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P R O C E E D I N G S

MR. VAN PRAAG: Good afternoon. Thank you for being with us for the launch of "Transition: The First Ten Years," which I'm sure all of you have picked up on your way in here.

This is a major retrospective study that a team of experts has been working on for the past couple of years. The team has been led by Pradeep Mitra and Marcelo Selowsky, who were the co-directors of the report, and this afternoon Pradeep is going to outline the main findings and the conclusions drawn therefrom, and then both Pradeep and Marcelo would be pleased to take your questions. So let's open the floor up, please, to Pradeep.

MR. MITRA: Is that sufficiently clear over there, the picture?
Good afternoon. As Nick said, this is a retrospective on ten years of transition, and we start this presentation, this is a picture of a coal mine in Poland, which was taken about a year ago and shows miners coming out of the dark and into the light.

Let me dive straight into the question of what the report is about. We asked ourselves three questions. The first question is: Why have some transition economies done better than others during the period of the '90s? We then asked a question: If economic reforms are so good for countries, why don't they--why are so many governments reluctant to accept them? And the third question we asked is: After a decade of transition, what have we learned? So looking ahead, the countries which have further, much further to go in the transition process, how do we modify our advice based on the lessons of the first decade and also the conditions that prevail today?

So those are the three main questions that the report is going to address. To start off, let's take a look at the behavior of output in our countries.

Now, what we have there is a situation where the top line refers to the Central, Southeastern Europe, and the Baltics? There was a sharp initial fall in output after 1990, about 15 percent, but they recovered from that reasonably soon, and by the end of--by 2000, output was about 10 percent higher than it had been at the beginning. In the case of Poland, for example, particularly faster, it was about 15 percent higher. Whereas, by contrast, if one looks at the CIS, there is a fall in output of the order of about 40 percent, comparable, for example, to the output decline in the U.S. during the Great Depression. And by the end of the decade, although all countries had started growing in the year 2000, output was barely about two-thirds of what it had been before the transition began.

The first question we asked ourselves is: Fine, what is it that can explain the difference in this kind of performance we saw in the graph above? And, clearly, initial conditions are important. For example, countries in the former Soviet Union had a huge amount of desertification. Some countries had civil war. So we found that initial conditions were actually quite important in explaining the first few years. The first four years or so when output dipped in most countries, initial conditions are quite important in explaining that.

But what we find subsequently is that policy reforms, by which we mean using--making markets the main mechanism for allocating resources, eliminating central planning, mandated allocations, stabilization, liberalizing the trade regime, pursuing pro-competitive policies, those kinds of things eventually explained the growth in the medium term. So initial conditions more important at the beginning, less important later on. Policy reforms more important in the medium term, and there are cases where, when the policy performance is strong enough, they're even able to offset a little bit the negative effects of initial conditions.

Let's now look at a figure which essentially divides countries into two, and what it finds is that if you look at the top part, Hungary, Czech Republic, Poland, Lithuania, Latvia, those are countries where the share of employment in small enterprises, typically new, fewer than 50 workers, grew very rapidly, where they were of the order of about 50 percent in 1998. So about half the employment in the economy provided in enterprises typically new, employing fewer than 50 workers.
By contrast, if one looks at the large countries of the former Soviet Union, that share is about 20 percent, at most, and also the lines are a lot flatter. If you look at Russia, Ukraine, Belarus, and Kazakhstan, the share of employment has not gone up very much.

So here's the--the impression that this figure leaves us with is that there's something about small, new enterprises which has something to do with growth, and the presumption would be that these kinds of enterprises are more productive, they use resources more efficiently than the old enterprises in the state sector that are typically large and in many cases unreformed. So that's the presumption that the picture generates, and we look at the presumption a little more concretely by looking at this diagram, which essentially was taken from a survey that the EBRD and we did in 1999, which shows that the red refers to old enterprises, the blue refers to new, small enterprises. And what we find is that on most dimensions between '96 and '99, new enterprises outperformed old enterprises' sales, investment, employment, and so forth. And this case is developed in the report, looking at the data more carefully, to figure out why you have new enterprises being more productive.

So if new enterprises are more productive than the old, then for resources to be reallocated and generate economic growth, one would typically want to squeeze old enterprises and encourage new enterprises. And what this figure shows is you want to have a process of discipline, hard budget constraints, no subsidies through financial mechanisms, through the budget, through non-payment of taxes, through arrears and so on, plus some amount of discipline over managers' keeping assets for their own personal gain. We call that discipline in the report, and we say old enterprises have to be subject to that. And that makes them shed assets which can be absorbed by new enterprises and that also some social assets like housing, clinics, schools, and so on, which enterprises used to provide in the Soviet days, have to be shed, taken over by municipal governments.

New enterprises we say have to be encouraged to a better investment climate, and we'll come to that in a little bit of detail, just to note that these are the two prongs of the strategy: number one, discipline; number two, encouragement. But notice the diagonal arrow. We're not saying that new enterprises should not be subject to market discipline. Indeed, new enterprises, just like old enterprises, should have to compete at whatever the market prices are.

So this is the basic strategy that we have, discipline and encouragement, and later on in the report we unbundle this a little bit into what all of this means.

The one question that people often ask--and it comes up in policy discussions--is that: Is it possible to downsize the old sector slowly? After all, this is a politically painful process. There may not be enough political capital to allow this to happen. What about if we said let's encourage the new sector, let's avoid the pain of liquidation and restructuring, until we have a cushion in place. Once the new firms are providing employment, it's political easier to do this. And the answer is that, without discipline, encouragement does not get very far, and there are examples.

For example, in Bulgaria and Romania, through the banking sector, a lot of assistance was funneled to old and basically inefficient enterprises. This figure is banking and macroeconomic crises in Romania and Bulgaria in the middle '90s, and it hurt new enterprises because they did not get bank credit because the banks were lending to old enterprises.

Another example is in Belarus and Uzbekistan, they used to have in the '90s special favorable schemes for directing foreign exchange and credit to those enterprises. And the result was that new enterprises didn't have access to market foreign exchange and credit and often paid several times the price that the old and favored enterprises were paying.

So politically attractive though it might be to go easy on discipline and push on encouragement, the data show that that leads to assets being sucked into old enterprises and there's not enough space for the new. And, similarly, the relationship goes both ways because unless there is a vibrant emerging sector which is providing employment, discipline will not also get very far, because it's going to be politically difficult to downsize unless there are some options that people have outside.

So what we say--and this is an important finding of the report--is that discipline and encouragement have to go hand in hand. This briefly looks at what discipline entails. We've talked about it briefly.

Discipline, the policy and the institutional reforms that are entailed by discipline is imposing hard budget constraints on enterprises and banks, having effective bankruptcy mechanisms, not giving tax exemptions, fiscal and financial subsidies, various kinds of offset mechanisms that the state often had with private large firms. That's an essential ingredient of discipline.

Another ingredient is monitoring managerial behavior where we found that because institutions of corporate governance were very weak that there was a lot of asset stripping and defrauding of minority shareholders. So that is an important part of discipline, and also encouraging competition.

Finally, on the social side, as I mentioned before, enterprises usually shed housing, clinics, kindergartens as part of the discipline process. Those have to be taken over by municipal governments, and the safety nets--pensions, unemployment insurance, and so on--have to be strengthened. So these we see as the five main prongs, the policy implications of pursuing a strategy of discipline.

Let me go next to what is entailed similarly by encouragement, and what we have here, liberalization of prices, allowing domestic and foreign competition to occur; tax reform, what we find is that the tax base is often very small and rates are very high. That has to be reformed to make it more broad based. Firms complain that business licensing and registration is very onerous; it's a source of corruption. In fact, the survey that we did with the EBRD in the CIS countries shows that small enterprises pay about 5.5 percent of their annual revenues as bribes. That's twice what--that's twice what large firms are paying. And the regressivity of the bribe tax, if you like, is highest in Armenia, Moldova, Ukraine, Uzbekistan.

In Russia, we found in 1996 that the average new business application must deal with 25 different agencies and complete 70 registration forms, and there were 30 kinds of licenses required for a business start-up. The numbers are not that important, but it does convey a sense of what a strategy of encouragement would have to deal with.

Legal and judicial reform, which is the fourth bullet, the enforcement capacity of the judiciary is very important, and, lastly, the status of the banks. What one wants to see is to encourage and see a few banks that satisfy prudential criteria, but also to shut down old banks which typically have been a source of hemorrhage in the system.

So on this part of the presentation, I think what we're saying is that the answer to the growth question--Why have some countries performed better than others?--is to be found in a strategy of discipline and encouragement. Both are important and one can't get very far with one without the other.

I now want to turn to the issue of the second question, the political economy question that we put up at the beginning, and what that political economy question says: If the advantages of economic reform are so obvious, why have some governments been so reluctant to accept them?

The way we tried to explain this in the report is that we say let us think of an economy, typically in the CIS, where what we do in this figure is we look at the unfolding of reforms, the extent of reforms, and we look at three categories of people--state sector workers, new entrants, and oligarchs and insiders--and see how different status of reform impact on these people.

Obviously, this is a stylized discussion, and we flesh out the details in the report. But I think it helps to put it out this way.

Now, let's look at the state sector workers. These are people for whom there is a sharp drop in income as the reform proceeds, and there's little hope of any substantial recovery if you're a state sector worker. So we have a line which shows the losses to these workers as reform proceeds.

Now, then we have potential new entrants, by which we mean the people who are going to come in, entrepreneurs, and establish these new firms which are going to be a source of growth, which had been a source of growth.

Now, initially, these people face some losses because they have to give up whatever they were doing, significant adjustment cost at low levels of reform, but where enough progress has been made when the policies of encouragement have been put into place, then these are the people who gain the more reform there is. So economists sometimes call this a J-curve where there are some losses at the beginning and gains afterwards.

Now, there's a third category pretty critical to this discussion. We call them oligarchs and insiders. These were people who were typically well connected with the nomenclatura before transition started, and initially they make a lot of gains as the reform process unfolds. When prices are liberalized, they can arbitrage between control prices and free prices. Since they're sitting on assets, they can earn a lot of rent from the initial reform moves.

Now, it takes some time for discipline to kick in. When one looks at this in the context of discipline, then eventually, as you push the reforms out more, then the gains to oligarchs and insiders are going to fall.

So what this is saying is that there is a point like R1--remember, this is a stylized presentation. There is a point such as R1 where the gains to oligarchs and insiders are maximized, and we call that a situation of partial reform. And we're going to call R2, which I'm going to explain a moment, a situation of comprehensive reform. But the first point to note is that there's a real risk that countries can get stuck in R1, and we see this--saw this in the 1990s in a lot of countries in the CIS.

What happens is this: If you have a government which is not credible, it says we are going to do comprehensive reform, but potential new entrants who are looking say, Can I believe this government? Is it actually going to do what it says it's going to do?, are going to hold back and they're going to say maybe they're not going to get very far, I might as well vote for partial reform where at least my losses are much lower than otherwise.

Oligarchs and insiders will always vote for partial reform because partial reform is the situation where they can collect rent. We see this particularly in the resource-rich countries where a very substantial fraction of GDP is accrued as rent to the oligarchs. So if a government cannot credibly signal to the potential entrants we will do comprehensive reform, this becomes a self-fulfilling prophecy, and you're stuck at a point like R1. And partial reform is what we observe. I mean, there are countries which have liberalized. There are countries which have imposed measures of discipline, but they're not very strong. You've got selective encouragement, you have limited discipline, and you end up in a point like R1.

Now, the point R2 is kind of a threshold where the gains to the new entrants are sufficiently high that they can begin to offset or put pressure on the system which weakens the oligarchs and the insiders in a relative sense. So it is that threshold where they can either compensate the other losers or they can generate--they become a political force where their claims are considered to be credible.

This is the situation which we found at the end of the '90s in a lot of CIS countries and countries in Southeastern Europe. And the issue there is what--supposing one is stuck in that kind of a political economy equilibrium where there's partial reform but not much else?

Supposing we now have a reformist team which comes to power with some mandate for change. In other words, there's a political window of opportunity. How would we advise them? What should they do when they're stuck in a point like R1 but there is some room for maneuver?
Well, the first thing they do is they have to appear credible to these potential new entrants, say we are going to go the extra mile up to R2, support us. It also has to be able to constrain the oligarchs and the insiders who have every incentive to derail reform beyond the point R1.

For example, in Russia, oligarchs and insiders have opposed the work that the Securities and Exchange Commission was doing to strengthen minority shareholders' rights, creditors' rights, because it is not in their interest to allow reforms to proceed that far.

So credibility and constraint are important, but in terms of actual measures, what a reformist team would have to do, they would have to tax the early winners to make sure that those gains can be used to support the things one needs to do to have discipline and encouragement. One needs that revenue to support worker training, retraining, severance payments, paying off wage and pension arrears, tax transfers, maintain essential school and health services, all of which were under threat in the late '90s and, to a certain extent, are today as well.

So in addition to the mobilization of the small- and medium-sized enterprises into business associations which can serve as a vehicle for such productive action, one has to use fiscal policy, both the tax and the expenditure side, quite aggressively in order to break out of what in the report we call a low-level equilibrium trap, and that's the point R1.

Now, I've spent a little more on this figure than perhaps would be appropriate, but it is important that we have a stylized theory in order to pin down what it is that we're talking about when we say why it is that reforms are not accepted by so many governments when the benefits are so clear.

Now, the third and final question that we asked at the beginning of the report when I put it up was, okay, so going forward now, what are the lessons that we have learned, and how should policy priorities be modified in the light of experience and in light of the fact that today in the year 2002 the conditions are different from what they were in 1991, just over ten years that the Soviet Union was dissolved? There are basically three policy priorities that I shall talk about, two on this slide and one on the next one.

The first one says that it is absolutely critical to focus on creation of new firms. That is a major source of growth. That's what the evidence and the story shows. One has to shift the emphasis more from privatization and restructuring of old firms towards improving the investment climate for the creation of new firms.

However, we need to remember that encouragement on its own without discipline doesn't get very far, so one still has to impose the hard budget constraints, things which will induce old firms either to restructure or close for this to get very far. But this is clearly a message. There has to be a lot more emphasis on the creation of new firms.

Number two, institutions for monitoring managerial behavior. This is something the importance of which was not fully understood at the beginning of transition. People did know that institutions were important, but perhaps underestimated how difficult it would be to build institutions of corporate governance. And here one is talking about rights of minority shareholders and creditors, accounting, auditing, and disclosure standards, supervision of banks. So that's one very important area which is stressed much more now than it would have been at the beginning of transition.

And, finally, there are a lot of enterprises where the state still has a stake, a substantial stake in many cases. Until a strategic investor is found to come and buy this, privatize it, the state has to exercise its property and cash flow rights. It's very important; otherwise, there will be a lot of asset stripping.

So these are two important respects in which policy priorities have shifted. I should say these are not radical departures, but at the margin they do represent a significant evolution of thinking.

And, finally, the third policy priority that we focus on in the report is something to which I have drawn attention. How should we break out of a low-level equilibrium trap? At the time the transition began, we were not aware of something like the low-level equilibrium trap. That has only emerged as transition has unfolded. And once one is in that position, we're saying if you have a reformist team which comes to power so that there's some window of opportunity for movement, one important thing is to use the media by way of public education to explain to citizens that there is a link. When there are subsidies to powerful businesses, that has to be linked in the public mind to the fact that public sector wages are not paid on time, pensions are not paid on time, social services are provided very badly, and there's a clear link in terms of what's going on with respect to the subsidies to incumbent managers, powerful businesses, and non-provision of basic social services and wages and pensions.

The second point we say is that one has to have a political strategy which encourages the formation of business associations by small- and medium-sized enterprises. The people who would gain from reform, the people who would gain from the movement from partial to comprehensive reform are precisely those people. This is not to suggest that the Bank is going to be involved in issues of political strategy. This is saying these are some of the things that a reformist team which comes to power in a situation of partial equilibrium would have to think seriously about.

But, finally, there's a very strong economic message, which says that we can use fiscal policy to advise that reformist team to redistribute gains from the initial stages of reform. I've already mentioned this: tax the early winners, reallocate public expenditures to worker retraining and severance payments, pensions, maintenance of schools and health services--in other words, all the things that are necessary in order to further a strategy of discipline and encouragement.

I think I'm almost at the end, just to remind that we started with these three questions--the growth question, the political economy question, and the policy question. The answer to the first one is a strategy of discipline and encouragement based on new firms, investment climate. The political economy question is the issue of what are the forces that trap you in partial reform instead of going for comprehensive reform. And the third is, okay, so what have we learned? What we have learned is the importance of new firms and investment climate. What we've learned is the importance of institutions to monitor managerial behavior. What we've learned is what are some of the things that a reformist team

which comes to power in a partial equilibrium kind of situation can do in order to move the reform process forward so that we can see a return to growth which is very badly needed both in the CIS and in Southeastern Europe.
With those remarks, I think I'll go to Nick.

MR. VAN PRAAG: Thank you very much, Pradeep.

If anybody has any questions to either Pradeep Mitra or to Marcelo Selowsky, who is the co-director of the report, please, would they make them? And if you could introduce yourselves as you do so. Thank you.

QUESTION: Barry Wood from Voice of America. Why in your formulations do you include Southeastern Europe as a winner vis-a-vis the CIS, when on page xxiii where you say the CSB, and page xix, Central Europe and the Baltics point the way forward, you very openly say that Central Europe and the Baltics are the winners and Southeastern Europe is not? Because surely the failures in Southeastern Europe--Bulgaria and Romania being such failures--would pull down all of the data for the winners. So I'm curious about that.

MR. MITRA: Nick, should we take them one at a time or collect questions?

MR. VAN PRAAG: One at a time.

MR. MITRA: One at a time.

I think there are some--inevitably some choices--I mean, your point is well taken. One inevitably has to make some choices when you're presenting aggregates. And I think if one were to take the Central, Southeastern Europe, and Baltics--sorry. If one were to take Central, Southeastern Europe, and Baltics and take out Southeastern Europe, take out Bulgaria and Romania, for example, what one would see is an even sharper acceleration of growth in Central Europe and Baltics. And the fact is that Central Europe and the Baltics on the one hand, CIS on the other hand, and Bulgaria and Romania straddle the two to some extent in terms of the progress with reform. And so I think one has to make a choice, yes, if one presents it in an aggregated way, we have to make some decisions.

But I think it does not fundamentally undermine the argument that we see discipline and encouragement much more strongly in countries that have grown more rapidly. That is true in Central Europe and Baltics. That's true in the CIS. That's true in Southeastern Europe as well. Because now when we see the situation in Bulgaria, for example, where there's been quite a bit of turnaround--

QUESTION: [inaudible] Albania for that five-year period where they were the big winners, and then they descended back down. I mean, I hope they continue to win in Bulgaria, but it's just hard to see in what context you think they're winners.

MR. SELOWSKY: Clearly, this is a very good point you made, and let me simply clarify a little bit, and I think that the presentation (?)-ation of the lines hide some of what you're saying. We're not saying that Central and Southeastern Europe and Baltics are the winners. When we look at that graph, we show that output has recovered more quickly in that group. But you're completely right that within that group of Central, Southeastern Europe, and the Baltics we have two very important categories--okay?--which is Central Europe and the Baltics and the southern part. And if we will break down that purple line, we would find much more of a change. Okay? But, still, with the leader Romania and Bulgaria more or less have done a little better than Russia and Ukraine until now.

But you're completely right in the sense that when we try, for example, to look for the variability of policies trying to correct for initial conditions, one of the findings is precisely the right one that you're saying, that within Central Europe and Southeastern Europe, the initial conditions were not very different in Hungary vis-a-vis Romania or between Slovenia and Romania, okay? But, obviously, the policies have changed--have been very different between Romania and Bulgaria until 1998, if you wish, and Slovenia, Hungary, and Poland, and that's the reason that the latter ones do a much better job.

So we basically take advantage of that variability that you mentioned within Central Europe and Southeastern Europe to get that variability due to policies. Okay? And I think you have a good point. If we would disaggregation the purple line in Graph 2, we could do that, this one here. In other words, this is--if we disaggregate that and break down between Central Europe and the Baltics, we would have a large (?) like that, and Southeastern Europe would be something like that. Okay?

So you're right. I mean, we could do that. It actually is a good point. There are too many graphs, but you're right. No, we're not saying that these are the winners in general, you know, simply this was a stylized fact of what happened to output in these countries.

MR. VAN PRAAG: There was a question over here.

QUESTION: Yes, can you update the story specifically with the Russian economy where growth rates were about 8 percent--I'm sorry. David Sands, Washington Times. Just picking up on--can you update the story? I was looking at the Russian economy, 8 percent growth rate in 2000, 5.5. percent last year. I think they're growing faster now than, say, the Czech Republic and Hungary. Is it your sense they've moved some from the bad equilibrium to a more virtuous cycle in the last couple years?

MR. SELOWSKY: Yes, well, this is a point of debate, but I'll tell you my personal--okay? I think they have moved some out of the bad equilibrium, but still they have quite a bit to go in the sense that I wouldn't attribute the high growth rate solely to moving out of the bad equilibrium. Part of the growth rate I would say is due to the oil price. Part is due to the devaluation of '98 that has given a one (?) boost, that may be eroded, okay? And part of it is probably due also to an improvement in the business environment that is taking place. I mean, the new economic team and the graph, there's no doubt that they have worked much more on the issues of encouragement and discipline. They are trying to pass legislation to include property rights, the land code. They try to be very active on reducing red tape for small enterprises. There is a limit which they can do at the local level. They're trying to do at least as much as they can from the federal point of view, but they have less control at the local level. Okay?

So I would say that part of the improvement has been long-term--improvements that suggest a long-term improvement. But part of it is also due to something that could be temporary, like the devaluation and oil prices. Okay? So probably the story is in between. In order to keep--in my personal view, in order to keep moving to the right in the reform graph, they will have to do more on the state and the business environment side.

QUESTION: Certainly they've taken it on [inaudible].

MR. SELOWSKY: Correct. Relatively, the oligarchs are--not absolutely. They're still very rich. But relatively, in terms of rents, in a universal society, the power has gone down, correct.

QUESTION: Again, a question. Corruption, you mention here quite often, and you do have it a [inaudible] imposing discipline and expanding encouragement. But I'm just--my own experience is that corruption is so pervasive that if you're looking for lessons from the transition ten years on, it is that corruption get worse. And I wonder why you don't have corruption as a special chapter.

MR. MITRA: Let me just explain. This report is part of a threesome of reports, a trio of reports that we have written, one of which focused exclusively on anti-corruption in transition, was what it was called, and it had a detailed analysis of issues of corruption in the region and by countries, drawing on survey information, our own operational work.

And what it did was to unbundle corruption into two dimensions. One is, if you like, some people call it grant corruption or state capture where legislation is bought--legislators are bought and sold, where firms pay in order to get legislation more favorable to them. That's not unknown in other countries as well. And then there's administrative corruption, which is sort of the petty corruption, if you like, harassment by tax inspectors, the fire inspector, the sanitary inspector, and so forth. And we looked at this quite carefully and looked at which countries were high on both dimensions of corruption and which were less so, and proposed a nuanced strategy which responds to that.

So we didn't pick this up in detail for that reason in this particular report, but there's one point of contact which I should tell you about, which is the notion of grant corruption which my political scientist colleagues in the Bank refer to as state capture, very much underlies the notion of partial equilibrium that I set out in this report as a place where a country can get stuck because the gains to people who are very well connected with the political elite is so large that it is--that it really requires a sort of political window of opportunity for a reformist team to come in and do something about it.

So that's the reason--I mean, there are clear--a two-part answer. Number one, we have a report, happy to share it with you, which has a more detailed analysis; and, secondly, we do have points of contact inasmuch as the political analysis here overlaps very much the analysis of state capture and grant corruption in the anti-corruption report. But we'll be happy to share that with you.

It's in the public domain. In fact, it's on the Web.

MR. VAN PRAAG: A question here?

QUESTION: Mark Dragin (ph) from Bloomberg News. Can you hear me?

MR. MITRA: Yes.

QUESTION: I'm a bit confused about--taking this down to a more simple level for those of us who aren't as adept at economics. When the title of this says, "World Bank Shares Lessons Learned from a Decade of Transition Experience," I gather from what I'm hearing that this isn't the lessons that the World Bank has learned. Is there anything in this report that is making the Bank look back at its advice from 1990 to 1995 and say this is maybe where our advice went astray or this is how, if we were doing it again, our advice would differ now?

MR. VAN PRAAG: Pradeep?

MR. MITRA: Let me try to answer that by focusing on the last issue, which was, So what have we learned? Right? I mean, the three shifting policy priorities.

The first one which we had said shift much more the focus of attention to encouraging the investment climate for new firms and less on privatization and restructuring.

Now, one issue is that in terms of small- and medium-scale privatization, in most countries a lot of that has already been done. So that's not an issue anymore at this point in time. I mean, one can say if you're sitting here now and saying how you should advise a country, let us say, like Yugoslavia, which is early on in the transition--it's only been a year and a couple of months--we would focus very much on new enterprises and less on privatization and restructuring. The emphasis would be much more on hardening the budget constraints. Anything that hardens the budget constraints is going to help discipline.

The evidence is that privatization per se does not lead to restructuring in the CIS countries, whereas it does overall, and certainly very strongly in Central and Southeastern Europe and the Baltics.

So I think at the margin we would advocate the investment climate for new firms much more strongly than we had done. But let me put this in perspective as well. The analysis of the report shows that while that is a very good thing to do, unless there is movement on the old sector, there are limits to what an encouragement strategy on its own can accomplish without discipline.

The second lesson in the shifting policy priorities was to say move--much more focus on institutions of corporate governance. I mean, on that the evidence is absolutely unmistakable. What we had--and this is just to remind you what we were saying here--develop institutions.

Now, here there is--obviously people--there is a very strong view that institutions were underestimated at the beginning of the transition, what it takes to build a market economy. Now, if one goes back, there was certainly a lot of discussion about institutions, but the challenge had been underestimated.

But one needs to keep this in perspective as well. We have in the report a discussion--in fact, the box on East Germany, which is a country where Western institutions were transplanted virtually overnight, and there was a massive fiscal reaction from West Germany, which continues, still continuing for a long time. But there were some policies chosen which were quite inappropriate in terms of what would the exchange rate be between the East German mark and the West German mark, one to one. What would wages have to be? What benefits--would the benefits accruing to East Germany through the social protection system be the same as in the West?

What we find is East Germany has done a lot worse than Poland or Hungary or some of the other neighbors. And so we say, yes, we focus more on institutions, but let's not forget that policies are important, that in a context where policies are inappropriate, even the best institutions are not going to be extremely helpful.

The third issue is breaking out of this low-level--I mean, this whole issue of state capture, oligarchs and insiders capturing the state, really became evident in around the middle '90s, and before that, yes, there were trends, but they were not sufficiently understood. And, therefore, going back at that time, this is something that we sort of learned as a result of the last ten years.

Let me just say one more thing. The focus of this report is very much on, as we look ahead, what lessons can we apply based on what we've seen in the last ten years. It's a different question--I don't know if that's what you have in mind. It's a different question to say now if you could be in a time machine and set yourself back in 1990 or 1991, with those initial conditions, not today's conditions, what would have been different?

What we say in the report--we don't have much discussion of it. What we say in the report is there are some very difficult, genuinely difficult historical counterfactuals which one has to deal with and say: What was the right case of privatization? What was the balance between policy and institutional problems? We have something of a discussion on that. But my bottom line is that it's probably more important to focus on what we can--what we know going forward, but if we do actually want to look backward, the answer is a fairly nuanced one because there are a lot of pros and cons in both directions.

Now, that's set out more in the report than I have time for, but if you want, we can discuss that bilaterally.

MR. VAN PRAAG: I think Marcelo has--

MR. SELOWSKY: Yes, briefly. If you want something more specific, what is the Bank doing today to incorporate that, for example, in the area of promoting encouragement, almost any budgetary support of the Bank in some of the countries in the CIS--Armenia, Georgia, Kyrgyzstan, Uzbekistan, even Russia--we're working with governments trying to understand the constraints to entry of small firms--okay?--at the federal level, at the local, the way the customs work. I mean, these are very sovereign(?) mechanisms, because you can reform something, but then at the local level there is another way in which a particular official finds a way of extracting bribes or--you know, so we're working actually with some surveys, even. There are several operations in the Bank in which the agreement of progress is going to be based on what surveys are. Are they on the field? And small enterprises are going to be detecting--actually, we have one expert here working--sitting with us who has been working on that--detecting from the point of view of serving small enterprises, whether there has been progress in the time they are taking to register firms, the cost of doing business, et cetera. Okay? And, actually, the Russians are very interested in this. We're working with (?) commission particularly without any adjustment operations, but on a technical level on how to monitor the problems by surveying small firms over time.

So there are several ways in which we're trying to incorporate some of this new emphasis.

MR. VAN PRAAG: If there are no more questions, thank you for coming, and the meeting is over.
[Whereupon, at 1:53 p.m., the press conference was concluded.]