region.

This first forum will be an occasion for reviewing the broad lessons learned from the transition to date including the inter-relationships between democratic and economic change and the implications for standards of living. USAID, by facilitating this environment that is conducive to dialogue, seeks to achieve the following objectives:

- To forge sustainable partnerships between participants;
- To foster open dialogue to find solutions to the problems of transition;
- To recognize and give credit to examples of cooperation and change that have the most significant results and potential;
- To create an opportunity to continue sharing the lessons of transition throughout the region.

After this first step in forging new partnerships, USAID anticipates the continuation of subsequent fora. The next event, Partners in Transition 2001, will be hosted by the Republic of Bulgaria.

Agenda

Sponsored by:

The United States Agency for International Development

The German Marshall Fund of the United States

SUNDAY, OCTOBER 3, 1999

4:00–7:00p.m. Delegate Registration

7:30 Reception, with receiving line

8:00 Buffet Supper

MONDAY, OCTOBER 4, 1999

8:00a.m. Delegate Registration

8:15 Introductory Remarks
Harriet C. Babbitt, Deputy Administrator, United States Agency for International Development
Craig Kennedy, President, German Marshall Fund of the United States

8:30 Welcoming Address
Prime Minister Jerzy Buzek, Republic of Poland

8:45 Keynote Address
The Transition in an Evolving Global Community, A Historical Perspective
Alexander Yakovlev, Chairman of the Presidential Committee on Rehabilitation of Victims of Political Repression; President of "Democracy" Foundation, Russian Federation

9:15 First Plenary Session

Support For The Democratic Transition
President Petar Stoyanov, Republic of Bulgaria

10:15 Coffee Break

10:45–12:30p.m. Breakout Sessions

Session I: **New Partnership Roles for Government and NGOs in the Road Toward Democracy in Transition Countries**
Vilija Blinkeviciute, Vice-Minister of Social Security and Labor, Republic of Lithuania
Pavol Demes, Director, Slovak Academic Information Agency, Slovak Republic
Tolekan Ismailova, Executive Director of the Coalition of NGO for Democracy and Civil Society, Kyrgyz Republic,
Peter Nizak, Foundation for the Development of Democratic Rights, Hungary

Session II: **Good Governance:**
Decentralization, Local Initiatives, Political Parties and Interest Group Development
Ginka Kapitanova, Executive Director, Foundation for Local Government Reform, Republic of Bulgaria,
Vasyl Kuibida, Mayor of Lviv, Ukraine,
Jerzy Stepien, Deputy Minister, Ministry of Interior, Republic of Poland

Session III: **Independent Press: An Evolving Institution**
Manana Aslamazian, Executive Director, Internews/Russia, Russian Federation,
Giorgi Bokeria, Board Member, Liberty Institute, Georgia,
Sarmite Elerte, Chief Editor of *Diena*, Republic of Latvia,
Sandor Orban, Director, Center for Independent Journalism, Hungary

Session IV: **Establishing Linkages Between the Rule of Law and Economic Growth**
Daniel Daianu, Center for Economic Policies, Romania,
Valve Kirsipuu, Member of Parliament, Republic of Estonia,
Alexandru Muravschi, Vice Prime Minister, Minister of Economy and Reforms, Republic of Moldova,
Veniamin F. Yakovlev, Chief Justice Supreme Commercial Court, Russian Federation

12:45 Luncheon

2:15 Second Plenary Session

The Transition to a Market Economy: A Comparative Analysis and Approach
Deputy Prime Minister and Minister of Finance Leszek Balcerowicz, Republic of Poland

3:15 Tea

3:45–5:30 Breakout Sessions

Session I: **Creating An Enabling Environment for New Business Development and Foreign Investment**
Arunas Degutis, American Chamber of Commerce, Republic of Lithuania,
Gregory Marchenko, President of Deutsche Bank Securities, Republic of Kazakhstan
Gabor Szorenyi, Deputy Director, Hungarian Energy Office, Hungary

Session II: **Effective Strategies for Achieving Environmentally Sound Economic Growth**
Anca Dumitrescu, MD, Institute for Public Health;Zlatna Health/ Environment Project, Romania,
Indulis Emsis, former State Minister for Environment, Republic of Latvia,
Maciej Nowicki, Head of Eco Fund, Republic of Poland,
Gulnara Roll, Environmental Governance Program, Republic of Estonia

Session III: **Economic Development: Perspectives from the National and Local Levels**
Leonid Grigoriev, Director General, Bureau of Economic Analysis Foundation, Russian Federation,
Ivan Miklos, Deputy Prime Minister for Economy, Slovak Republic,
Risto Penov, Mayor of Skopje, Republic of Macedonia,
Valter Rescic, Deputy Minister of Finance, Republic of Slovenia

Session IV: **The Role of Financial Institutions: Banking Supervision and Capital Markets**
Leslaw Paga, Head of the Securities Exchange Commission, Republic of Poland,
Jana Pospisilova, Czech Securities Commission, Czech Republic,
Marat Sultanov, Minister of Finance, Kyrgyz Republic,
Martin Zaimov, Governor of the Central Bank, Republic of Bulgaria

7:30 Reception and Buffet

TUESDAY, OCTOBER 5, 1999

8:15a.m. Opening Remarks

Donald L. Pressley, Assistant Administrator for Europe and Eurasia, United States Agency for International Development

8:30 Third Plenary Session

National Identity and Ethnicity: Impact on Minority Populations

Ljubomir Frckovski, Professor of International Law, University "St. Cyril and Methodius," Republic of Macedonia,
Peter Huncik, Director, Sandor Marai Foundation, Slovak Republic,
Katarina Kruhonja, Board Member, Center for Peace, Non-Violence and Human Rights, Republic of Croatia,
Dimitrina Petrova, Executive Director, European Roma Rights Center, Republic of Bulgaria

9:45 Fourth Plenary Session

Standards of Living: Realities, Expectations and Policies

Harriet C. Babbitt, Deputy Administrator, United States Agency for International Development

10:30 Coffee Break

10:45–12:30p.m. Breakout Sessions

Session I: **Unemployment and the Labor Market: The Social Cost to Governments and Families**

Michal Boni, Chief Advisor to Minister of Labor, Republic of Poland,
Svetozar Janevski, General Director of Skopje Brewery, Republic of Macedonia,
Marina Kokanovic, Economic Advisor to the Union of Autonomous Trade Unions, Republic of Croatia,
Vladimirs Makarovs, Minister of Welfare, Republic of Latvia

Session II: **Women in the Transition: Leadership Roles in Economics and Democracy**

Session III: **Individualizing Safety Nets: Moving from Protection by Firms to Empowerment of Citizens, Pension Reform**

Marek Gora, Professor, Warsaw School of Economics, Republic of Poland,
Serjei Holovaty, former Minister of Justice, Ukraine

Session IV: **Development and Maintenance of Health Care Systems with Local Initiatives**

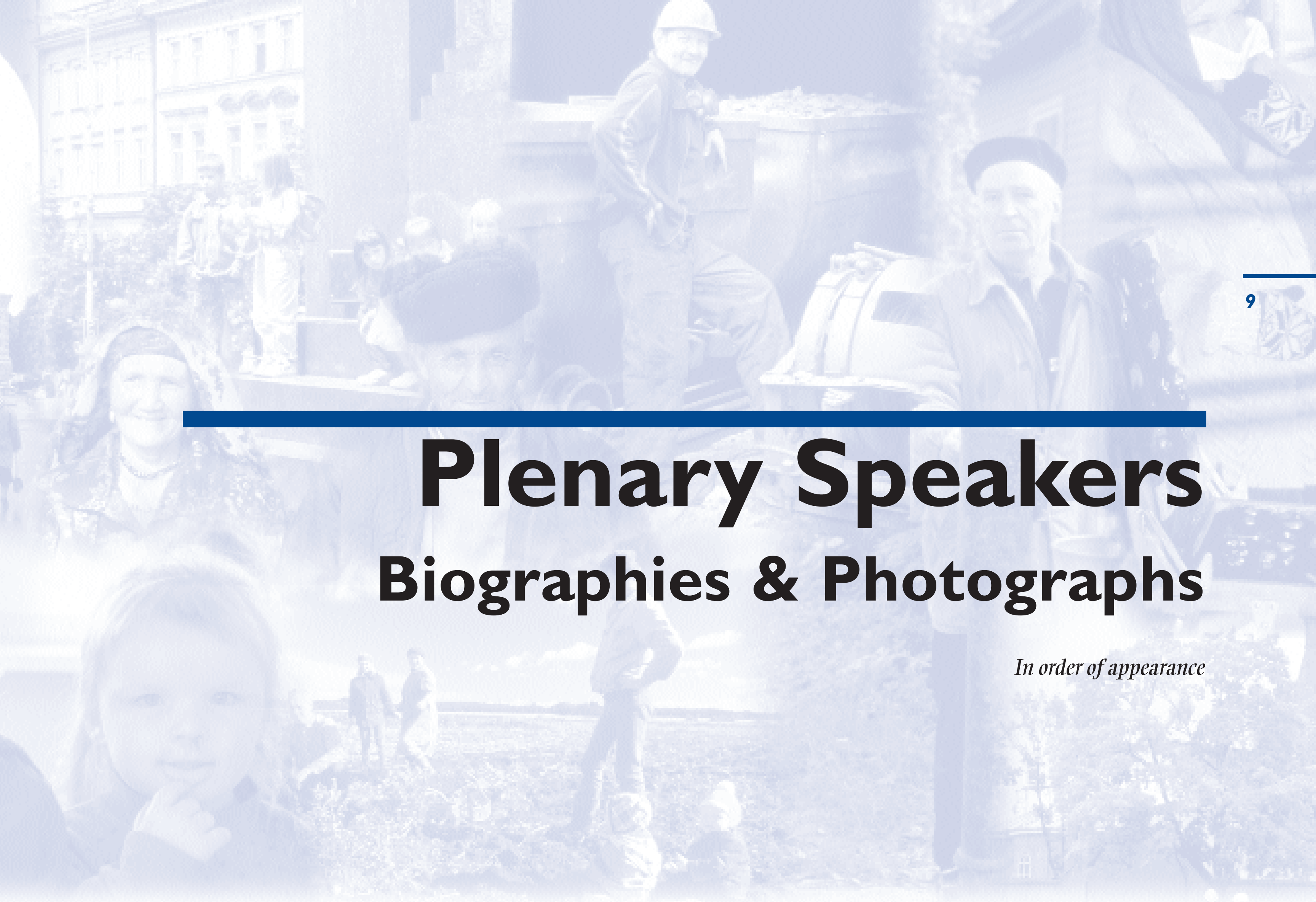
Tatoul Akopyan, Head of the General Department of Provisions, Ministry of Health, Republic of Armenia,
Adik Levin, MD, PhD, MSD, Head of Department, Tallinn Children's Hospital, Republic of Estonia,
Tolebai Rakhipbekov, Chairperson, Committee of Health, Republic of Kazakhstan

12:45 Luncheon

Guest Speaker
First Lady of the United States, Hillary Rodham Clinton

3:00 Closing Remarks

Donald L. Pressley, Assistant Administrator for Europe and Eurasia, United States Agency for International Development



Plenary Speakers

Biographies & Photographs

In order of appearance

Prime Minister Jerzy Karol Buzek
Prime Minister, Republic of Poland

He was born on 3 July, 1940 at Smilowice. He graduated from the Mechanical–Power Engineering Department of the Silesian Polytechnic, specialising in chemical engineering. He is technical sciences professor. He was a scientific researcher at the Chemical Engineering Institute of the Polish Academy of Sciences in Gliwice.
He has written several dozen articles and monographs on mathematical modelling, desulphurisation of exhaust gases and optimisation of processes.

Prime Minister Buzek has been involved in the activity of the "Solidarity" trade union since its formation. He assisted in the organization of the underground structures of "Solidarity" in Silesia and in the Zaglebie region, and he was an active member of the national and regional authorities of clandestine "Solidarity." He chaired the union's 1st, 4th, 5th and 6th National Congress. He sat on the AWS (Solidarity Election Action) team of experts and was a co-author of the economic chapter of AWS program.

Alexander Nikolayevich Yakovlev

Chairman, Presidential Committee on Rehabilitation of Victims of Political Repressions, President of "Democracy" Foundation, Russian Federation

Mr. Yakovlev was born on December 2, 1923 in the small village of Korolyevo in the Yaroslavi region of the former Soviet Union. In 1941 he was drafted into the army and fought in the Marines Brigade for a short time, until he was decommissioned after being heavily wounded in battle. He graduated from the Pedagogical Institute with a degree in History in 1946 and worked as a teacher, journalist and a member of the Yuroslavl Regional Party Committee.

From 1953–56 Mr. Yakovlev was a member of the Department of Schools of the CPSU Central Committee. In the year 1958–59, Mr. Yakovlev was a distinguished scholar in the Fulbright postgraduate exchange program at Columbia University in New York. In 1960 Mr. Yakovlev earned a postgraduate degree at the Academy of Social Sciences and began a position at the Department of Propaganda, of the CPSU Central Committee. He held this position until 1973, when he was appointed the Ambassador of the USSR to Canada. Mr. Yakovlev represented the USSR as Ambassador to Canada until 1983, at which time he left the foreign service to act as Director of the Institute of World Economy and International Relations at the USSR Academy of Sciences.

From 1985 through 1991, Mr. Yakovlev held numerous senior-level positions in the CPSU Central Committee. In 1985-86, he was the Chief of the Department of Propaganda and from 1986 until 1990 he was the Secretary of the CPSU Central Committee and Chairman of the CC Commission for International Policy and of the Politburo Commission for Further Study of Materials of the Stalin Repressions. From 1990 until March, 1991, Mr. Yakovlev was a member of the Presidential Council and from March-December 1991 he was the Senior Advisor to the USSR President. In early August 1991, Mr. Yakovlev was expelled from the CPSU. Throughout the year

1991, Mr. Yakovlev served as the State Counsellor for Special Missions of the President of the USSR.

Since 1992 Mr. Yakovlev has held the position of Chairman of the Presidential Commission for Rehabilitation of Victims of Political Repression. From 1993-95 he was the Head of the Federal Service of Television and Radio and the Chairman of *Ostankino* All-Russian State Television and Radio Company.

In addition to his position as Chairman of the Presidential Commission for Rehabilitation of Victims of Political Repression, Mr. Yakovlev is currently the Chairman of the Russian Party of Social Democracy and the Public Advisory Board of the *Kultura* weekly newspaper. He is the Honorary Chairman of the Board of Directors of the Russian Public Television Ltd. and a Co-Chairman of the Congress of Intelligentsia of Russia. Mr. Yakovlev is the President of the International Democracy Foundation, the International Charity and Health Foundation and the Leonardo Club, Russia.

Mr. Yakovlev is the Founder of the International Democracy Foundation (1993), the Movement for Democratic Reforms (1991), the International Foundation of Socio-Economic and Politological Studies (Gorbachev Fund) (1991) and the Foundation for the Support of Christian Culture (1994). He has Honorary Doctorates from Durham and Exeter Universities in Great Britain, from Soka University in Japan and from the University of New Brunswick in Canada. Mr. Yakovlev has been awarded numerous distinctions and decorations for his bravery and leadership in military service, as well as his charismatic leadership in peaceful political and social initiatives.

His Excellency, Petar Stoyanov
President, Republic of Bulgaria

President Stoyanov began his professional life as a lawyer, after graduating from Sofia University "St. Kliment Ohridski" in 1976. From 1978 through 1990, he practiced law throughout the Republic of Bulgaria. In 1990, President Stoyanov became a spokesman of the opposition Union of Democratic Forces (UDF) in Plovdiv. In 1992, he was appointed Deputy Minister of Justice in the UDF government, the first non-communist government since 1944. In 1993 the UDF government collapsed, precipitating President Stoyanov's resignation at Deputy Minister of Justice. In 1994, he re-entered the political arena and was elected a Member of Parliament to the 37th National Assembly. As a Member of Parliament, he served the Bulgarian people as Chairman of the UDF Parliamentary Group and Deputy Chairman of the Committee on Youth, Sports and Tourism.

In 1995, President Stoyanov guided domestic policy design and implementation by serving as the Deputy Chairman of the UDF in charge of domestic policy. After winning a primary election in June, 1996, he was nominated candidate for President of the Republic by the opposition coalition United Democratic Forces. On November 3, 1996, President Stoyanov was elected President of the Republic of Bulgaria with 57.73% of the total popular vote. He was sworn in as President of the Republic of Bulgaria on January 19, 1997 and officially took office on January 22, 1997.

Deputy Prime Minster Leszek Balcerowicz

Leszek Balcerowicz was born in Lipno, Poland in 1947. In 1970 he graduated with distinction from the Foreign Trade faculty in the Central School of Planning and Statistics in Warsaw (now the Warsaw School of Economics). In 1974 he earned an MBA at St. John's University in New York, and in 1975 he received his Ph.D. in economics at the CSPS. In 1981-1982 he was the Deputy Chairman of the Polish Economic Association.

In September 1989 Leszek Balcerowicz became Deputy Prime Minister and Minister of Finance in the first non-communist government in Poland after World War II. He also served as President of the Economic Committee of the Council of Ministers. In this vital period in Poland's transition he designed and executed the radical stabilization and transformation of the Polish economy. Leszek Balcerowicz retained his positions in the government until December 1991.

Since October 1992 Leszek Balcerowicz has been a professor at the Warsaw School of Economics. Since 1993 he has also been the Director of International Comparative Studies at WSE. He is a Chairman of the Center for Social and Economic Research (CASE) and Chairman of the Program Board of the Foundation for Economic Education, both based in Warsaw. Since April 1995 he has been the President of the Freedom Union (UW).

His academic distinctions include visiting fellowships at the University of Sussex (1985), and Marburg University (1988).

In 1992 he was awarded the Ludwig Erhard Prize from the Ludwig Erhard Foundation. Leszek Balcerowicz received the Honoris Causa title from the University of Aix-en-Province in 1993 and from the University of Sussex in 1994. In 1996 he received this distinction from De Paul University, the Mikolaj Kopernik University of Torun and the Dundee University in Scotland.

Leszek Balcerowicz has given many lectures and seminars in countries throughout the world, including Austria, France, Great Britain, Belgium, Germany, Hungary, Sweden, Japan, the Czech Republic, India, Italy, Ukraine, Lithuania and USA. He has over 100 publications on economic issues in Poland and abroad. He is a member of the European Economic Association, Polish Association of Sociologists and Polish Association of Economists.

In the Parliamentary Election of 1997, Leszek Balcerowicz became the Deputy Prime Minister, Minister of Finance and President of the Economic Committee of the Council of Ministers in the newly formed AWS-UW coalition government.

On October 5, 1998, Mr. Balcerowicz was awarded the title "Finance Minister of the Year" by a British financial daily, Euromoney. On January 21, 1999, the European Institute of Washington, D.C. granted him the "Transatlantic Leadership Award," for being the most outstanding European personality.

Ljubomir Frckovski

Ljubomir Frckovski is Professor of International Law at Cyril and Methodius University in Skopje,Macedonia. His subjects include international law and the theory of international relations.

From 1990–97, Professor Frckovski held various positions in the Macedonian government, including Minister of Internal Affairs and most recently, Minister of Foreign Affairs. He also assisted with the preparations of Macedonia's new Constitution.

Professor Frckovski has participated in numerous conferences on international relations, organized crime, and human rights. He has been a fellow of the Salzburg Seminar and the 21st Century Trust, and is a member of IFRI, the French Institute for International Relations and the Association for International Law in Skopje. He is the author of several articles and teaching materials on international relations, democracy in Macedonia,organized crime and Macedonia and the Kosovo crisis.

Peter Huncik

Dr. Peter Huncik is the Director of the Sandor Marai Foundation in Bratislava, Slovakia. Since 1993, Dr. Huncik has established and worked with the Ethnic Conflict Training Centers sponsored by the Foundation.

From 1990–1992, Dr. Huncik served as advisor to President Vaclav Havel on minority and human rights issues. In 1989, Dr. Huncik co-founded the first independent political movement in Czechoslovakia, the Independent Hungarian Initiative. Also in 1989, Dr. Huncik estalished the first independent newspaper in Czechoslovakia, NAP (the Sun).

Dr. Huncik has participated in several conflict resolution and communications conferences and seminars in the USA, UK, Canada, and Hungary. He has published numberous books, articles and poetry.

Since 1985, Dr. Huncik has been a psychiatrist, and continues to treat individual patients. Dr. Huncik's accomplishments also include the foundation of Nova, an independent television company, in 1993.

Katarina Kruhonja

In 1974 Katarina Kruhonja graduated with a doctorate in medicine from the School of Medicine at the Universityof Zagreb, and by 1983 she had completed her specialization and postgraduate studies. Initially her main professional interest was focused on medicine and health. However, in 1991 with the emergence of the war in the Former Yugoslavia, her professional interest shifted completely to civil initiatives, peace groups and non-violent activities. Consequently, in early 1992, Ms. Kruhonja, together with a group of colleagues, established the Center for Peace, Non-violence and Human Rights—Oijek, which is the first human rights and peace NGO in the war-affected Slavonia region. The Center was also an active member of the Anti-War Campaign Network of Croatian human rights, supporting peace building and reconciliation.

For seven years Ms. Kruhonja served as the elected President of the Center for Peace, Non-Violence and Human Rights-Osijek. She is one of the well-known NGO human rights and peace leaders, critical in starting numerous initiatives, i.e., direct assistance to victims of war, protection of human rights, development of peace building and educational programs, and provision of psychological assistance. Ms. Kruhonja has been very critical in supporting reconciliation and peace building not only in the Slavonia region and Croatia but also in other countries of the former Yugoslavia.

In 1996 Ms. Kruhonja received the European Circle Award for Human Rights (European Movement of Croatia), and in 1998 she received the alternative Nobel Peace Award, "Right Livelihood Award."

Dimitrina Petrova

Dimitrina Petrova is the Executive Director of the European Roma Rights Centre which is an international non-profit human rights organisation based in Budapest, Hungary.

Previously, from 1992 to 1996 she was the Chair of the Human Rights Project in Sofia, Bulgaria. This organisation monitors the human rights situation of Roma in Bulgaria and undertakes legal defense in cases of human rights abuse.

In the spring of 1995, she was Chairholder and held courses on the "Human Rights and Ethnic Relations in Eastern Europe" at the University of Oregon.

In 1995–96 she was a Regional Co-ordinator for Southeastern Europe, and in 1994 a Field Officer at the International Secretariat of the International Helsinki Federation for Human Rights in Vienna, Austria.

Between 1982 and 1995 Dimitrina Petrova was teaching at the V. St. Kliment Okhridiski University of Sofia, where she lectured on Philosophy and Philosophy of Law.

From 1990 to 1991 she was a member of the Bulgarian Parliament, where she participated in the drafting of the 1991 Bulgarian Constitution.

She has worked in various fields of human rights movements such as training human rights experts; conducting fact missions on human rights abuses; organising conferences; participating in a number of conferences on human rights and related fields. She was also a visiting lecturer to several universities and issued numerous publications.

She is the recipient of several awards such as the Human Rights Award for 1994 from the American Bar Association.

Harriet C. Babbitt

Harriet C. Babbitt was sworn in on December 1, 1997, as deputy administrator of the U.S. Agency for International Development (USAID). USAID is the government agency that provides economic assistance and humanitarian relief worldwide. Its six main objectives include: promoting economic growth and agricultural development, advancing democracy, delivering humanitarian and post-conflict transition assistance, improving health and population conditions, advancing education and training, and protecting the environment.

Before joining USAID, Ambassador Babbitt was the U.S. permanent representative to the Organization of American States (OAS) from 1993 to 1997. She led the successful U.S. effort to reform the OAS to concentrate on high priority hemispheric goals. She worked closely with her counterparts from other OAS member states and the OAS secretary general to make the organization more responsive and effective, emphasizing democracy, human rights, sustainable development and trade.

Prior to joining the administration, Ambassador Babbitt was an attorney with Robbins and Green, P.A., from 1974 to 1993.

Ambassador Babbitt served from 1988 to 1993 on the board of the National Democratic Institute for International Affairs (NDI), where she chaired the Latin American Committee. NDI is an independent organization affiliated with the Democratic Party that promotes the establishment and growth of democratic institutions in foreign countries.

First Lady of the U.S. Hillary Rodham Clinton

Hillary Diane Rodham was born in Chicago, Illinois, on October 26, 1947. After graduating from Wellesley College in 1969, Hillary enrolled in Yale Law School, where she developed a strong concern for protecting the interests of children and families, and met Bill Clinton, a fellow law student.

Hillary married Bill Clinton in 1975. While her husband served as Governor of Arkansas Advocates for Children and Families, introduced Arkansas' Home Instruction Program for Preschool Youth, and worked tirelessly on behalf of children and families, while practicing law in Little Rock. She served on boards of organizations including the Children's Defense Fund and the American Bar Association Commission on Women in the Profession.

In 1996, the First Lady authored It Takes A Village and Other Lessons Children Teach Us, a national call for all sectors of society to take responsibility for our children. In her book, the First Lady emphasizes that while parents are the most important influence in their children's lives, and have primary responsibility for them, society also plays an important role in rearing our nation's children. In addition, since 1995, the First Lady has penned a weekly syndicated newspaper column, “Talking It Over.” In this column, she draws upon her experiences as First Lady and on her observations of women, children, and the families she has met across the country and around the world.

In addition to her work at home, the First Lady serves as a goodwill ambassador for the United States during her visits abroad. From Europe to Asia, Africa to Latin America, the First Lady takes her message of human rights, health care, and economic empowerment for women across the globe. During her trips the First Lady has advocated for human rights, promoted microcredit as a means to economic self-sufficiency, pushed for equality in education for girls and boys, and spoken of the importance of health care with an emphasis on meeting the critical needs of women and children, including family planning and safe motherhood. She has also been a leading voice for democracy building, for women's rights, and for he developing of a voluntary sector in emerging democracies.

Like her predecessors, First Lady Hillary Rodham Clinton brings to the role of First Lady of the United States her own special talents, experience, and interests.

Background Issues

Ten years after nations all over Central and Eastern Europe and the former Soviet Union undertook the task of transforming their political and economic systems, they and their Western partners have accumulated a wealth of experience in reforming economies and political systems from central planning and authoritarian rule to free market and pluralistic democracy. At the same time, they have encountered numerous problems, some that were not foreseen at early stages of transition, others that have proven to be much more difficult to solve than was initially hoped.

This paper provides a discussion, necessarily general, of issues encountered across the 27-country region and some suggestions for topics that might form the basis for discussions during the course of the two-day Partners in Transition Conference. It is not meant to cover all topics related to the transition or to foreclose discussion of any topic at the conference. Rather its aim is to provide a general framework and a set of starting points for discussion and debate. Those attending the conference bring immense knowledge and experience to bear on the themes of this meeting and a paper such as this can best serve the limited purpose of provoking that capability into conversation at the conference.

The paper has four main sections: cross-cutting issues, democratic reforms, economic reforms and evolution of safety nets. The topics are inter-related and the suggestions for discussion are not meant to necessarily be limited to a particular conference session.

1. BACKGROUND

A. Expectations

At the beginning of the transition most reform proposals included three main elements: economic liberalization (price decontrol), privatization, and macroeconomic stabilization. This led in turn to the expectation that the role of government in the new economies and societies would be drastically diminished, as governments withdrew from resource allocation taken over by market forces. That would defuse political conflicts of transition, as allocation of economic resources was transferred from the domain of public decision making into the domain of voluntary exchanges between private parties. Relieved of excessive administrative and fiscal burdens of centralized economic management, governments would assume and effectively handle the much less arduous functions of providing essential public goods for the economy and society, and maintaining safety nets for those unable to earn adequate income in the marketplace.

Although the role of economic, legal and political institutions of market democracy was generally appreciated, the task of establishing such institutions was not viewed as an urgent reform priority. This de-emphasis was predicated on the assumption, often implicit, that institution building would occur spontaneously to accommodate the interests of economic agents. These interests, in their turn, would be articulated through democratic political processes, and post-communist governments would respond to grassroots demand with necessary legislative acts.

The evident failures and the gigantic waste of the old system had created expectations that reforms were bound to lead to a significant and immediate improvement of living standards and that the anticipated economic gains would be broadly shared. It was not assumed that specific groups, such as women, would be made more vulnerable by the transition itself. Reform was supposed to transform initial hopes for a better life into a sustainable support of the new economic order at the ballot boxes. Social peace would be cemented by the new, liberal, concept of justice, based on individual freedoms, equal opportunities, and rewards that are dependent on effort and merits. This was an appealing alternative to the discredited egalitarian doctrine with its disincentives and de-facto privileges to the "nomenclatura" elites.

B. Lessons Learned

Why have some nations managed to establish legal and political institutions conducive to economic restructuring and growth and imposing necessary checks and balances upon governments, while in other transitional countries political and institutional risks deter investors, public officials lack accountability, and corruption and abuse of power are rife?

Ten years of post-communist transition in over two dozen nations in Europe and Asia have produced mixed results. In some countries dramatic progress has been made; in others progress seems stalled in many areas. The former have accomplished relatively quick economic turnarounds and since then sufficiently robust growth and political stability. In places with less reform, economic growth, if any, has often been short-lived and fragile. Several countries have stagnated for most of the decade or, worse yet, seen their output and living standards on a steady decline, breeding chronic political instability. There has been little convergence between the two groups of countries. And of course within countries there has been wide disagreement about the best course forward.

Political explanations for stalled reform shed little light on why in some countries political processes were favorable for economic reform, whereas elsewhere they were not. It appears that processes of post-communist transition have their inner dynamics, which were little known and certainly downplayed ten years ago. These dynamics feature the powerful influence of initial circumstances that lead to distinctly different outcomes. Thus, countries differ from each other not only in rates of growth (or lack thereof) and other economic indicators, but also, and perhaps most importantly, in institutional setups.

Countries that have been failing in their economic transition have developed surrogate institutions instead of the conventional ones required for efficient functioning of a market economy. Institutional surrogates include non-monetary transactions (via barter, non-payments, dubious notes of exchange etc.), private enforcement of outstanding contractual obligations, and sprawling informal sectors that outperform and crowd out economic units complying with officially sanctioned rules and institutions. Against these backdrops, otherwise sound policies (e.g., aimed at macroeconomic stabilization), have only limited and often superficial impact, leading to emergence of the "virtual economy." The latter provides a means to evade badly needed restructuring at the cost of growing imbalances and rapidly accumulating public debt, ultimately leading to monetary and fiscal meltdowns. Value-creating activities in these countries are usually confined within a small number of regions and industries, with the rest of the economy remaining severely depressed. Narrow bases for market income lead to growing inequality and poverty, which, in turn, narrow political support for government policies.

Another lesson of the past decade is that economic, political, legal and social transformations are tightly linked with each other. Newly established economic institutions will be functional or moribund depending on incentives of economic agents and available institutional alternatives. Draft laws have to be evaluated, *inter alia*, by the extent to which they reflect economic and political realities, as well as the human and social capital of the country. Lasting macroeconomic stability cannot be accomplished unless the labor market becomes fully functional and large social groups cease to rely on explicit and implicit government subsidies.

Political stability and support for sound policies cannot be assured without a robust and sufficiently numerous middle class, which is also an important prerequisite for truly independent mass media.

All these linkages mean that successful transition is a holistic problem, which requires thorough coordination of partial reform efforts. Such coordination is particularly important when economic failures aggravate social and political problems, and political instability, in its turn, hampers economic reform and restructuring. Initial blueprints for transition did not foresee such vicious circles and therefore had no suggestions as to how to find ways out of them.

Earlier reform programs had only cursory implementation blueprints, and in particular paid little attention to the interaction of government and society in the course of reform. Both were often viewed as constraints upon transition policies—governments because of their incompetence and proneness to corruption, and society because of likely resistance to painful "shock therapies." While the outcome of transition was expected to bring about harmony based on a social contract between free citizens and a limited government protecting their rights, the roles of government and society in advancing reform were largely downplayed. The notable exception was the aforementioned ideology of rapid privatization as a means to create an empowered constituency with vested interests in secure property rights—a constituency that would press the government through advocacy efforts into actions upholding the new economic order.

Much of the reform "triad"—liberalization, privatization and financial stabilization—was aimed at the curbing power and discretion of the previously oppressive and overly invasive government. Indeed, liberalization removes government controls over production and exchange, privatization transfers production assets from government ownership into private hands, and financial stabilization requires the government's adherence to strict rules of macroeconomic policy. Extrapolation of this drive had led to the general conclusion "less government = more reform."

While few questioned the role of the government in provision of conventional public goods, such as law and order, economic infrastructure, and social safety nets, the notion that market democracy in itself is a major public good and its delivery might require an integrated and positive view of a limited, but effective state was much less common. This coordination was often regarded as redundant, if not potentially harmful, an impediment to spontaneous growth of new institutions from the grassroots.

The present view of government's role is more balanced. Today it is broadly recognized that a pro-active government could greatly expedite transition by offering leadership, accumulating institutional requirementsof dispersed economic agents, and constraining the level of political transactions that serve narrow interests at the expense of society at large. The problem is that in reality post-communist governments often fail the tests of administrative efficiency and political accountability, and as a result are unable to perform these roles. Policy stalemates due to government inaction are common.

An often-proposed remedy is decentralization of reform, which parallels decentralization of government. First, this should alleviate policy conflicts, since populations of smaller units tend to be more homogeneous than nation-wide agglomerations, which makes it easier to reconcile individual preferences over policy options. Second, sub-national jurisdictions can experiment with different policies, legal and regulatory regimes, thus opening a competitive "market" for institutions and providing for selection and dissemination of best policies. However, the success of this scenario is contingent upon sufficient economic integration of regions, high spatial mobility of capital and labor, and certain coordinating constraints upon regional initiatives. Implementation of these conditions, known as "market-preserving federalism," is in the hands of the central government, which is responsible for policing the unity of the national market and enforcing constitutional provisions on division of power between tiers of government. A failure of the central government to perform these functions produces political incentives for sub-national administrations to control regional economies, rather than set impartial rules for economic agents.

A credible commitment of government to pursue reform policies must be based on a broad consensus in the society that would welcome a market democracy. The common explanation of unsuccessful transition due to a lack of political will is incomplete: it does not address the question why such a will is missing. A more accurate diagnosis would examine the social base for market reform. Expanding such a base is an urgent priority for the countries that have been less than successful in their earlier efforts. At present this problem is much more difficult than a decade ago when expectations were high, and the idea of economic freedoms and democracy had not been undermined by the policy setbacks and hardship that followed. Today's opposition to reforms is often fed not only by a lack of progress up to date, but also by widespread skepticism about the future.

Reversing this trend is a complex social, political and economic problem. Desired social transformations include strengthening and expansion of the middle class. Well-targeted and adequately funded safety nets and efforts to reduce barriers blocking access to the labor market and suppressing development of small businesses would lead to broader acceptance of a new economic regime. These and other similar changes have to be triggered in the political sphere, where earlier unsuccessful attempts to build unwieldy alliances and manipulate the electoral processes should give way to broad participatory approaches, public discussions and social evaluation of policy options.

Today, as ten years ago, post-communist nations are faced with numerous policy dilemmas and intellectual challenges. The difference is that in 1989 there was a broad agreement, among reformers at least, about necessary policy measures. A decade later in less successful transitional countries these earlier approaches and premises are subject to revision and re-assessment, and workable alternatives are still to be found and broadly shared. Answering these urgent questions requires a new partnership of reformers from different transitional countries with each other and with their Western partners.

A large amount of real life experience—both positive and negative—of institutional transformations has been accumulated by post-communist leaders inside and outside of government. This experience includes unlocking legislative stalemates, building social support for reforms and reaching consensus about policy options, facilitating small business development and reducing entry barriers for new entrepreneurs, discovering and testing new institutional forms, customizing formal institutions to the realities of transition nations and thus making them work. Apart from being of great practical importance, country-specific experience and the results of local experimentation are highly valuable for a general understanding of processes of economic development, institutional change and political transformations, and indeed, of the very nature of market economies and democracies. However, this experience, although a vitally important intellectual resource for future reforms, remains highly dispersed and therefore unavailable in its entirety to potential users across the region. Putting this experience in the public domain is therefore an urgent priority.

There are three reasons to suggest that the answers to today's intellectual and policy challenges of post-communist transition can be sought through an intensive international and interdisciplinary dialog and partnership of reformers from different countries and fields of professional expertise, and their Western counterparts. The three areas are interdependency of reform policies in different fields, the dispersion of the relevant experience and the likelihood that there is more than one solution to similar problems. Such dialog and partnership should replace traditional donor-recipient relationships, common for the first years of transition. It is expected that this conference will be an important step in this direction.

C. Multiple Outcomes of Transition: How to Unlock "Bad Equilibria"?

The tendency of successfully reforming countries to continue to improve while in other places slow reform and slow growth reinforce each other, is based on a number of factors and mechanisms. One of them is *complementarity between economic progress and political stability*. Successful implementation of a reform program in a democratic political environment is much more likely when a program produces sufficiently broad social and economic benefits, or at least credible and broadly shared expectations of an economic turnaround. In other words, to bring a post-communist nation to prosperity, the government needs popular support, which lends credibility to government policies, reassures investors, and makes it possible to overcome the resistance of narrow interests that gain from an unreformed economy. Such support, however, is in turn contingent upon economic progress to date. This mechanism, when political and economic successes and failures are feeding upon each other, leads to divergent outcomes. Successful nations continue to do well and those less fortunate stagnate. Where the institutional foundations for a market economy remain absent or shaky, the weakness deters investments, confines market exchanges to primitive spot trading, and stimulates capital flight.

Another, closely related, component of a difficult transition is a weak government. The weakness of the government increases non-compliance with laws and official regulations, and in particular tax evasion. Breach of law becomes a natural choice when authorities lack resources to reward law-abiding individuals and firms with high-quality public services, or to punish violators. This further undermines the government's capacity and creates another vicious circle. Weak governments are almost invariably plagued with *corruption*. When violation of official rules is endemic, non-compliance is hard to conceal, and it requires the paid complicity of authorities. Low pay to public servants and short horizons of politicians and officials make them less concerned about their reputations and raise the attractiveness of kickbacks. Worse yet, as widespread corruption becomes a social routine, such expectations become self-fulfilling.

Desperate to collect revenue, a weak government sets excessively high tax rates, which makes tax evasion a matter of survival for producers faced with competitors who *en masse*, are escaping the taxman. This leads to vast *informal sectors*, which offer produc-

ers better terms of operation than the official economies. A large informal sector, however, is a highly imperfect goal, since its institutions lack legitimacy and credibility and cannot form a basis for long-term economic commitments.

One of the most damaging constraints is the inability of a weak government to create a predictable and enforceable legal and regulatory environment that would attract private investment. *Stalled investments* are the central problem of stagnating post-communist economies, which lack a modern industrial base and economic infrastructure. Investments are badly needed not only for creation of new firms—they also facilitate closures of old and unprofitable ones without raising unemployment to socially unacceptable levels. When a nation is trapped in a bad equilibrium, domestic and foreign investors alike are deterred by prohibitively high institutional and political risks and erratic government policies, and these concerns outweigh the pent-up demand for capital and potentially high return that it could earn under better conditions.

The problems of a malfunctioning public sector are compounded by "informal" modalities of private transactions, such as *barter and arrears.* As with corruption, acceptance of these highly inefficient means of exchange depends on their commonality: when barter and arrears are known to be endemic, they are acceptable for lack of better option.

All of the above problems have been observed by all of the transitional nations in varying degrees and time periods. The difference between good and bad outcomes is in the scope and scale of institutional distortions and un-law-bound behavior. What factors were responsible for a particular outcome is still debatable. The "distance" that a transitional country had to cover in the process of its post-communist transformation has surely played a major role: the greater the distance, the more difficult is the transition. Such distances have institutional and structural dimensions. The former is concerned with existence prior to transition of "proto-institutions" of market economy, civil society, law and order and modern government. Arguably, such proto-institutions greatly facilitate reforms as they form a natural basis for a new institutional order, which does not have to be built from scratch. The role of the structural component, i.e. the depth of economic distortions left by central planning, is still largely underestimated. And yet, such distortions greatly complicate transition, not just because they call for deeper and thus lengthier restructuring, but also by triggering political processes that block such badly-needed restructuring.

When patterns of informality and corruption are widespread, they become the rational choice of an individual agent. This means that "bad equilibria" have no internal mechanisms for their gradual improvement, and can linger indefinitely, depleting the resources of a nation. Another conclusion is that a bad equilibrium is likely to resist and reject partial reform efforts. Unlocking such equilibria requires concerted across-the-board changes, involving the coordi-

nated action of the government, affected economic agents, and society at large.

D. New Institutional Order: Efficiency, Fairness, Credibility

As has been suggested, the new economic and political order can only be sustained by popular endorsement. Social consensus is the ultimate cornerstone of the market democracy. Normally such consensus evolves over long periods of time. In post-communist countries fundamental changes in economies and societies have been compressed within a few years. This was bound to produce acute political and distributional conflicts. To steer reform through the turbulence of this period, it was often suggested that reforms be sequenced, starting with economic transformations and postponing political liberalization until the new economic order is firmly rooted. With the notable exception of China and Vietnam, this option has never been implemented. Although some of post-communist nations in the course of their transition have employed more autocratic forms of government, this has not proven to be a successful way to strengthen market institutions, speed up restructuring and facilitate economic growth. Elsewhere in the region, democratic forms of government have been broadly accepted and gained constitutional legitimacy, and are not challenged by any political force of significance, including those seeking major economic redresses. The idea of constitutionality has gained wider acceptance, and even though there are exceptions, significant political and economic changes are often being resolved by constitutional means.

An appealing strategy for implementing reform under democratic conditions, without going through a complex and largely unpredictable process of dealing simultaneously with a wide range of difficult institutional issues at an early stage, was to allow the new institutional order to emerge spontaneously. This scenario called for fixing a socially acceptable status quo and allowing the interested parties to bargain out of this status quo in search of a better allocation of economic resources, property rights, etc. This bargaining would result not only in better allocation of privately-held resources, but also in efficiency-enhancing public arrangements, such as institutions of the market economy, as well as laws and regulations enacted by the government in response to private pressure. The outcome of such bargaining was expected to be *economically efficient*. Based on voluntary exchanges, it should also be perceived as *fair*—otherwise it would have not been endorsed by the involved parties. For the same reason, this outcome should also be *credible*, that is, perceived as serving interests of the public which would thus uphold and defend it.

Although this approach has never been adopted as an official government policy, it was employed *de facto* to different extents by various transitional countries. Its implementation, however, has revealed several problems, all of which could be illustrated by the Russian privatization program. The main immediate objective of the program was to privatize the predominantly state-owned firms as quickly as possible in order to create an economically empowered constituency of private owners—natural agents for secured property rights. Once the initial privatization was completed, new owners were expected to start pressing the government for necessary legislation and at the same time engage in a mutually beneficial trade in property rights, thus correcting the inevitable misallocation of assets resulting from a landslide privatization.

The difficulty with this approach is the assumption that all relevant groups will be represented in such bargaining. Obviously, large social groups that are economically and politically disenfranchised cannot effectively participate in such bargaining. Consequently, the outcome will not reflect these groups' interests and won't have their seal of approval (a broad rejection by the Russian public opinion of the controversial "loans-for-shares" schemes implemented in 1996 is a case in point). The closely related second problem is that the pre-bargaining status quo was in itself a result of poorly regulated and non-transparent process riddled with irregularities. The outcome of this process has never been endorsed by a majority of population and is broadly perceived as unfair (The designers of the Russian privatization program were primarily concerned with "buying" consent of then-current stakeholders who were capable of blocking privatization at the outset). The dubious legitimacy of the initial privatization makes insecure all the future transactions and stifles development of an efficient market for corporate control. This leads to the third problem: the insecurity of newly established property rights shortens the time horizons of private owners, making them less interested in the long-term market value of their assets, than in opportunities to reap short-term gains. Such an attitude often leads to asset-stripping and capital flight. Another option is to use economic assets for political influence, which allows so-called "oligarchs" controlling large fortunes to dominate both the economy and political life. Somewhat counter-intuitively, oligarchs could be opposed to secured property rights as a *public* institution, as it would complicate their economic and political expansion. The expected grassroots demand for an efficient institution thus fails to materialize.

2. THE DEMOCRATIC TRANSITION

A. General

The process of politics has undergone dramatic change in the region. Among the most notable accomplishments is the increased number of elections deemed free and fair by international observers. Greater independence of the press and reduced constraints on political and social associations have increased the means by which governments communicate with citizens. And more slowly, institutional changes that provide for the rule of law are being established. Among these are courts able to enforce contracts, to constrain executive branch agencies and officials, and to arbitrate debates about newly emerging, fundamental political institutions. Against this must be balanced concerns about widespread corruption (both petty and grand), the weakness of government institutions in the face of local or sectoral powers, and the evolution of political institutions toward more democratic and economically useful outcomes. The resilience of prior interests and patterns of decision-making has surprised some.

While the importance of transition to a society governed by the "rule of law" is generally agreed, the steps necessary and the way to accomplish them are not at all clear, and even when clear not necessarily easy to implement. Societies tend to function in familiar ways and arrangements must take account of existing interests and processes. At the same time, the process of massive and peaceful institutional change is itself not well developed. Thus, just as economic and social programs face challenges that grow out of the existing circumstances and challenges inherent in the transformation itself, so too does political reform. The interrelationship of the three areas of reform makes both discussion and action difficult to compartmentalize.

The number of laws that have been drafted and passed, the number of decrees that have been issued, and the extent of reorganization of the structure, size and responsibilities of governmental entities of all sorts represent undertakings of historic proportion. Yet too often the new laws go unimplemented, decrees are ignored and bureaucrats go on doing (or not doing) what they have always done. Despite hopes that repressed political voice would, once freed, flower quickly to guide and constrain political actors, the reforms have not always proceeded smoothly or consistently. The demand for better political institutions may have been broad, but it has proved difficult to translate into specific reforms. Wide agreement about the problems of the old regime has not translated automatically to agreement on the way forward. This has at least two sources: real disagreement on what steps are needed and resistance to change by interests that are either already in place or that have found profit in the uncertainty.

Attention to the positive aspects of reform—drafting of laws that respond to the needs of market participants—has come in advance of progress in understanding or implementing reforms that constrain predatory behavior of either private or public entities. Even more difficult to establish have been the range of policies and constraints on the use of the power of government to establish special policy preferences or exemptions for selected private interests. The web of constraining governance mechanisms that might limit such reform-undermining efforts are evolving more slowly and less uniformly among the transition countries. These institutions include effective legislative oversight, checks on administrative irregularity, more transparent policy development and implementation, and broader and more frequent participation in these steps by the affected publics.

The degree of change is remarkable, even if there are significant variations among the 27 countries. For most of the new states, this transition has involved not only a change of regime, but the breakup of a prior state and reconstitution of new states. Others have either changed regime (such as Albania, Bulgaria, Hungary, Poland or Romania) or inherited federal structures from predecessor states (Russia, the Federal Republic of

Yugoslavia and the Czech Republic). Violence has constrained political reform in several states as well, the examples are mainly in the Caucasus, Southeastern Europe and Central Asia.

B. Constitutions and Elections

Background. While constitutions exist as the highest formal declaration of a state's scope, their importance to political and economic life varies widely among countries. Every country in the region, except Hungary, has adopted a new written constitution since 1989, and some have made subsequent changes as well. The adoption of a constitution, of course, does not lead inexorably to the "rule of law," to smooth functioning of all branches of government, or protection of the rights of citizens. To the extent that the debates about constitutions provide for public airing of issues fundamental to the functioning of democracies, these have been productive parts of the transition. Places where the debates have been more contentious and protracted (Poland only adopted a new Constitution in 1997) have not necessarily suffered for lack of a new document. Places where the constitutional reform process occurred more quickly may reflect less open debate of important issues, leading to later conflict and confrontation, or simply a by-passing of parliament. So it is not clear that the timing of formal constitutional reform is as important as is some means of attention to "constitutional" issues.

The political structures provided for in the new constitutions have had mixed success in establishing checks and balances among the branches of government. Systems with very strong presidencies or with unclear division of authority have made less overall progress toward consolidating democratic reforms. If a parliament can remove a government and a President can in turn dissolve the parliament, the opportunities for conflict are abundant. This conflict leads to policy uncertainty at best; it has also led to violent confrontation and to use of extra-constitutional methods of political action such as electoral irregularities or calling of rushed referenda.

In places with relatively unchecked presidential power, political parties have not developed, parliaments have tended to be complaisant, presidential decrees have been more common, and constitutional courts have been less effective arbiters of political structure issues. In several countries, the authority to call referenda has been used to extend presidential terms beyond constitutional limits.

Similarly, the constitutional attention to the relationship between regional governments and central authorities has not always resolved deeper issues. In Russia, for example, ambiguity as to the scope of regional or central authority has led to ad hoc negotiation of center-region relationships, resulting in an asymmetric federal structure. Further, debate about authority for deciding the scope of local government further confuses the constitutional landscape. The cases of Bosnia-Herzegovina and the Federal Republic of Yugoslavia pose their own continuing issues in this regard. On the other hand, resolution of the scope of sub-national authority has advanced usefully in places such as Poland.

The variety of constitutional success should not diminish the accomplishment represented by the holding of multi-party elections in every post-communist state except Turkmenistan. Most countries have held elections that meet international standards of fairness and regularity. Development of agreed-upon processes of political contest have evolved faster in some places than others. That great efforts are made to comply with constitutional procedures, even when these are uncomfortable or unfamiliar for many leaders, speaks to the advance of constitutionalism in the region. At the same time there remain in a subset of countries significant examples of voting irregularity, prosecution of opposition figures, disbanding of elected parliaments and broader constraints on civil rights and political freedoms.

Issues for Discussion

- When and how can remaining constitutional issues be best addressed?
- What are the payoffs to free and fair elections?
- What steps are possible for countries to move out of authoritarian or unbalanced political structures?
- What are the implications of party lists or single-member electoral methods? Do lower thresholds for party parliamentary participation increase representation or retard consensus?
- How can devolution of political authority be peacefully accomplished? In what areas do regions and center complement each other? In what areas do they compete?
- In what areas of the transition should government serve as the "institutional architect?" What areas ought to best develop spontaneously?

C. Rule of Law: Courts, the Procuracy and Enforcement

Background. Under communist governments, the exercise of government power was relatively unconstrained by the rule of law. Courts had little prestige and little power, and the law was not a principal means of resolving disputes. Similarly, individuals facing the power of the state could not rely upon adequate legal representation against the state or unbiased adjudication of controversies. In general, the law was not a guarantee against the arbitrary exercise of state power, but rather its instrument.

Significant progress towards an effective rule of law has been made since that period in many of the transition countries. For example, a recent survey of firms in Russia found that both the law and courts were important elements in resolving disputes between firms and promoting the enforcement of contracts.

At the core of this progress has been the emergence of wide consensus about the building blocks of an effective legal system, and the agenda which must be pursued in light of the communist experience. Some countries in transition have made greater progress on this agenda than have others, but for all, a fully effective legal system consistent with democratic governance remains an as yet imperfectly realized goal. Some of the key elements and issues in this agenda are the following.

First, the law as a neutral, principled and unbiased arbiter of disputes is a critical element, and that must mean the development of a judiciary genuinely independent of influence from the parties to a dispute and from the state itself. This may or may not require that the judiciary be administratively separate from the executive branch of government, but it surely means termination of the conflict between being the operator of the justice system and the supervisor of its legality at the same time. Achieving an effective and independent judiciary consequently requires a judiciary knowledgeable in the law, and with clear incentives to achieve a high level of competence and independence. Ongoing training to enhance judicial competence, and the development of adequate mechanisms of judicial discipline, removal, and appointment, remain items on the agendas of most transition countries. Furthermore, providing private parties with choices as to the adjudicating body can, in appropriate cases, introduce competition into the system to create incentives for improved quality and to permit the parties more freedom in handling their legal affairs.

Second, the procurator can no longer play as large a role in state policy as it once did, and to some extent this change has occurred across the region. Under the communist governments, the procuracy was "the supreme and general supervisor of legality," a centralized hierarchical organization with broad powers in criminal and civil matters that dominated the administration of justice at the expense of neutral and independent courts. Both constitutional and statutory changes are altering that skewed allocation of discretion between courts and procurators, separating them into two distinct functions and administrative structures to enhance the independence of the judiciary and the law-based neutrality of outcomes. Reform of the functions of procurators, reassignment of some functions to other governmental bodies, and mechanisms for increasing the accountability of the procuracy, have been widely undertaken, But inconsistencies in reforms leave anomalies in place in many countries. The important role of the procuracy in reviewing the legality of administrative actions while it is dependent on administrative authorities on matters concerning appointment, budget support and location of procurators, creates obvious conflicts of interest. Furthermore, an unavoidable paradox is created by the fact that the discretion of the procuracy must be constrained at the same time that crime and corruption are widely viewed as major measures of the weakness of the state.

Third, across the region there has been a flurry of law drafting. Civil codes have been reviewed and rewritten to take account of the needs of markets. Hundreds of other laws have been drafted and enacted as well. Criminal codes and procedures have been rewritten. However, though valuable, these newly-drafted laws have had less success than expected in advancing the rule of law, for several reasons. One is the overall weak credibility of the state as a provider of consistent policy: newly-drafted laws are sometimes incompatible with other existing laws or inconsistent with routines and expectations upon which relationships in place depend, and sometimes the changes are haphazardly communicated to affected public constituencies. Another reason is the continuing low reliance on formal legal institutions in economies characterized by barter, dependent on pre-existing commercial relationships, and increasingly dominated by tax or corruption-avoiding informal economic activity.

A fourth issue that must be addressed in many of the transition countries is assuring the effectiveness of the enforcement of judgments. Too often, transition countries have struggled to improve the quality of their courts and the laws those courts implement, only to have those efforts sabotaged by inadequate ability to enforce the decisions of the courts. The reasons for these difficulties are manifold, from inadequate legal doctrines such as weak statutes relating to fraudulent transfers, to banking and company law which permits assets to be too easily hidden to evade collection efforts, to inadequate incentives for agents to succeed in achieving collection of judgments. The issue of enforcement has been too little addressed, and often seen as a detail of only marginal relevance to the activities of the courts. Ultimately, without adequate enforcement measures, public reliance on the law to resolve disputes cannot be enhanced, and the problems of enforcement must be addressed with the same seriousness that more traditional areas of law have received.

Fifth, increasing the respect for the rule of law involves increasing the professionalism and capability of lawyers. Part of this demand relates to new roles as advocates or arbiters of matters related to market transactions. But it also relates to the allocation of responsibility and authority for law enforcement, from investigation to prosecution to enforcement of judgments. Training and information are two key resources to be applied to this challenge. Much of this must be the province of bar associations and judicial associations, through which legal professionals can work together to enhance their own effectiveness and bring an independent and concerned voice to the choices made by the government with respect to legal matters.

This is not an exhaustive list of issues affecting the ongoing development of the rule of law. A change of governmental philosophy as massive as that which the transition countries have undergone in the last decade will unquestionably have effects and problems that reach into every corner of the legal system.

Issues for Discussion

- What constitutional constraints have helped reform the role of the procuracy? To which branch of government should the procurator report? What functions should be assigned to others (prisons, criminal investigation
- Given the widely reported levels of crime and corruption, should we be limiting the reach of the procuracy?
- What steps have led to a more independent and capable judiciary, and to a more accountable procuracy?
- Should steps focus on judges themselves or on other inputs to consistent, rights-respecting judicial performance?
- What circumstances affect the utility of importing laws from successful market democracies?
- How can non-government bodies assist in training, oversight or on-going information needs of judges, prosecutors, bailiffs and others?

D. The Role of Civil Society

Background. Voluntary and non-profit organizations play important roles in most market democracies. By providing social services, creating and disseminating information, or advocating on behalf of members, self-formed non-profit or voluntary organizations are playing important roles in the transition countries as well. At the same time, organizations aimed at influencing political outcomes and indeed gaining political power, also constitute important parts of the transition landscape—parts that are neither state nor private. A full consideration of civil society ought to include not only non-governmental organizations (NGOs) and other organizations that are non-profit or charitable, but also those that have strictly policy advocacy ambitions. Thus for the current purposes it seems useful to consider two aspects of civil society: that activity aimed at providing social services and that aimed at influencing government policy even as some organization engage in both activities. Community activism and empowerment to advance common goals are important assets for any democracy. Increasing the role of NGOs of various sorts broadens opportunity for citizen involvement in public affairs, stimulates innovation in delivery of services and diversifies voices participating in policy development and oversight of government.

NGOs and Social Services. Disentangling the state from cradle-to-grave social support is a complicated political, fiscal and social challenge. Compounded by the constraints of economic contraction, by structural distortions of the inherited economy and by uncertainty about the location of governmental social service responsibility, these challenges have left a gap in delivery of a wide variety of social services. Development of a new consensus on the nature and level of state social support is taking time as political processes determine the allocation of state effort. As this occurs, individuals dependent on such services find themselves without access or voice. NGOs specializing in social services have sometimes stepped into these gaps. In addition, empowerment of the beneficiaries of various social services is an important contributor to more responsive and efficient design and delivery of programs.

Civic initiatives and communal activity existed prior to the advent of the communist regimes and indeed in a constrained form, throughout the period of state control of society. Many organizations prior to the transition served as modest outlets for the expression of political interests. Industry, regional or occupation-specific groups come to mind. In addition, informal networks or groups among intellectuals, technical elites and youth served as precursors to NGOs that have blossomed since political liberalization.

The legal apparatus recognizing the NGO sector typically consists of a law on the legal status of voluntary, self-governing, non-commercial organizations set up for various public purposes; of tax laws providing for treatment of the revenue and expenses of such organizations; of laws on charitable giving and of a variety of regulatory requirements. Attention to a new legal environment for NGOs among the 27 countries of the region varies in parallel with more general political liberalization, with greater scope for NGOs provided in countries with more open political life.

Sustainability. New laws have not been adequate in themselves to develop the NGO sector and will not insure the longer term role of civil society organizations. First, weaknesses in the initial laws have often limited the development of NGOs by complicating registration and leaving important matters either unclear or still subject to state interference. Second, dependable revenue sources and professional management are linked to sustainability of the sector and to realization of the several benefits that flow from a stronger NGO sector.

Funding for NGOs comes from a wide variety of sources: members, contracts and grants from government and foreign donors. Sources of sustainable, domestic support depend on development of broader traditions of charitable giving, simplification of procurement process for contracting out of services to the NGO sector and improvement in the fund-raising capability of NGO operators. Success in this regard will come as NGOs themselves develop professional governance and management systems to insure regularity of financial operations and to assure pursuit of the core goals. These both relate to increasing the levels of confidence among citizens and others.

Policymakers in the region face other issues related to non-profit organizations that are similar to those faced in more settled political environments. These include ways of legally and practically distinguishing the scope of appropriate activity defined as non-profit or for-profit, limits on the commercial activity of non-profits, the political activity of NGOs receiving state support, and other areas where state organs or officials may participate in NGOs. Resolution of these issues in a way that leaves clear guidelines for NGO decision-making without erecting or maintaining a state regulatory role is an emblematic challenge of the transition.

Influencing Government Policy. Political advocacy organizations aim to affect government policy. Political parties do this too, though only parties formally propose candidates for elected office. During the transition, as political freedoms have expanded, the role for both types of organizations has changed dramatically. Both parties and advocacy organizations are essential to reducing the alienation of individuals from society and improving the responsiveness of politics to the needs of citizens. It is symptomatic that full-fledged political parties in the region often begin as social organizations. Even social service NGOs often play important roles as advocacy organizations as well.

During the transition the need to resolve fundamental matters of constitutional and economic policy contributed to the rapid evolution of existing interests groups into lobbying organizations. Traditional trade associations organized by industry or region, and labor organizations associated with individual firms insured that the status quo was well represented in policy debates. New organizations, particularly those representing new professions or new industries, have had a more difficult time establishing themselves as effective voices. An exception is the banking sector where resources for political activity are more readily available. In contrast, organization of new or small firms is hampered by the issues facing all NGOs as well as a range of issues related to non-transparent policy processes that discourage outsiders. (This constraint might lead such organizations to focus on providing services to members rather than on seeking their own special interest legislation or subsidies. But this does not suggest that a useful counterbalance to the well-organized interests will emerge easily.)

As with the recognition of political parties of diverse viewpoints, accepting political activity of non-profit organizations or associations does not necessarily insure that such activity advances development of democratic or market institutions. In order to gain and maintain members, most associations will need to provide direct services and/or access to benefits that can be provided by the government. Often these take the form of increased budgetary support or legislative special treatment for members of the organization or protection from domestic or foreign competition of various sorts. Even organizations that begin with appeal to broad concerns or with external support may find that pressures to maintain momentum force them to target or obtain selective incentives that benefit only those who are active members.

Increasing the voice of associations representing new or traditionally under-represented groups will be facilitated as public policy is developed in more open and transparent fashions. Publication of proposed policies, consultation with affected populations, and the development of independent research and analysis organizations all reduce the advantages of proximity to political power. Dozens of such policy analysis centers have been established during the transition, with varying degrees of independence from political or state organs. But the level of information and analysis contributing to transition policy discussion is in many countries increasing the diversity of viewpoints in useful ways.

Issues for Discussion

- What role can NGOs have in improving policy development?
- How relevant are democratic procedures within civil society organizations?
- Is it important to distinguish among social service NGOs, advocacy or lobbying groups?
- What level of state oversight of fundraising, finances, governance or activity is consistent with advancing democratic practices?
- What functions, formerly the responsibility of the central government can be transferred to other organizations such as non-government organizations or local government?

E. Independence of the Press

Background. Freedom of expression, limitations on state control of the media and access to government information all advance democratic processes. Independence of the media and access of political parties to the media are important not only for the success of elections, but also in the development of specific government policies and programs and in oversight of government performance.

In general, there have been dramatic increases in press independence and pluralism. Newspapers and other media are now freer to criticize government actions and to present the views of opposition parties. But the picture is not uniformly positive. Television, the medium relied upon for news, is still controlled by the state in most countries of the region. There are notable exceptions to this; Russia and Romania are two. And despite state ownership, there has been impressive growth in the number of independent stations. Even here, however, independence from the state has not meant that there have developed editorial standards that create pressure for political and economic reporting that is independent of the owners of the press entity.

Given historical practices as well as conflicts inherent in any governmental regulation, the development of professional standards and ethical norms in the media seems particularly suited for self-governing standards effort. Development of regularized access to government-held information can play a role in increasing public expectations of media quality.

One constraint on the independence of the media is libel laws making it either a crime or imposing civil liability for offending officials or criticizing the government. In places where courts are functioning relatively independently, such actions have not advanced as serious threats to press independence.

Issues for Discussion

- What steps can lead to professionalization of the media?
- How can standards for media independence and disclosure of conflicts of interests be advanced? Is self-regulation practical? How should such standards be balanced with individual remedies for defamation?
- How concerned should we be with concentration of media ownership in private hands?

3. ECONOMIC TRANSFORMATION

There have been wide differences among the CEE/NIS countries with regard to the extent and depth of structural changes undertaken in their economies. But virtually all these countries experienced, in the late 1980s and early 1990s, a sharp fall in GDP, arising from a combination of the collapse of the central planning system, the dissolution of the mutual trading arrangements under COMECON, and the inevitable delays in building a new, market-based economic system. In nearly all these countries, the fall in output was accompanied by high inflation. In some countries, generally those where economic reforms are most advanced, positive growth has resumed since 1995 (i.e., in most Central and Eastern European countries, outside the CIS). However, even in these countries, over-employment in large state enterprises remains a threat to the unemployment situation in the future. In Russia, the largest country of the region, the only year of even small GDP growth was 1997; output fell again in 1998, with the financial crisis of the summer, and it is likely to fall further in 1999.[1] Similar developments have plagued the other CIS countries.

The huge task of restoring growth and building a dynamic, market-based economy is discussed here under the following headings. First, there is the achievement of macroeconomic stability, itself a prerequisite for stimulating the saving and investment required for sustained growth. Next, there is discussion of the problems involved in building the markets for labor and capital required for a properly functioning market economy, followed by the closely related topic of how to create an environment attractive to domestic entrepreneurs and foreign investors. The final topics in this section are local economic development and the role of local government, and environmental protection.

A. Achieving Macroeconomic Stability

Macroeconomic stability was and remains one of the top priorities of transitional policy-making. Stable money is imperative for efficient market exchange, encouragement of saving and investment, and ultimately sustainable economic growth. A majority of post-communist nations were burdened at early stages of their reforms by macroeconomic imbalances inherited from the old regimes and further fueled by transformational recessions. As a result, almost all of these countries experienced a period of falling output and high inflation, which inflicted heavy social and economic losses. In general, stabilization programs implemented across the region have delivered the desired results, reducing inflation to economically acceptable levels and maintaining steady exchange rates of national currencies. In several countries, however, price and exchange rate stability remain a problem. In most countries output is still below pre-transition levels, although in many countries positive economic growth has resumed.

Some countries achieved macroeconomic stability relatively quickly, and since then have been reaping the expected benefits of low inflation and stable currencies. This financial well-being is sustained by healthy economic fundamentals, such as prudent fiscal policies, that render credible the commitments of governments and central banks to maintain stable national currencies. This credibility, in turn, suppresses inflationary expectations and stimulates investment and growth.

Elsewhere in the region, the hard-won financial stability remains more fragile. Normally, the key to such stability is a sound banking system, in which banks serve as intermediaries channeling financial resources into the economy and transforming savings into investments. All of the transition countries have put in place two-tier banking systems, with a central bank and a system of commercial banks. But in many countries, commercial banks are plagued by non-performing loans, poor management, and less-than-arm's-length relations with businesses and governments.

1. See footnote 2. It is difficult to estimate the extent to which these measured falls in output are mitigated by increases in unmeasured informal economic activity.

Moreover, governments faced with severe fiscal imbalances have resorted to massive borrowing, paying a premium interest rate on their bonds, with the result that high-yield government securities have dominated banks' investment portfolios and crowded out industrial investments. At the same time, tax evasion tends to discourage businesses from using the banking system for purposes of payments and saving, encouraging them instead to resort to foreign exchange or surrogate non-monetary transactions.

Under these conditions stable money does not trigger steady economic growth, and servicing the mounting public debt against the backdrop of a stagnating economy becomes increasingly difficult. This endangers hard-won financial stability, and a fiscal and monetary meltdown, as the 1998 crisis in Russia has shown, is an ever-present possibility. Nevertheless, with the exception of Russia, other countries in the region weathered the global financial problems of 1997–1998 quite well.

Foreign investments, instead of providing an impetus to economic growth, could make matters worse. While in some countries (notably Hungary, Poland and the Czech Republic) foreign direct investment has been substantial and growth-enhancing, in other countries, to the extent that there is foreign investment at all, it tends to flow into highly liquid assets that allow a quick repatriation of funds at first signs of an approaching crisis. Such reflows contribute, of course, to self-fulfilling expectations of a devaluation of the national currency and foreign debt problems.

While a number of transition countries have gone far toward developing effective and credible mechanisms of macroeconomic management and financial regulation, in many countries central banks—despite *de jure* independence—have not yet developed the tools to ensure that the goal of financial stability is met. First, even if the central bank is in full control of monetary policy instruments, fiscal policies are in the government's hands, and given the dominant role of government securities on financial markets of fiscally troubled nations, the executive branch's decisions strongly interfere with the central bank's policies. Second, the ability of the central bank to regulate the national banking system and other financial institutions is often sharply reduced by a non-cooperative legislature. Third, central banks themselves are still in the process of building capacity to carry out prudential oversight of national financial systems, and have occasionally been engaged in dubious practices. For all of the above reasons, not to mention the vulnerability of monetary authorities to lobbying pressures from narrow interest groups, the very idea of sovereign control over transitional nations' monetary policies is questioned at times. A system like that in Estonia, with a currency board ensuring tight linkage of the money supply to hard currency reserves, is sometimes suggested as a more credible, if inflexible, alternative.

The important and, perhaps, most difficult task is to restore trust in national banking systems. Confidence building is critically important for stopping capital flight and for inducing households to take their savings, often in hard currencies, from under mattresses and turn them into a potential investment resource for the national economy. A large number of banks, some with numerous clients in the industry and the household sector, have serious balance sheet problems stemming from the past legacy of the "soft budget constraint." Bailing out these banks would preserve their infrastructure and spare their clientele massive losses, but such bailouts need to be highly selective, in order not to weaken the incentives of financial institutions to exercise diligence and prudence in their future investments and lending. Likewise, introduction of a deposit insurance system, while critical for strengthening public confidence in the national banking system, must be designed so as not to dilute the incentives to depositors to choose sound financial institutions. Strengthening technical aspects of banking systems, like payments systems and collateral registries, is also crucial to making banks serve the needs of the public and businesses. The availability of credit for small and medium-size enterprises is a problem requiring particular attention if a growth dynamic is to be restored to these economies.

The Russian financial crisis of 1998 has heightened debates about the order and sequence of financial liberalization. Financial institutions that enjoy freedom of action in an incomplete legislative and regulatory environment are not constrained by effective safeguards against incompetence and abuse, including abuse originating with links to governments. Attempts to fill the legislative and regulatory void after an initial liberalization have sometimes been impeded by powerful financial interests.

Issues for Discussion

- How can confidence in the financial systems of CEE/NIS countries be strengthened?
- To what extent do governments of CEE/NIS countries bear responsibility for systemic banking crises? What should be government policies towards banks and their clients who have become victims of such crises?
- What role could foreign banks play in establishing efficient and credible financial institutions in transition countries?
- What measures should be taken to reverse capital flight and turn domestic savings into investments?

- How should financial liberalization be coordinated with regulatory and legislative reforms? How can the banking system be made more responsive to the needs of depositors and borrowers?
- How can monetary, fiscal and other macroeconomic policies be coordinated among the central banks, executive agencies and the national legislature?

B. Market Development and Restructuring

Economic recovery and growth in transition countries must be based on a reallocation of the existing stock of human, physical, natural and financial resources. This alone can produce broad efficiency gains, eliminating the structural distortions and wasteful use of resources prevalent under the previous system and thereby bringing the level of output closer to the economy's potential capacity. Efficient allocation of resources, in turn, requires a set of well-functioning markets. While markets for final sale to consumers have developed rapidly in these countries, the development of the input markets required for redeployment of wrongly allocated resources is often hampered by various barriers, both natural and man-made.

The inefficiency of labor markets in most transitional countries is manifested by the large discrepancies between output contractions—sometimes as high as 50% of the pre-reform level—and relatively low official unemployment figures, rarely exceeding 10% of the labor force. Workers are reluctant to quit their old employers for a lack of better options, and tolerate instead meager salaries and chronic wage arrears. This is partly due to an overall shortage of vacancies, but even when aggregate demand for labor is weak, in severely distorted economies there is still plenty of room for efficiency-enhancing turnover within the labor force. In fact, labor mobility is also restricted by inadequate and poorly administered unemployment insurance systems, vast price differentials of real estate between relatively prosperous and stagnating areas, and administrative barriers, often unconstitutional, erected by local authorities to hold off migration from other regions. While distance is not such an important factor for geographically smaller countries with well-developed transportation systems, it leads to spatial segmentation of labor markets in the larger CEE/NIS nations, and consequently to deep interregional wage and income differentials. Workers are often trapped within recession-hit cities and regions, where jobs used to be concentrated at a few—sometimes one or two—large enterprises that are presently defunct. In addition, important social services are often tied to employment—housing, health care, and child care, to name a few key ones.

Instead of alleviating these disparities, structural changes under economic transition could make them worse. At early stages of reform new business development is largely confined within the service sector. Unlike manufacturing, services cater to local demand and tend to be concentrated within areas with higher household incomes. This pattern of structural change does not assist adjustments in the cities and regions of "rust belts," where "poverty traps" retard development of small and medium business and leave highly inefficient subsistence production, like the cultivation of small plots of land, as the only recourse. It makes poverty chronic and leads to massive waste of human capital.

Another important prerequisite for successful economic restructuring is an *adequate legal and regulatory framework for corporate governance.* Corporate governance is particularly sensitive to the quality of the nation's legal and regulatory setup, and its malfunctioning in the transition countries that are lagging behind in their institutional reforms and experience chronic political instability comes as no surprise. It was mentioned earlier that sweeping privatization programs have not necessarily led to concentration of property rights in the hands of "effective owners" concerned about the market value of their assets. In particular, corporate managers often face few constraints in pursuing their own objectives at the expense of shareholders and the economic health of their firms. Another problem is domination in corporate decision making of large economic and financial groups, which put the goal of expanding their clout ahead of concerns about the profitability and efficiency of the firms they control. In this environment, the rights of minority shareholders and foreign investors are often disregarded and abused. Energetic implementation of reformed corporate law and regulation is necessary to offset these tendencies.

Bankruptcies, which are supposed to be a potent means to discipline managers and create incentives for raising firms' efficiency, have so far failed to fully perform these roles in transition countries. One of the reasons for this is that privatization has often not succeeded in eliminating subsidies and influence-peddling and in imposing "hard budget constraints" on firms. In reality, discretionary subsidies to nominally private companies continue, especially in implicit forms such as tax offsets and toleration of arrears to government-controlled natural monopolies. In fact, in some transition countries collusion between government officials and private businesses might well be on the rise, since concentration of economic power facilitates lobbying. The second reason for delayed bankruptcies is social: the social costs of layoffs, high as they are in developed market economies, are often prohibitive under conditions of systemic crises, chronic recession and poorly developed social safety nets.

Stalled liquidation and downsizing, apart from perpetuating inefficient or even predatory management, deprives the fledgling private sector of production assets and other resources that could have been released in the process. In some countries in Eastern and Central Europe, restructuring has proven to be highly important for a successful economic turnaround, where initial recessions due to a sharp reduction of output of traditional firms were quickly reversed by the rapid growth of private firms.

Transition countries have had various degrees of success in establishing capital markets. Unfortunately the countries which need these markets most—namely those with badly distorted industrial profiles—have been least successful in promoting security trading because of political and financial instability, lack of protection of shareholders' rights, and high institutional risks. These countries' stock markets are unstable and disproportionately thin, and their capitalization remains low. There is, of course, a close relationship between the preconditions for establishing a properly functioning capital market and those for encouraging direct foreign investment (see section 3.c, below).

While most CEE/NIS countries still have a long way to go until they have full-fledged and efficiently functioning markets for corporate control, they are experimenting with *non-conventional forms of management and ownership*. One of these forms is financial-industrial conglomerates comprising companies and financial institutions. Such conglomerates, which are surrogates for corporate mergers, are able to internalize transactions among their members, thus partly making up for the immaturity and volatility of transitional markets. Cross-ownership, coordination, and trust within close-knit company managements solve problems arising from inadequate market information and facilitate financing of participating companies. On the negative side, conglomerates restrict competition, put in question the soundness of lending decisions of participating banks, and often acquire massive political clout that is used to seek preferential treatment by the government. The opposite, and often hailed, trend is *breaking up large firms* into several independently operated entities, which reduces the cost of managerial mistakes and relieves potentially viable parts of a company of the burden of supporting the loss-making units.

Another pattern is participation of *subnational governments in ownership and control of firms*. This form, which has proven to be highly effective in China, is becoming increasingly popular in Russia, where regional administrations are increasingly intervening in corporate decision making. To legitimize this involvement, local authorities build up their holdings of firms' shares, which they acquire in lieu of non-paid taxes. Finally, privatization programs that transferred large portions of equity to firms' insiders have revived the idea of *labor management*. Despite the well-known deficiencies of labor-managed firms, they offer a solution to the problem of abuse by managers when a conventional corporate control market is defunct. In particular, labor management is an effective safeguard against asset stripping.

It remains unclear whether the above forms of corporate control are temporary second-best adjustments to imperfections of transitional institutional setups, which will be evolving towards conventional patterns, or whether they have lasting merits and could be preserved in the long run as viable alternatives to the standard model. It should be kept in mind, however, that prevailing forms of behavioral and organizational adjustment to the existing incomplete institutional environments are likely to have a strong impact on the subsequent process of institutional change.

Issues for Discussion

- How can labor mobility in CEE/NIS economies be enhanced? (See also issues for discussion, Section 4.b)
- How can the social costs of bankruptcies be reduced or compensated?
- What policies could initiate the restructuring of regional economies dominated by obsolete firms and industries?
- Can the private sector best be developed from privatized traditional firms or from newly established private companies?
- How can the accountability of managers to shareholders be strengthened?
- Should the participation of regional governments in the ownership and control of industrial firms be encouraged or resisted?
- Should transitional countries view development of stock markets as an urgent priority or as a long-term goal?

C. Environment for New Business and Foreign Investments

The initial contraction of output in most CEE/NIS economies has been at least partly reversed by industrial investments and small business development. Both small businesses and private investments are highly sensitive to the quality of the institutional environment. Unlike the spot markets that have sprouted up instantly throughout the region in response to economic liberalization, small business development and investment activities show profound variations from one CEE/NIS country to another.

Most transition economies feature various niches in their industrial structures that promise potentially high returns to investment capital. However, these natural and structural advantages could be utilized only if investors are satisfied with the country's institutional setup, legal system, fiscal and financial policies and overall political stability. Promises of good investment climates are common for governments throughout the region, but the critical issue is the credibility of governments' commitments to honor investors' rights. This credibility is in part based on past policies: better-performing transition economies can build on their earlier successes, whereas less fortunate nations are haunted by past crises and policy failures, and as a result are unable to raise private capital that they need so badly.

The domestic investment resources of CEE/NIS countries are typically insufficient to meet the needs of their economies, which induces these countries to vie for foreign investment. In today's world, countries' own financial resources are losing their importance as a factor of economic development in comparison with the quality of their infrastructure and of their human and social capital. The latter, in particular, increases returns to investment in the national economy, reduces investment risks, and thereby could help raise necessary capital on global markets. One important benefit of direct foreign investment is that it is generally accompanied by the transfer of new technologies, modern know-how and efficient management.

Not just the volume, but the structure of foreign investment is of key importance. High interest rates and temporarily fixed exchange rates may attract temporary inflows of capital from abroad. However, such inflows do not lead to accumulation and modernization of production capital, because investors are seeking speculative capital gains rather than corporate profits and dividends, and, as a result, such foreign investment has little impact on economic performance. The record of those countries and companies that have been able attract long-term loan and equity capital from abroad give important examples to be followed by other parts of the post-communist world.

Despite the need for direct foreign investment for modernization and restructuring of traditional enterprises and creation of new industrial firms, stimulating investment from domestic sources is an important first step towards economic recovery and growth, not least because domestic capital accumulation signals international investors that those best informed about the local situation find it sufficiently promising and trustworthy. In the process of stimulating domestic investment, small businesses play a key role by filling numerous market niches, absorbing labor released in the course of restructuring, and stimulating entrepreneurship and innovation at the grassroots level. Small business development usually spearheads an economic turnaround in transitional countries, as it provides for quick and efficient redeployment of available human and physical resources.

Small entrepreneurs also play a very important social and political role by forming a core of the middle class—the centerpiece of support for reform policies. Women entrepreneurs are a major—though often unrecognized—component of this class. For example, in Hungary, women created more than 40% of businesses established between 1990 and 1997, and in Poland, 38% of all registered businesses are women-owned.

Small businesses thrive in a competitive environment with moderate taxes and efficient market infrastructure, including public protection of property rights, law and order, and access to capital and other resources. Unlike large firms, individual small businesses have no political clout and cannot wrest from the government exclusive benefits and concessions. Accordingly, the health of small business is a litmus test of the country's ability to create a rule-based competitive economic environment.

Once the political constituency of small entrepreneurs is firmly established, it can become politically influential, pressing government to respond to its needs by sustaining and further improving the environment for business. Creating a broad constituency for small business reduces the likelihood of successful special interest lobbying by particular industries. However, if small business development is retarded, national policy making tends to be dominated by a few powerful political and economic groups that are not interested in policies supporting competition and reducing barriers to entry. In this case, natural obstacles to the formation of small businesses— such as sluggish consumer demand during a recession, difficulties to raise start-up capital, and insufficient information and know-how—are exacerbated by man-made hurdles, such as oppressive taxation and unnecessarily restrictive regulations, both of which inevitably breed corruption. In such an environment, the government may not offer small businesses protection against the criminal underworld, and small and medium-size firms will tend to join the informal sector.

Improvement of the environment for small business remains an urgent priority of many transition nations. An important policy problem is which of these improvements could be accomplished at the grassroots level within the community of small entrepreneurs through professional associations, credit unions, and small business support institutions, and which of them require government actions. In both cases, the critical problem is consolidation and coordination of efforts of small and medium entrepreneurs — either for the sake of advocacy of their interests, or for other types of collective actions.

Issues for Discussion

- What have been the most successful approaches to attracting direct foreign investments: offering prospective investors tax breaks and similar benefits, or improving the overall investment climate of the country?
- What have been successful techniques for CEE/NIS countries to improve their previously negative investment image?
- Should there be restrictions on repatriation of foreign investment capital (such restrictions could prevent an investment panic, but at the same time they negatively affect investor's confidence)?
- What approach has been most useful in best serving the needs of small businesses: through private business support firms, business associations, or by government agencies?
- How might collective action problems among numerous and dispersed small and medium entrepreneurs best be dealt with?
- How might access of small businesses to start-up capital and other resources best be facilitated?
- Women start one-third of new businesses in the region: how can this contribution to economic growth be further stimulated?

D. Local Economic Development

Decentralization of economic policy making and devolution of power to regions and localities increases the accountability of public servants and makes it possible to customize the provision of public goods and choice of regulatory regimes to local needs and preferences. Local governments can experiment with various policies and approaches and compete for economic resources, first and foremost capital, by offering investors more attractive and business-friendly conditions. This opens up a competitive market for local institutional regimes and economic development policies, which might be particularly appealing for transition countries. In addition, when national policy-making is in gridlock due to conflicting interests, it might be easier to reach a consensus for reform within a smaller locality with relatively homogeneous economic and political preferences, than in the more heterogeneous national polity. Once reform policies are implemented by more advanced regions and have proven their superiority, they will tend to be emulated by other localities.

Decentralization of government therefore opens an opportunity to advance reform "from the bottom up." Indeed, devolution of power, which has become a standard feature of successful post-communist transition, has made it possible to target more precisely and raise the efficiency of social programs, spur local economic development through infrastructure projects and incentives to private investors, increase the transparency of the public sector, and stimulate broad civic participation in communal affairs.

Nevertheless, the experience of the past decade has also shown that the success of government decentralization depends on certain conditions. The first of these conditions is a balanced, predictable and efficient system of intergovernmental public finance, which matches the responsibilities of regional and municipal units with their own tax revenues and, where necessary, grants from higher-level governments. Such grants should be designed so as to stimulate local fiscal efforts; in particular, regional units should be subject to hard budget constraints that create incentives to expand local tax bases and cut waste in the government. Another condition is the coordination of regional policies and regimes by market-preserving national legislation that prevents local attempts to curb competition, protects property and contract rights, and supports other economic and political freedoms. Finally, successful decentralization is more likely if there is sufficient mobility of capital and labor between jurisdictions, to enable people to "vote with their feet" for better regional policies.

When some or all of the above conditions are violated, decentralization is in danger of replacing national rules with local government discretion, and of confiscation and redistribution of wealth in favor of the cronies and political supporters of the local leaders. Poorly functioning markets under such regimes tend to make local residents economically and politically dependent on the local administration, which can use this dependence to strengthen its hold on power. Nontransparent relations between the central and local government budgets dilute responsibilities for provision of social services and programs and stimulate influence activities, which lead to politically motivated decisions instead of those based on principles of economic efficiency and social justice. "Unfunded mandates" of sub-national governments make proclaimed social rights and entitlements fiscally unfeasible, and actual provision of social services becomes a matter of bureaucratic discretion.

This analysis suggests that regional policies to a large extent depend on the national regulatory, institutional and fiscal environment. If the central government is able to effectively police the national market, protect property rights, and maintain rational and stable fiscal relations with localities, the latter will seek to attract investment through efficient tax and expenditure regimes and pro-market policies. But regional efforts to foster competitive markets and create an environment conducive for private investments, in the absence of such efforts nationally, lack credibility and are overshadowed by country-wide political, institutional and economic risks. Under such conditions efforts to advance the reform "from bottom up" are far less likely to succeed.

Issues for Discussion

- Which reform policies are most appropriate for national implementation, and which should be passed to regions?
- What are the necessary constraints on regional economic policy initiatives, and how are these constraints related to the economic situation in the country?
- How can incentives be strengthened for local governments to improve revenue collection and the efficiency of budgetary programs?
- How much discretion should localities have in choosing their taxes and setting tax rates?
- How can central governments prevent the formation of economic and political monopolies in the regions?

E. Protecting the Environment

The transition countries face enormous environmental challenges. During the pre-transition years, many countries enacted strict environmental controls but virtually none were effectively enforced because economic incentives exerted powerful forces in contrary directions. Heavy subsidies on natural resource prices led to overuse of fuels and power. As a result, countries of Eastern Europe and the New Independent States use 2-4 times as much energy to produce a unit of GDP as do the industrial countries of Western Europe and North America. The same influences, combined with a failure to consider the value of conserving resources and maintaining clean air and water (or the corollary costs of pollution and waste), led to excessive emissions, poorly controlled disposal of toxic and hazardous wastes (including radioactive byproducts of weapons manufacture), over-use of pesticides and other agricultural chemicals, and over-exploitation of forests and other natural resources. These practices left 27 countries with a legacy at independence that included countless contaminated industrial and military sites, heavily polluted waterways, degraded lands and reduced biodiversity. And while few studies have been published documenting a clear link between these hazards and unusually high instances of cancers, birth defects and other health problems in some communities, many people believe in such causality based on observation of population groups with high exposure.

Concern about environmental hazards, including the growing evidence of health effects, contributed to public support for change in Central and Eastern Europe and in the Soviet Union in the late 1980s, and loosely-organized groups of citizen environmental activists became among the most vocal advocates of political and economic change and of greater citizen involvement in public decisions affecting the quality of people's lives. The accident at Chernobyl was a particularly powerful catalyst for the growth of this movement.

The environmental impacts of the transition since 1989 and 1991 have been mixed. A silver lining to the severe economic contraction experienced by most countries has been the clearing of the air and the reduction of discharges into waterways around the many heavy industrial factories that have closed or operated far below capacity. Increased energy prices, while leading immediately to non-payment by many financially-stressed industries, households and government agencies, have laid the foundation for improvements in energy efficiency and related pollution reductions. Privatization of businesses and housing stock, and of land in some countries, has led to improved environmental protection of these assets.

But economic downturn has also led to reductions in state budgets that have led, in turn, to the inability to maintain infrastructure such as water treatment and solid waste disposal systems. Budgetary problems have also led to further weakening of regulatory enforcement and non-payment of some technical personnel responsible for operating and maintaining public environmental systems, further eroding environmental quality. And the vast investments that would be required to clean up polluted sites from the past have been far beyond the reach of both central and local governments in virtually all countries.

Opinion polls indicate that public support for better environmental conditions remains strong among educated groups, but understanding of the causes and remedies of pollution is limited among the general public. Some of the non-governmental organizations (NGOs) dedicated to environmental issues have grown and evolved into formal political parties whose leaders serve in parliaments and governments, but many NGOs have faced organizational and financial problems, including lack of legal protection of their advocacy rights, governmental restrictions on their access to information, and taxation of any financial contributions they receive. And in those countries where the fall in output and increase in incidence of poverty have been especially severe, the public has tended to give environmental concerns second place to what are perceived to be more immediate and urgent economic problems.

For the many privatized and not-yet-privatized firms that are struggling to remain in existence, as well as new firms, there is a natural tendency to evade the additional cost burden of complying with environmental regulations, and the same considerations apply to worker safety laws. And the same fiscal constraints already alluded to have limited the government's capacity to monitor and enforce environmental and safety regulations. In some countries, economic recovery has meant recovery also in the sectors—natural resources, energy, metallurgy and chemicals—whose activities were especially harmful to the environment. This leads to the arguable perception that there is, at least in the short run, a trade-off between the level of economic activity and the extent of environmental harmful discharges of industrial wastes.

In spite of these difficulties and constraints, some countries have taken decisive steps to deal with their environmental problems over the last few years. Many countries have enacted environmental protection legislation that is more appropriate to market economies and democratic systems than their old laws. Some have included explicit provision for citizen lawsuits and public disclosure of environmental information, including facts on potential health hazards. Implementation, enforcement and strengthening of environmental regulatory entities remain as significant challenges throughout the region, however.

In Eastern Europe, countries' efforts toward accession to the European Union (EU) have begun to drive reform of environmental laws, policies and regulatory practices. Conforming to EU environmental directives is expected to cost these countries billions of dollars, however. A few of the region's private exporters into European and American markets have begun to improve their environmental management systems in order to comply with market standards, including voluntary labeling systems. Market mechanisms, such as tax incentives and waste discharge fees, are being used in a few places to encourage environmentally-friendly investment.

Recognizing that concern over potential liability for industrial environmental hazards has been a serious impediment to privatization and new investment in privatized firms, a number of countries have created environmental liability laws to indemnify purchasers and/or reduce sales prices by the anticipated cost of cleanup. In such cases, there is evidence that some privatizing companies have actually brought higher prices than they would otherwise have done, thus compensating the government for the cost of cleanup.

Higher energy and natural resource prices have led to efforts to improve energy efficiency in some public facilities such as municipal hospitals and schools, and to reduce waste and prevent pollution in new and privatized businesses, especially those under new management. While such projects enjoy favorable economic returns, financing them has been a challenge. Some countries have undertaken creative approaches to financing. Environmental funds offering grants and loans to municipalities and business for environmental investment have been created in most Central and Eastern European countries. Poland has an entire system of funds at three levels of government that currently pumps about $500 million into investments in environmental improvement each year. In the Czech Republic, commercial banks have established a lending market for environmental infrastructure in which municipalities have participated as increasingly creditworthy borrowers. Further, the share of environmental project financing provided by loans rather than grants by the Czech State Environmental Fund, has steadily increased in recent years. Poland and Bulgaria have both undertaken "debt-for environment swaps" that have provided funds for local environmental projects. Three countries—Russia, Ukraine and Kazakhstan—have made commitments to establish systems for trading emissions credits for greenhouse gases if a global system for emissions trading comes to fruition under the Kyoto Protocol on Global Climate Change. If such a system does develop, these countries stand to benefit financially from selling credits that are available because their emissions levels are now below 1990 levels—another silver lining to the economic downturn.

The unfinished environmental agenda remains daunting throughout the region. In general, transition countries need to continue to focus first on getting laws, institutions and incentives in place to promote better environmental performance in the future, while foregoing for now most costly cleanup of past problems. As environmental leaders better understand that clean production is good business and good economics—since preventing pollution and minimizing waste are far more cost-effective than cleaning up contamination or controlling emissions through "end-of-pipe" technologies—their challenge is to build a broad constituency for this view among economic policy-makers and business managers. Together, political, business and environmental leaders need to work toward environmentally sustainable economic growth.

Issues for Discussion

- How can countries in the region better integrate the goals of economic growth and environmental quality? How can ministries of environment, health, finance and economy work together toward such integrated policies? How should responsibilities for environmental protection be shared among different levels of government?
- How can regional (e.g., EU requirements) and global market forces that are increasing demands for improved environmental performance and environmentally sound goods and services be used to advantage by businesses in transition economies?
- How can cross-border dialogue among governments, businesses, and NGOs in the region and the international community be enhanced to more effectively share experiences in applying innovative environmental policies, practices and technologies?
- How effective have been "command-and-control" regulatory approaches for improved environmental performance? What has been the experience in the region with using market-based instruments and information-based policies to provide incentives to supplement the regulatory approach? How applicable is this experience throughout the region?
- To what extent can public sector financing meet the environmental investment needs of the region? How can governments, donors and development banks more effectively target resources toward the greatest needs? How can government policies stimulate private sector financing for such environmental improvements as recycling, recovery of polluted land, and restoring waterways and lakes?
- How can public/private and private/private partnerships be enhanced to improve environmental performance?
- How can countries in the region better assess environmental health risks and communicate the links between improved environmental quality and improved health?

4. EVOLUTION OF THE SOCIAL SECTOR—SELECTED ISSUES

A. Introduction

The social responsibilities of government have not diminished with the transition from central planning to market-based economies in the CEE/NIS region. However, this transition has brought with it a change in the role of the state, implying a transformation of the way in which these responsibilities are discharged. Of these responsibilities, three are chosen for focus in this paper: dealing with failures in the labor market; the system of social insurance and selected related aspects of the social safety net; and health care. (These three topics correspond to breakout sessions planned for the conference on "Partners in Transition"; it does not deal with such important issues as education and humanitarian relief for victims of conflicts and disasters.)

Social problems and policies in the CEE/NIS Region can be seen as the result of both *pre-transition conditions* and the problems arising specifically from the social and economic developments created by the transition itself, referred to below as *transition-related developments.* Examples of *pre-transition conditions* include overly generous, poorly targeted pension and disability systems—which reflected over-employment in a heavily subsidized and largely low-productivity state sector—as well as growing health problems reflecting both the deteriorating physical environment and the stagnating economies in most of these countries. Examples of *transition-related developments* include reduced income and increased unemployment because of price and output shocks of the transition,[2] and growing fiscal problems because of the difficulties of finding new revenue sources in a market economy with declining or stagnant income. All but a few of the CEE/NIS countries continue to face these economic difficulties in varying degrees.

Social insurance systems and other measures sometimes referred to as *the social safety net* are intended to protect citizens from the effects of either changes that affect the lives of individuals (such as becoming disabled or reaching retirement age or contracting serious illness) or systemic changes (such as economic reforms) that affect large numbers of individuals. In either case, systems must be established that are both equitable and financially sustainable. It obviously follows that at a time of increasing income inequities and declining national income and government revenues, there is a simultaneous rise in the need (and political demand) for social protection and shrinkage in the resources that can be mobilized to meet these demands. The governments of transition economies are thus faced with especially difficult choices in their attempt to design and implement effective social insurance and safety net systems.

The policy issues confronting governments in this region can be broken down into two main, if somewhat overlapping, categories:

- Systemic (structural, medium-term) problems, and
- Immediate problems (urgently required response to conditions created by the fall in output and rise in unemployment).

Systemic problems include: pension and disability payments; unemployment benefits and labor market institutions; the health care system; and, finally, poverty relief and other income transfer/consumer subsidy policies. These problems arise from or are exacerbated by the privatization of enterprises, declining state revenues, and changes in the economic role of the state.

2. In making these statements, it should be noted, first, that there is a wide range of difference between some countries where income levels have recovered or nearly recovered to pre-transition levels (Poland, Hungary, Slovenia, etc.) and others where they remain significantly or even greatly below, in some cases still falling. Second, data is poor and misleading, probably exaggerating income falls by not accounting adequately for the much increased activity in the private, informal sector, as well as for the greater availability and choice, and better quality, of goods and services. Third, effective income inequality was greater than appeared in pre-transition economies, because the elite enjoyed ready availability of otherwise scarce goods and resources, as well as generous in-kind "perks."

In some cases, new systems can be built using the structures and personnel that existed previously; in others, systems have to be built more or less from scratch. In all cases, the problems are complicated by the process of creating and implementing a new structure of government revenues and expenditures.

Immediate problems include: raising pension, disability and unemployment payments to levels that arrest the erosion of real income for recipients of these benefits; and creation of unemployment benefits, in conjunction with other labor market measures, so as to create incentives to facilitate rather than block necessary adjustments. The humanitarian need to assure the survival and dignity of the poorer groups of the population—among whom the impact on women and children has often been especially severe—and the political demands that are associated with this need in the more democratic countries, put great pressure on governments to find necessary resources, at a time when revenues have been tending to decline. One way of doing so has been to replace subsidies to enterprises with increased subsidies to individual citizens and families.

There is, of course, obvious *interaction between the systemic and immediate problems:* for instance, growing unemployment tends to encourage governments and enterprises to push older workers into the pensioner and disabled categories, thereby increasing the difficulties of transition to a more sustainable and efficient pension system. At the same time, the fiscal pressures created by a declining ratio of actively employed workers to those supported by the government tend to result in declines in the real support provided to unemployed and other dependent individuals. Thus, the government faces an increased poverty problem, as well as reduced real demand and output. And there is also the well-known dilemma that the more generous are unemployment and other welfare benefits, the lower are the incentives for unemployed recipients of benefits to seek new employment.

With these problems and interconnections in mind, we will set out the discussion under the following headings: (1) labor markets and unemployment benefits, (2) pension, disability and other income transfers, and (3) the health care system.

B. Labor Market Reform and Unemployment Benefits

Current situation and trends. Data on unemployment (and, where available, informal employment) are difficult to interpret, because of the large amount of hidden unemployment still existing in state-owned (and some privatized) enterprises that keep workers formally employed in order to assure their continued access to employment-related benefits like municipal housing. Published data show great differences among countries in the region, due less to differences in their actual situations than in the way unemployment is registered, measured and dealt with. Thus, no one supposes that Hungary, with reported unemployment rates of about 11% in the period 1992–1997, was worse off than Russia, with reported unemployment of only 3–4% (or 8–10%, according to a different source) during the last years of this period. GDP data tell quite a different story, showing, in this case, some recovery in the Hungarian economy, with little measured improvement from the initially steep fall in Russian output. As mentioned earlier, as a broad generalization, the countries that have been most determined in carrying out economic reforms at an early stage in the transition have seen the greatest recovery of output.

Social background. The behavior and expectations of workers and enterprises are heavily influenced by such *pre-transition conditions* as heavily subsidized consumer goods, housing, power, transportation, free health care (often dispensed within the enterprise), and free day care and education. This substantial labor compensation paid in kind mitigated the impact of low monetary wages and limited availability of goods in stores. *Transition-related developments*, which include continued low monetary wages (now determined to a greater extent by market forces, reflecting the generally low labor productivity in much of the industrial sector), are accompanied by the gradual attrition of compensation in kind and of consumer subsidies. These developments have had a devastating effect on living standards in most CEE/NIS countries, and create economic and political pressures to maintain the previous arrangements, even when this slows down adjustment to a market-oriented and eventually more prosperous economy. Other post-transition trends relevant to the labor situation include: the increase in skewedness of income distribution, both among social groups and among regions; the initial fall in income and output (in all countries, with stronger recovery seen in CEE countries than in the NIS); declines in all types of income transfers and health care, resulting from the fall in output itself and from the fiscal crisis that has arisen (from both the output drop and new role of the state in a market-oriented economy); and the tendency for governments to be lax in enforcing safety and environmental regulations on already struggling enterprises, with inevitable effects on worker well-being. It should be added that to the extent workers are laid off, there has been a tendency to discriminate against women.

Labor market background. The labor problems that have arisen since 1989 should not be construed as new developments. There were a number of *pre-transition conditions*, which included hidden unemployment (symptoms were low productivity, early retirement ages, and generous disability policies) and the lack of labor mobility. In part, the persistence of these phenomena can be traced to the "soft budget constraint" that faced the many enterprises with low or negative value-added. There were also politically motivated restrictions on the free movement of persons, as well as such practical problems as housing shortages in the cities to which workers might have moved if free to do so. Of the many *transition-related developments* affecting the labor market, open or incipient unemployment was created by the revision of relative prices after the gradual lifting of government controls, the greater foreign competition that was officially permitted, the collapse of COMECON (which resulted in falling demand for many enterprises). Although the measured rates differ, depending on the methodology used, women are experiencing higher unemployment rates than men in many countries. For example, in Ukraine, women are 61 percent of the registered unemployed. One result of this trend is the increasingly high poverty rates of female-headed households.

Policies to improve labor market. Economic decline and unemployment is not uniform across regions or urban centers in countries. Overall unemployment might decline if unemployed workers were given better opportunities to find jobs elsewhere. What is needed, however, is first of all the freedom to move, which is still restricted by bureaucratic fiat in some countries. On top of this, there may be instances where subsidies to move to areas where jobs are more plentiful might be in the interest of the society, combined with improved information about available jobs (through labor exchanges or other mechanisms) and skill retraining. Special efforts need to be made to target women, who have been especially hurt by layoffs, and to design job creation activities based on women's skill base. Another impediment to labor mobility is often poor housing availability and poorly or non-operating housing markets. A social safety net for the temporarily homeless and jobless might also facilitate the movement of labor out of especially depressed areas. Allowing real wages to fall so as to reflect the marginal productivity of labor might also improve enterprise competitiveness and ultimately employment; there is evidence that there has in fact been a positive relationship between the decline in real wages and the buoyancy of employment. Where the real wage is at a poverty level, there is some case to be made for subsidies, for instance housing allowances, which allow families to live at a low but acceptable standard of living. But such allowances, at a time of fiscal constraint, compete against other uses of scarce government resources, like health services and child care: the choices are painful and difficult.

Policies to improve unemployment benefits. Despite the recent improvements in employment that have taken place in a few CEE/NIS countries, and the possibility of further improvements through labor market reforms, the need to deal with unemployment remains severe in most countries in the region. Most governments in the region have undertaken some form of unemployment compensation program, but to achieve maximum benefits with scarce resources, ways must be found to target benefits more accurately—for instance, avoiding multiple benefits for the same individuals. At the same time, benefits need to be designed to provide incentives both to enterprises to shed unneeded labor and to unemployed individuals to seek employment. To the first of these ends, it is necessary to provide adequate unemployment benefits, to avoid inducing workers to stay in nominal roles in their old workplace in order to continue receiving in-kind benefits; for the second end, unemployment benefits should be for a limited period (replaced if necessary by poverty relief), with built-in incentives and assistance to job search.

Issues for Discussion

- What ways have been found, in practice, to obtain and provide information on new jobs that are available? To provide training to unemployed workers with low or obsolete skills? To create new jobs in communities affected by layoffs? To remove bureaucratic, institutional and market impediments to mobility?
- Do these labor-market responses, particularly training and job creation, take women—who are at least 50% of the unemployed—adequately into account?
- How can unemployment benefits be better targeted?
- What ways of financing adequate levels of benefits have been found?
- How can benefits be provided in ways that do not provide disincentives to layoffs in enterprises with over-employment and to job seeking by workers who are laid off?
- What are the implications of labor, price, trade, investment and other economic policies on employment?

C. Other Types of Income Transfers (pensions, disability payments, family and children allowances, housing allowances)

General. Depending on the country, benefits—such as pensions and health care—were often dispensed through enterprises, which in turn were compensated for their social outlays by price adjustments and various types of cross-subsidization vis-à-vis the government and other enterprises. Some of this has persisted into the transition period, especially in the NIS. In general, however, central governments bore, and continue to bear, the responsibility for pensions, disability programs, and social safety net programs, although in some countries administration and even responsibility for these programs have been decentralized.

Pensions. The *pre-transition conditions* characterizing CEE/NIS countries featured early retirement ages and high ratios of pensions to wages, features that make pensions for an aging population increasingly difficult to sustain. One might hypothesize that the reason this extremely generous system was developed was to mitigate the hidden unemployment resulting from the government's commitment to universal employment, and the low labor productivity generally prevailing; another hypothesis might be that it reflected the realities of poor health (see below). Under pre-transition regimes, pensions were paid on a pay-as-you-go (PAYG) basis, often financed by payroll taxes paid into a special fund. This legacy has greatly complicated the economic transition since 1989. The chief *transition-related developments* have been fiscal difficulties constraining pension payments, and labor market pressures on older workers to move into early retirement, while many pensioners who had been eking out their pensions with active employment on the side tended to make up another substantial part of the increase in unemployment. The money value of pensions has tended to fall behind the price inflation that has taken place in almost all these countries, owing chiefly to fiscal problems. The chief *policy implications* of these developments are, in the short run, the need to increase retirement ages while trying to avoid further deterioration in the real value of pensions. For the longer run, governments need to put in place a system that replaces the pay-as-you-go system with a multi-pillar system in which there is growing importance for the defined contribution and voluntary contribution pillars. A system of this sort has now been introduced in Hungary. But even where pension reform is underway, the state-run segment will for the foreseeable future remain dominant—and will prove unsustainable at present benefit levels unless financed by broadly based, equitable contributions from the entire working force, including the growing numbers that are presently evading their tax responsibilities by hiding in the "informal sector."

Disability payments. As in the case of pensions, *pre-transition conditions* for disability payments included generous benefits that were easy to obtain. Like early retirement ages, this policy was both a way of dealing with underlying hidden unemployment but also reflected the poor and often deteriorating health of the population (see below). Again, as with pensions, *transition-related developments* included new economic incentives to push older workers into early retirement—for which disability could be a convenient excuse—together with reduced funding available, as growing unemployment, declining wages, and the flight to the informal sector all tended to lower contributions to social funds and taxes. At the same time, there was a tendency for the real value of disability pensions and the availability of health care to decline. The *policy implications* of these developments are clear but difficult to implement: for a start, there must be stricter requirements for, and more accurate targeting of recipients. At the same time, like pensions, the revenue base must become broader and more reliable.

Housing allowances. As is well known, the *pre-transition condition* faced at the onset of transition was free or heavily subsidized housing, which formed a major element in the compensation package for workers and retirees. Housing was state-owned, in line with socialist principles, so that virtually no housing market existed at the time the transition began. Furthermore, because housing was linked with jobs, labor mobility was rendered extremely difficult, quite apart from bureaucratic restrictions to movement. The *transition-related development* of privatization of home ownership and the creation of a housing market has been more marked in the CEE countries, and in some large NIS cities, than in the rest of the CEE/NIS region. While these developments can be expected to lead to economic incentives to build housing in response to demand, the end of state ownership has also meant that a large number of people could be exposed to homelessness if jobless or receiving reduced real wages or pensions. One problem is that housing is usually registered in the name of male family members, leaving women increasingly "homeless" on paper. The clear *policy implication* has been to introduce—as notably in Ukraine—housing allowances. While such a program can serve to prevent social catastrophe, it must be carefully designed to avoid unnecessary waste or inequities. Precise targeting is essential, for instance, not extending this benefit to those who can actually afford housing. At the same time, steps should be taken to create an efficient housing market with information exchanges, credit facilities, mortgage acceptances, etc. In this area, donor assistance has proved useful.

Poverty relief, child and family allowances. *Pre-transition conditions:* Although various monetary allowances, especially child or family allowances, were common in Communist countries, and have persisted into the transition, they tended not to be large, since such a large part of workers' compensation packages were in kind. Because these benefits were aimed at complementing low wages and redistributing income, but not specifically designed to alleviate poverty, the continuation of these systems has partially cushioned the effect of the transition on households but have not been targeted to the most vulnerable groups. *Transition-related developments:* Since long-term unemployment benefits tend to disincentivize job seeking, it is advisable to use some kind of relief or "welfare" system to provide a floor to the incomes of the unemployed. Family, or children, allowances, for the working poor as well as the unemployed, reflect the fact that low-wage families are tipped into poverty without additional income support for children. Inflation and limited fiscal resources have tended to make these already low allowances even lower in real terms, or too inconsistently administered, to prevent destitution among women and children, who have suffered especially from the general economic decline. The chief *policy implications* of these developments are easy to state but difficult to implement: resources in transition economies are especially scarce, and for any welfare system to make effective use of scarce resources, careful targeting and monitoring of benefits are absolutely essential. A system of individual identity numbers, and simplification of welfare systems, would help ease the task of efficient, equitable implementation.

Issues for Discussion

- What are feasible paths for pension reform in these countries? Could the Hungarian reform be replicated elsewhere?
- How could disability payment systems be more economically targeted?
- How might eligibility criteria (such as retirement ages) be changed to make these programs more sustainable? How might they be funded? How can cost-of-living adjustments be more adequately built into such systems?
- How could local communities be more effectively used to dispense housing allowances, family allowances and other poverty relief? What are feasible systems for better targeting of such benefits? What are feasible systems for better targeting vulnerable women?
- How can cost-of-living adjustments be more adequately built into all these systems?
- How could fiscal resources be found to fund such programs more adequately?

D. Health Care

General considerations. Health indicators depend on four factors: income, lifestyle, environmental pollution and occupational risks, and the quality of available health care. Experts agree that the first two of these factors are the most important. All four, however, probably explain the decline in health indicators in many CEE/NIS countries both before and after the onset of the transition to market-oriented economies. In examining these factors, it is also essential to analyze the differential impacts on men and women, since they have dissimilar morbidity and mortality rates resulting from different factors. For example, men suffer more from cardiovascular disease, and women suffer significant morbidity and mortality from reproductive health complications.
Pre-transition conditions. Health care was financed and delivered by the government, free to patients, in these countries, although the availability of such care was in fact not equally distributed (more in cities than in the countryside, and under-the-table payments by wealthier patients sometimes secured better care). Despite universal access to health care, some health indicators, such as life expectancies, were steadily declining in most of these countries, owing apparently to environmental and lifestyle factors.

Transition-related developments. In many countries, notably Russia, there has been a further decline in health indicators, although in a few of the "advanced reformer" countries, notably Poland, there have been positive trends. Declining income, and further deterioration in environmental and lifestyle factors, may explain the negative shifts. A number of CEE/NIS countries have been shifting toward an insurance-based system, although a number still maintain the government-based system (with health care often delivered at the workplace). To the extent that health care is still based on government finance and delivery, the fiscal contraction in all CEE/NIS countries has led to declining pay of medical personnel, deteriorating conditions in hospitals and closing of some facilities, and shrinkage of available care and benefits. Shortages of medicines, and decline in preventive programs like vaccination, have also been observed. The skewed income distribution noted earlier, combined with increased tendency for medical care to be paid out of the patient's pocket, has led to a related skewedness in medical care among income groups.

Policies. As already noted, some CEE/NIS countries have moved toward a health system based on universal health insurance, but most of these systems are at an early stage of development, and there are gaps in revenue collection, coverage and monitoring. There has been a decline in the absolute and relative amounts of income spent on health care. In view of the fall in income and government revenue, there is a need for more accurate targeting of health care (for instance, more emphasis on preventive and primary care, rather than tertiary care), and generally more efficient use of benefits (e.g., financing spa attendance by Russian workers can be cut in favor of more widespread vaccination and public education). As the formal privatization (much is already informally privatized) of health care proceeds, and health insurance systems are developed, health care access for poverty-stricken groups and individuals needs to be provided in a more reliable and systematic way.

Issues for Discussion

- What are the factors that have led to deterioration in health care and indicators in particular countries? What has been the role of fiscal constraints? Of enterprises shedding previous health-care responsibilities?
- The factors that have led to deterioration in health care and indicators are different for men and women. Are these being taken into account?
- How can resources be found to finance health care? What should be the relative roles of the public and private sectors? Of local and national governments?
- What measures need to be taken to build up health care resources over the long run? How can donor assistance be most useful in this respect?
- How can health care resources be better targeted? What factors determine the allocation of resources among preventive, primary and tertiary care? Between high-income patients paying for private care and indigent patients dependent on government assistance? What steps can be taken to improve this allocation?

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Mr. Jacek Wojnarowski, Executive Director, Stefan Batory Foundation

Speakers

Mr. Michal Boni, Chief of the Advisory Team to the Ministry of Labor and Social Policy
Dr. Marek Gora, Professor, Warsaw School of Economics
Mr. Maciej Nowicki, President of Eco Fund
Mr. Leslaw Paga, President, Deloitte and Touche Central Europe, former Chairman of the Securities and Exchange Commission
Mr. Jerzy Stepien, Judge, Constitutional Court

Romania

Dr. Ion Anton, President, International Center for Entrepreneurial Studies
Mr. Stefan Boboc, Chairman, Romanian National Security Commission
Professor Ovidiu Nicolescu, President, National Council on SME Privatization
Mr. Mirel Tariuc, President, Agency for Small and Medium Size Enterprise

Speakers

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Ms. Anca Dumitrescu, Medical Doctor, Institute for Public Health

Russian Federation

Ms. Marina P. Pisklakova, Director, Women's Crisis Center "Anna"
Mr. Aleksei Valentinovich Uljukaev, Deputy Director, Institute for Economy in Transition

Speakers
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Mr. Leonid Grigoriev, Director General, Bureau of Economic Analysis Foundation
Mr. Veniamin F. Yakovlev, Chief Justice, Supreme Commercial Court

Republic of Tajikstan

Ms. Tochinisso Azizova, Chief, Legal Department of the President's Office
Mr. Gulomjon Babaev, State Advisor to the President on Economy
Mr. Nuriddin Karshiboev, Executive Director, Association of Independent Electronic Mass Media of Tajikistan (TAJANESMI)
Ms. Dilbar Khalilova, Executive Director, NGO, "Fidokor"
Mr. Khalifabobo Khamidov, Legal Advisor, President's Legal Subcommission of CNR
Mr. Isomiddin Salokhiddinov, Senior Advisor, President's Office on Relations with Public Communities, Information, and Culture
Mr. Khabibullo Sanginov, Chairman, Refugee Subcommission of CNR

Turkmenistan

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Slovak Republic

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Mr. Pal Csaky, Deputy Prime Minister, Human Rights
Mr. Jan Fule, President, Slovak Syndicate of Journalism
Mr. Daniel Lipsic, General Secretary, Ministry of Justice
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Speakers
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Mr. Ivan Miklos, Deputy Prime Minister, Ministry for Economy

Republic of Slovenia

Mr. Joze Mencinger, Rector, Ljubljana University, Former Minister of Economy
Ms. Alenka Selak, State Undersecretary, Ministry of Finance
Mr. Marko Voljc, President and Chief Executive Officer, Nova Ljubljana Banka
Ms. Alenka Kajzer, Advisor to the Government, Slovenian Institute for Macroeconomic Analysis and Development
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Mr. Valter Rescic, State Secretary, Ministry of Finance

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Mr. Volodimir Oliynyk, Mayor, Cherkasy Executive Committee
Mr. Serhei Tyhypko, Vice Prime Minister, Economic Reform
Mr. Yuri Yechanurov, Rada Deputy
Mr. Victor Yushchenko, Governor, National Bank of Ukraine
Speakers
Mr. Serhei Holovaty, Former Minister of Justice, President, Ukrainian Legal Foundation
Mr. Vasyl Kuibida, Mayor of Lviv

Republic of Uzbekistan

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Mr. Yuldash Nazarov, Group Head, "Group of Experts" for the President
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Ms. Oral Ataniyazova, Director, NGO Center "Prezent"
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