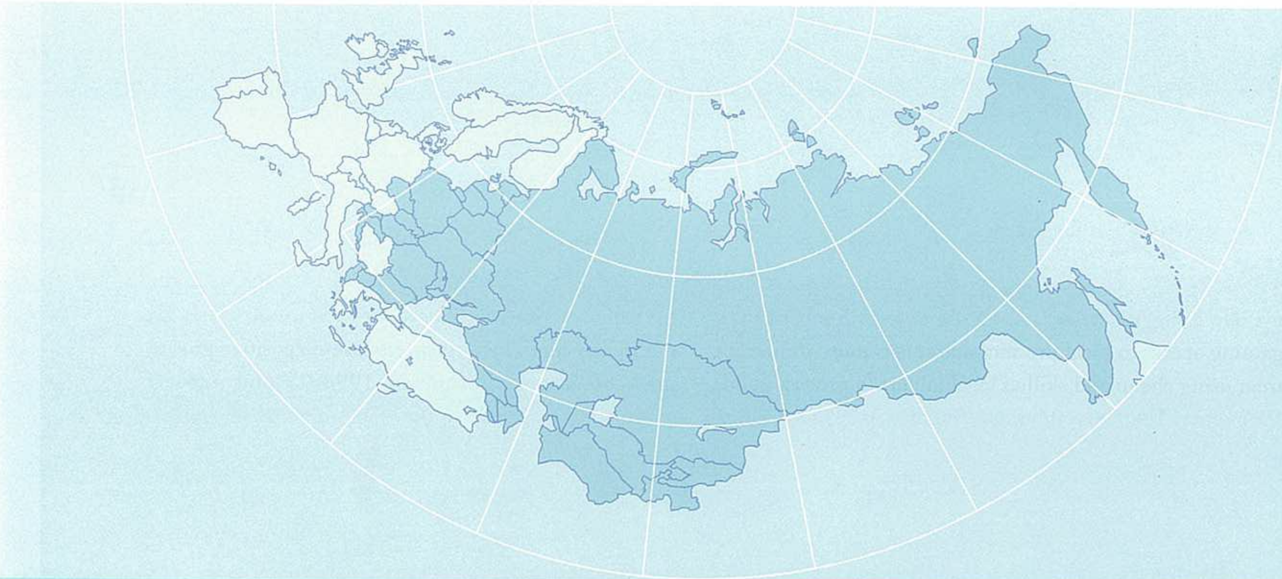
Transition report

Part I



Defining and measuring transition

1. The meaning of transition

1.1 Transition: the purpose of the EBRD and of the Report

The Agreement Establishing the European Bank for Reconstruction and Development was signed in Paris on 29 May 1990. The objectives of the Bank are defined in Article 1 as follows: "In contributing to economic progress and reconstruction, the purpose of the Bank shall be to foster the transition towards open market oriented economies and to promote private and entrepreneurial initiative in the central and eastern European countries committed to and applying the principles of multiparty democracy, pluralism and market economics". The purpose of the *Transition Report* is to examine the transition in the Bank's countries of operations and to measure, interpret and understand its progress.

As an investor the EBRD promotes the transition through its projects. This Report does not describe the Bank's investments in detail nor does it try to identify their impact on transition. Rather it tries, in measuring and interpreting the transition, to help in the understanding of the process it is attempting to promote. This in turn provides the context in which the Bank can direct and assess its investment activities, help other investors in the region in understanding economic prospects, and contribute to any assessment by the shareholders of the Bank of progress by the countries towards the basic objectives which were set in 1990. However, it will be the countries themselves, and not an external agent such as the EBRD, which will be the prime movers of economic change, and the EBRD is only one, although a significant one, among many investors in the region. It is, of course, much more than an investor, being specially concerned with the demonstration effects of its projects and with the whole context for private sector development.

In this Report the concepts of development, transition and stabilisation are firmly distinguished. While the concepts are very different, the relationships between them are strong. Some principles behind both the concepts and their relationships are discussed briefly in the second section of this chapter. The third section of this chapter discusses the essential ingredients of an open market economy, and thereby points to the choice of indicators of progress towards that goal: indicators of transition.

1.2 Development, transition and stabilisation distinguished

Development is a summary term which includes as its basic element the advancement, in a number of key dimensions, of the standard of living of individuals. Among these dimensions, education, health and command over resources are central. There are many possible indicators along these dimensions: literacy, years of schooling, and skill levels are common for education; infant mortality rates, life expectancy and various morbidity measures are common for health; wealth, income and consumption are common for command over resources. The environment in which the individual lives and works is clearly an important aspect or determinant of his or her standard of living. The focus on individuals and their standard of living makes poverty and income distribution crucial issues for development. Data on the development status of 22 of the Bank's countries of operations are presented in Box 1.1.

Transition is not only an intermediate goal contributing to economic development. It may also be regarded as an ultimate objective in itself. The market economy, in contrast to central planning, gives, in principle, the individual the right to basic choices over aspects of his or her life: occupation and place of work, where to live, what to consume, what risks to take or avoid, and so on. The right to these choices may be seen as a basic liberty and as a fundamental aspect of standard of living. Of course, the notion of liberty goes far beyond the elements of choice described but these choices may be regarded as basic to it. Thus the transition is also an end in itself.

Whether or not the open competitive market economy contributes to development is an analytical and empirical issue, on which the founders of the Bank expressed a very strong and positive view. Such a view had become increasingly widespread during the 1970s and had become dominant by the late 1980s. But it must be recognised that it was not so at the time of the founding of the Bretton Woods institutions, nor indeed for the first two or three decades after the Second World War. In summary, the argument is that individuals freely pursuing their interests and interacting in the market place together provide a more efficient, dynamic and creative economy than one based on centralised commands. The centralised command economy may suffer more severely from political manipulation, corruption, the arbitrary exercise of power, poor information, cumbersome systems and perverse incentives. While it is recognised that there are many respects in which markets may fail, and that there are circumstances (such as war or natural disaster) where command systems may be required, the dominant view now is that, on balance, a market-based system has overwhelming advantages over central planning.

The transition from a command to a market economy is the movement towards a new system for the generation and allocation of resources. It involves changing and creating institutions, particularly private enterprises. The role of the state in a market economy remains important, although very different from that in a command economy. This changed role requires fundamentally different governmental institutions. The meaning and measurement of transition is examined in the next section of this chapter.

Stabilisation concerns basic macroeconomic variables including inflation, balance of payments, debt, unemployment and output shocks. Progress in achieving macroeconomic stability will be an important determinant of achievements in the transition, but it is very different from the transition itself. For example, an unstable macroeconomic position will discourage private investment, hindering both transition and development. One would also expect setbacks in other aspects of economic development, as the provision of medical and educational services may be disrupted by the shocks facing large enterprises that supplied many of these services in the old regime, or as fiscal shocks may disrupt public sector payments for the services. Such disruption would, of course, be additional to the economic problems for individuals caused by the dislocation of employment.

The notions of development, transition and stabilisation, although strongly inter-related, are therefore distinct.

1.3 The ingredients of transition and some measurement issues

In general terms, transition is the progression from a command economy to an open market-oriented economy. The transition concerns institutional change. It is the institutional arrangements for the allocation and generation of goods and resources, and the ownership incentive and reward structures that institutions embody, that characterise the differences between a market and a command economy; these arrangements are the subject of Part II (which comprises Chapters 3-6) below.

Before indicators of this progression can be selected, the key ingredients of the open market-oriented economy must be examined more closely, enabling the identification of the important dimensions of the progression which the indicators are intended to capture. In identifying the "key ingredients" it must be remembered that there are many varieties of market economy which may be viewed as the "end point" or "target" of the transition. The contrasts between the economies of Japan, Germany and the USA illustrate that the possibilities are very broad. Given that there were also many, and large, differences in the starting points for the Bank's countries of operations and, further, that there could be many routes between any given starting point and any given end point, it is important to remember that the transition is not a simple, linear, one-dimensional progression to a "standard" market economy.

While there are no doubt important basic choices to make over the long term, it must also be recognised that the countries of the region are faced with existing systems and international arrangements in which they wish to participate. These include, for example, the European Union, the GATT, the EBRD, the IMF, the World Bank and the OECD. The member countries and the systems themselves will provide both models and constraints for the EBRD's countries of operations. Also there is in part a joining, or re-joining, of a historical development of market economies from which they were previously excluded.

What then are the key ingredients of a market economy? There are many ways they may be categorised. The characterisations chosen in this Report are intended to capture the essential properties from the point of view of economic analysis, and in a form which provides some possibility of empirical measurement or assessment. The categories selected provide the basic structure for the main table on transition indicators presented and discussed in Chapter 2. Basic elements of the market economy are:

- *enterprises* and *households*, which are responsible for decisions concerning production and consumption. These decisions are taken in response to incentive structures embodied in the workings of the markets in which they operate;
- *markets*, which are the means by which goods and resources are exchanged between enterprises and households;
- *financial institutions*, which are crucial players in the integration of transactions over time; in particular the channelling of savings and investments, the organisation of payments, and the enforcement of individual (household or enterprise) financial discipline.

The state plays a major role in the market economy, across many dimensions, which is very different from that of the command economy. Basic elements include: (a) legal and regulatory structures and governmental responsibilities concerning the behaviour of enterprises and financial institutions, property rights, transactions and contracts, and the functioning of markets; (b) the provision of parts of education, public health and medical care; (c) the provision and protection of certain public goods or services including defence, law and order, the environment, and elements of the infrastructure; (d) the provision of protection against important aspects of poverty; (e) a system of taxation that can support the provision of the above services.

In describing the key elements of the market economy the Report lays emphasis on those aspects affecting most strongly the functioning of enterprises, since the Bank's main tools are investments in enterprises. This chapter comments briefly on the five elements above, focusing on the aspects that avail themselves to some measurement or assessment as presented in Table 2.1 and Appendix 2.1.

The *privately owned enterprise* is the basic element of the market economy. Ownership has many dimensions, including rights of control, access, sale and so on, but central here is the right to the surplus income after costs and taxes have been met, i.e. the net profits. Owners of private enterprises, therefore, wish to maximise profits. It is this seeking after profit which provides the driving force in the market economy. The extent to which output derives from private enterprises is the first, and arguably the most important, indicator of progress towards a market economy: the transition. This can be measured in a number of ways, including total output and total employment. It is the adaptation, creation and growth of private enterprise which is at the heart of the process.

It is important not to have a narrow view of what constitutes private ownership. There can be long-term leases with unlimited rights to and control of output, but very limited rights of resale of the leased assets. There may be onerous obligations to maintain or provide certain services. Prices, profits and investment can be strongly regulated, as for example in many privatised utilities. There are often, or usually, rules governing the relationships between different participants in the firm including stockholders, managers and employees. These can vary greatly in different environments. All these differences will result in different behaviours and outcomes, and are therefore important to understanding the nature of the economy and how it functions. Many of the aspects described are summarised under the headings "property rights" and "governance", and some are measured or assessed in the table in Chapter 2. These differences remind us that we should not have a single model of what is meant by a private firm.

The relationships between the individual private firms and the state will be crucial elements in the functioning of the economy. It is the state which should ultimately enforce honesty and transparency in the firms' transactions, including observance of contracts and proper accounting. It is ultimately the state which should ensure that enterprises and households operate within their own resources, although wider cultural and social patterns conditioning attitudes towards tax evasion, compliance with contracts, bribery and corruption are of great importance as well.

For all these reasons, emphasis is placed on legal structures in describing enterprises. It is important, however, to recognise that resort to the law to settle or enforce rules of behaviour varies greatly across societies. Reputation and social convention on accepted behaviour are generally very powerful sanctions in most societies. It would therefore be a mistake to look only, or even in some cases first, to legal structures in the understanding of property rights and governance. Indeed in many countries capitalism developed a long way with weak enforcement of rules, little transparency, and no competition and bankruptcy law.

The *market* is the key arena in which enterprises and households interact. A well-functioning set of markets has the following features: trade possible in a very broad range of goods and services covering the crucial inputs and outputs; good information about quality and prices; flexible prices; and above all competition. It is competition which provides the incentive for creativity, innovation and efficiency. Without competition the economic system is unlikely to deliver the virtuous outcomes claimed for the market economy. The most important factor in competition is freedom of entry into a market. It is important constantly to be aware of, and attempt to embody in measures and analysis, the extent to which markets are competitive, and are open to entry of new companies.

A force of special relevance is competition in international trade. If producers have to compete in export markets or with importers then their production activities are subject to the rigours of a much fiercer market, embodying broader knowledge and techniques. Performance is likely then to be much superior to an economy that is not subject to this discipline. This analytical observation receives strong support in the empirical evidence concerning the performance of economies that have attempted to shield their producers for long periods from international competition. Hence the emphasis on openness to international trade in this Report's measures of market development. Part III (which comprises Chapters 7-9) is also devoted to international issues.

Financial institutions are at the heart of a market economy. They play fundamental roles as links for the allocation of resources over time (channelling savings and investment), for the allocation and assessment of risks, for payments mechanisms, and for the enforcement of financial discipline. Most importantly their knowledge of, and ability to monitor, enterprises makes it possible for investments to take place and thus to make productive use of investible funds. They are therefore crucial intermediaries for the investment process and, in particular, for the EBRD. Accordingly, a section of the indicators is devoted entirely to measuring and assessing the emergence and role of financial institutions.

The relationship between firms and financial institutions is basic to the development of each. In the old regime the banks played a fairly passive role and had to respond to government directives where loans were demanded of them. This lack of choice, and the absence of any incentive for financial discipline in enterprises, in the command economy meant that budget constraints were "soft" and many of the loans were "bad". Thus the softness of the budget constraint facing enterprises in the old regime and the poor state of the balance sheet of many banks (with many "non-performing" loans) are intimately connected. Correspondingly, the independence of financial institutions from government directions to lend to certain enterprises and the ability to harden the budget constraint (and ultimately to enforce bankruptcy) are crucial parts of the establishment of an effective market economy.

It is fundamental to an understanding of the market economy to recognise that the role of the state is not eliminated in the transition but is transformed. Instead of directing output and resources, the role of the state is to set, supervise and enforce "the rules of the game"; provide certain goods or services, the markets for which may have inherent problems or failures; ensure certain rights, for example to aspects of education and health services; offer protection from certain catastrophes, including safety nets; and so on. While the fulfilling of these responsibilities does not necessarily imply public ownership, participation by the state in these activities will mean that production of goods and services in the market economy will usually be far from 100 per cent in the private sector. Thus the "distance" from the market economy cannot be measured in terms, for example, of the difference between 100 per cent and the proportion of output arising in the private sector. One hundred per cent private output is not the goal of transition.

These are responsibilities which, if not accepted by the state, could lead to poor functioning of the market economy and potentially disastrous consequences for individuals and households. How and to what extent these responsibilities are discharged is a challenge for analysis, decision and implementation. The issue of the role of the state is rendered still more complex in the context of transition since it is the state itself which is responsible for directing its changing form. Detailed discussion of all these elements goes far beyond the scope of this Report. Some of them will be discussed in more detail in future *Transition Reports*. This Report focuses on some aspects of special relevance for the emergence of private enterprise. The changing of institutions, towards those described as being key elements of the market economy, defines the transition. This Report is devoted to the analysis and measurement of this institutional change.

Box 1.1.

Indicators of development

What is meant by "degree of development" relates to a whole complex of characteristics. Special attention is usually given to GDP per head. That is not easily measured when patterns of relative prices vary widely and exchange rates are liable to distortion. Moreover, an oil-rich island whose dictator is accumulating financial assets in off-shore countries while the populace struggles to survive on subsistence incomes without education, clean water or health services is not highly developed, even if per capita GDP is high. The standard of living is a concept that goes far beyond purchasing power. Indicators of development should include, as well as average income, income distribution, nutrition, education, morbidity, and mortality or life expectancy.

In Table 1.1 below, a number of indicators are set out, where available, for 22 of the 25 countries under review, together with comparable data on five other groups of countries. These are the World Bank's groups of low-, middle- and high-income countries; the G7 (Canada, France, Germany, Japan, Italy, United Kingdom, and the United States) as a subset of high income countries, a major force in the International Financial Institutions and also the leading bilateral donors; and seven South American countries some of which are also undertaking market reforms and most of which have similar per capita income to that of the east European economies. The first column in Table 1.1 relates to GNP per head in "international dollars" adjusted for differences between purchasing-power parity (PPP) and market exchange rates. The countries are listed in ascending order of this indicator. The difference between PPP and market exchange rates can be very large, especially for the EBRD's countries of operation. It should be noted that, although the source used in Table 1.1 for data on GNP per capita in international dollars is a publication of the World Bank, this is not the income concept on the basis of which the World Bank itself classifies countries as low-, middle- or high-income economies (as set out in greater detail in the footnotes to Table 1.1).

From Table 1.1, it can be seen that the Bank's countries of operations fit squarely in the middle-income range, with Tajikistan on the fringe of the low-income group on the basis of per capita income and Albania on the fringe on the basis of the proportion of population in agriculture. Of the rest, perhaps two thirds fall into the World Bank's lower-middle category and one third, including Russia with its large population, in the upper-middle class.

Table 1.1
Estimated real incomes and other indicators of development for each country in transition

	PPP-based GNP per capita (in "international dollars" [1])	Share of agriculture in GDP (in per cent) [2]	Share of urban population in total population (in per cent)	Infant mortality (per 1,000 live births)	Life expectancy at birth (years)	Total fertility rate [3]	People per doctor	People per hospital bed (latest available observation)	Secondary school enrolment [4]	Energy use (oil equivalent) per capita (kg)
	1992	1992	1991	1992	1992	1992	1990	1987-92	1991	1992
Albania	na	56	36[5]	32	73	2.9	na	246	79	421
Tajikistan	2,000	33	32	49	69	5.1	350	96	na	na
Georgia	2,470	48	56	19	72	2.2	170	90	na	na
Armenia	2,500	41	68	21	70	2.8	260	120	na	1,092
Uzbekistan	2,600	39	41	42	69	4.1	290	83	na	na
Azerbaijan	2,650	29	54	31	71	2.7	250	101	na	na
Romania	2,750	20	55[5]	23	70	1.5	560	113	80	1,958
Kyrgyzstan	2,820	28	38	37	66	3.7	280	85	na	1,148
Lithuania	3,710	28	68	16	71	2.0	220	79	na	na
Moldova	3,870	33	47	23	68	2.3	250	77	na	1,600
Turkmenistan	3,950	48	na	54	66	4.2	290	92	na	na
Latvia	4,690	24	71	17	69	1.8	200	72	na	na
Kazakhstan	4,780	38	57	31	68	2.7	250	75	na	4,722
Poland	4,880	8	63[5]	15	70	1.9	490	153	83	2,407
Ukraine	5,010	23	67	18	70	1.8	230	na	na	3,885
Bulgaria	5,130	16	68	16	71	1.5	320	100	71	2,422
Estonia	5,250	13	72	13	70	1.8	210	82	na	na
Slovak Republic	5,620	6	na	13	71	2.0	280	na	97	3,202
Hungary	5,740	7	66[5]	15	69	1.8	340	99	81	2,392
Russia	6,220	13	74	20	69	1.7	210	73	na	5,665
Belarus	6,840	24	66	15	71	1.9	250	na	na	4,154
Czech Republic	7,160	6	na	10	72	1.9	na	na	na	3,873
Low-income [6,7]	1,300	30	27	73	62	3.4	6,000	1,050	40	335
Middle-income [6,7]	4,000	10	67	42	69	3.0	2,100	450	55	1,750
High-income [6,7]	17,800	3	78	7	77	1.7	420	144	93	5,100
G-7 countries [6]	19,600	2.5	78	7	77	1.7	402	120	na	4,864
South America [6]	5,500	12.3	73	39	68	3.3	1,186	540	na	780

Sources: *World Development Report* 1994, World Bank; *Social Indicators of Development* 1994, World Bank; UNESCO *Statistical Yearbook* 1993.

1 PPP stands for purchasing power parity. The estimates quoted here stem from the World Bank's *World Development Report* 1994. In the computation of these estimates each country's nominal GNP per capita was divided by the "purchasing power parity", defined as the number of units of the country's currency required to buy the same amount of goods and services in the domestic market as one US dollar would buy in the United States.

2 The numbers in this column are drawn partly from the World Bank's *World Development Report* and partly from the data presented in Appendix 10.1 to this Report. For Belarus, Georgia, the Russian Federation, Slovak Republic, Turkmenistan and Ukraine the figures refer to the share of agriculture in Net Material Product.

3 The "total fertility rate" represents the number of children that would be born to a woman if she were to live to the end of her childbearing years and bear children at each age in accordance with prevailing age-specific fertility rates.

4 Defined as the ratio of children of all ages enrolled in secondary school to the country's population of 12-17 year-olds. Note that the exact definition of secondary school may vary across countries and that late entry of more mature students as well as "bunching" in final grades can influence these ratios. A different, and possibly more interpretable statistic, is the ratio of 20-24 year-olds that have at some point in their lives entered secondary or higher levels of education. On this measure some selected ratios were: CSFR 81% (1980), Estonia 89% (1989), Hungary 75% (1990), Kazakhstan 91% (1989), Poland 83% (1988), and the Soviet Union 99% (1989).

5 Data refer to 1992.

6 The figures shown in these rows are unweighted averages (exceptions are listed below) of available observations for, respectively, low-income countries (see the definition of low, middle and high income in footnote 7), middle-income countries, high-income countries, G-7 countries, and South American countries (in the latter group we have included Bolivia, Brazil, Chile, Columbia, Peru and Venezuela). For the rows covering low, middle and high-income countries, columns 2 to 10 contain weighted averages.

7 These categories refer to the World Bank's classification of low-, middle- and high-income countries. The key for this classification is nominal GDP per capita (as opposed to PPP-based per capita GNP which is defined in footnote 1). For the purpose of this classification the World Bank converts national GDP data into common currency using the so-called Atlas method which applies the average exchange rate for three years, adjusted for differences in inflation between the individual country under analysis and the United States. The countries are placed by the World Bank in the three income categories based on the following ranges for the Atlas estimates of per capita GDP: low: US$ 675 or less; middle: US$ 676-8,355; high: US$ 8,356 or higher.

The health indicators, such as infant mortality and medical provision (on the listed indicators) were all better than the typical middle income country around 1990 and than our South American sample but a number of these indicators have since deteriorated. Secondary school enrolment was also high by the standards of middle-income countries.

While the Central Asian countries have a particularly young population and a high birthrate, eastern Europe and the remainder of the former Soviet Union have west-European demographic structures and trends but substantially lower per capita income levels. This may lead to heavy pressure for reform of social security systems in the years ahead.

With the exception of Albania, energy consumption ran ahead of income status, with that of Russia, Belarus and Kazakhstan high, even by OECD standards. It is well known, however, that much of this energy was wasted and that the pattern of usage did not conform in any way to that of high income countries. It has been suggested that half to two-thirds of the former Soviet Union's energy consumption was wasted. Making allowance for rather less inefficiency elsewhere suggests that only Albania conformed to the low income pattern of energy scarcity while none of the formerly centrally planned European economies used energy as a high income country would. Albania's per capita energy consumption was little more than half that of our South American sample.

Table 1.2
Percentage share of income or consumption

	Lowest 20%	Second 20%	Third 20%	Fourth 20%	Highest 20%	Highest 10%
Poland (1989)	9.2	13.8	17.9	23.0	36.0	21.6
Hungary (1989)	10.9	14.8	18.0	22.0	34.4	20.8
Yugoslavia (1989)	5.3	10.7	16.2	23.7	44.2	27.4
Bulgaria (1992)	10.4	13.9	17.3	22.2	36.2	21.9
Low-income [1]	2-9	6-13	10-16	19-22	40-60	25-45
Middle-income [1]	2-7	7-12	11-16	19-22	45-60	25-45
High-income [1]	4-8	10-13	16-18	22-25	40-45	20-30
G-7 countries (various years) [2]	6.2	11.7	17.2	24.0	41.1	25.0
South America (various years) [2]	4.1	8.0	12.4	19.7	55.9	40.1

Source: World Bank, *World Development Report* 1994.

1 See the definitions of these categories in footnote 7 to Table 1.1 above.

2 The estimates in these rows are unweighted averages of the latest available observations for, respectively, the G-7 countries and a selection of South American countries (Bolivia, Brazil, Chile, Columbia, Peru and Venezuela).

2. Transition: measurement and indicators

2.1 Summary

The previous chapter distinguished between development (on which Box 1.1 provides data), stabilisation (the subject of Chapters 10 and 11 below) and transition itself which is the subject of this chapter and the focus of the Report.

The discussion in the first section of this chapter is organised around Table 2.1, which summarises in tabular form the position of the 25 countries of the Bank's operations in their transition from their centrally planned and state-owned past to their private enterprise and free market future. It is a summary table which draws on material set out in greater detail and precision in the transition indicators in Appendix 2.1. The latter are discussed more extensively in Section 2 of this chapter.

The structure of Table 2.1 builds on the discussion of the preceding chapter. The lead indicator, and the only one in this table that is quantitative rather than qualitative, is the measure of private sector activity. The next block of indicators concerns the basic unit of production, the enterprise. This is followed by measures relating to markets, where enterprises interact. The final block pertains to financial institutions, which represent a crucial element in the foundations underpinning a market economy.

Considerable caution is needed in using Table 2.1. The indicators are by no means comprehensive, nor is the classification system for each individual indicator, provided with the table, able fully to encapsulate the countries' different efforts and progress in reform in each field. Central to transition is the role of the state in the economy, whether as owner, regulator or director of market signals. The transition indicators provide a guide to the extent to which the state has withdrawn from ownership and regulation, but zero ownership and zero regulation are clearly not ideals. None the less, progress on both fronts from the levels inherited from socialist regimes remain crucial indicators of transition.

Despite the extensive caveats above, Table 2.1 serves to illustrate a number of clear trends, some taking place throughout the region (as reflected in variations across columns of the table), others serving to delineate certain "transition groups" of countries (represented in the table by rows with similar patterns). While transition has many dimensions, its essence lies in the expansion of private sector activity. This is also a dimension which allows quantitative, albeit rough, measurement. Accordingly we have chosen this as the first of the indicators on which we focus. We have, drawing on official statistics as well as on subjective judgement, produced an estimate of the private sector's share of GDP for each of the countries under analysis (see Box 2.1 for a discussion of the great conceptual and practical difficulties associated with these data). The estimates indicate that the private sector, including informal activity, accounts for more than half of GDP in 9 of the 25 countries.

Each of the other columns in Table 2.1 is concerned with a particular area of market-oriented reform. The table shows that almost all the countries of the region have initiated reform in all the listed areas. Most of them have already completed widespread liberalisation of prices and foreign trade. At least two-thirds of the countries in the region have embarked upon, and in many cases completed, comprehensive small-scale privatisation.

Banking reform, enterprise restructuring and large-scale privatisation are the areas where progress in the transition has been slowest. This is not surprising as fundamental change in large-scale institutions, if it is to be rational and effective, must take time. Markets can be created and reformed and small enterprises privatised much more quickly.

Those countries that have made most progress are the Czech Republic, Hungary, Poland, the Slovak Republic, the Baltic states, and several countries of former Yugoslavia. Most of these countries have also started to tackle the much more thorny problem of large-scale privatisation and the related issue of financial sector reform. None the less, even the most advanced countries are finding the latter particularly difficult.

An intermediate group includes the other east European countries, Kyrgyzstan and Russia. The latter two countries, especially Russia, have made spectacular progress on privatisation over the past year, but are less advanced than the countries listed above in the areas of financial sector reform and enterprise restructuring.

The remainder of the CIS states have made less advancement with transition. They have found it particularly difficult to liberalise their trade regimes, embark upon enterprise restructuring and even, in some cases, achieve small-scale privatisation.

Box 2.1

Concepts of private output

If an enterprise is state-owned and state-run the convention is to classify all its net output as state production. Consider, however, a case in which a state-owned factory is leased to a private enterprise. In this case, all the net output is generally classified as private. *A fortiori*, a private enterprise in which the pension fund of a state enterprise holds a minority stake does not thereby experience any diminution of its privateness. How would one treat the contribution of a private sub-contractor buying from and selling to state-owned enterprises? In principle, again, its contribution is as private as that of a manufacturer of pencils which uses timber from state forests and sells its products entirely to government ministries.

The measure quoted in the first column of Table 2.1 relates to the whole value added of privately controlled enterprises even if they buy inputs, including the services of leased equipment, from the state and sell their product to it and even if the state, or state-owned organs, are (non-controlling) minority shareholders. The figures in the column build on official estimates, where available.

It is obviously difficult to apply these criteria precisely and to identify the net output of the qualifying enterprises. Their employment is likely to be more easily identified and, if output per person does not vary systematically with the sectoral control of their employer, the private share of employment may be suggestive of the private share of GDP. Unfortunately, however, many people in transition economies have several employments or work in groups that effectively become private enterprises once their state quotas are fulfilled. Thus, it is difficult to apply even this indicator with any precision.

Table 2.1 Progress in transition in eastern Europe and the former Soviet Union[1]

(see classification system for transition indicators opposite)

		Enterprises			*Markets and trade*		*Financial institutions*
Countries	Private sector share of GDP Mid-94 in % (rough EBRD estimate)	Large-scale privatisation	Small-scale privatisation	Enterprise restructuring	Price liberalisation and competition	Trade and foreign exchange system	Banking reform
Albania	50	1	3	2	3	4	2
Armenia	40	1	3	1	3	2	1
Azerbaijan	20	1	1	1	3	1	1
Belarus	15	2	2	2	2	1	1
Bulgaria	40	2	2	2	3	4	2
Croatia	40	3	4	2	3	4	3
Czech Republic	65	4	4	3	3	4	3
Estonia	55	3	4	3	3	4	3
FYR Macedonia	35	2	4	2	3	4	2
Georgia	20	1	2	1	2	1	1
Hungary	55	3	4	3	3	4	3
Kazakhstan	20	2	2	1	2	2	1
Kyrgyzstan	30	3	4	2	3	3	2
Latvia	55	2	3	2	3	4	3
Lithuania	50	3	4	2	3	4	2
Moldova	20	2	2	2	3	2	2
Poland	55	3	4	3	3	4	3
Romania	35	2	3	2	3	4	2
Russian Federation	50	3	3	2	3	3	2
Slovak Republic	55	3	4	3	3	4	3
Slovenia	30	2	4	3	3	4	3
Tajikistan	15	2	2	1	3	1	1
Turkmenistan	15	1	1	1	2	1	1
Ukraine	30	1	2	1	2	1	1
Uzbekistan	20	2	3	1	3	2	1

1 Many west European countries would for almost all transition elements qualify under category 4. What is being assessed in Table 2.1 is the status rather than the pace of change. Thus, for instance, the placement of Slovenia's small-scale privatisation in category 4, despite the absence of a comprehensive small-scale privatisation programme in that country, reflects the fact that small-scale activity in Slovenia was largely private before a comprehensive transition process was initiated.

Classification system for transition indicators[2]

Transition element	Category	Description of the category
Large-scale privatisation	4	More than 50 per cent of state-owned enterprise assets privatised in a scheme that reflects support for corporate governance
	3	More than 25 per cent of large-scale state-owned enterprise assets privatised or in the process of being sold but with major unresolved issues regarding corporate governance
	2	Advanced comprehensive scheme almost ready to be implemented; some sales completed
	1	Little done
Small-scale privatisation	4	Comprehensive and well designed programme implemented
	3	Nearly comprehensive programme implemented, but design or lack of central supervision leaves important issues unresolved
	2	Substantial share privatised
	1	Little done
Enterprise restructuring	4	Restructuring programme which substantially improves corporate governance in operation; strong financial discipline at the enterprise level; large conglomerates broken up
	3	Structures created (for example through privatisation combined with tight credit and subsidy policies and/or enforcement of bankruptcy legislation) to promote corporate governance; or strong action taken to break up conglomerates
	2	Moderately tight credit and subsidy policy; weak enforcement of bankruptcy legislation; little action to break up large conglomerates
	1	Lax credit and subsidy policies weakening financial discipline at the enterprise level; few other reforms to promote corporate governance
Price liberalisation	4	Comprehensive price liberalisation and price competition; anti-trust legislation in place
and competition	3	Comprehensive price liberalisation and price competition
	2	Price controls remain for several important product categories
	1	Most prices remain formally controlled by the government
Trade and foreign exchange system	4	Few import or export quotas; insignificant direct involvement in exports and imports by ministries and state-owned former trading monopolies; almost full current account convertibility at unified exchange rate; no major non-uniformity of customs duties
	3	Few import quotas; almost full current account convertibility at unified exchange rate
	2	Few import quotas; almost full current account convertibility in principle but with a foreign exchange regime which is not fully transparent (possibly with multiple exchange rates)
	1	Widespread import controls or very limited legitimate access to foreign exchange
Banking reform	4	Well functioning banking competition and prudential supervision
	3	Substantial progress on bank recapitalisation, bank auditing, and establishment of a functioning prudential supervisory system; significant presence of private banks; full interest rate liberalisation with little preferential access to cheap refinancing
	2	Interest rates significantly influencing the allocation of credit
	1	Little progress beyond establishment of a two-tier system

2 The classification system established here is crude and builds on the judgement of EBRD economists. More detailed and less subjective descriptions of country specific progress in transition is provided in descriptive form in Appendix 2.1. The classification system used in Table 2.1 may be revised and refined in future editions of the *Transition Report*.

While the starting point is important in a number of respects, it is noteworthy that progress with transition is not necessarily rigidly associated with any single opportunity (or handicap) inherited after the collapse of communism. Countries with a similar inheritance from the former Soviet Union have varied enormously in their degrees of progress. The countries that inherited a higher GDP per capita have by no means uniformly done better in reform than the poor. Even regional or internal conflict has not necessarily acted as a bar to reform.

While this Report focuses on assessing and analysing transition itself, it is important to bear in mind that progress with transition influences the type of assistance that IFIs can provide. This issue is taken up in greater detail in Box 2.2.

2.2 Commentary on transition indicators

This commentary draws on the detailed transition indicators in Appendix 2.1.

The private sector's share in GDP

In 1993, the private share of output rose in the countries of eastern Europe by 10-40 percentage points. There were very large gains, from a low base, in Albania, the Czech Republic and the Slovak Republic, with the Czech Republic moving past Poland into first place. Smaller gains were posted by Poland (which was already close to 50 per cent) and Romania (which, along with Bulgaria, Croatia and FYR Macedonia, is still close to 35-40 per cent - well ahead of the majority of CIS countries).

Nevertheless, Russia and Armenia now have private shares in employment and output similar to those of countries of central Europe. In Russia's case, this involves more than a doubling from below 25 per cent a year ago to around 50 per cent now. In the rest of the CIS, the private sector's share of GDP is put in the 15-30 per cent range. This range reflects not only variation across countries, but also considerable uncertainty in each particular case, arising not only from the conceptual problems, but also from additional difficulties relating to cooperatives and other entities in which property rights are not well defined, as well as the so-called "shadow economy" which includes many operations by employees of state enterprises using facilities of these enterprises for their own purposes. Such activity is now widespread in many countries. Uncertainty in this respect not only obscures the measurement of private sector activity but also raises important questions about the level and path of total output itself, questions which are taken up later in this Report (see Chapters 10 and 11).

Box 2.2

The role of IFIs at different stages of transition

The individual governments and countries will remain the key players in transition. None the less, international financial institutions (IFIs) can provide valuable assistance in advancing reform.

A country's stage of transition will determine, to a significant extent, the type of investment or assistance that can and should be provided. In countries that are at the early stages of transition, including many smaller countries of the CIS, private sector opportunities for investment may be limited, especially where modest progress on structural reform is combined with great macroeconomic imbalances. In these countries, project-financing IFIs will tend to channel more of their efforts through the public sector, including for work on infrastructure. Greater emphasis on state projects is a corollary of the comparatively modest size of the private sector, greater country risk, difficulty in analysing enterprise accounts, and a less developed legal framework. Technical assistance in projects and in promotion of a market-friendly environment will be important, as will encouragement of the development of financial intermediaries.

As transition progresses, the scope for targeting IFI assistance more directly to the private sector increases, as seen in the Baltics, Russia, south-eastern Europe, and to some extent Kyrgyzstan. Local financial institutions may be available to act as intermediaries for IFI funding in local projects; the opportunities for participation in both joint ventures with foreign companies and early-stage equity funds will increase.

At more advanced stages of transition and macroeconomic stabilisation, for example that achieved in the Czech Republic, Hungary, Poland and the Slovak Republic, it becomes possible for IFIs in general, and the EBRD in particular, to place greater emphasis on direct investment in the local private sector. Meanwhile there is a decline in demand for IFI funding for the strongest segment of private investment projects as joint ventures and fully domestically owned companies gain access to private foreign sources of finance. Although the state sector, at this stage of transition/stabilisation, typically enjoys access to international capital markets, infrastructure projects may continue to have IFI involvement, especially projects that contain a private sector promoting (or privatising) element, such as certain types of investment in the telecommunications sector. Moreover, even in advanced stages of transition, the problems of bank and financial sector restructuring remain areas with potential for beneficial IFI involvement.

Large-scale privatisation

The large increases in private sector activity in the Czech Republic, Russia and the Slovak Republic were achieved by transferring existing assets into private hands through various forms of privatisation of large-scale enterprises. One very significant development in 1993 was Russia's privatisation, with its heavy reliance on transfers to workers and managers individually rather than collectively. This model is likely to prove influential in other parts of the CIS.

Voluntary share-ownership by individual employees, for instance in Russia, may be motivated by a desire on the part of these employees for some control of their own futures, and may not encourage restructuring schemes. It may, however, given some employee solidarity, help in resolving some of the governance issues highlighted in the EBRD's *Annual Economic Outlook 1993* (Chapter 2) and in Chapter 4 below.

Small-scale privatisation

In most of eastern Europe, privatisation of small-scale enterprises had already gone a long way in 1992. However, Bulgaria has continued to make only slow progress. The Baltic countries, Kyrgyzstan and Russia have made substantial advances on small-scale privatisation over the past 1 ½ years.

The growth of small-scale enterprises (SMEs) already privatised and that of new businesses (typically concentrated in the previously underdeveloped service sector) is a second, but less well documented, source of additional private activity. Ninety-three per cent of trading activity in Poland is now in private hands. Many small and new enterprises may not be registered or have well-reported activity. About 10,000 new enterprises were created in Estonia in 1993 but, as elsewhere, between a third and half are inactive. The number of non-agricultural firms rose in 1993 by 65 per cent in Romania and by 40 per cent in Slovenia. In Poland's larger and older private sector, the number of private domestic companies grew by only 15 per cent, while those with foreign participation increased by 50 per cent to account for about 20 per cent of the total. Many registered enterprises are known to be inactive; in Bulgaria, for instance, only about half of the nearly half a million new businesses registered are believed to be functioning. In Croatia, the number of both active and inactive enterprises probably roughly doubled last year. About a third of registered enterprises file reports, but these may understate their activity rate.

Growth in the size and number of SMEs and their problems is less fully documented for the CIS than for eastern Europe and the Baltics. Russia now has 700,000 registered enterprises and, on some estimates, about four unregistered ones for each that is registered. Non-registration is attractive as it enables enterprises to escape the notice of the revenue authorities. Turkmenistan saw substantial spontaneous small-scale private sector growth in 1993, with one-third of registered SMEs in private hands in mid-1993. At that point about 20 per cent of such non-agricultural businesses were private in Belarus. In Ukraine about 30 per cent of smaller enterprises have been leased to private entities. Heavy taxation there has boosted the informal sector despite attempts to reimpose regulation.

Though rapid, the growth of the private sector in both eastern Europe and the former Soviet Union is still constrained by the obstacles encountered by individual enterprises, obstacles which may also account for the low activity rate. Outright legal and regulatory barriers have been removed progressively in many countries but inadequate financial and utility infrastructure is widely cited, as is macroeconomic, policy, tax and regulatory instability. Small enterprises obtain 10 per cent or less of new credits in several countries. The level of settlement and advisory services are as important as access to credit itself; and for medium-sized growing enterprises the under-developed non-bank capital market is also a problem.

In much of the CIS, the obstacles encountered by private business are greater than in eastern Europe, with war-damaged infrastructure in Armenia, Azerbaijan, Georgia and Tajikistan, and difficulty in obtaining access to accommodation and labour in some still heavily regulated economies.

Enterprise restructuring

Much restructuring of large enterprises has taken place, mostly in response to privatisation, a cut in many countries of state subsidies and a tightening of policies guiding provision of bank credits to companies. Rarely has the rationalisation in the enterprise sector reflected vigorously implemented and carefully targeted government restructuring programmes. Hard budget constraints in disequilibrium economies, such as those emerging from decades of central planning, would be expected to lead to a high incidence of bankruptcy. In practice, this has not materialised (there were nine bankruptcies in the Ukraine and 13 in Lithuania in 1993) although nearly all the countries have made some legislative provision for bankruptcy. Typically, such laws are stronger on the consequences of bankruptcy than on ensuring that it is declared where enterprises are, indeed, insolvent. Enforcement is weak.

Even Poland and the Czech Republic have been cautious in implementing bankruptcy. Only Hungary has gone very far, and there too administrative constraints have given many enterprises a stay of execution. One reason for this may be that in many cases bankruptcy and subsequent liquidation would not be the best outcome: it could reduce output more than consumption and add to unemployment. This last argument is more plausible in those countries (such as all but the Czech Republic in eastern Europe) where unemployment exceeds the 10 per cent now typical of western Europe, than in those of the CIS where recorded unemployment remains well below 5 per cent.

Competition and liberalisation of prices, wages and interest rates

The benefits associated with the use of markets depend strongly on competition. As mentioned above, price and import liberalisation is well advanced in most of eastern Europe and the former Soviet Union. However, freed markets in economies dominated by very large enterprises - which characterise the former centrally planned economies - are unlikely to be competitive without major enterprise reform, even though import liberalisation helps generate competitive pressure.

Few of the reforming economies have taken radical steps to break up state-owned enterprises, partly because of their physical integration within very large plants. Rather than follow Western models of anti-trust and competition policy, they have tended to resort to the model of regulated monopolies confined in the West largely to natural monopolies in the public utility field. While some regulations on the activities of monopolies may be desirable, the current regime for these extensive monopolies' prices or margins remains a major limitation on price liberalisation in parts of the CIS such as Belarus, Moldova and Uzbekistan. Such regulation is often exercised by local governments, as in Russia. In Ukraine, controls were tightened in 1993 but are circumvented in the shadow economy. Bulgaria has also recently imposed temporary controls following the introduction of value added tax. The regulation of utility prices, rents, basic foodstuffs and medicines remains widespread. Of course, some of these regulations would also be present in mature market economies and some may be desirable.

Labour markets seem to have been generally liberalised. However, taxes on "excessive" wage increases have been applied in a number of countries including the Czech Republic and Poland. In the CIS countries, it is common to tax enterprises on the excess of their payroll over a specified multiple of the number of employees and the minimum wage. Average wages in excess of 10 times the statutory minimum may be taxed as profits. This has several effects. It encourages the retention, or even hiring, of employees who are paid only the minimum and may not be asked to work. This may be a partial substitute for a free-standing unemployment compensation system which ensures that redundant individuals continue to have access to those goods and services distributed by or through enterprises. It may be less beneficent if such "unemployed" people are not effectively available for hire by new start-up businesses - in which case they are probably also rather ineffective in restraining nominal wage increases.

Since wages and profits in an enterprise together amount to its value added, a tax on both (less a per-employee allowance) is equivalent, at the margin, to an additional value added tax. In much of the CIS, the two rates taken together, if rigorously applied, would become a very stiff VAT indeed. Neither the effects of the excess wage tax, nor those of the minimum wage, represents a wage control mechanism that differs substantially from that ruling in the West, but direct controls apply to the state sectors of most east European economies. Controls on state sectors do not represent major infringements of market precepts if they can be interpreted as the exercise of a managerial prerogative by the state in relation to its own employees. Labour market structures, trades unions, and the size and attitude of employers differ markedly - as do labour market institutions such as collective agreements, labour exchanges and the legal status of strikes.

Government monetary policy is bound to be reflected in market interest rates. While these were high in real terms in the economies (such as Poland's) undergoing early radical reform, they remained negative in most of the CIS, as interest rates failed to catch up with the inflationary consequences of accommodating money and credit policies until very recently. Real rates are now positive in Kyrgyzstan, Russia and Ukraine, among others, but there are some doubts about the sustainability of the tight policies they reflect.

Throughout the period, there have been directed credits at below-market rates, targeted on preferred sectors and distressed enterprises, particularly, but not exclusively, in the CIS. Even where a market interest rate is apparently charged, the quality of the credit may reflect the borrower's access to political, and ultimately state-directed, support rather than its ability to generate a cash surplus.

Trade and the foreign exchange system

Only the Baltic states have yet committed themselves to full convertibility of their currencies for both current and capital account purposes, whereas the issue of convertibility has only just presented itself to the 10 members of the CIS that have introduced national currencies only in the past two years.

The norm - in eastern Europe now as in western Europe between 1950 and 1980 - is free convertibility for current account purposes only. This means that a prospective importer can freely buy the currency needed to effect his purchases. He cannot, however, hold it as an asset in itself, or convert it into overseas assets, or keep it against some vague intention to purchase imports at some future date. This last restriction implies that an exporter must convert the hard currency proceeds of his sales into local currency promptly. This is sometimes referred to as an obligation to "surrender" the hard currency. That terminology is somewhat harsh if the rate at which the conversion takes place is a free market rate - subject of course to a ban on residents' capital account transactions. In several countries, however, such as Ukraine, the mandatory conversion is at an unfavourable official exchange rate - in which case the arrangement is equivalent to an export tax.

In a number of countries, again particularly in the CIS, exporters are not required to convert all their proceeds into domestic currency (whether at market or at penal official rates). Such partial surrender conditions amount to an element of capital account convertibility in as much as the exporter is allowed to hold foreign currency for a period without immediate plans to spend it on imports. The exporter is legally free to use it only for imports in the end; in the meantime, the choice, whether to hold foreign currency or convert it into local currency, will be determined by a comparison of nominal interest rates with expected exchange rate changes.

This mechanism thus brings capital account considerations into the determination of interest and exchange rates, which is what capital controls were largely designed to avoid. They are also designed to avoid the flight of domestic capital, but they have been singularly ineffective in several CIS countries, such as Russia and Ukraine.

Capital inflows are generally more welcome and require that foreign investors can convert and remit their profits (a current account transaction) and, at least at the end of the day, can extricate their investment (unwinding the original capital account transaction). Rules along these lines are in force everywhere except in Georgia, Latvia and Lithuania (which are more liberal) and parts of the CIS that have not yet progressed so far. A number of countries, including Hungary, that welcome foreign capital and workers impose restrictions on the remittance of salaries, as they could be used both to reduce taxable profits and to syphon off capital.

The previous paragraphs have made several references to importers and exporters whose activities were controlled directly in the old regime, under which most people and enterprises were formally debarred from international trade, as well as indirectly obstructed through the inconvertibility of the currency. Trade liberalisation is almost complete in eastern Europe and the Baltics, with rather more qualifications in Bulgaria, Latvia and Romania than elsewhere. The picture is very different in the CIS, where most inter-state trade is still intergovernmental and based on state orders. Progress there has varied, with Kyrgyzstan and Russia relatively advanced.

Russia's liberalisation has been accompanied by more extensive use of trade taxes. In general, such taxes raise revenues and are compatible with free markets, although they are inefficient from the point of view of production (see Chapter 6). In the limiting case a tax can reach a prohibitive level, at which point it does not differ from a ban. Moreover, taxes are quite often waived in particular cases or classes of cases. A structure of highly varied and selectively waived tariffs has similarities with a system of controls and licensing. In this respect, Russia's progress has perhaps been more modest than revolutionary.

Banking reform

The establishment of a well functioning banking sector and prudential supervision has proven to be an extremely difficult task. Following the massive structural shifts caused by reforms in all the areas covered above, virtually all large state-owned banks in eastern Europe and the former Soviet Union have seen a sharp decline in the real value of their asset base as companies that have been rendered uncompetitive have become unable to repay their obligations. One task of financial sector reform is to establish incentives for banks to allocate their lending to those enterprises and individuals that can be expected to earn the highest return on their placements. A number of east European countries, including the Czech Republic, Hungary, Poland and Slovenia, are in the process of creating these incentives through a combination of state-financed recapitalisation of the large banks, tightening of prudential requirements and supervision, and privatisation (see Chapter 4). However, this process has not come close to completion in any country in the region.

The challenges ahead

The purpose of this chapter has been to provide an analytic description of the stage of transition, rather than a prescription. However, the differences in economic circumstances and the stage of transition across countries do indicate different sets of priorities for policy. For the countries where transition is most advanced, and generally where progress has been made on macroeconomic stabilisation, the priority is for enterprise restructuring and the development and reform of financial institutions, while maintaining and advancing stabilisation achievements. Progress on these fronts may require substantial attention to the social consequences of restructuring.

The intermediate group share the problems of the advanced group but face, in many cases, larger macroeconomic imbalances. In this group, privatisation and issues of corporate governance tend to remain high on the agenda.

For countries at an earlier stage of transition, the liberalisation of markets and privatisation remain the priority within the field of structural reform. These are generally also the countries where macroeconomic instability remains a severe and urgent problem.

Appendix 2.1. Transition indicators

Introductory remarks | **Enterprises**

Albania

The reform process was initiated in 1991, and a comprehensive programme was adopted in 1992.

Size of the private sector
Fifty per cent of total employment is estimated to be in the private sector.

Large-scale privatisation
Privatisation of large companies has been insignificant. At the end of 1992, 300 enterprises were categorised as "large-scale", which excluded them from the more active small-scale privatisation programme (discussed below). However, many of the then-large-scale companies have now cut staff levels sufficiently to fall into the category of "small and medium-sized enterprises" (which at present includes all companies with less than 300 staff).

Small-scale privatisation
The Privatisation Law (1991) and subsequent amendments regulate the privatisation of small-scale entities (defined as those with less than 15 staff). Privatisation of these units progressed rapidly in 1991-92 as many entities were taken over by employees. Privatisation of retail shops is virtually complete. Since mid-1993, responsibility for the small-scale privatisation programme has rested with the National Agency for Privatisation, and the programme has been expanded to include entities with less than 300 employees or a book value of less than US$ 1/2 million. During the second half of 1993, the Agency sold about 500 units (with a total book value of lek 659 million).

The Law on the Main Constitutional Provisions (1991) and the Law on Land (1991) prohibit the sale and purchase of land. Foreign individuals or companies cannot own land, but are permitted to enter a land-lease contract for up to 99 years.

By the end of 1993, 92 per cent of agricultural land had been privatised; most of this happened in 1991-92 as farmers spontaneously took over the land of former cooperatives. The sale of state-owned housing is regulated by the Law on the Privatisation of State Housing (1992) and by subsequent by-laws. By the end of 1993, 80 per cent of state buildings had been privatised.

Property restitution
According to two laws passed in 1993, former owners and their heirs can claim compensation or restitution of non-agricultural land. In the case of property that has already been privatised, the law prescribes co-ownership between the new and former owners.

Growth of private enterprise
The number of individuals employed in the non-agricultural private sector rose from about 50,000 at end-1992 to 130,000 at end-1993.

Enterprise restructuring
The main "restructuring tool" has been a sharp tightening of enterprise access to bank credits and government subsidies. A rapid accumulation of inter-enterprise arrears in 1991-92 was halted in early 1993 by the nationwide move to a settlement system relying on payment before delivery. Inter-enterprise arrears were netted out and a strictly limited set of financially viable firms were granted the financial means to write off their claims on non-viable companies. Despite the adoption by parliament of a bankruptcy law in 1992, no bankruptcies have yet taken place. An agency was established in 1993 to restructure or terminate the operations of 31 large companies.

Armenia

The reform process was initiated in 1987 as part of perestroika. A comprehensive reform package was adopted in January 1992. Significant progress has been made on price liberalisation, privatisation, tax reform, and the liberalisation of the exchange and trade system.

Size of the private sector
About 40 per cent of GDP is thought to be generated in the private sector, which employs about 35 per cent of the labour force.

Large-scale privatisation
The Law on Privatisation and Denationalisation of State-owned Enterprises and Unfinished Construction Sites was adopted on 27 August 1992 and amended in November 1993. At least five large-scale enterprises have been privatised. The government intends through its newly introduced privatisation programme to distribute freely to the population 20 per cent of the shares in 70 per cent of the country's large- and medium-scale industrial enterprises.

Small-scale privatisation
By the end of 1993, over 350 small units had been privatised, mainly in the retail and trade sector. Privatised agricultural units account for more than 60 per cent of arable land. More than 10 per cent of housing entities have been privatised. The 1994 privatisation programme approved by parliament in January 1994 envisages accelerated privatisation of housing and the privatisation of 50 per cent of small-scale units (30 per cent of which are to be allocated to citizens in the form of mass privatisation vouchers).

Property restitution
No property restitution had taken place by summer 1994.

Growth of private enterprise
The growth of the private sector outside the disengagement of the state from its assets is considered to be substantial, but no precise estimates exist. Obstacles to growth include interruption in supply of vital commodities, damage to infrastructure and lack of finance.

Enterprise restructuring
Industry is dominated by large conglomerates. Heavy industry is still working to fulfil production quotas matching state-negotiated barter agreements within the former Soviet Union. A preliminary start has been made on restructuring of three large "pilot" enterprises ill-suited for mass privatisation. A draft Bankruptcy Law is to be resubmitted to parliament. There has been no significant incidence of bankruptcy.

Markets and trade

Commodity price liberalisation
Price liberalisation has been comprehensive, although 25 items remain subject to administrative price setting. Efforts have been made to bring administered prices closer to cost-recovery levels.

Trade liberalisation
Since 1992 there have been virtually no quantitative restrictions on imports and very few on exports. More details on trade agreements and trade regimes is contained in Table 8.3.

Currency convertibility and exchange rate regime
The exchange system is largely free of restrictions on current account transactions including for profit repatriation. Controls are maintained on capital transactions but not on repatriation of capital placements by foreign investors. The exchange rate is freely determined in the interbank market, which competes with a small number of private dealers and foreign exchange bureaux.

Wage liberalisation
The Law on the Power of Defining Wages (1992) regulates wage formation. In September 1992 the government introduced nominal wage ceilings. To allow well-performing enterprises to reward their employees, enterprises were permitted to exceed the wage ceilings by 5-20 per cent in early 1993 and by 30 per cent in the middle of the same year, subject to strict performance criteria. Wage ceilings were generally respected in 1993.

Interest rate liberalisation
There is no cap on deposit or lending rates, but banks have tended to set rates mainly by following the lead of the central bank. Real interest rates on both deposits and lending have been positive since the first quarter of 1993.

Financial institutions

Banking reform
A two-tier banking system was introduced in 1992. A law from 1992 defines the functions of the Bank of Albania to include implementation of monetary policy and supervision of banks. The central bank has the right to issue licences for commercial banks to operate, approve mergers and division of banks, and approve the issue of securities. A few banks dominate the market. The Savings Bank takes the bulk of household deposits and the National Commercial Bank undertakes more than half of all lending to enterprises. The household funds are at present channelled to the National Commercial Bank through the central bank.

In October 1992, the government provided state bonds to the banks to replace on their asset side non-performing loans to the former agricultural cooperatives (see the section above on privatisation). Issuance of government bonds to banks in exchange for non-performing loans to former state farms and state-owned enterprises has been deferred until an expected reorganisation of state commercial banks. None of the "old" commercial banks have yet been privatised or gone bankrupt.

Securities markets
Albania has no stock exchange. The introduction of an exchange for secondary market trading in government securities is scheduled for 1994.

Role of the state

Taxation
Until 1990, the state budget relied essentially on three revenue sources: the turnover tax, enterprise profit transfers and social security contributions. All of these were paid by the enterprises. Reforms since 1991 have introduced as new revenue sources a personal income tax, a property tax and customs duties. They have also replaced profit transfers by profit taxation and removed some of the most notable inefficiencies in the turnover tax system. The new sources of income for the government have only been a small counterweight to a very sharp drop in revenues collected from enterprises. In 1992 the profit tax rate was set at 30 per cent, the progressive rates for personal income taxation at 5-40 per cent, and the basic turnover tax at 15 per cent. Tax conditions for foreign investors are described in more detail in Table 9.3.

Social security
Contribution rates of the social security system differ across the spectrum of economic activities. In 1992, the rate for private sector contributions was set at 19 per cent of the wage sum.

Commodity price liberalisation
After a limited start in mid-1991, comprehensive price liberalisation was introduced in January 1992. Controlled prices and subsidies still exist for bread, medical care, energy and certain public utilities.

Trade liberalisation
A system of state-negotiated barter agreements with other countries of the former Soviet Union still dominates trade. Otherwise there are few explicit tariff or non-tariff barriers to trade. More detail on trade agreements and trade regimes is contained in Table 8.3. A 50 per cent export surrender requirement of foreign exchange is in place.

Currency convertibility and exchange rate regime
A national currency, the dram, was introduced in November 1993 and became sole legal tender on 1 March 1994. The government adopted a floating exchange rate regime in the second half of December 1993, after a short period with a fixed peg to the dollar. The exchange rate is determined in an auction in which currency surrendered by enterprises is offered for sale to financial institutions. Full convertibility for current account purposes has not yet been achieved.

Wage liberalisation
A Wage Indexation Law was adopted in early 1992, which gives the government discretion on nominal wage adjustments. A "minimum consumption basket" is used to guide monthly minimum wage adjustments to price increases.

Interest rate liberalisation
Lending interest rates are controlled. Real interest rates were negative until at least the first quarter of 1994, but are expected to increase during 1994.

Banking reform
The banking reforms within the former Soviet Union in 1987-88 created a two-tier system in which Armenian institutions participated. In 1991, two Armenian branches of Soviet sector-banks became independent; these are now the main commercial banks in Armenia. Former Soviet prudential guidelines are still in use. A draft Act on the National Bank of Armenia, which forms the basis for prudential regulation and banking supervision, is under discussion by parliament. The financial system is still highly concentrated and consists of: the National Bank of Armenia; four state joint-stock commercial banks (Agricultural Bank, Bank for Industry and Construction, Armenia State Commercial Bank, Export-Import Bank); the state-owned Sber Bank; about 50 domestic commercial banks (a third of which are private); several foreign banks, mostly from CIS republics; a state insurance company and several private insurance companies. The state-owned banks hold the vast majority of the assets, bank branches and staff. According to official estimates, bad debts comprise 13 per cent of the banks' portfolios. Unofficial estimates have put the figure far higher.

Securities markets
No stock exchange has been established yet.

Taxation
A value added tax (VAT) was introduced in January 1992 to replace the former Soviet sales and turnover tax. The VAT rate was 20 per cent in 1993. An *ad valorem* excise tax (with rates between 10 and 73 per cent) was introduced in January 1992 to replace specific duties. Enterprise profit tax rates, introduced in April 1992, vary between 12 and 25 per cent. The Law on Personal Income Taxation was introduced in January 1992, making this tax more progressive; rates varied in July 1992 between 12 and 45 per cent. There is no separate tax on capital gains. By July 1994, parliament was considering a draft Property Tax Law (with a 0.2 per cent rate for citizens and a 0.208 per cent rate for enterprises), a draft Customs Tax Law and a draft Land Tax Law (with rates between 15 and 30 per cent). Tax conditions for foreign investors are described in more detail in Table 9.3.

Azerbaijan

Introductory remarks

The reform process was initiated as part of perestroika in 1987; it was continued in early 1992, after independence, by new tax legislation, a foreign ownership law, price liberalisation and property ownership reform. In autumn 1992, currency reform and improvements to banking legislation were introduced. However, no truly comprehensive reform programme is in place.

Enterprises

Size of the private sector
The size of the private sector, including informal activity, is likely to be within the 15-25 per cent range.

Large-scale privatisation
A government programme put forward in April 1994 envisages privatisation of medium-sized enterprises (50-300 employees) in 1996-98 and large-scale privatisation from 1998.

Small-scale privatisation
The government programme of April 1994 earmarks 8,000 small enterprises (about 30 per cent of the total) for privatisation in 1994-95. These comprise small trading and service enterprises (less than 50 employees), material production firms and public catering firms. So far, there has been a change of ownership of half the taxi cab fleet, some housing and a few construction projects. The privatisation of agriculture will be reviewed after approval of a land law.

Property restitution
In November 1991 all former Soviet property in Azerbaijan was nationalised. There is no individual property restitution law.

Growth of private enterprise
10,000 small private enterprises are registered with local authorities, but many are inactive.

Enterprise restructuring
The pre-independence management structure and relationship between enterprises and ministries remain largely intact, supported by budgetary subsidies and bank credits to enterprises. There is no bankruptcy law in Azerbaijan. There has been some managerial reform of large enterprises by division into smaller units. The 1993 Law on Anti-monopoly Activities established the State Anti-monopoly Committee, which is drawing up plans to curb monopolistic practices through institutional reform and establish a regulatory regime for natural monopolies.

Belarus

The reform process started in 1987 as part of perestroika. Since then, several reform programmes have been adopted (1992 liberalisation of prices, and 1993 reforms supported by the IMF and the World Bank), but a comprehensive package has yet to be implemented.

Size of the private sector
According the State Committee for Statistics, the private sector in 1993 accounted for about 5 per cent of employment and 10 per cent of non-agricultural output. Estimates from other sources vary greatly.

Large-scale privatisation
Privatisation of state-owned enterprises began in 1991 on the basis of legislation passed within the former Soviet Union. Under this law, 272 enterprises (employing about 60,000 workers) were leased to private entities in 1991-92. In 1993, the Law on Privatisation of State Property and the Law on Privatisation Vouchers were approved. Privatisation of state enterprises under the new law began in June 1993, and about 300 enterprises were privatised at the end of that year. According to the legislation, two-thirds of state assets are to be privatised by 1997, with half being privatised by the distribution of vouchers to the general population. A voucher-based privatisation programme was launched in July 1994.

Small-scale privatisation
Most small enterprises are owned at the local level and their privatisation is controlled by the local authorities. The State Committee for the Management of State Property provides technical support. The status of small-scale privatisation varies, with the cities of Minsk and Brest and the regions of Mogilev and Gomel initiating auctions and tenders in 1993. A voucher-based privatisation programme started in July 1994.

Property restitution
No property restitution has taken place to date.

Growth of private enterprise
Private businesses accounted for about 20 per cent of enterprises in the non-agricultural sector in 1993, including about 15,000 small businesses and 1,200 joint ventures with foreign investors. The joint ventures are mostly small businesses in trade and services.

Enterprise restructuring
There has not yet been a significant restructuring of state enterprises. The Bankruptcy Law was enacted in 1992, but has been inoperative.

The State Anti-monopoly Committee was established in 1991, and in 1992-93 enabling legislation and administrative regulations were approved. As a first step, the Committee has begun to break up a major trading conglomerate. The Committee also monitors and regulates monopolistic enterprises.

Markets and trade

Commodity price liberalisation
In January 1992, 70-80 per cent of producer and consumer prices were liberalised, with further rounds later in 1992 and 1993, leaving bread and energy as the main goods subject to continued price controls. Energy prices are still at about a quarter of international market prices.

Trade liberalisation
Foreign trade is largely centrally controlled. Extensive export quotas are backed by a licensing system and export taxes. Most imports and exports are arranged by bilateral agreement. More detail on trade agreements is contained in Table 8.3.

Currency convertibility and exchange rate regime
Since May 1994, the official manat rate has been set weekly, based on a weighted average of exchange rates quoted by commercial banks authorised to deal in foreign exchange. Plans are being drawn up by the National Bank to promote an interbank foreign exchange market. Both current and capital account convertibility is heavily restricted. The official manat rate is used for all official transactions in foreign exchange and mandatory surrender of proceeds from non-strategic exports.

Wage liberalisation
A minimum wage, set by the government, is linked to nominal prices by a formula which falls short of full indexation. Since August 1993 public sector wages (and social benefit payments) have been linked to a minimum wage. Since May 1994, wage ceilings have been imposed on enterprises.

Interest rate liberalisation
Credit is rationed, largely through four state-owned commercial banks, at interest rates which continued in the first half of 1994 to fall far short of the rate of inflation.

Financial institutions

Banking reform
Following the absorption by the Azerbaijan branch of Gosbank of two Azerbaijan branches of Soviet specialised sector banks in February 1992, the rudiments of a new two-tier system were established in August 1992 through the National Bank Law and the Law on Banks and Banking Activities, which again split off the specialised banking operations into two separate institutions. So far, there has been little restructuring of state banks. Credit allocation is administered according to a plan subject to parliamentary approval. Since 1992, over 200 very small commercial banks have been created. As a result of new rules on capitalisation passed in July many new banks are not expected to survive.

Securities markets
Although a Law on Securities and Stock Exchange has been passed, no stock exchange has been established.

Role of the state

Taxation
In 1992, turnover and sales taxes were replaced with a value added tax, and a new enterprise profits tax was introduced along with new excise duties, a car ownership tax, a royalty in petroleum production and a progressive personal income tax. Laws on import customs tariffs and export taxes were adopted; the latter is not yet effective. Plans are being drawn up to extend the base of VAT to non-CIS imports and to reduce exemptions.

Tax conditions for foreign investors are described in more detail in Table 9.3.

Social security
In 1992 the Social Protection Fund, created from a merger of two pre-existing social security programmes, was established to provide pensions and social allowances, financed by payroll contributions. A separate committee for refugees deals with the problems of war-displaced persons.

Commodity price liberalisation
Producer prices were liberalised in early 1992; however, after prices were freed, ceilings on profit margins for traders were introduced to check the increase in retail prices. Prices on products produced by monopolistic enterprises are also controlled by ceilings on profit margins. These enterprises in 1993 accounted for about 30 per cent of industrial output.

Trade liberalisation
Quantitative restrictions and taxes on exports were substantially reduced in early 1994. There have been few quantitative restrictions on imports, although import taxes have varied widely. The tariff structure was harmonised at the end of 1993. Belarus broadly unified its export and import duty system *vis-à-vis* third countries with that of Russia in May 1994. More detail on trade agreements and trade regimes is contained in Table 8.3.

Currency convertibility and exchange rate regime
There are a number of exchange restrictions. The national coupon is now the main means of exchange in Belarus. Belarussian and Russian governments signed a framework agreement on economic and monetary union in September 1993 and a union treaty in 1994. However, their implementation remains uncertain.

Wage liberalisation
The 1990 Law on Enterprises allowed for the free determination of wages; however, many enterprises follow adjustments in public wages. The minimum wage is set by parliament and is periodically adjusted for inflation.

Interest rate liberalisation
Although the level of interest rates in the largely state-owned commercial banks is not subject to restriction, the interest rate on central bank refinancing has been significantly lower than inflation, keeping the entire spectrum of interest rates low and negative in real terms.

Banking reform
The 1990 Laws on the National Bank and on Banks and Banking Activities established the National Bank of Belarus, which operates as the central bank, and five banks constituted from former branches of the specialised banks of the former Soviet Union. The Belarussian financial system includes 28 new commercial banks owned by state enterprises and by private individuals and business interests, but the former specialised banks control a major share of banking activity.

Securities markets
The Law on Commercial Paper and Stock Exchanges was passed in 1992; however, an exchange has not yet been established.

Taxation
A value added tax (VAT) was introduced in 1992. The general VAT rate was 28 per cent, except for agricultural products which were taxed at 14 per cent. Also, the enterprise profits tax was overhauled in 1992 and an excess-wage tax was introduced; but a number of distortions in enterprise taxation remained. The VAT rate was lowered to 25 per cent in 1993, when a special 12 per cent rate for certain services and a zero rate for agriculture products sold domestically were introduced. The 1994 budget called for the harmonisation of the enterprise profits tax rate at 30 per cent, elimination of elements of the personal income tax that discriminated against private activities, reduction in the top marginal income tax to 30 per cent from 60 per cent, and reduction in export taxes. To compensate for the loss in revenues, the tax base was broadened by eliminating exemptions from the profit tax and VAT. Many of these changes are consistent with movement toward harmonisation of tax legislation with Russia. Tax conditions for foreign investors are described in more detail in Table 9.3.

Bulgaria

Introductory remarks

The range of permissible private sector activities was expanded in 1987. A comprehensive programme was adopted in 1991 with the removal of price controls and subsidies on most goods and services, and liberalisation of interest rates.

Enterprises

Size of the private sector
30-50 per cent of GDP is generated in the private sector, mostly in the trade/retail and service sectors. About 30 per cent of the workforce is employed in the private sector.

Large-scale privatisation
Large-scale privatisation in Bulgaria has been slow but may be set to accelerate this autumn. The regulating laws are the Privatisation Law (1992) and the Privatisation of State Enterprises Programme (1993). By June 1994, one in 16 large-scale enterprises (defined in Bulgaria as those with assets exceeding Lv 200 million) had been privatised. From a total of 870 medium-sized state-owned enterprises (with assets of Lv 10-200 million), 17 had been privatised. Sales during 1993 represented less than 1 per cent of the book value of state-owned enterprises. Privatisation vouchers were, before it was known that an election would be called in for the autumn of 1994, meant to be distributed in early September this year in the context of a mass privatisation scheme, which was passed by parliament in the autumn of 1993 and involves 340 enterprises.

According to the Law on Ownership and Use of Agricultural Land (1991), foreigners cannot own land, although they may obtain user and building rights.

Small-scale privatisation
A law regulating small-scale privatisation was adopted in January 1993. By March 1994, 69 of the 5,000 small state-owned enterprises (those with assets below Lv 10 million) had been sold by ministries. In addition, 93 entities (most of them small-scale) had been sold by municipalities.

Property restitution
A substantial amount of restitution to dispossessed owners has taken place, following the Law on Ownership Restoration (1992) and the Compensation Law (1993). Approximately 25,000 privately owned and managed small and medium-sized businesses were created in 1992 through restitution of urban business properties. Land restitution has been relatively slow, partly because the new owner must pay a high fee for the issue of the title deed.

Growth of private enterprise
About 460,000 new businesses are currently registered, half of which are thought to be active. Around 1,940 are joint ventures and about 2,000 fully foreign-owned.

Enterprise restructuring
At the beginning of 1991, the government broke up 871 of the largest monopolies in manufacturing, construction, trade, transport and tourism into 3,485 independent state-owned enterprises.

There is no separate bankruptcy law. Provisions for bankruptcy are included in a law which was passed in 1989, but the environment is very protective of debtor enterprise and allows indefinite deferral of creditor claims.

Croatia

The first elements of "market socialism" were introduced in 1952. In 1976 a law on "associated labour" institutionalised "social ownership". In 1988, the so-called "Markovic reforms" included widespread price, import and foreign exchange liberalisation. A comprehensive programme was adopted in the second half of 1991, leading to the creation of the central banking system, the introduction of temporary currency, and a national budget. The framework for private ownership was laid down. A Labour Law and a Law on Business Association were adopted. In October 1993, parliament adopted a comprehensive macro economic stabilisation programme.

Size of the private sector
The private sector is likely to account for 30-40 per cent of total GDP, including a rough estimate of informal activity.

Large-scale privatisation
The inheritance of "social ownership" of former Yugoslavia provided a degree of self-management to the enterprises. The Law on the Transformation of Enterprises with Social Capital (April 1991), administered by the Privatisation Fund (after the merger of the Croatian Fund for Development and the Restructuring and Development Agency), requires the conversion of almost all "socially owned" enterprises into joint-stock companies. 2,877 applications for autonomous privatisation have been received, of which well over half (by number, less by capital value) have so far been privatised. The acceleration of privatisation is now a government priority.

Small-scale privatisation
Extensive small-scale private sector activity already existed under the former Yugoslav law. The small-scale privatisation process, started after independence, has now largely been completed.

Property restitution
No law on restitution has yet been sent to parliament, nor are there plans to do so.

Growth of private enterprise
Very low registration fees for new companies have resulted in a massive growth in the number of registered enterprises, from 55,000 in December 1992 to 96,000 in April 1994. Many of these are inactive. Nevertheless, the number of active enterprises has at least doubled over the past two years.

Enterprise restructuring
Workers' councils for enterprises have been replaced by management boards. There has so far been only limited success in the transformation of management structures, with or without privatisation. The acceleration of plans to break up large monopolies is now a government priority.

A draft Law on Competition and Monopoly is being considered by parliament. The draft law deals with conditions prohibiting restraints on trade, monopolistic practices, and abuse from mergers and dominant position. A competition protection agency is to be established to implement the policy.

Markets and trade

Commodity price liberalisation
In February 1991, 90 per cent of prices were liberalised. The government frequently adjusts administered prices.

Trade liberalisation
The foreign trade regime is liberal, following reforms started in 1989, though import tariff rates have recently tended to increase after large cuts in earlier years. Quantitative restrictions apply to only a limited number of imports and exports. More detail on trade agreements and trade regimes is contained in Table 8.3.

Currency convertibility and exchange rate regime
The lev has been floating freely since February 1991 and is internally convertible. Profits and invested capital may be repatriated by foreign investors in hard currency.

Wage liberalisation
The government imposes a ceiling on wage increases in enterprises. In 1993 wage ceilings began to be based on government discussions with unions and employers in order to check social tensions. Minimum wages are indexed 100 per cent to inflation with quarterly adjustments.

Interest rate liberalisation
Interest rates were liberalised in 1991. Commercial bank rates tend to follow the lead from central bank changes in refinancing rates. Spreads remain very large (up to 20 percentage points) due to an overhang of non-performing assets and undercapitalisation in the banks.

Financial institutions

Banking reform
A two-tier banking system was introduced in 1989. During 1993 progress was made on consolidating the banking sector; 53 financially weak state banks were merged into five groups. Few foreign banks operate in Bulgaria. All the domestically owned commercial banks are going through a severe liquidity crisis. Only one commercial bank has been privatised. No bank has formally gone bankrupt.

Banking supervision has developed slowly. New rules on capital adequacy and liquidity were introduced in 1993, and the banks are to comply fully by March 1995.

The government plans to recapitalise the banks. Legislation to this effect was passed in December 1993; compensation is to be provided to the banks for loans that became non-performing before December 1990. Under the scheme, the state will buy from the banks a pool of non-performing loans with a total face value of Lv 107 billion. The state will pay for the loans in the form of state bonds.

Securities markets
There are two main functioning stock exchanges: the First Bulgarian (FBSE) and the Sofia (SSE). The FBSE has two weekly auctions with widely varying turnover, and trades mostly shares of financial institutions. The SSE has weekly auctions with a small volume of transactions.

Role of the state

Taxation
In 1990-91, a dramatic terms-of-trade loss and drop in export demand caused a large decline in output that, coupled with increased wages, reduced both profit and turnover tax revenues. Meanwhile the government sharply cut direct and indirect enterprise subsidies, which reduced budgetary expenditures but added to the financial strain of the enterprise sector. Budget revenues dropped 52 per cent in real terms between 1990 and 1992.

Faced with this, from 1990 onwards the government began to cut its payroll and capital expenditure and reform the tax system, albeit in a limited way. Notably, interest deductibility and depreciation allowances were reduced in the early 1990s. The most significant tax reform to date has been the introduction in April 1994 of a VAT as a replacement for the previous turnover tax.

Personal income is taxed progressively at rates of 20-52 per cent. The dividend tax rate is 20 per cent and there are two basic profit tax rates: 30 per cent and 40 per cent. The tax rate on banks' profits is 50 per cent. Tax conditions for foreign investors are described in more detail in Table 9.3. In August 1993 excise taxes were increased on a number of luxury goods (with rates between 30 and 60 per cent). The value added tax introduced this year is set at a uniform 18 per cent.

Social security
Social security is financed by a tax on wages of 40 per cent and transfers from the state budget. The bulk of social security outlays cover pensions to 2.4 million individuals. Some cuts in entitlements were implemented in 1992. However, at present entitlement levels and demographic trends, Bulgaria will face substantial increases in social security outlays in the medium to long term.

Commodity price liberalisation
All direct price controls have now been removed, including those on energy and food. Some indirect controls remain, largely through government influence on major enterprises, particularly in the energy sector.

Trade liberalisation
The foreign trade system is liberal. Most imports and exports are tariff free. An import tax of 10 per cent was introduced as part of the government's macroeconomic stabilisation programme in autumn 1993. All quantitative restrictions have been removed.

Currency convertibility and exchange rate regime
The currency is in principle floating but the National Bank intervenes in the light of market conditions in the interbank market. A new law on foreign exchange operations provides a high degree of current account convertibility. Capital controls are still in force for foreign direct investments abroad by Croatian residents and enterprises.

Wage liberalisation
A wage freeze is in place for the state-owned sector, supported until November 1994 by a "social agreement" with unions. There are no wage restrictions on private enterprises.

Interest rate liberalisation
Rates are set at a level that is regarded as positive in real terms, in support of rigorous macroeconomic stabilisation, introduced in October 1993.

Banking reform
At independence the National Bank of Croatia was made the regulatory authority of a two-tiered banking system. The Banking Law of 1993 provides the main regulatory framework for commercial banks. The National Bank is drawing up plans to restructure and privatise the major banks, whose shareholders are the major debtors. The intention is to swap holdings in the banks for government holdings in the enterprises, followed by bank recapitalisation and privatisation. The Law on Bank Rehabilitation (providing a procedure by which banks will be recapitalised) and the Law on the Deposit Insurance Agency were both passed by parliament in June 1994.

Securities markets
The securities markets are developing slowly. The Zagreb Stock Exchange auctions privatisation shares weekly but there is little activity. Very few shares are listed and traded. A new legal and accounting framework is to be introduced in autumn 1994. There has been some activity in a recently established informal over-the-counter market.

Taxation
In January 1994 laws on Tax Administration, Income Tax, Profit Tax and Sales Tax were enacted. Preparatory work has begun on a value added tax (VAT). There is a corporate tax on profits at 25 per cent, with relief for modernisation of production facilities and for war reparation. Tax conditions for foreign investors are described in more detail in Table 9.3. Payroll taxes paid by employees, including social security contributions, run at between 50 per cent and 70 per cent of gross salary. Turnover taxes on consumer goods have been halved to 20 per cent, with simplification planned in preparation for the introduction of the VAT. A draft budget law is in preparation, streamlining budgetary procedures.

Czech Republic

Introductory remarks

After the Velvet Revolution in the Czech and Slovak Federal Republic (CSFR) in November 1989, market-oriented reform was initiated during 1990 and a comprehensive programme was adopted in January 1991. The CSFR broke up at the end of 1992 and the Czech Republic became an independent country on 1 January 1993.

Enterprises

Size of the private sector
The private sector accounts for about 60 per cent of GDP (prior to the second wave of privatisation). Private sector employment (excluding cooperatives and associations) at the end of 1993 stood at 2.23 million, about 47 per cent of total employment.

Large-scale privatisation
A comprehensive sell-off of state assets has been pursued through two "privatisation waves". The first of these was launched by the CSFR in May 1992 and completed by mid-1993. It involved 1,900 enterprises (with book value of CZK 650 billion) in the Czech Republic. In this process, CZK 212 billion worth of shares in 988 firms in the Czech Republic were distributed through a voucher-based "mass privatisation" scheme which created 8.5 million shareholders in total in the Czech and Slovak Federal Republic. The second wave in the Czech Republic involves 2,000 enterprises (with estimated book value of CZK 550 billion) and was initiated in 1993. It is to be completed during autumn 1994. In this second wave, shares in 861 companies with a book value of CZK 155 billion will be distributed through the voucher scheme.

Direct foreign ownership of land is not allowed, but ownership through a Czech legal entity wholly owned by foreigners is permitted.

Small-scale privatisation
The sale of small state-owned enterprises was launched in January 1991. It was largely completed during 1992 with approximately 22,000 enterprises auctioned in what is now the Czech Republic. The yield to the state exceeded CZK 30 billion.

Property restitution
A restitution law was adopted by the CSFR in October 1990. About 30,000 industrial and administrative buildings, forests and agricultural plots, which had been nationalised in 1948-55, as well as 70,000 commercial and residential entities nationalised during 1955-59, were handed back to the original owners. The value of assets returned has been estimated at between CZK 70 billion and CZK 120 billion.

Growth of private enterprise
At the end of 1993, about 1.2 million businesses had been registered, of which 60,000 were legal entities (joint-stock companies, etc.), and 1.1 million individuals were conducting business activities.

Enterprise restructuring
The main restructuring tools have been indirect: privatisation and tight access to credit and subsidies for enterprises. Restructuring has been left to the new private owners, although some restructuring may have taken place in the process of drawing up privatisation plans.

The initial law on bankruptcy was passed August 1991, with virtually no possibility of external creditors forcing companies into bankruptcy. The current law became effective in April 1993, allowing creditors to bring bankruptcy cases to court after a three-month protective period. Private farmers will be protected from bankruptcy until December 1994. Enterprises in the voucher scheme are protected until two months after the transfer of at least 34 per cent of shares to the new owners.

A competition law was passed in 1991 and amended in November 1993 to widen the definition of illegal practice and to increase maximum fines. Another objective was to bring the law closer to consistency with EU legislation. However, the law remains rudimentary and ineffectively enforced.

Estonia

The reform process started in 1987 as part of perestroika. In January 1989, while Estonia was still part of the former Soviet Union, a law on economic autonomy was approved which entailed independence in price and wage setting, fiscal strategy and financial policies. Market reforms accelerated following Estonia's independence in August 1991.

Size of the private sector
At the end of 1993, enterprises that were non-state and non-municipal accounted, according to official estimates, for 40 per cent of industrial output and more than 50 per cent of employment. Due to statistical problems and under-reporting, reliable estimates of the total GDP-share of the private sector do not exist but the share is likely to exceed 50 per cent.

Large-scale privatisation
Large-scale privatisation is accelerating after having been relatively slow immediately after independence. The process gathered pace with the adoption of the Privatisation Act (1993) which allowed for voucher payment in addition to cash only, partial sell-off of enterprises and repayments in instalments for domestic buyers. A sixth international privatisation tender has been announced (the second one in 1994). Between 40 and 56 large enterprises are offered in each tender. The first four tenders generated more than US$ 63 million in sales proceeds. The government's ambition is to complete large-scale privatisation by the end of 1995.

Small-scale privatisation
The Privatisation of State-owned Trade and Service Enterprises Law (1991) and amendments to this law during 1992 launched a rapid small-scale privatisation. By May 1994 more than 85 per cent of small enterprises (representing more than 1,000 units) had been privatised through employee buy-outs and auctions. An Act on Privatisation of Housing was passed in May 1993 but implementation has been slow so far.

Property restitution
More than 200,000 claims for restitution (of homes, farms, and businesses expropriated during the communist period) had been submitted by the April 1993 deadline. By February 1994 approximately half of these had been validated. However, unresolved issues of restitution are slowing down the privatisation of housing.

Growth of private enterprise
The establishment of new private enterprises started with the adoption of the Enterprise Law in 1989. New private enterprises grew rapidly in number, primarily in retail trading, catering and commerce. During 1993 approximately 10,000 new enterprises were created. It is estimated, however, that 30 to 50 per cent of newly created enterprises exist only on paper.

Enterprise restructuring
Restructuring of privatised state enterprises is generally left to investors who have to present a business plan as part of their bid. However, certain turn-around programmes are planned for privatised enterprises with the help of international organisations. A bankruptcy law was passed in September 1992 and was quickly implemented, notably during the banking crisis of late 1992. Bankruptcy proceedings have been initiated for some 200-300 enterprises.

Markets and trade

Commodity price liberalisation
In January 1991, 85 per cent of consumer prices were decontrolled and further liberalisation measures were undertaken during that year. The only remaining significant controls pertain to utility charges, rents and public services. In addition, mark-ups are closely regulated in the energy sector.

Trade liberalisation
Most quantitative controls on imports and exports were removed in January 1991. This was initially combined with a surcharge on consumer goods imports of 20 per cent, but the surcharge was lowered gradually to 10 per cent by January 1992 and later abolished. More detail on trade agreements and trade regimes is contained in Table 8.3.

Currency convertibility and exchange rate regime
Current account convertibility for enterprises was introduced in January 1991. Capital account transactions remain subject to some control. The exchange rate is pegged to a basked comprising the Deutschmark (65 per cent) and the US dollar (35 per cent).

Wage liberalisation
Wages are regulated through a tax on "excessive increases". This was initially imposed during 1991 in the context of a macroeconomic stabilisation package with agreement from unions (the so-called "social contract"). The intention was to regulate the rise in real wages. The tax was reintroduced in the second half of 1992 for enterprises with majority state or municipal ownership, taxing wage increases exceeding a measure which is linked to specific performance targets. The tax was reintroduced in July 1993, this time unilaterally by the government, and it now applies to all enterprises with more than 25 employees. Real wage increases are restricted to 5 per cent with allowances made for trends in sales.

Interest rate liberalisation
Interest rates were freed progressively from 1990 onwards, with complete liberalisation in April 1992.

Financial institutions

Banking reform
A two-tiered banking system was adopted in January 1990. Laws on the central bank and commercial banks were passed in February 1992. The former law grants the central bank supervisory powers. With the split of the CSFR, the Czech National Bank was established in January 1993 as the Czech successor to the former State Bank of Czechoslovakia. At the end of 1993, 43 banks, 10 foreign bank branches and four buildings and loan associations were operating in the Czech Republic. All commercial banks are now in private hands, including former state banks that were privatised during 1993.

The regulatory regime sets the required capital adequacy (following the Basle definition) at 6.25 per cent by the end of 1993 and 8 per cent by the end of 1996. During the CSFR-period, a state-owned Consolidation Bank was established in March 1991 to take over Kcs 110 billion (20 per cent of credits to enterprises) of "permanent revolving credits" (perpetual loans characterised by low interest rates and issued for inventory financing). Further state-financed recapitalisation of the banks totalling Kcs 50 billion was conducted in November 1991. The role of the Consolidation Bank (and its Czech successor) has expanded gradually to involve enterprise restructuring operations. The purchase by the Consolidation Bank of non-performing assets held by commercial banks is being considered to ensure that the state-owned banks will be able to comply with the capital adequacy requirement. Bad debt in the private banking system is estimated to represent about 20 per cent of bank assets.

Securities markets
The Law on the Stock Exchange and Securities was adopted in 1992. Prague Stock Exchange (PSE) and the RM-system (an over-the-counter exchange) began operation during the first half of 1993. Foreigners are free to buy and sell shares; profit repatriation is subject to payment of income taxes on capital gains.

The trading volume and prices on the Prague Stock Exchange have rocketed. Though erratic, monthly trading volumes of shares are well over CZK 1 billion. The index of share prices quadrupled between August 1993 and March 1994 but has subsequently fallen sharply. The frequency of trading days has increased from one per fortnight at opening to three days per week by the middle of March. Only a few shares that fulfil standards are listed, and most stock trading in the Czech Republic is in the unlisted segment of the market.

Trading via the RM-system remains limited due to less frequent trading (initially one per month) and long lags between order placement and actual trading.

Role of the state

Taxation
Stop-gap tax reforms were introduced in 1990, involving simplification of turnover tax rates and a lowering of corporate and individual tax rates. A comprehensive tax reform was implemented in January 1993, which introduced a value added tax (in two tiers at 23 per cent and 5 per cent), streamlined the corporate profit tax (at 42 per cent in 1994, down from 75 per cent in the mid-1980s) and individual income taxes (top rate 44 per cent). Tax conditions for foreign investors are described in more detail in Table 9.3.

Social security
The reform in January 1993 also transferred funding for social security from general taxation to an insurance-based system. Social security contributions amount to 37 per cent of the wage sum for employers and 13 per cent of wages for employees.

Commodity price liberalisation
The removal of price controls started in late 1989 as part of the programme on economic autonomy, and continued incrementally until completion at the end of 1992. The few remaining subsidies (e.g. on housing) are currently being cut.

Trade liberalisation
Virtually no restrictions on foreign trade remain. Import tariffs apply only to furs and to sea and road vehicles (at a rate of 10 per cent), representing 14 per cent of total imports in 1993. Export controls have been removed with few exceptions. More detail on trade agreements and trade regimes is contained in Table 8.3.

Currency convertibility and exchange rate regime
An independent national currency, the kroon (or EEK), was introduced in mid-June 1992 under a currency board arrangement. The kroon is pegged to the Deutschmark at 8 EEK/1 DM. There is full current account convertibility.

Wage liberalisation
Wage setting (apart from the minimum wage) became free as a result of wage reform in 1990. However, the government has subsequently relied in part on an incomes policy to contain wage inflation. Wages in government agencies are set according to pay scales approved by the government. The government also sets a ceiling for pay increases in state-owned enterprises. Wage setting in the private sector is free and wage negotiations are decentralised.

Interest rate liberalisation
A two-tier banking system with a domestic Estonian central bank has been in operation since mid-1992. The central bank (Bank of Estonia) does not interfere, except through indirect instruments, with the setting of interest rates by commercial banks. Real interest rates are positive for short-term lending, but are arguably negative for loans with longer maturities. The spread between average lending and time deposit rates remains more than 10 percentage points.

Banking reform
The Bank of Estonia was established as a central bank in 1990 but the local branch of the Soviet Gosbank continued to carry out most central bank functions until January 1992. An Estonian-based two-tier banking system became fully operational after the currency reform in June 1992. Between 1989 and 1992, 42 commercial banks were established, mostly small and undercapitalised. After the banking crisis of late 1992 to early 1993, the number of commercial banks was halved, either through merger or liquidation. Following this the government raised the minimum capital requirement and more stringent supervision of commercial banks by the Bank of Estonia was introduced. Foreign banks (mainly Finnish) are starting to open offices in Estonia.

Securities markets
Although a Securities Market Act was adopted in 1993, the market for stocks and bonds is in an embryonic state. The only regularly traded securities are short-term certificates of deposit (28 days maturity) which are issued by the central bank and traded in the interbank money market.

Taxation
A new taxation system became effective from January 1994. A flat income tax of 26 per cent for companies and individuals was introduced (this rate also applies to investment income). State-owned enterprises pay an additional 10 per cent of after-tax income in mandatory dividends to the budget. A value added tax was introduced in January 1992 at 10 per cent; the rate was increased to 18 per cent in June 1992. There are differential excise taxes on petrol, alcohol and tobacco. Other taxes include social security tax, gift and inheritance tax, land tax and gambling tax. Tax conditions for foreign investors are described in more detail in Table 9.3.

FYR Macedonia

Introductory remarks

1952 saw the first Yugoslav experiments with "market socialism". Other landmarks were the Law on Associated Labour (1976), which institutionalised "social ownership", and the 1988 Markovic reforms which included widespread price, import and foreign exchange liberalisation. In April 1992 independence (approved by referendum the previous September) was translated into radical economic reform: a new currency was accompanied by a first attempt at macroeconomic stabilisation, further price liberalisation and elaboration of plans for privatisation.

Enterprises

Size of the private sector
Private activity, including in the informal sector, probably accounts for 25-40 per cent of GDP.

Large-scale privatisation
The "Agency of the Republic of FYR Macedonia for the Transformation of Enterprises with Social Capital' is to receive applications for privatisation from large-scale enterprises by the end of 1995. About 400 larger enterprises are expected to apply. Enterprises without proposals at that time will have privatisation or restructuring imposed on them by the Agency. In addition, the Agency has selected 25 large enterprises for immediate privatisation, with a further 40 under consideration. The Law excludes 58 enterprises, among them the utilities and transport system, from privatisation for the time being.

Small-scale privatisation
Over 90 per cent of all enterprises are already privately owned, almost all of them very small, with a share of total employment of probably 20-40 per cent. The Law for Transformation of Enterprises with Social Capital (June 1993) plans for privatisation of 1,069 socially owned small enterprises (less than 50 employees).

Property restitution
A draft law on restitution is in preparation.

Growth of private enterprise
Since 1989 there has been rapid growth from a low base in the number of private enterprises. Active small enterprises (generally with one or two employees) number 12,000-17,000. Statistics from FYR Macedonia's Social Accounting Office suggest that the main concentration is in "commerce" and financial/technical services.

Enterprise restructuring
A task force was established in 1994 to implement restructuring of large-scale enterprises. The 1989 Bankruptcy Law of former Yugoslavia is still in force.

Georgia

Partial reform was initiated in 1987 as part of perestroika. A comprehensive reform package has not been implemented.

Size of the private sector
The private sector probably accounts for about 20-30 per cent of GDP.

Large-scale privatisation
The Law on Privatisation of State Ownership was adopted on 1 October 1991. The government plans to use a voucher programme to privatise most medium or large-scale enterprises. So far three of the over 900 medium or large-scale state enterprises have been privatised.

Small-scale privatisation
By April 1994 about 22 per cent of the almost 5,000 state-owned small-scale enterprises (those with assets below Rb 30 million by end-1992 and fewer than 50 employees) had been privatised, mainly in the retail and trade sector, and another 15 per cent are to be privatised in 1994. Before independence a significant share of housing was already in private hands: privatisation of housing is now virtually complete. More than half of agricultural land has been privatised in small plots via leasing (private land ownership rights have not yet been granted). The government intends to keep approximately 25 per cent of agriculture in state hands.

Property restitution
No property restitution has taken place in Georgia.

Growth of private enterprise
Obstacles to growth of the private sector include civil unrest, interruption in supply of vital commodities, damage to infrastructure and lack of finance.

Enterprise restructuring
Most of the formal economy remains subject to a system of state orders, and industry continues to be highly monopolistic. Despite sharp falls in output, state enterprises have not fundamentally restructured and continue to have access to soft bank credits and fiscal transfers.

The Law on Bankruptcy was adopted by parliament in 1991. There has been no significant incidence of bankruptcy.

Markets and trade

Commodity price liberalisation
Liberalisation of the price system is advanced. A "notification requirement" remains for milk, municipal rent, water, central heating and vehicle insurance. There have been large increases in the relative price of electricity and oil derivatives, with further increases planned.

Trade liberalisation
The dismantling of the complex former Yugoslav trading system is well advanced; few tariff and non-tariff barriers remain in place. More detail on trade agreements and trade regimes is contained in Table 8.3.

Currency convertibility and exchange rate regime
The denar has been floating since the beginning of 1994. There is near full current account convertibility, except as regards access for FYR Macedonian citizens to foreign currency for tourism abroad.

Wage liberalisation
A rigorous incomes policy has been in place since the end of 1993.

Interest rate liberalisation
Real interest rates are positive. Interest rates are linked to the auction price of National Bank credits (first auction November 1993). The intention is to liberalise interest rates fully in 1994.

Financial institutions

Banking reform
A comprehensive bank rehabilitation plan is being drawn up for implementation in 1994 and 1995, but the exact mode and amount of state-financed recapitalisation for the dominant bank remains unclear.
The plan includes:

- the audits of four major banks accounting for 90 per cent of assets of the banking system;
- the establishment of a bank rehabilitation agency, amending the Law on Banks and Savings Institutions;
- legislation to improve the regulatory and supervisory framework.

Securities markets
No stock exchange has been established yet.

Role of the state

Taxation
The January 1994 tax reform reduced sales tax rates from 21 to 3: there is now a general rate of 25 per cent, and rates of 5 per cent for food and 10 per cent for most services. Excise duties on oil, alcohol, cigarettes and cars were increased in April 1994. Income tax rates have been consolidated and many exemptions have been removed. An inland revenue service has been created from the merger of the Social Accounting Office and part of the Ministry of Finance. The 1994 budget provides much greater transparency as a result of a sharp curtailment of off-budget finance. Tax conditions for foreign investors are described in more detail in Table 9.3.

Commodity price liberalisation
Price controls were lifted for most goods and services during price liberalisation rounds in 1991 and 1992. Price controls continue to apply to, *inter alia*, bread and milk.

Trade liberalisation
A state order system, largely based on bilateral trade agreements and barter arrangements with countries of the former Soviet Union, remains in place. Outside this system, many export items are subject to export licensing and taxes, but imports are subject to few restrictions. More detail on trade agreements and trade regimes is contained in Table 8.3.

Currency convertibility and exchange rate regime
An interim and parallel currency, the Georgian coupon, was introduced in April 1993 and declared sole legal tender in August 1993. Due to very high inflation, domestic transactions have increasingly taken place in foreign currency or in the form of barter. Georgia has adopted a floating unified exchange rate regime. A fully fledged national currency (the lari) is expected to be introduced after a certain degree of macroeconomic stability has been achieved.

Wage liberalisation
Adjustments to minimum wages have lagged behind inflation.

Interest rate liberalisation
Interest rates have not been fully liberalised and remained substantially negative in real terms during 1993.

Banking reform
The Law on Banks and the Banking System was adopted in August 1991 but new laws are currently being drafted. An independent national two-tiered banking system was created in 1991. The financial system now consists of the National Bank of Georgia; five specialised state-owned banks (Agricultural Bank, Industry and Construction Bank, Social Development Bank, Export/Import Bank, Savings Bank); and about 200 small domestic commercial banks (about half have state enterprises as principal owner and only few are fully private). Only the Export/Import Bank has been corporatised. The state-owned banks hold more than 90 per cent of the assets, branches and personnel of the banking system. The central bank still plays an important role in the execution of government policy through its issuance of directed credits. Unofficial estimates indicate that bad debts comprise between 14 per cent and 35 per cent of the state-owned banks' portfolios.

Securities markets
No stock exchange has been established in Georgia.

Taxation
A law passed in December 1993 set the value added tax at 14 per cent. Profit taxes (now governed by a law adopted in January 1994) vary between 10 per cent and 35 per cent. Tax conditions for foreign investors are described in more detail in Table 9.3. The Law on Personal Taxation was adopted in January 1994 with marginal rates varying between 12 per cent and 20 per cent. Enterprise property is taxed at a rate of 1 per cent. There is no separate capital gains tax.

Social security
The social security system is under severe financial strain, faced with a rise in poverty and an inflow of refugees.

Hungary

Introductory remarks

A package of partial reform policies introduced in 1968 expanded enterprise influence on investment decisions, partially liberalised the price system, and eroded the power of the central government to set physical output targets for individual enterprises. Hungary embarked on more comprehensive market reforms in 1988.

Enterprises

Size of the private sector

The private sector share of GDP was estimated at the end of 1993 at more than 50 per cent. The private sector (excluding cooperatives) accounted at the end of 1993 for 42 per cent of total employment.

Large-scale privatisation

Large-scale privatisation has been gradual but steady. Out of almost 2,000 companies owned by the State Property Agency when it started operations in 1990, 569 are now (mid-1994) fully privately owned while state ownership in 167 has been reduced to a minority share. Another more than 400 of the initial 2,000 companies have been liquidated.

Small-scale privatisation

Out of 10,423 shops in state ownership in 1990, 9,065 have been transferred into private hands.

Property restitution

About 1.2 million Hungarians have been granted "compensation coupons" as restitution for property expropriated during the communist period. The coupons carry a total nominal value of Ft 300 billion and may be used to settle purchases for a number of items, including shares in state-owned companies and flats. The coupons are also traded at the Budapest Stock Exchange.

Growth of private enterprise

At end-1993, there were 773,600 registered businesses of which 85,600 were legal entities (joint-stock companies, etc.); the remainder were individuals conducting business activities.

Enterprise restructuring

The main restructuring tool has been subsidy reduction and a market-orientation of credit policies which has tightened access for loss-making enterprises to financing, resulting in production cutbacks, rationalisation, a scale-down of employment in large formerly or presently state-owned enterprises, and sales of enterprise assets to the private sector.

A much tighter bankruptcy regime from 1992 has also contributed to this process. Hungary's Law on Bankruptcy was enacted in October 1991 but was substantially amended in September 1993. In the new version of the law, companies with overdue liabilities are no longer forced to declare themselves bankrupt and a qualified majority of creditors may decide on an out-of-court restructuring against the will of minority shareholders. The earlier version had been criticised for forcing potentially profitable companies into liquidation. The results of the revision are evident in the following figures: the first quarter of 1994 saw the initiation of 182 new bankruptcy cases and the completion of 45 liquidations, down from 621 new bankruptcies and 181 completed liquidations in the first quarter of 1993.

The Law on the Prohibition of Unfair Market Practices was passed in 1990. It provided the legal framework for a newly established anti-monopoly office but has not in practice been used to break up large companies with a high degree of market power.

Kazakhstan

The reform process started in 1987 as part of perestroika. A package of partial reform policies had been introduced since independence in December 1988, but a more comprehensive reform programme was implemented in January 1993.

Size of the private sector

The private sector probably accounts for more than 20 per cent of GDP.

Large-scale privatisation

The National Privatisation Programme for 1993-95 launched the mass privatisation of medium-sized and large enterprises through auction-sale of shares to private investment funds. Kazakh citizens have received points-denominated vouchers from the state and have placed the vouchers under the administration of the investment funds. The first investment funds were created in July 1993; this was followed by the distribution of vouchers to citizens during the second half of last year. Since then two major waves of auctions have taken place but the government's goal of privatising 30 per cent of the assets of non-agricultural medium and large-scale enterprises has not yet been met. The privatisation of the largest enterprises started in July 1993 with the first successful tender and proceeds on a case-by-case basis.

Small-scale privatisation

Kazakhstan was the first former Soviet republic to introduce a law on privatisation (June 1991, amended April 1993). The aforementioned National Privatisation Programme includes a small-scale component: by mid-1994 about 10,000 small, service-sector entities - one-fifth of all such entities - had been privatised. The government aims to privatise in the near future all enterprises in wholesale, retail trade, storage and distribution.

Property restitution

There has been no property restitution to date in Kazakhstan.

Growth of private enterprise

At the beginning of April 1994, more than 11,000 private businesses (excluding farms), about 2,000 cooperatives, 1,400 joint ventures and 17,000 private farms were registered. Private farms and plots account for 35-70 per cent of the major agricultural outputs.

Enterprise restructuring

Restructuring has largely been left to the new owners following privatisation. A new anti-monopoly law was introduced in June 1994.

Markets and trade

Commodity price liberalisation
More than 90 per cent of prices, weighted by their share in the consumer price index, are free of administrative controls.

Trade liberalisation
Trade liberalisation has been phased in gradually. In 1989, licensing requirements and quotas were eliminated for 40 per cent of imports (weighted by the share of different goods-categories in 1988-imports). This ratio was raised to 65 per cent in 1990 and 90 per cent in 1991. By now there are very few remaining licensing/quota restrictions on imports and exports. More detail on trade agreements and trade regimes is contained in Table 8.3.

Currency convertibility and exchange rate regime
The forint is convertible for current account transactions other than tourism. Each Hungarian citizen is currently able to buy US$ 800 worth of foreign currency a year at the official exchange rate for the purpose of tourism abroad. The limit was increased from US$ 350 on 1 April 1994. Capital account transactions are gradually being liberalised.

The exchange rate is pegged to a basket of currencies. The basket was changed in May 1994 from 50 per cent US dollar and 50 per cent Deutschmark to 30 per cent US dollar and 70 per cent ECU.

The Law on Investment by Foreigners in Hungary (1988) guarantees the foreign investor the option of repatriating profits and capital in the currency of the original investment and full and immediate indemnification for any loss resulting from nationalisation or expropriation.

Wage liberalisation
Wages are now freely determined at the level of the firm in the competitive sector. Attempts to control wages by taxing wage increases above a defined limit were abolished in 1993.

Interest rate liberalisation
The government removed administrative control of interest rates on enterprise deposits and loans in 1987 and for household deposits and loans in 1991-92.

Financial institutions

Banking reform
A two-tier banking system was introduced in 1986. The law on commercial banks, which became operative in January 1992, imposes the Basle-defined standard for capital adequacy on Hungarian banks, although temporary exemptions have been granted to the large state-owned banks.

The government launched in autumn 1992 a "consolidation scheme" covering banks that were partly state-owned and had a capital adequacy ratio below 7.25 per cent. In the first round of the scheme (effected in March 1993), banks exchanged non-performing loans for 20-year state bonds carrying a face value equivalent to 2.9 per cent of 1993-GDP. In the second round (December 1993), a state-financed capital injection of 20-year bonds worth nominally the equivalent of 3.4 per cent of 1993-GDP was combined with the purchase by the state of bank claims for state bonds worth 1.7 per cent of 1993-GDP to bring capital adequacy to zero in the large state-owned banks. Another injection of about HUF 30 billion in May 1994 (0.8 per cent of 1994-GDP) aimed to raise the ratio to 4 per cent.

The best-capitalised former state-owned bank, the Foreign Trade Bank, was privatised earlier this year. The law on commercial banks requires a reduction in state ownership in all banks, except the National Savings Bank, to less than 25 per cent by end-1997. There is a substantial presence on the Hungarian banking scene of smaller private banks, many with foreign participation.

Securities markets
In June 1990, the Budapest Stock Exchange was opened as a formalised stock market. From a low of 700 in mid-1993, the BSE-index moved up strongly in the second half to reach 1,257 by end-1993, and stood at 1,692 on 6 September 1994. Stock turnover remains dwarfed by the volume of trade in treasury bills.

Role of the state

Taxation
The most radical measures were taken in 1988-89 when the government introduced both a value added tax and a personal income tax while streamlining taxation of enterprise income. Among the results was a drop in consumption taxes and direct taxation of enterprise income, largely offset by steep increases in taxation of personal income and rising social security contributions. However, the tax code remained plagued by distortions, including sector/activity-based tax reliefs, special preferences for foreign investors and diverging taxation of, respectively, wage and non-wage income for individuals.

Reforms of the tax system in the past few years have focused on removal of sector/activity-based tax reliefs. Tax conditions for foreign investors are described in more detail in Table 9.3.

At present, personal incomes are taxed progressively at rates up to 45 per cent and corporate income at 36 per cent. On a wage of Ft 100, employers and employees pay, respectively, Ft 52.5 and Ft 9 in payroll taxes. A large part of these are social security contributions. The new government is planning to raise the lower VAT-rate from 10 per cent to 12 per cent from 1 October (the standard rate is 25 per cent) and to move a number of services to the 25 per cent tier.

Social security
Social security reform is at a relatively early stage. An increase in the retirement age (which is now 55 for women and 60 for men) has been contemplated but not implemented. The population is currently shrinking and ageing and the cost of the pension system is expected to grow substantially over the next two decades in the absence of change in eligibility criteria. Eligibility for unemployment benefits has been tightened substantially over the past two years.

Commodity price liberalisation
In January 1992, most prices were freed. By June 1994, only prices for transportation and communication services, bread and bakery products, baby foods, some energy products and imported medicines remained subject to control.

Trade liberalisation
Though the foreign trade system was streamlined in 1994, state-owned trading continues to be prominent and taxation of imports and exports (at mostly low rates) remains somewhat discretionary. More detail on trade agreements and trade regimes is contained in Table 8.3.

Currency convertibility and exchange rate regime
A new national currency, the tenge, was introduced on 12 November 1993. The tenge is convertible for the purpose of foreign trade undertaken by enterprises. There is a 50 per cent surrender requirement for export proceeds.

Wage liberalisation
The Law on Employment of the Population (1991) gives the government discretion on nominal wages and minimum wage adjustment.

Interest rate liberalisation
Lending interest rates remain centrally controlled and real interest rates were strongly negative in 1993.

Banking reform
A two-tier banking system was introduced in 1987. The main laws on banks and the operations of the banking system were adopted on 13 April 1993 and 22 June 1993. The banking system consists of the National Bank and about 200 commercial banks, while another 30 licensed banks deal with hard currency. Despite the large number of new commercial banks, financial resources have continued to be channelled mainly through four specialised state banks, which together hold 80 per cent of the assets in the country's banking system.

Securities markets
The Law on the Circulation of Securities and the Stock Exchange was adopted on 11 June 1991, and amended on 7 April 1993, but there is not yet a functioning stock exchange.

Taxation
Value added is taxed at a rate of 20 per cent; profits at 25 per cent (recently reduced from 30 per cent) with a special 45 per cent rate for banking and insurance; and personal incomes at 12-40 per cent. Tax conditions for foreign investors are described in more detail in Table 9.3. Social security payments include an employment fund levy of 1 per cent of wages and a pension fund contribution of 37 per cent of the wage sum.

Introductory remarks

Enterprises

Kyrgyzstan

Limited reforms, granting a greater degree of financial autonomy to enterprises, were implemented in 1987 as part of perestroika. Following independence in December 1991 a more comprehensive reform programme was initiated in July 1992.

Size of the private sector
The private sector probably accounts for about 30 per cent of GDP.

Large-scale privatisation
The predominant method of privatisation has been to transform state-owned enterprises into joint-stock companies and transfer share ownership to the work collectives, with the state usually retaining significant portions of shares. No voucher auctions have taken place and competitive bidding has been used for only 1.4 per cent of total privatised assets. In industry, 99 per cent of privatised assets have been transferred through conversion to joint-stock companies.

At the end of 1993, the government significantly accelerated the pace of privatisation. By January 1994, about 4,450 state-owned enterprises (accounting for 33 per cent of total fixed enterprise assets) were privatised. In January 1994 the government passed a new Concept Note on Privatisation which provides for privatisation of all small-scale enterprises (with up to 100 employees) through auctions and/or competitive bidding with use of cash and vouchers. Medium (100 to 1,000 employees) and large-scale enterprises (over 1,000 employees) will be transformed into joint-stock companies as a first stage before privatisation. The main methods for future privatisation of those enterprises will be competitive cash bidding (by individual investors for up to 70 per cent of the equity) and voucher auctions (open to individuals and investment funds for 25 per cent of the equity), while 5 per cent of the equity would be reserved for the labour collectives.

Small-scale privatisation
Privatisation of small trade outlets, retail and service establishments is largely complete, comprising 80 per cent of fixed assets in these units.

Property restitution
Kyrgyzstan has no restitution programme.

Growth of private enterprise
While the formation of new private enterprises is accelerating, the process is impeded by unfavourable entry rules, lack of finance, a high tax burden, lack of access to commercial space, and low mobility of the labour force (artificially restricted by a system of residence permits).

Enterprise restructuring
The state-owned enterprise sector is characterised by weak financial discipline. The transformation of such enterprises into joint-stock companies has done little to enhance corporate governance. In May 1994 a presidential decree established the Enterprise Reform and Resolution Agency (ERRA) for a period of four years to oversee restructuring of 29 large, loss-making, state-owned enterprises.

The Insolvency Law, adopted on 15 December 1993, was followed by a number of decrees aiming to impose financial discipline on state-owned enterprises, improve corporate governance, and restructure or liquidate large, loss-making enterprises.

The Anti-monopoly Law of January 1994 defines "monopoly producers" as those with a domestic market share of at least 35 per cent. On 17 December 1993 the maximum profit margins for monopoly producers were eliminated. The number of firms classified as monopolists was reduced to 50 in September 1993, further to 15 in February 1994, and to nine on 16 May 1994 (five of which are classified as natural monopolies). The process of determining which firms constitute monopolies will be further examined with a view to limiting state regulation only to natural monopolies such as electricity, water and railways.

Latvia

Economic reforms were first introduced in 1987 as part of perestroika. After Latvia regained independence in 1991, price liberalisation accelerated and a comprehensive reform package centering on macrostabilisation was adopted in mid-1992.

Size of the private sector
The official estimate of the private sector's share of GNP in 1994 is 55 per cent. The non-state sector's share in industrial output was estimated at 30 per cent in 1993. State sector employment dropped to 50 per cent of total employment in 1993. Much private activity is small-scale and concentrated in trade, services, banking and selected export industries.

Large-scale privatisation
Large-scale privatisation is lagging behind other areas of reform; only 85 enterprises were privatised by April 1994, out of a total of 698 to be privatised. The legal framework is still incomplete, but the privatisation law of February 1994 streamlines the process of privatisation by creating an independent Privatisation Agency and State Property Fund. Methods will include tenders, auctions and liquidation. Privatisation vouchers are to be used for up to 25 per cent of capital but implementing legislation is incomplete. Following the Czech model, investment privatisation funds are to be set up. The government is committed to privatise 75 per cent of state property by end-1996.

Small-scale privatisation
Privatisation, mostly via auction of 4,000 municipally owned small enterprises, is advanced, with two-thirds of enterprises transferred by April 1994 (trade and services). The legal framework for privatisation of housing is almost complete; priority is given to tenants. Payment is in the form of privatisation vouchers or cash. Legislation regarding ownership rights over real estate and land is inconsistent. The Law on Lease and Purchase after Lease of February 1993 stipulates that land and real estate can be privatised only through leases up to 99 years; full ownership rights are only available via restitution.

Property restitution
There are over 300,000 restitution claims on land (including urban), of which 70,000 have been processed. Following the Law on Land Reform in Country Districts (1990), a first phase of land restitution and/or privatisation established user rights (over half of total land transferred); a second phase, to establish ownership rights, is proceeding more slowly with inconsistent legislation.

Growth of private enterprise
Between 1991 and early 1994, 20,000 new private enterprises were created. There are no serious administrative obstacles to entry but the absence of legislation covering secured transactions (collateral law) is acting as an impediment. There is unrecorded growth and informal sector activity, in particular in trade and services.

Enterprise restructuring
Outright credit and budgetary subsidies to enterprises have been eliminated, and have contributed to the highest unemployment rate in the former Soviet Union (over 6 per cent). However, while a Bankruptcy Law was passed in 1991 it is considered inadequate, since it does not set out criteria for initiating bankruptcy proceedings, nor does it provide mechanisms for the rehabilitation of enterprises. Similarly, court-ordered liquidation has occurred in only few cases. The Anti-Monopoly Law of December 1991 provided the basis for establishment of a Price and Tariff Council, with representatives from enterprises and consumers. The Council oversees price determination of monopolies (with limited enforcement powers) and can recommend the break-up of large enterprises.

Markets and trade

Commodity price liberalisation
There are few direct controls on prices. Significant adjustments were made to administered prices for bread, rents and other items during 1993. The maximum retail margins imposed on all goods after the introduction of the som (the national currency) were lifted on imported goods in August 1993 and on most domestically produced goods in November 1993. In March 1994, all retail margins were eliminated except for that on bread.

Trade liberalisation
After a first wave of reforms, when restrictions on imports, quotas for exports and foreign exchange surrender requirements were abolished, some momentum was lost in 1993. The government moved to reintroduce compulsory state orders, export licences and prohibitive export taxes. These measures, together with continued dominance of two ministries (of Industry, Trade and Material Resources and of Agriculture) in trade and distribution, created a system whereby about 70 per cent of output became subject to direct and indirect state control. In external trade, the state's direct involvement has been mainly through clearing agreements which allow goods to be exchanged between republics on a barter basis.

In early 1994, the trade system was substantially liberalised. Remaining import and export licensing agreements were lifted, and export taxes reduced. More detail on trade agreements and trade regimes is contained in Table 8.3.

Currency convertibility and exchange rate regime
The national currency, the som, was introduced in May 1993 and allowed to float (with some state intervention). The som is in principle convertible for transactions related to foreign trade of the enterprise sector.

Wage liberalisation
Increases in the budgetary wage bill are to be limited to targeted future inflation rates. For state-owned enterprises the total wage bill that is deductible for tax purposes in any enterprise cannot exceed 10 times the number of employees multiplied by the minimum wage.

Interest rate liberalisation
Deposit interest rates - freely set by banks - are substantially positive in real terms. In October 1993, the re-finance credit auctions were suspended, but they were resumed in April 1994.

Financial institutions

Banking reform
A two-tier banking system was adopted in 1987. The banking system is dominated by three large state-owned banks: Agroprom, Promstroibank and Kyrgyzstan Bank, together accounting for about 85 per cent of total assets of the banking sector. Fifteen new commercial banks have been established by (and are almost exclusively owned by) state-owned enterprises and ministries. Little progress has been made towards improving the quality of banking services, especially in domestic and international payments. Prudential regulations regarding capital adequacy, exposure limits and lending to shareholders have been enacted, but are not being enforced. The National Bank's supervisory capacity is limited.

Securities markets
The Law on Securities and Stock Exchanges was passed in December 1991. A stock exchange is to be established before the end of 1994.

Role of the state

Taxation
The basic rate of profit tax is 35 per cent. Tax conditions for foreign investors are described in more detail in Table 9.3. Other taxes are as follows: a value added tax at 20 per cent; a sales tax at 5 per cent (since August 1993); and a personal income tax with marginal rates of up to 40 per cent.

Commodity price liberalisation
Price liberalisation began in early 1991, and was virtually completed by late 1992. No formal price controls remain. Rents and public transport and heating prices are set by municipalities, often with inadequate allowance for capital costs.

Trade liberalisation
Trade has been largely freed of quantitative restrictions. However, after tariff reform in March 1994, the basic import tariff rate is relatively high at 15 per cent; agricultural products enjoy an even higher degree of protection as the system has proved vulnerable to lobbying. Some export duties remain, e.g. on certain raw materials. More detail on trade agreements and trade regimes is contained in Table 8.3.

Currency convertibility and exchange rate regime
The lat is informally pegged to the SDR via central bank intervention in foreign exchange markets. Base money is fully backed by net international reserves. Latvia offers complete and effective current and capital account convertibility with no repatriation or surrender requirements.

Wage liberalisation
Wages are set freely by enterprise managers, with union influence remaining modest. The existing minimum wage legislation is without material impact on wage setting in the private sector.

Interest rate liberalisation
Banks have been free to set interest rates since 1992. The spread between lending and deposit rates remains very high at 25-35 per cent. Central bank open-market intervention to influence interest rates is largely ineffective because of the high liquidity of the banking system.

Banking reform
The Central Banking law of May 1992 established a two-tier banking system. Ownership of 49 commercial branches of the former Monobank passed to a Privatisation Fund; 21 were merged into Universal Bank in 1993, the rest liquidated or sold off to private commercial banks. The rehabilitation of Universal Bank and the State Savings Bank are under way (bad loans replaced with treasury bonds) with privatisation planned for early and late 1995 respectively. There is a buoyant private banking sector (over 50 institutions), with structural weaknesses, including large amounts of non-performing loans, undercapitalisation, high loan concentration and insider lending. Bank supervision, both on and off-site, is strengthening, but much remains to be done; several bank licences have been withdrawn and further closures are expected. Regulations are mostly in place. One foreign bank has set up office in Riga.

Securities markets
Treasury bill auctions were introduced in December 1993; a secondary market window has recently been established by the central bank to strengthen money-market operations. No stock exchanges are operating yet. Eleven commodity exchanges are operating, some of which are expected to be amalgamated.

Taxation
A tax package was introduced in November 1993, and has adjusted Latvia's tax structure to market economy standards. However, the corporate income tax schedule continues to differentiate between income sources, with rates varying from 25 per cent up to 45 per cent (with 35 per cent being the standard rate). The top rate of the progressive personal income tax schedule is 35 per cent. Tax conditions for foreign investors are described in more detail in Table 9.3.The standard VAT rate was raised to 18 per cent and has become a key revenue source (29 per cent of central government revenue in the first quarter 1994). Budget and tax administrations were successfully tightened in 1993.

Social security
There is a social security payroll tax of 37 per cent paid by employers, and 1 per cent paid by employees. Latvia maintains a pay-as-you-go pension and unemployment benefits system, financed out of payroll taxes. The system is under strain, primarily since the ratio of pensioners to employed population is 53 per cent. There are plans for pension reform, including introduction of a private funded tier.

Lithuania

Introductory remarks

Economic reforms were first introduced in 1987 as part of perestroika. Since the country regained independence in 1991, reforms accelerated and a broad programme to achieve macroeconomic stability and structural reform was launched in mid-1992.

Enterprises

Size of the private sector

Estimates of private sector value added are highly unreliable, but it is likely to approach 50 per cent of GDP due to progress in privatisation and the presence of a dynamic, partly unrecorded private sector in trade, finance and other services. The share of the state sector in total employment dropped from 80 per cent in 1990 to 47 per cent in 1993. Individual private farmers, partnerships and households held 80 per cent of agricultural land at end-1993.

Large-scale privatisation

Privatisation is based on the Law on Initial Privatisation of State Property of late 1991, amended during 1993. Originally only voucher privatisation had been envisaged, but some cash auction sales have also taken place. Previous preferences for employees and management (up to 50 per cent of shares reserved) are being eliminated. By the end of 1993, 1,915 state-owned enterprises had been privatised (420 million litai asset value), out of 2,203 in the privatisation programme (524 million litai) and a total of some 5,500 state-owned enterprises.

Small-scale privatisation

Small-scale privatisation is based on the same law as large-scale privatisation. Progress on the sale of small units has been substantial. By December 1993, privatisation of housing had been completed, 80 per cent of farmland was under non-state ownership, and 2,318 of 2,660 eligible small enterprises had been privatised (9.4 million out of 12.4 million litai in asset value). However, there has been no privatisation yet of non-agricultural land.

The Constitution provides for the private ownership of land, but implementing legislation is lacking. Joint ventures and firms with foreign capital may only lease land and buildings necessary to carry out business. Leases are for up to 99 years. These restrictions may be eased shortly.

Property restitution

The deadline for applications by former land-owners was March 1994. So far, there have been 86,000 restitutions out of a total of 500,000 applications, and full resolution is likely to take many years. There is continuing ownership uncertainty because of complex procedures (which are now undergoing revision).

Growth of private enterprise

Various legal barriers to entry and restrictive licensing requirements for production and distribution have been progressively removed. At this stage, the often prohibitive real interest rates on or unavailability of medium- to long-term credit is probably the key obstacle to broad-based small enterprise growth, with property uncertainty also playing an important role.

Enterprise restructuring

Direct subsidies to enterprises have been discontinued (except for agriculture, energy and housing), but there has been little progress on restructuring in spite of broad privatisation. An indication of this is the low rate of unemployment (less than 2 per cent). Many firms are effectively worker-controlled because of privileged treatment during voucher privatisation (now being amended), hindering rationalisation and labour-shedding. Inter-enterprise arrears have stabilised in nominal terms and declined by half to 5.8 per cent as a share of GDP during 1993. A Bankruptcy Law was passed in September 1992, but it is cumbersome and ambiguous; implementing regulations and institutional arrangements for enforcement are still not in place. By end-1993, three enterprises had been liquidated, two reorganised, and eight were under bankruptcy proceedings. Some action has been taken to split up conglomerates, but there is no consistent policy. The newly created Ministry of Industry and Trade is to address enterprise reform and industrial policy. An Agency for Prices and Competition has been established, with the ability to negotiate margins with enterprises whose market share exceeds 40 per cent, but no effective power to break up monopoly enterprises. Profit margins of many distribution networks continue to be very high.

Moldova

First elements of market-oriented reform were introduced with perestroika in 1987. Parliamentary discussions in 1990 and detailed planning after the disintegration of the former Soviet Union in 1991 led to a reform programme in early 1992, the legal components of which included a Property Law, a Privatisation Law, and a law of Agrarian Reform and Land Code. In March 1993 parliament adopted the "Action Plan for the Stabilisation and Recovery of the Economy" and the Privatisation Plan. September 1993 saw the start of an IMF-supported stabilisation programme.

Size of the private sector

The private sector is thought to account for 10-25 per cent of GDP, including an allowance for informal sector activity.

Large-scale privatisation

The March 1993 Privatisation Plan envisages the privatisation within two years of about 1,600 enterprises, mostly through distribution of ownership vouchers to the whole population. According to government estimates, these 1,600 enterprises account for 40-45 per cent of the assets of the state. The programme also includes privatisation of 124 medium-sized and large-scale enterprises under control of the Ministry of Privatisation and State Property. Agricultural privatisation is under way (but not subject to the voucher scheme) with the transfer of shares of some state and collective farms to present and former farm employees. At least 10 per cent of state holdings in agriculture were transferred to private owners in 1992 and further sales took place in 1993. The intention is to privatise nearly two-thirds of farm assets. As part of the privatisation programme, agro-processing enterprises will be converted into joint-stock companies with 50 per cent share distribution to suppliers, 20 per cent to employees and 30 per cent to the Ministry of Privatisation. Some state corporations have been designated to remain in state ownership, including some utilities, scientific institutes, and large-scale food processing companies.

Small-scale privatisation

The sale to private entities of small-scale units began in September 1993 with the first, relatively modest, auctions under the privatisation programme. Around 900 small-scale enterprises are to be auctioned as soon as possible. More than two-thirds of housing is already in private hands, and privatisation of the remaining 350,000 dwellings is under way. Some small-scale land ownership was already permitted before independence.

Property restitution

No property restitution for pre-communism owners has taken place.

Growth of private enterprise

About 23,000 private enterprises have been registered since independence. About half are active, most of which are in small trading and services. In December 1993 there were 256 registered joint ventures, of which 104 were said to be operational.

Enterprise restructuring

A presidential decree in December 1991, consolidated in the Law on Joint-stock Companies (1992), is designed to free enterprises from direct state control over commercial decisions, leaving the ownership function with the State Property Fund. Further legislation in September 1993 places day-to-day control of enterprises (except those exempted, classified as "state corporations") with a governing council of workers and branch ministry representatives. Implementation has been patchy: only 300 enterprises have so far been incorporated and there have been mixed results from management reforms.

A Bankruptcy Law was adopted in 1992 but was hardly used during 1993.

Markets and trade

Commodity price liberalisation
Prices of food, consumer and industrial goods were fully liberalised during 1991-92. Restrictions remain on energy and housing, and in general the setting of transport and utilities prices does not yet reflect capital replacement costs.

Trade liberalisation
Foreign trade has been largely freed of non-tariff restrictions. While taxes have been imposed on certain exports, import tariffs are generally moderate. However, the government appears to be responsive to pressures from lobbies, in the agricultural sector in particular. More detail on trade agreements and trade regimes is contained in Table 8.3.

Currency convertibility and exchange rate regime
Lithuania introduced a currency board system of monetary management in early 1994, with a peg to the US dollar, thus displaying a very high degree of commitment to exchange rate stability. Convertibility of the litas on both current and capital account is virtually unrestricted. Most commercial banks are licensed to carry out international money transactions.

Wage liberalisation
Administrative wage guidelines for the state sector, in force until mid-1993, have been replaced by voluntary guidelines. A (low) minimum wage is enforced. There is little union activity.

Interest rate liberalisation
There are no restrictions on interest rate setting by commercial banks. However, real interest rates and spreads remain very high reflecting, *inter alia*, market segmentation and risk perceptions.

Financial institutions

Banking system
The Bank of Lithuania transferred its remaining commercial functions to the State Commercial Bank in early 1993. Twenty-two branches of the former monobank had been spun off previously and privatised. Twenty-seven commercial banks were in operation in mid-1994, including three with majority government ownership (holding 54 per cent of the non-consolidated assets of the banking system at end-1993). Plans for dealing with non-performing assets in remaining state banks and their privatisation have made little headway. In addition, unregulated non-bank enterprises are engaged in deposit-taking and lending, increasing the fragility of the financial system. There is no foreign ownership of banks as yet. The Commercial Banking Act of June 1992 introduced prudential regulation; it is in the process of being reformed in line with international standards. Central bank supervision capabilities are still weak, but an increasing resolve shows in various temporary suspensions.

Securities markets
A National Stock Exchange began operations in September 1993, but trading is limited (mostly privatisation vouchers). Turnover on the first day was US$ 400. Seventy-three securities are registered, and 29 brokers. Money-market securities such as treasury bills are not yet in existence.

Role of the state

Taxation
A series of tax laws has been adopted since mid-1990, providing Lithuania with a tax structure broadly similar to market economies. The new VAT law, effective since 1 April 1994, establishes a basic rate of 18 per cent. Corporate income tax reform introduced a flat rate of 29 per cent but many exemptions severely erode the tax base. Tax conditions for foreign investors are described in more detail in Table 9.3. The personal income tax schedule is progressive up to a maximum marginal rate of 33 per cent. The tax administration is inadequate and has insufficient powers to cope with the new private sector; as a result, tax arrears are high and increasing, partly reflecting inter-enterprise arrears.

Social security
There is a social insurance payroll tax of 30 per cent assessed on the employer, and 1 per cent on the employee. Real levels of transfers to households have fallen sharply, but remain insufficiently targeted. Pension payments, on a pay-as-you-go basis, represented only 4 per cent of GDP in 1993; there are no serious reform plans yet.

Commodity price liberalisation
In January 1992 most consumer goods prices were liberalised. The exceptions were prices of bread and dairy products, some transport prices, and utility charges. Initially indirect price control remained through heavy producer regulation and strict retail margin controls, but 1993 saw some liberalisation and an increase in milk prices to 75 per cent of production costs.

Trade liberalisation
The State Monopoly on foreign trade was abolished in 1992. In April 1993 the generalised export licensing system was replaced with a list of 155 categories, subsequently reduced to 77, mainly related to security, cultural goods and medical items. At the same time the licensing procedure was simplified. The import regime is fairly unrestricted though average tariff levels remain high by the standards of the transition economies. More detail on trade agreements and trade regimes is contained in Table 8.3.

Currency convertibility and exchange rate regime
November 1993 saw the introduction of a new national currency, the leu. Before this, the national "coupons" had displaced the Russian rouble as the main means of payment. The exchange rate is now largely market determined with thrice-weekly currency auctions. The Transdniestr region introduced a separate currency in late August 1994.

January 1994 saw a new legal framework for regulation of foreign exchange transactions. Most payments and transfers for current transactions and some capital transfers are now free of controls. There has been a reduction in the surrender requirement: repatriation of export earnings is required, but only 35 per cent is compulsorily sold on the domestic interbank market.

Wage liberalisation
Before 1993, indicative wage levels were imposed by law. This practice has been replaced by wage floors.

Interest rate liberalisation
Since the introduction of the leu, Moldovan lending and deposit rates have been linked to the rate established at auctions for National Bank credit. On 12 May 1994 monthly interest rates were 15 per cent; well above the rate of inflation.

Banking reform
In mid-1991 a new national two-tier banking system was established. The direction of credit operations of the new central bank initially remained greatly influenced by the government and parliament. In 1993 the central bank's powers were enhanced.

Securities markets
In December 1993 a consortium of local banks and investment trusts announced the intention to establish a stock exchange. The Privatisation Law permits an open secondary market for fully privatised companies.

Taxation
Major tax reforms in 1992 included the introduction of a VAT and restructuring of the personal income tax. In 1993, there was further reform with several new taxes including road tax, some import tariffs and an extension of the VAT base. A progressive enterprise profits tax (exporters and foreign joint ventures are exempted from the progressivity) was also introduced. Tax conditions for foreign investors are described in more detail in Table 9.3.

Poland

Introductory remarks

The reform process began in 1981-82 with measures aimed at reducing economic administration, increasing enterprise autonomy, and strengthening workers' self-management. Second stage reforms in 1987 reaffirmed the earlier measures and introduced wage-price controls. The 1989 Balcerowicz plan launched much more comprehensive market-oriented reforms.

Enterprises

Size of the private sector
The private sector accounted for more than an estimated 50 per cent of GDP and 46 per cent of total employment in 1993.

Large-scale privatisation
The 1990 Privatisation Law introduced a multi-track approach to privatisation. Enterprises can be liquidated and their assets sold, leased or transferred to a new private company; or can be commercialised and then privatised through share sales, restructuring (managed under contract), or inclusion in the recently authorised mass privatisation programme. At the end of 1993, 12 per cent of the 8,772 enterprises owned by central government agencies at the outset of reforms had been privatised. Under the National Investment Funds Law of 1993, 600 enterprises are targeted for the mass privatisation programme, which is expected to start operations at the end of 1994.

Small-scale privatisation
Most small retail, wholesale, and construction enterprises (approximately 20,000) were privatised by local governments early in the reform programme.

Property restitution
Legislation on property restitution for dispossessed owners is pending before parliament.

Growth of private enterprise
The number of private domestic companies increased by 14.2 per cent in 1993 to 66,457, whereas the number of private companies with foreign capital participation increased by 49 per cent to 15,053. Obstacles to growth include an under-capitalised banking system (both state and private banks), an under-developed non-bank financial sector, and inadequate infrastructure.

Enterprise restructuring
The Law on the Financial Restructuring of Enterprises and Banks (1992) required the nine main state banks to set up special debt work-out departments and to enter into conciliation negotiations (outside of the courts) with those enterprises whose loans had been declared non-performing by the end of 1991. The agreements, for which the deadline was end-March 1994, can involve debt rescheduling, partial write-offs, and conversion of debt into equity. Loan-restructuring has been agreed between creditors and debtors for about 82 per cent (by value) of the loans that were slated for workouts, according to preliminary estimates.

The Bankruptcy Law (1934), as amended in 1990, provides for both liquidation and reorganisation of a private company under a court-appointed receiver. The State Enterprise Law (1981) provides for court-supervised liquidations of enterprises. At the end of 1993, 1,045 enterprises had entered into such proceedings, but only 191 cases had been concluded.

Romania

The most important reforms undertaken during the year after the revolution in December 1989 were radical price liberalisation in November 1990, and the devolution of decision-making power to enterprises. Gradual further reform steps, including small-scale privatisation, import liberalisation, subsidy reduction and improvements in tax management followed in 1991-92. Since mid-1993, a serious effort has been made to tighten the budget constraint facing enterprises and to improve efficiency in the allocation of credit and foreign exchange.

Size of the private sector
The private sector share of GDP was estimated by the end of 1993 at more than 31 per cent, up from 16 per cent in 1990 (government estimates). Private sector employment at end 1993 accounted for about 42 per cent of total employment.

Large-scale privatisation
For larger companies, the National Agency for Privatisation has designed a scheme involving the establishment of five "private ownership funds" and one "state ownership fund". The latter holds 70 per cent of the shares in 6,280 "commercial companies" while the rest are held in one of the "private" funds which are themselves joint-stock companies. During 1992, vouchers representing shares in the private ownership funds were distributed to all adult citizens. The management of these funds has been appointed by the government. About 270 small companies were privatised under this scheme in 1993 and another 250 during the first four months of 1994, mostly by management/employee buy-outs. The government intends to amend the voucher scheme before the end of the year. New vouchers are to be issued to the population; the new vouchers will carry a far greater nominal value than the old ones which will, nevertheless, continue to be usable for share purchases.

Under the Land Law of 1991, more than 90 per cent of farm-land has been distributed in small plots to farmers (up to 10 hectares per family), and the drawn-out process of providing formal titles to the new owners is almost complete.

Small-scale privatisation
More than 7,000 small-scale units have been put up for sale and about 3,000 have been privatised, involving 13,500 employees. These units include retail outlets, workshops and hotels.

Property restitution
A draft law granting limited restitution rights to former owners of around 250,000 residential properties confiscated after 1945 by the former communist regime was passed by the Romanian senate in June 1994, but must also be passed by the lower house of parliament before becoming law.

Growth of private enterprise
By March 1994, there were 2.4 million private farmers (although many were still waiting for the formal title to their land) and 334,000 other registered firms (up from 200,000 at end-1992). The average size of private units remains small and some new company registrations are used as a legal means of extending tax holidays for new companies.

Enterprise restructuring
The Romanian approach to enterprise restructuring has been gradual and sometimes erratic. The main restructuring tool has been subsidy reduction and attempts to introduce market-oriented credit policies. However, these efforts were interrupted on two occasions during 1991-93 by massive credit injections from the central bank aimed at "clearing" a rapidly growing stock of inter-enterprise arrears. A renewed effort at strengthening financial discipline in enterprises was initiated in the second half of 1993 and is still being pursued. Credit policies have been tightened, a re-structuring agency has been established (with EC-PHARE support) and financial supervision has intensified for 25 enterprises that account for the bulk of inter-enterprise arrears.

Romania does not at present have a bankruptcy law or an anti-trust law. A draft bankruptcy law has for long been under debate in parliamentary commissions and an anti-trust law has recently been submitted to parliament.

Markets and trade

Commodity price liberalisation
Since 1992, all prices have been market determined except those for electricity, gas, central heating, hot water, basic medicines, rents in housing belonging to local authorities, television fees and spirits. In general, for those prices that remain centrally administered, the authorities aim at price adjustments that outpace inflation. Energy prices are adjusted periodically according to a schedule agreed with the World Bank.

Trade liberalisation
Most quantitative trade restrictions and export subsidies were eliminated in 1990. However, in particular sectors, such as the automobile sector, import barriers can be substantial, and Poland has undertaken several upward revisions to its import tariff structure after the sharp reductions in 1990. More detail on trade agreements and trade regimes is contained in Table 8.3.

Currency convertibility and exchange rate regime
Restrictions on the availability of foreign exchange for current account transactions have been largely removed. Limits remain on individual travel allowances and the transfer abroad of resident-owned capital. The exchange rate follows a crawling peg to a basket of currencies; the pre-announced pace of adjustment in the rate *vis-à-vis* the basket is 1.5 per cent per month.

Wage liberalisation
For state enterprises, a tax is applied in the initial reform years to the excess of average wages over a predetermined norm, the so-called "Popiwek" tax. The excess wage tax expired in April 1994, but was re-introduced on 1 August 1994.

Interest rate liberalisation
Banks are free to set their own deposit and lending rates, which are typically positive in real terms.

Financial institutions

Banking reform
In 1989, nine commercial banks were established from branch offices of the National Bank of Poland, following the creation of the PKO Savings Bank and other specialised lending institutions (including the Agricultural Bank) in 1987. The Banking Law (1989) and Act on the National Bank of Poland (1989), both as amended in 1992, provided the regulatory framework for banking operations. The Law on the Financial Restructuring of Enterprises and Banks (1993) provided for the recapitalisation of seven state-owned commercial banks, the agricultural bank and the main savings bank. This was done during 1993 by issuing to the banks state bonds worth PZL 21 trillion (1½ per cent of GDP). The aim was to bring banks into line with international bank capital adequacy standards. The two state banks less tainted by bad loans were privatised in 1993 and early 1994. Further recapitalisation of the Agricultural Bank is expected during the autumn of 1994.

Securities markets
The Warsaw Stock Exchange was reopened in 1991. The Act on Public Trading and Trust Funds (1991) provides a legal and regulatory framework for securities activities that is intended to conform with EU standards. The Securities Commission supervises the Stock Exchange and its members. At the end of 1993 there were 22 companies listed on the Exchange.

Role of the state

Taxation
There has been a substantial overhaul of the tax system. An enterprise income tax with a uniform rate of 40 per cent was introduced in 1989 (this was still the rate in 1993); an unemployment insurance scheme (Labour Fund) financed by a 2 per cent payroll tax was initiated in 1990; a personal income tax was launched in 1992 with a top marginal rate of 40 per cent; and a value added tax was introduced in 1993 with a standard rate of 22 per cent and a reduced rate of 7 per cent. In 1993, the payroll tax for the Labour Fund was increased to 3 per cent, while the top marginal income tax rate was raised to 45 per cent in 1994. Tax conditions for foreign investors are described in more detail in Table 9.3.

Social security
The payroll tax to finance the Social Insurance Fund was increased in two steps to 45 per cent in 1992 from 38 per cent in 1989. A revision of the system through which pensions are indexed to wage increases has been considered by the government but a decision on this has been put off until 1995.

Commodity price liberalisation
Having controlled virtually all prices for many years, Romania freed half of the prices in the consumer goods basket in November 1990. Price liberalisation picked up again in 1993 as consumer subsidies were phased out, mark-up limits were eliminated (in June) and the number of consumer goods under direct price control dropped to five.

Trade liberalisation
Most licensing requirements for export and import were eliminated in May 1992, leaving quantitative import restrictions only for a few products related to public health or security. There are no duties on exports, and the tariff treatment of imports is fairly liberal. More detail on trade agreements and trade regimes is contained in Table 8.3.

Currency convertibility and exchange rate regime
The leu is virtually fully convertible for the purpose of foreign trade transactions and for capital and profits of foreign investors. Residents may purchase up to US$ 500 per year for tourism abroad.

In April 1994, the interbank foreign exchange rate was unified with the rate quoted by the so-called "bureaux" as the interbank market was freed of administrative intervention after a large gradual depreciation during the first quarter. The exchange rate of the leu is floating.

Wage liberalisation
Collective bargaining is well established. The government pursues an incomes policy by taxing "excessive" wage increases.

Interest rate liberalisation
During the first half of 1994 the combination of declining inflation rates and rising interest rates has brought what is arguably positive real interest rates on a large share of central bank refinancing. The banks are free to set their lending rates.

Banking reform
A two-tier banking system was created in December 1990 as the commercial functions of the National Bank of Romania (NBR) were spun off to the Romanian Commercial Bank (RCB), allowing the NBR to function as a central bank. There are now four state-owned banks. A number of private banks began operations in 1990 and more have been established in subsequent years. Five foreign banks have branches in Bucharest.

In 1991, the government bought from the banks 90 per cent of their non-performing claims and then cancelled the loans, the total nominal value of which was 7.5 per cent of 1991-GDP. The banks' balance sheets are now much better than in 1990 due to this recapitalisation, reinforced by another injection of state capital in 1992 (through which three state-owned banks received the equivalent of 0.8 per cent of GDP), highly negative real interest rates, and large spreads between lending and deposit rates during much of 1991-93.

Securities markets
The National Bank of Romania issued the first treasury bills in more than 50 years at the end of March 1994. The bills were of three months maturity and carried a monthly yield of slightly more than the April inflation rate of 6 per cent.

Taxation
Substantial tax reforms have been implemented. In 1990, revenues dropped by the equivalent of 10 per cent of GDP as profit transfers to the government were replaced by a less onerous profit tax. The 1990 reforms also introduced an "individual wage tax" to replace the old system's "wage fund tax" which was levied on the total enterprise wage bill. On 1 July 1993, the turnover tax was replaced by a VAT.

Previously large state subsidies on food, electricity and transportation were eliminated during 1992-93. After rising sharply in the initial post-revolution years, total government outlays on subsidies and transfers dropped from 22 per cent of GDP in 1992 to 14 per cent in 1993. Capital expenditure was reduced from 18 per cent of GDP in 1989 to about 4 per cent in 1993.

At present, the enterprise profit tax is levied progressively at rates of 6-45 per cent, whereas personal income is taxed at rates from 5 per cent to 60 per cent. The value added tax is levied at a flat 18 per cent with basic consumer goods and exports exempted. The government has made proposals that will set the corporate tax rate at 38 per cent (25 per cent for agriculture) from January 1995, and has taken to parliament during the summer of 1994 a draft law which will index the profit tax base to inflation. Tax conditions for foreign investors are described in more detail in Table 9.3.

Social security
Employers contribute to Romania's social security system through a payroll tax amounting to 32.5 per cent of the wage sum; employees pay 1 per cent of the wage sum. Social security rates have risen substantially since 1991. In addition, all companies are subject to a 1.5 per cent tax on their turnover.

Russian Federation

Introductory remarks

Partial reforms were introduced in 1987 in the framework of perestroika. A comprehensive reform package was adopted in January 1992.

Enterprises

Size of the private sector
The private sector represents about 50 per cent of both GDP and employment.

Large-scale privatisation
About 15,000 medium- and large-scale enterprises employing more than 70 per cent of the industrial workforce had been privatised through the Russian mass privatisation programme by July 1994. Voucher privatisation was largely completed by then. A proposed framework for the second (post-voucher) phase of the privatisation programme has twice been rejected by parliament but was launched by presidential decree in late July 1994. In this phase, privatisation will focus on cash-based sales to strategic investors.

Land and buildings may also be privatised. Farm privatisation has made limited progress so far, with most large farms choosing to re-register under collective ownership. Sales of farm assets are expected to proceed slowly.

Small-scale privatisation
By mid-1994 more than 70 per cent of state-owned small-scale businesses in retail trade, public catering and consumer services (about one-third of the estimated total of 250,000 small enterprises) had been privatised. The number of private farms, however, had increased at a comparatively slow pace to 270,000, covering about 5 per cent of total agricultural land. Housing privatisation began in late 1992 and more than 30 per cent of units nationwide had been privatised by mid-1994.

Property restitution
No property restitution to former owners has taken place to date.

Growth of private enterprise
There are currently about 700,000 registered small businesses operating in Russia. By June 1994 the number of joint ventures and foreign companies amounted to 14,000, of which only about 4,000 were operational.

Enterprise restructuring
In response to sharp output falls, working hours have been reduced and real wages cut. Redundancies have been much less common. About 10 per cent of the privatised enterprises have changed management after the shift in ownership. Restructuring is impeded by the important role of enterprise-insiders in the privatisation process and the related lack of effective corporate governance. The pressure to restructure has also been weakened by a low degree of competition and slow progress in financial sector reform. The second privatisation phase is to include measures to speed up restructuring.

A Bankruptcy Law was adopted in November 1992 and became effective on 1 March 1993. Until March 1994, bankruptcy proceedings had been initiated against about 50 enterprises. None had been liquidated. By June 1994 an initial list of 1,150 insolvent enterprises, some of which are candidates for bankruptcy, had been drawn up. The first bankruptcies were declared in July 1994.

The primary body for the management of the bankruptcy process is the Federal Agency on Insolvency Affairs, created on 20 September 1993 at the State Committee on State Property Management.

The Law on Competition and Limitation of Monopolistic Activity in the Goods Market was adopted in March 1991. A state programme for the demonopolisation of the economy was approved by the government in December 1993, but pro-competition policies have remained ineffective so far. A register of dominant firms was established in 1992; at the outset it contained around 2,000 enterprises. Anti-trust activities have focused so far on *ex-ante* price, profitability controls over monopolies and controls on concentration of ownership during the privatisation process. Current plans to establish financial-industrial groupings (24 in 1994, increasing to about 150 over the next two to three years) threatens to cartelise further the Russian economy.

Markets and trade

Commodity price liberalisation
In early 1992 about 80 per cent of wholesale prices and 90 per cent of retail prices were freed of administrative controls. Only basic necessities and a restricted list of producer goods and services remained subject to price controls. In 1993, prices of petrol, coal, grain and bread were also de-controlled. There are, however, widespread direct and indirect price controls set by local authorities (on about 30 per cent of consumer prices). In addition, price and profitability ceilings apply to monopolies.

Trade liberalisation
Trade with CIS countries is still largely dominated by bilateral trade agreements. Virtually all quotas on imports from non-CIS countries were removed in 1992. Import subsidies were phased out in 1993. The export regime was liberalised in the first half of 1994 as the scope of the export quota and licensing system was reduced and export taxes were cut. However, restrictions remain particularly on raw material exports. A special "commodity passport" system has been introduced to rein in capital flight. The import tariff regime has become increasingly restrictive after the drastic liberalisation in 1992. The July 1994 revision of import tariffs raised average rates by about 50 per cent, with particularly strong increases in the consumer goods sector. More detail on trade agreements and trade regimes is contained in Table 8.3.

Currency convertibility and exchange rate regime
The exchange rate was unified in mid-1992 and the rouble has been floating since then. The rouble is convertible for most current account purposes, including profit repatriation for foreign investors. There is a 50 per cent export surrender requirement for foreign exchange. In January 1994 the use of foreign currencies for cash transactions within Russia was prohibited.

Wage liberalisation
"Excessive" wage increases are subject to punitive taxation. Minimum wages and pensions are indexed quarterly. A "General Agreement Between All-Russia Associations of Trade Unions, All-Russia Associations of Employers and the Government of Russia for 1994" contains general guidelines for wage-setting and social protection.

Interest rate liberalisation
Interest rates have been liberalised. Since July 1993 the refinancing rate has closely followed the benchmark interbank market rate. Real interest rates have been positive since October 1993.

Financial institutions

Banking reform
A two-tier banking system was created in 1987 as part of the perestroika reforms. Independent Russian laws on, respectively, the central bank and commercial banking activities were adopted in December 1991. New draft banking laws have been prepared by the parliament's budget committee. On 1 June there were 2,214 commercial banks, operating as universal banks.

Prudential regulations have been very liberal. However, the minimum capital requirement for new banks was raised in March 1994 to Rb 2 billion and will be raised gradually to reach ECU 5 million in 1999. Existing banks have to reach the capital level of Rb 2 billion only by January 1995.

Banking supervision remains weak and poorly enforced. The financial system includes banks that mainly channel directed credits to state enterprises and banks created by enterprises to act as their house banks. In 1992-93 about 20 small banks were shut down. A recently launched reform programme aims to create a core group of 30-40 banks that would be capable of complying with international prudential standards and which would in return become eligible for certain privileges.

Privatisation of banks is to proceed gradually in parallel with the privatisation of enterprises. Tight restrictions on the access of foreign banks to establish themselves in Russia were imposed in November 1993 but were eased in June 1994. Foreign banks' aggregate capital may not exceed 12 per cent of the total capital of the Russian banking system.

Securities markets
The first Russian stock exchanges opened in the summer of 1991, and there are currently close to 70 authorised stock exchanges. The securities market is still largely unregulated and segmented and has been dominated by trade in 3-6 months' T-bills, gold certificates and privatisation vouchers (trade in the latter ceased in mid-1994). The range of traded paper is widening; it includes shares in commercial banks and investment funds (of which there are currently about 650) and shares and bonds issued by a growing number of privatised companies, promissory notes, currency futures and hard currency-denominated certificates of deposits.

Outside the organised share market there is significant trading in shares over the counter. During the first half of 1994, portfolio investments by foreigners amounted to an estimated US$ 1-2 billion. A presidential decree issued in October 1993 "On Measures to Ensure the Rights of Stockholders" and another issued in June 1994 "On the Protection of Investor Interests" represent significant steps towards the creation of elementary rules for the securities market, including registration, rights to issue securities and information disclosure.

Role of the state

Taxation
The main taxation reforms took place in late 1991 and during 1992, including the introduction of a value added tax (VAT) and excise taxes, the creation of the legal base for the tax system comprising a Law on the Basic Principles of Taxation (December 1991) and a series of individual tax laws. Since then tax legislation has been introduced in an ad hoc fashion. The overall tax burden is high, regulatory changes are frequent, while tax exemptions are widespread. Tax evasion is rampant.

Russia has a three-level taxation system consisting of federal, regional and local taxes. Revenue shares and expenditure assignments between the different levels of government are still not clearly defined.

The main tax rates were as follows in 1994: the enterprise profit tax was at 35-38 per cent, the VAT at 23 per cent and the progressive personal income tax at 12-40 per cent. In addition, excise taxes ranged from 0 per cent to 90 per cent and export taxes were an important source of income for the budget. Tax conditions for foreign investors are described in more detail in Table 9.3.

Social security
Russia's social security system is financed mainly through extra-budgetary funds and through expenditure undertaken by enterprises on social services. Social security contributions are set at 40 per cent of the wage sum.

Slovak Republic

Introductory remarks

After the Velvet Revolution in the Czech and Slovak Federal Republic (CSFR) in November 1989, market-oriented reform was initiated during 1990 and a comprehensive programme was adopted in January 1991. The CSFR broke up at the end of 1992 and the Slovak Republic became an independent country on 1 January 1993.

Enterprises

Size of the private sector
The private sector share of GDP was estimated at more than 50 per cent at the end of 1993, before the second wave of privatisation.

Large-scale privatisation
A comprehensive sell-off of state assets has been pursued through two "privatisation waves". The first of these was launched by the CSFR in May 1992 and was completed by mid-1993. It involved 750 enterprises with a book value of SKK 166 billion in the Slovak Republic. In this process, SKK 80 billion worth of shares in 503 firms in Slovakia were distributed through a voucher-based "mass privatisation" scheme which created 8.5 million shareholders in total in the Czech and Slovak Republics. The second wave in the Slovak Republic involves 514 enterprises with an estimated book value of SKK 220 billion. It was initiated in 1994 after delays pending an internal debate over the appropriate method of privatisation. Roughly one-third of the shares will be distributed through voucher-based distribution, expected to begin in autumn 1994.

Small-scale privatisation
The sale of small state-owned enterprises was launched in January 1991. It was largely completed during 1992 with approximately 10,000 enterprises auctioned off. The yield to the state was almost Kcs 13 billion.

Property restitution
A restitution law was adopted by the CSFR in October 1990. About 30,000 industrial and administrative buildings, forests and agricultural plots, which had been nationalised during 1948-55, as well as 70,000 commercial and residential entities nationalised during 1955-59, were handed back to the original owners. The value of assets returned has been estimated at between 70 billion and 120 billion Kcs. A further law on restitution covering former church property was adopted in October 1993.

Growth of private enterprise
The number of incorporated private economic organisations (i.e. excluding self-employed) was 6,090 at end-1991 and 13,819 at end-1992.

Enterprise restructuring
The main restructuring tools have been indirect: privatisation and tight access to credit and subsidies for enterprises. Restructuring has essentially been left to the new private owners, although some restructuring may have taken place in the process of drawing up privatisation plans.

The initial Law on Bankruptcy was passed in August 1991 with virtually no possibility of external creditors forcing companies into bankruptcy. The current law became effective in June 1993, allowing creditors to bring bankruptcy cases to court after a three-month protective period. Until June 1994, courts could declare bankruptcy only if liabilities exceeded assets and the enterprise was not in the transportation or communications sector. Agricultural producers were exempt from bankruptcy until September 1994.

A competition law was passed in 1991 and amended in October 1993 to bring it close to consistency with EU legislation.

Slovenia

The first elements of "market socialsim" were introduced in 1952. In 1976 a law on "associated labour" institutionalised "social ownership". In 1988 the so-called "Markovic-reforms" included widespread price, import and foreign exchange liberalisation. A comprehensive reform programme was adopted in 1990 after independence.

Size of the private sector
According to official estimates, the share of the private sector in total employment amounted to 9.5 per cent in 1993. Unofficial assessments put the share substantially higher.

Large-scale privatisation
Large-scale privatisation has been slow to materialise in Slovenia but is likely to become comprehensive by about the end of 1995. Privatisation of the more than 2,500 "socially owned" enterprises is guided by a law passed in December 1992. Enterprises with "socially owned capital" that fail to produce "acceptable" privatisation plans by the end of 1994 will become the responsibility of the Privatisation Agency. Subsequently all 2,500 companies are to be privatised.

For this purpose, a voucher-based mass-privatisation programme has been initiated. All citizens have received from the state "ownership certificates" with a value of 100,000-400,000 tolars, depending on the age of the recipient. Twenty per cent of the shares are reserved for employees. Another 40 per cent must be sold by way of employee purchases, public tender or auction (with strong incentives favouring employee buy-outs). The remaining 40 per cent are to be allocated without payment to three types of state-owned funds. Of these, half will be auctioned to "investment funds" which are to be created by the state but which will be owned exclusively by private individuals who will be offered participation (using their ownership certificates) in auctions for shares in these funds.

Small-scale privatisation
Almost all small-scale trade and service activity is operated by the private sector. Extensive small-scale private activity already existed under former Yugoslav law.

Property restitution
Under the Law on Denationalisation (1993), land and buildings can be returned to former owners.

Growth of private enterprise
The number of small businesses (with less than 50 employees) increased by 40 per cent during 1993; a total of 26,165 were registered at the end of 1993. The majority of private sector companies is concentrated in the services sector.

Enterprise restructuring
A lot has been done to break up large "socially managed" enterprises into smaller units. Slovenia's law on bankruptcy and liquidation was approved in 1989.

Markets and trade

Commodity price liberalisation
In January 1991, 85 per cent of consumer prices were decontrolled. Further liberalisation measures were undertaken during that year. The only remaining significant controls pertain to utility charges, rents and public services. In addition, mark-ups are closely regulated in the energy sector.

Trade liberalisation
Most quantitative controls on imports and exports were removed in January 1991. This was initially combined with a surcharge on consumer goods imports of 20 per cent, but the surcharge was lowered gradually to 10 per cent by January 1992 and later abolished. The average weighted tariff is extremely low at about 4.7 per cent. More detail on trade agreements and trade regimes is contained in Table 8.3.

Currency convertibility and exchange rate regime
Current account convertibility for enterprises was introduced in January 1991. Some restrictions on capital remain. The exchange rate is pegged to a basket in which the Deutschmark has a weight of 60 per cent and the US dollar a weight of 40 per cent.

Wage liberalisation
Wage increases are regulated through a tax on "excessive increases". This was initially imposed during 1991 in the context of a macroeconomic stabilisation package with agreement from unions (the so-called "social contract"). The intention was to regulate the rise in real wages. The tax was reintroduced in the second half of 1992 for enterprises with majority state or municipal ownership, taxing wage increases above a measure which is linked to specific performance targets. The tax expired at the end of 1992.

Interest rate liberalisation
Interest rates were freed progressively from 1990 onwards, with complete liberalisation in April 1992.

Financial institutions

Banking reform
A two-tiered banking system was adopted in January 1990. Laws on the central bank and commercial banks were passed in February 1992. The former of these grants the central bank supervisory powers. With the split of the CSFR, the Slovak National Bank was established in January 1993 as the Slovak successor to the former State Bank of Czechoslovakia. At the beginning of 1994, 28 commercial banks, including a number of foreign bank branches/representative offices, were operating in the Slovak Republic. All commercial banks, except the Slovak Savings Bank, are now in private hands.

The regulatory regime sets the required capital adequacy (following the Basle definition) at 6.25 per cent by the end of 1993 and 8 per cent by the end of 1996. During the CSFR-period, a state-owned Consolidation Bank was established in March 1991 to take over Kcs 110 billion (20 per cent of credits to enterprises) of "permanent revolving credits" (perpetual loans characterised by low interest rates and issued for inventory financing). Further state-financed recapitalisation of the banks totalling Kcs 50 billion was conducted in November 1991.

Securities markets
The Bratislava Stock Exchange, the RM-system (an over-the-counter exchange) and the Bratislava Options Exchange began operation during the first half of 1993. The Bratislava Stock Exchange opened in April 1993 with trading in shares and bonds. In March 1994, nine companies were listed. The RM-system provides individuals with direct access to the system for sales and purchases of shares in nearly 600 companies distributed under the voucher privatisation scheme. Foreigners are free to participate in the market for shares; profit repatriation is subject to payment of income taxes on capital gains. The monthly trading volume during February and March 1994 was around SKK 500 million.

Role of the state

Taxation
Stop-gap tax reforms were introduced in 1990, involving simplification of turnover tax rates and lowering of corporate and individual tax rates. A comprehensive tax reform was implemented in January 1993, introducing a value added tax (VAT) in two tiers at 23 per cent and 5 per cent and streamlining corporate and individual income taxes. In July 1993, the VAT rates were raised to 25 per cent and 6 per cent.

Further revisions in January 1994 reduced the corporate tax rate from 45 per cent to 40 per cent, and the maximum personal income tax rate from 47 per cent to 42 per cent.

Social security
The 1993 reforms also transferred funding of social security from general taxation to an insurance based system.

Commodity price liberalisation
Price liberalisation is almost complete.

Trade liberalisation
The Law on Foreign Trade Transactions adopted in February 1993 simplified foreign trade transactions and abolished unnecessary permits and obstacles to foreign trade. Imports and exports of goods are generally free from quantitative restrictions and duties, except where, for developmental or protection reasons, the government decides to revert to quotas. More detail on trade agreements and trade regimes is contained in Table 8.3.

Currency convertibility and exchange rate regime
The Law on Foreign Exchange Transactions and the Law on Foreign Credit Transactions were adopted in January 1991. The national currency, the tolar, was introduced in October 1991. The exchange rate is floating. Convertibility is full for current account purposes. Some restrictions on capital account convertibility remain but are to be phased out.

Wage liberalisation
The Labour Code of 1989 liberalised wages. In August 1990, the first general agreement between the Chamber of Economy of Slovenia and the old trade union set the minimum wage for each category of worker and introduced a collective bargaining system. Incomes policy laws have also been used (1991, 1993).

Interest rate liberalisation
Commercial banks are free to set their deposit and lending rates. Since the establishment of the national currency, the tolar, rates have been highly positive in real terms.

Banking system
A national two-tiered banking system was introduced in 1991. The Bank of Slovenia became the central bank responsible for monetary policy, exchange rate management and the regulation of commercial banks. In order to reduce the dominance of the largest bank, Ljubjanska Banka (LB), the government has created separate banks out of some of LB's subsidiaries. Two Austrian banks are the only foreign banks to have opened subsidiaries in Slovenia with a full banking licence. In 1993, a state agency recapitalised two state-owned banks, swapping state-bonds for bad loans.

Securities markets
Securities markets are regulated by the Law on Securities (1989 and 1990), and the Law on Money Market and Capital Market. The Ljubljana Stock Exchange was founded in December 1989. A total of 34 securities are listed and 57 members are registered for trading on the Exchange. Government, municipal and enterprise bonds are traded. There are two trading sessions per week.

Taxation
Following a comprehensive revamping of tax legislation in 1990-93, there are four main categories of taxation: a corporate profit tax (the present rate is 30 per cent, to be reduced to 25 per cent according to a draft legal amendment); a personal income tax (at marginal rates of up to 50 per cent); a sales tax (20 per cent); and contributions to social security (in 1993 employers and employees each contributed at a rate of 23.9 per cent of the wage sum). Dividends are taxed at a 25 per cent rate for residents and 15 per cent for non-residents. Tax conditions for foreign investors are described in more detail in Table 9.3.

Tajikistan

Introductory remarks

In 1987 limited reforms were introduced as part of perestroika. A comprehensive economic reform programme has not yet been adopted.

Enterprises

Size of the private sector
At least 10-20 per cent of GDP is generated in the private sector including informal sector activity.

Large-scale privatisation
The Law on De-statisation and Privatisation of Property was adopted in February 1991. Privatisation methods include lease (with or without option to buy), creation of joint-stock company, sale by instalment to work collectives and others, employee buy-out, and free transfer of state property. Privatisation started in 1991 but was stalled due to political instability. The 1991-92 privatisation programme, approved in October 1991, targeted the sale of 1,276 enterprises of all sizes and in different sectors of the economy.

By mid-1994, 152 of a total 1,304 medium-sized and large-scale enterprises had been privatised in the agriculture, trade, transport and construction sectors. The 1993-95 privatisation programme proposes to add 79 medium-sized and large-scale enterprises to the list.

Small-scale privatisation
About 600 small-scale enterprises (less than 50 employees) were privatised in the 1991-92 privatisation programme. By October 1993, more than 50 per cent of all dwellings had been privatised.

Property restitution
There has been no property restitution to pre-communism owners in Tajikistan.

Growth of private enterprise
Obstacles to the growth of the private sector include entry and exit rules, lack of finance, limited access to business information, labour regulations and an incomplete legal framework.

As of October 1993, 182 joint ventures and 12 fully foreign-owned companies were registered. About 40 of these companies were active.

Enterprise restructuring
Enterprises still operate under the system of state orders and state instructions to enterprise management. A clear strategy to improve the performance of state-owned enterprises is lacking.

Turkmenistan

The right to administer resources for investment was partially delegated to the enterprises during the perestroika period, especially in 1987. Since gaining independence in 1991, Turkmenistan has made some progress on price reform and has established a national currency. However, no comprehensive market-oriented reform package has been designed.

Size of the private sector
No official estimate for the private sector share of GDP is available but the share is likely to be around 15 per cent.

Large-scale privatisation
Privatisation remains largely at the planning stage. No significant effort has been made to privatise large-scale state-owned enterprises.

Small-scale privatisation
The government's policy is to initiate the privatisation process with the sale of small service units, but little has been achieved to date. In agriculture, a small share of the land has been leased to private individuals. Land ownership has been legalised. The maximum plot size that can be owned privately is 15 ha.

Property restitution
Turkmenistan has no programme of property restitution.

Growth of private enterprise
Spontaneous growth in the number of small-scale private enterprises has been substantial. In mid-1993, one-third of the 9,000 registered small-scale enterprises were in private hands. By March 1994, there were 10 fully foreign-owned companies and 109 joint ventures with more than 30 per cent foreign ownership.

Enterprise restructuring
Little effort has been made to initiate orderly restructuring of enterprises. The enterprises have been faced since the second half of 1993 with shortages of imported production materials due to a sudden drop in the country's gas-related hard currency revenues, but have been helped to keep employees on the payroll through the rapid extension of credits from the banking system.

The Law on Bankruptcy was passed in June 1992 but few companies have been forced into bankruptcy to date. There is no anti-trust law.

Markets and trade

Commodity price liberalisation
Limited price liberalisation was introduced in April 1991. In January 1992 the government lifted price controls on 80 per cent of goods. Further liberalisation of prices has reduced the number of goods and services under price controls to about 2 per cent of the total. Price controls apply mostly to the staple consumer goods - such as flour and milk.

Trade liberalisation
A command system, based on state orders, quotas, export licences and centralised trading, still dominates production and trade. Until October 1993, export licences were classified in 33 categories and were subject to 10 different rates of surrender requirement, ranging from 32 per cent to 100 per cent of export proceeds. In November 1993 a new decree unified different surrender requirements at 30 per cent of export proceeds for exports not traded by the general contractors. Customs duties range from 5 per cent to 100 per cent of the rouble value of imports, and lower rates if the imports are paid in foreign exchange at the rate set by the National Bank of Tajikistan. Information on trade agreements is contained in Table 8.3.

Currency convertibility and exchange rate regime
The Russian rouble remains the official currency. In September 1993, Tajikistan signed an agreement with the Russian Federation, which envisages the establishment of monetary union with Russia. This agreement was ratified in December 1993 by Tajikistan's parliament. The framework and operational arrangements for the joint monetary zone have not yet been finalised.

Wage liberalisation
Wages in the state-owned enterprises tend to be adjusted proportionately and at the same time.

Interest rate liberalisation
Interest rates have remained centrally controlled and negative in real terms.

Financial institutions

Banking reform
The Law on Banks and Banking Activities and the Law on the National Bank were adopted in February 1991. Amendments to these laws have been proposed but have not yet been adopted. As well as the National Bank there are 14 banks, a state insurance company and seven new cooperative insurance companies. Adequate data related to bank solvency are not available. The banking sector is dominated by large specialised banks - Agroprombank, Orienbank and Tajikbankbusiness - which account for over 96 per cent of bank lending.

Securities markets
A stock exchange has not yet been established.

Role of the state

Taxation
A value added tax has since early 1992 been set at 20 per cent. The basic profit tax rates range from 30 to 45 per cent (in banking and insurance). Personal income is taxed at progressive rates with a maximum of 40 per cent for monthly income more than 43 times the minimum wage. Tax conditions for foreign investors are described in more detail in Table 9.3.

Commodity price liberalisation
Prices for 19 consumer goods remain controlled and subsidised by the state, including bread, butter and vodka. Certain other items, including electricity and gas, are provided free to the population (with the subsidy showing up as absent revenues in the accounts of state-owned enterprises).

Trade liberalisation
Centralised state trading remains a prevalent influence on both foreign trade and production. Outside this system, licenses can be obtained for most imports and exports. However duties and tariffs can be very high. More detail on trade agreements and the trade regime is contained in Table 8.3.

Currency convertibility and exchange rate regime
In principle, Turkmenistan introduced full currency convertibility and a unified exchange rate for the purpose of trade transactions when the manat was introduced on 1 November 1993. The initial official exchange rate of 2 manat per US dollar was adjusted on 6 November to 1.98 manat per US dollar. In mid-March 1994 it was moved to 10 manat per US dollar, except regarding obligatory currency surrender for the gas companies for which the exchange rate remained 1.98. Meanwhile the government eliminated for non-state entities the previous 100 per cent surrender requirement and reduced it for state-owned enterprises to a less onerous 50 per cent. At that point the kerb exchange rate was about 60-70 manat per US dollar. On 2 May a new "commercial" rate of 60 manat per dollar was introduced for sales of hard currency to the central bank; however, the exchange rate for obligatory surrender stayed at 1.98 for the gas companies and 10 for other exporters. These rates remained the same in mid-July, at which point the black market rate had reached 100 manat per US dollar.

Wage liberalisation
A statutory minimum wage is set by the state. Wages throughout the state-owned sector tend to be adjusted in parallel.

Interest rate liberalisation
The commercial banks have some freedom to set interest rates, while rates in the Savings Bank are government-determined. Rates have in practice been highly negative in real terms.

Banking reform
Like other republics of the former Soviet Union, Turkmenistan established in the late 1980s a number of so-called "specialised banks" to handle commercial lending and deposit-taking previously undertaken by the State Bank. The State Bank was thereby left mainly with the task of being the link to the Soviet Gosbank. Upon the introduction of the manat, in November 1993, the State Bank became Turkmenistan's central bank.

Turkmenistan's banking sector now includes - besides the central bank - two sector banks, plus the National Savings Bank, the Foreign Trade Bank, and 20 commercial banks. The sector banks are owned by state enterprises that are also the main recipients of loans from these banks. Eight of the commercial banks are privately owned: three in the form of cooperatives and two in the form of joint-stock companies.

Securities markets
There is no securities market in Turkmenistan.

Taxation
The standard rate of profit taxation (introduced in 1991 to replace profit transfers to the budget) was reduced from 45 per cent to 35 per cent in January 1992 and further to 25 per cent a year later. Some sector-specific rates apply. Tax conditions for foreign investors are described in more detail in Table 9.3. The top marginal personal income tax rate was reduced from 40 per cent to 30 per cent in January 1993: the rate applying to most taxpayers was lowered from 12 per cent to 6 per cent. The VAT was reduced to 20 per cent in 1993 with preferential rates of 0-10 per cent for certain staple goods. In March 1994, the rate was reduced to 11 per cent for value added in state-owned enterprises and VAT was suspended for non-state-owned enterprises. There is a 50 per cent tax (reduced in March 1994 from 80 per cent) on sales of natural gas abroad for hard currency (the rate is 20 per cent for oil).

Price subsidies in 1992 accounted for about one-third of central and local government expenditure (with the latter, which excludes outlays from a number of extra-budgetary funds, totalling 31 per cent of GDP).

The secession from the Soviet Union led to a sudden interruption in transfers from the Union budget and an even more massive increase in tax revenues from the gas sector. Gas-related revenues dropped sharply in 1993 as Russia phased out the practice followed during 1992 of settling 15-20 per cent of gas deliveries from Turkmenistan in hard currency at world market prices.

Social security
A generous social security system is partly financed by payroll taxes, which are set at 37 per cent for enterprises.

Ukraine

Introductory remarks

The right to administer resources for investment was partially delegated to enterprises during the perestroika period, especially in 1987. Since then several reform programmes have been adopted only to be abandoned. A comprehensive reform package has never been implemented and the central authorities still have great control over the economy.

Enterprises

Size of the private sector
The private sector may account for up to 30 per cent of GDP if the contribution of the large informal sector is taken into account.

Large-scale privatisation
The Law on Privatisation of Assets of State Owned Enterprises was adopted in March 1992. However, so far little progress has been made on large-scale privatisation.

Small-scale privatisation
Parliament adopted the Law on Privatisation of Small State-owned Enterprises in March 1992. By early 1994 about 4 per cent of the 60,000 small-scale units to be privatised had been sold. Pilot mass privatisation auctions are scheduled for the end of 1994. The 1994 privatisation programme targets the sale of 20,000 small-scale units (30 per cent of the total number of state-owned small units). However, the target is unlikely to be reached. Privatisation has been most active in wood-processing, light industry, trade and public catering. About 17 per cent of housing units had been privatised by March 1994.

Property restitution
There has been no restitution for former owners in Ukraine.

Growth of private enterprise
The informal economy is growing rapidly.

Enterprise restructuring
Virtually the entire formal economy is still highly monopolised and exhibits a high degree of integration and concentration. Enterprise budget constraints have remained soft because of budgetary subsidies and directed credits from the banking system.

The Law on Bankruptcy was adopted in May 1992. There has been little enforcement of bankruptcy legislation.

Uzbekistan

Limited reforms have been introduced since 1987 as part of perestroika. Following relatively comprehensive price reform in early 1992, a more gradual path of further market-oriented reforms was initiated. A comprehensive reform programme is under preparation with assistance from the World Bank.

Size of the private sector
About 20 per cent of GDP is thought to be generated in the private sector.

Large-scale privatisation
The presidential decree on Denationalisation and Privatisation of March 1994 sets the broad guidelines for the sale of state assets. About 4,000 medium-sized or large companies are marked for privatisation this year. The first auctions took place in March 1994. About a quarter of the state farms are to be privatised before the end of 1994.

Small-scale privatisation
Laws on Denationalisation and Privatisation and on Leasing were introduced in November 1991, with implementation in late 1992. By mid-1994, more than 50,000 enterprises, mostly small-scale businesses, had been privatised or leased, mainly in retail trade, consumer services, public catering and local industry. Housing privatisation is almost complete.

Property restitution
There has been no property restitution for former owners in Uzbekistan.

Growth of private enterprise
By April 1994 more than 11,000 private enterprises had been registered and 560,000 hectares of farm-land (over 10 per cent of the cultivated land) had been leased to private farmers. The main obstacles to the growth of the private sector include unfavourable entry rules, financial constraints, a high tax burden, lack of access to commercial space and low labour mobility.

Enterprise restructuring
Enterprise restructuring is hindered by the insider nature of the privatisation process together with the continued soft budget constraints, and the low degree of competition throughout the economy. Joint-stock companies will be transformed from their typically closed forms to allow ownership participation of outsiders. State farms have been transformed into cooperatives or joint-stock companies.

The Law on Bankruptcy was adopted in May 1994. No bankruptcy proceedings have yet been initiated.

The Law on Restrictions of Monopolistic Activities was adopted in July 1992 and further anti-monopoly regulation was approved by the government in March 1993. A Directorate for Anti-monopoly monitors market activity. About 350 enterprises are classified as monopolies and their output prices remain controlled.

Markets and trade

Commodity price liberalisation
Price regulations have intensified since the beginning of 1993 after price liberalisation in 1991 and 1992. Prices are set administratively for housing and transport, goods of "social significance" and goods produced in monopolistic sectors. In addition, profit margins are subject to regulatory limits.

Trade liberalisation
A system of state contracts and barter arrangements still dominates exports and imports. While virtually all exports are subject to restrictive licensing, imports outside the trade order system are relatively free of tariff and non-tariff restrictions. More detail on trade agreements and trade regimes is contained in Table 8.3.

Currency convertibility and exchange rate regime
An interim national currency, the karbovanets, was introduced in March 1993. Although the rate has in principle been floating since then, state intervention to reduce the pace of depreciation, including through limitations on convertibility, has been pervasive. A multiple exchange rate regime was reintroduced in August 1993 following a period of market-based exchange rate policies.

Wage liberalisation
A law on the indexation of wages and social benefits was passed in October 1991. Several measures and decisions have been taken to limit wage increases.

Interest rate liberalisation
A large share of bank lending is represented by state-directed credits at heavily subsidised interest rates. Real interest rates on non-directed credits remained strongly negative during 1993 but appeared to have become positive during the first quarter of 1994 (this is based on a comparison of monthly interest rates with actual inflation rates during this period).

Financial institutions

Banking system
The banking system consists of the National Bank of Ukraine, the five successor banks of the Ukrainian branches of former state-owned specialised banks, and over 200 other smaller (often undercapitalised) domestic private banks. The former state-owned specialised banks hold more than 90 per cent of the assets, branches and personnel.

Securities markets
The Law on Securities and Stock Exchange has been in effect since January 1992. Seven stock exchanges have been established, of which the Ukrainian Stock Exchange is most prominent (with at least 15 branches and more than 50 registered brokers).

Role of the state

Taxation
A number of new tax laws and decrees have been introduced since independence in 1991. A decree from December 1992 sets the rates for the two-tiered value added tax at 22 per cent and 28 per cent. Another decree adopted the same day set excise taxes on a string of goods at rates of 10-85 per cent. The Law on Income Taxation of Enterprises and Organisations (1992) provides for the taxation of enterprise revenues at 35 per cent. The Decree on Income Taxation of Individuals, effective since 1 January 1993, sets marginal rates at 10-50 per cent. Tax conditions for foreign investors are described in more detail in Table 9.3.

Commodity price liberalisation
The bulk of consumer prices were liberalised in January 1992. After a partial reversal of these steps, liberalisation was resumed in mid-1993. By early 1994 only the prices of basic necessities remained fixed. However, on other goods there are indirect price controls through ceilings on mark-ups for trade organisations and profitability ceilings for a range of producers in monopolistic positions.

Trade liberalisation
Trade with CIS countries is largely determined by bilateral intergovernmental agreements. In early 1994, it was made legal for private individuals to engage in foreign trade. At the same time customs duties on all imports were suspended until mid-1995 and the number of product categories subject to export quotas and export licensing systems was reduced from 70 to 26.

Export taxes apply to 65 product groups and range from 5 per cent to 50 per cent. Exporters must surrender 30 per cent of export proceeds at exchange rates set by the central bank. Information on trade agreements is contained in Table 8.3.

Currency convertibility and exchange rate regime
The som-coupon, a temporary national currency, was introduced in mid-November 1993, first as a parallel currency alongside the rouble and since early 1994 as the sole legal tender. Originally the som-coupon was pegged at one som to one rouble, but since mid-April 1994 the exchange rate has been determined via a managed floating system. Nevertheless, there is still a wedge between the official rate and the street rate reflecting less than full convertibility, including for current account transition. A fully fledged national currency was introduced in July 1994.

Wage liberalisation
Minimum wages and pensions are adjusted every few months to keep pace with inflation.

Interest rate liberalisation
Interest rates are linked to the central bank's refinancing rate and are negative in real terms. Preferential rates still exist for directed credits to priority sectors.

Banking system
A two-tiered banking system was introduced in early 1988. The Republican Law on Banks and Banking Activities was adopted in February 1991 and amended in May 1993. The statute of the central bank was approved in March 1992. Prudential regulations are fairly loose compared with international standards. There are over 40 commercial banks, including a few domestic private banks and an Uzbek-Turkish bank. Corporate banking remains dominated by Agroprombank and Promstroibank with about 90 per cent of total credit to enterprises. The National bank for Foreign Economic Affairs provides the bulk of foreign exchange services and administers the hard currency funds for the government.

Securities markets
A stock exchange was established in January 1992. The Law on Securities and Stock Exchange was adopted in September 1993.

Taxation
Enterprise profits are taxed at a rate of 18 per cent (for some branches between 12 per cent and 35 per cent); the VAT was reduced from 25 per cent to 20 per cent in June 1994; personal income is taxed at rates between 15 per cent and 50 per cent; excise taxes on selected goods range from 5 per cent to 130 per cent; there is a tax on foreign exchange receipts of 15 per cent; and export taxes are 5-50 per cent. Tax conditions for foreign investors are described in more detail in Table 9.3.

Social security
Attempts to streamline and improve targeting of the social security system have been made since the end of 1993.