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Beyond Transition

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Theme of the Issue: Labor Markets and Migration

New Findings

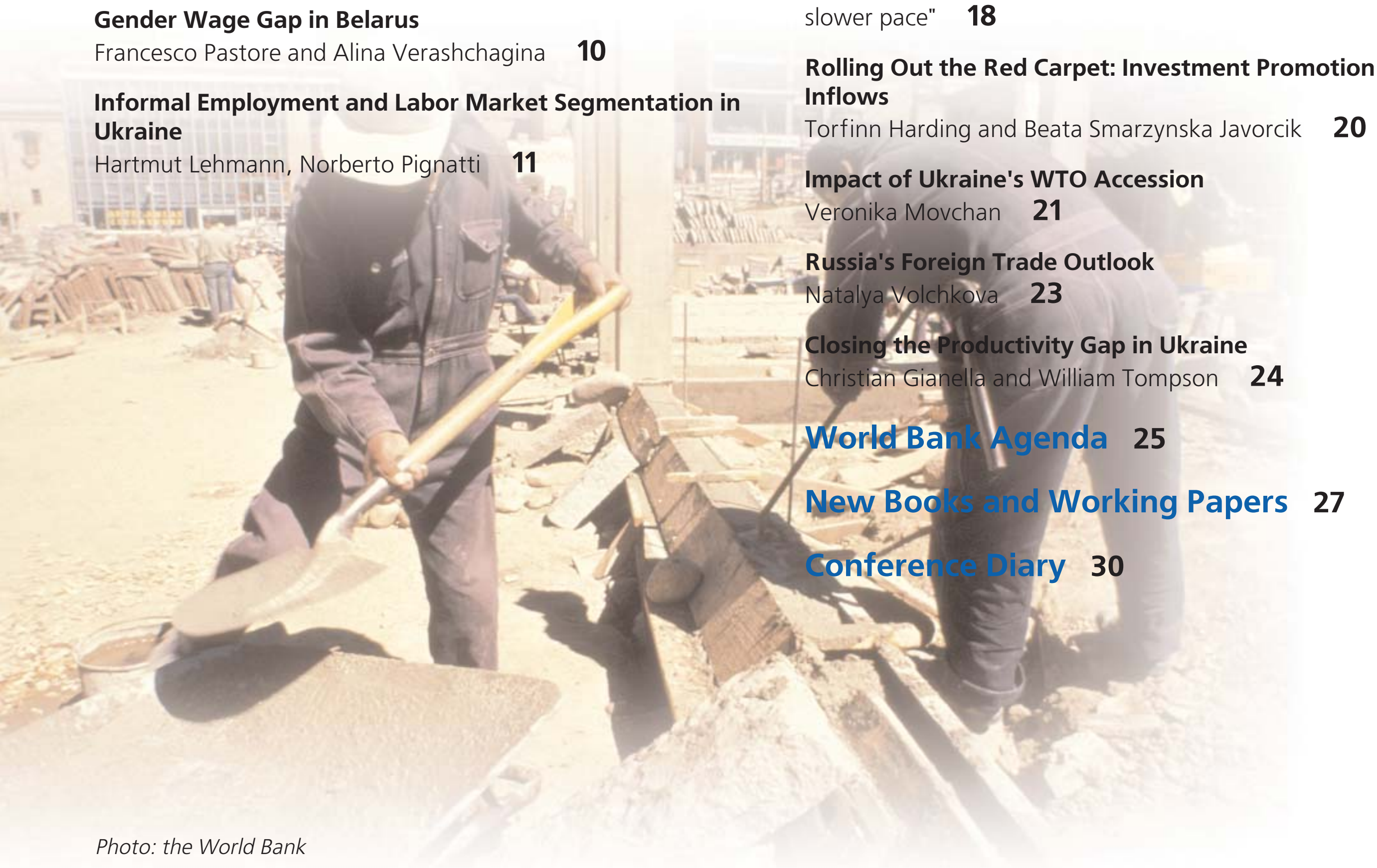

Photo: the World Bank

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From the Editor:

Dear Reader,

In this issue we look at labor markets in transition countries. As the transition process comes to an end, and transition countries converge either to the developed or developing countries clubs, the region is experiencing dramatic changes. In the 1990s labor demand in all transition countries declined. Existing firms were shedding workers, who either remained unemployed or looked for jobs in the new private sector, including the informal one. In Eastern and Central Europe, which introduced a Western European type of social security system, this process resulted in high unemployment rates and jobless growth. In the CIS countries governments often put pressure on firms not to shed labor, so adjustments were made in terms of wages and hours worked. After several years of high growth in the early 2000s the situation in the labor market has seen changes in both groups of countries. Firms have moved from "defensive" to "strategic" restructuring, which includes expanding markets and increasing market share (Rutkowski; Gimpelson and Kapelyushnikov; Denisova, Eller, and Zhuravskaya). Labor demand has increased rapidly, and skill shortage has become the major challenge for growth in all the countries. This gap can only partially be overcome by migration (Lazareva). At the same time labor supply behavior in transition economies has become very similar to the one in mature market economies (Bicakova, Slacalek, and Slavik).

In these new circumstances, labor policies mainly impact on low-skilled workers and women, who have higher unemployment rates and/or receive lower wages (Jurajda and Terrell; Bicakova, Slacalek, and Slavik; Pastore and Verashchagina). Many of these workers end up in the informal sector. Only few choose informal jobs of their own free will, while for the majority formal employment is a much more favorable destination as it produces a higher level of satisfaction and well-being (Lehmann and Pignatti; Krstic and Sanfey). Active labor market policies, such as public employment services and small business assistance can improve both employment opportunities and the incomes of workers (Rodriguez-Planas).

The New Findings section of this issue focuses on topics related to globalization. The impact of the recent WTO accession on Ukraine is estimated in the article by Movchan, while other challenges faced by the country are discussed by Gianella and Tompson. Volchkova examines Russia's export diversification opportunities, and related government policies. One of these policies is FDI promotion, and the study by Harding and Javorcik produces recommendations regarding the effectiveness of government efforts to attract higher FDI inflows.

Finally, in this issue we can not leave unnoticed the global financial crisis. Transition economies are highly open to trade and dependent on financial inflows, so the crisis may have a profound impact on their short-term growth opportunities. Two prominent economists — Robert Shiller from Yale University and Neven Mates from the IMF — agreed to discuss the nature of the crisis and its impact on transition economies in this issue of *BT*.

Ksenia Yudaeva, Managing Editor

From Job Shortage to Skilled Worker Shortage

To address skill and labor shortages countries need to increase effective labor supply

Jan Rutkowski

Until the early 2000s labor market outcomes were disappointing in virtually all New Member States (NMS — the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, the Slovak Republic and Slovenia, Bulgaria and Romania). Unemployment was high — often in double digits — and the employment/working age population ratio, at around 60%, was low and below the EU-15 average of about 65%. These unfavorable labor market outcomes persisted despite economic growth; in fact, many countries experienced periods of jobless growth.

Firms in these countries tried to become competitive by reducing costs and shedding redundant labor. The size of the new expanding sector (mainly small private firms and services) was too small to absorb labor released from declining industries (such as heavy industry and mining). Moreover, many workers, especially older ones, who lost their jobs in these declining industries, lacked the skills required in the new sectors and withdrew from the labor force, discouraged by the scarcity of job opportunities. This was facilitated by the availability of early retirement schemes and other welfare benefits.

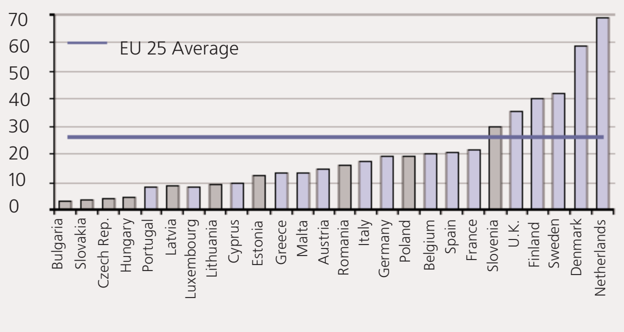
The scarcity of job opportunities is no longer present in the NMS. In the mid-2000s — ignited by favorable global market conditions, the EU accession of eight transition economies and an increase in the labor driven growth — labor demand picked up and since then jobs have become more plentiful. The most spectacular turnaround occurred in the Baltic States, but also in Poland and Bulgaria. For example, in Estonia the annual rate of employment growth increased from -2.0% during 1997-2000 to 3.7% during 2005-2006.

In the early 2000s the unemployment rate in the NMS hovered around 15% (with the exception of the Czech Republic, Hungary, Romania and Slovenia). Currently, in most countries the unemployment rate is below 10%. The most dramatic drops in the unemployment rate occurred in the Baltic States, Bulgaria, Poland and Slovakia. For example, in Lithuania the unemployment rate fell by nearly 11 percentage points over six years.

Surge in Labor Demand

What has caused the recent spectacular improvement in labor market conditions in the region? Strong economic growth can only be part of the story. Among other possible explanations for the recent fall in unemployment, an increase in firms' demand for labor associated with successful firm restructuring is the most plausible one.

Graph 1. Share of 15–24 in Part–Time Employment, 2006



Source: Eurostat, Bank staff calculations

The average job vacancy rate in the region, which is an indicator of the strength of labor demand, increased by almost 60% within the last two years alone. For example, from 2005 to 2007 the vacancy rate more than tripled in Lithuania, doubled in Poland, and almost doubled in the Czech Republic and Latvia.

The wage growth that has accompanied employment growth is yet another sign of an increase in labor demand in the region. During the most recent period (2003-2006) wage growth was strongest in the Baltic States, where large-scale out-migration (relative to labor force) reduced labor supply adding to the wage pressure.

While in the earlier period firms were able to meet the demand for their products by increasing productivity, and improving competitiveness through laying-off redundant labor — a process known as "defensive restructuring" — recently firms have moved to "strategic" restructuring, which is associated with using productivity gains to increase market share, expand output, and consequently, hire more workers. Strong and robust export growth since 2004 (at an annual rate of around 20%) supports the assertion that the countries reaped the benefits of the earlier restructuring efforts, became more productive, and can now successfully compete in the global market.

Low Participation Rates among Youth and Older Workers

While the unemployment rate has declined substantially, the employment/working age population ratio remains relatively low, especially among younger and older workers. In the NMS the average youth employment rate is 27%, compared with 40% in the EU15. The difference for older workers is less pronounced: 42% against 45%; however, it varies widely: from 28% in Poland, to 59% in Estonia. Clearly some countries face a bigger challenge in increasing the employment rate among older workers than others.

The youth employment rate is low because young people in the NMS tend to stay longer in education than their EU15 counterparts, and they are less likely to combine education with work. In few countries does youth account for more than 10% of part-time employment, which is still well below the EU25 average of 27% (see Graph 1). Young workers may also suffer from strict employment protection regulations, such as high rates of labor taxation or high minimum wages, which discourage employers from hiring inexperienced workers whose productivity is uncertain.

The low employment rate among older workers in the region is strongly affected by the design of social security systems. Many people of working age (55-64) are not employed because of the low statutory retirement age, and ample opportunities for early retirement. As a result, the average retirement age is significantly lower than the statutory retirement age (see Graph 2). In some countries the gap between the statutory and actual retirement age is striking, with Poland being the most dramatic example. In addition, many older workers take advantage of the often lax rules governing eligibility for disability pensions and use them as a substitute for retirement pensions or unemployment benefits. For example, disability pension recipients account for some 30% of all the economically inactive population aged 55-64 in Poland. In Estonia and Lithuania the share is even higher.

Pervasive Problem of Long–Term Unemployment

The incidence of long-term unemployment — which is the most socially costly form of unemployment — is still high at 53% in the NMS and Croatia compared with 42% in the EU15. Under conditions of strong labor demand, the long-term unemployed are largely workers who lack skills (or incentives) necessary to take available jobs. The problem is pervasive in virtually all countries in the region, but is particularly pronounced in Slovakia, Croatia, Romania, Poland and Bulgaria. Slovakia is an extreme case: three out of four unemployed persons are jobless for more than one year.

Less educated and older workers are disproportionately represented among the long-term unemployed. For example, in Poland workers with less than secondary education account for as much as 60% of the long-term unemployed, but only 40% of the employed. Apparently, long-term unemployment is strongly associated with poor or obsolete skills. This implies that unemployment in the NMS has a strong structural component that will persist even with further increases in labor demand.

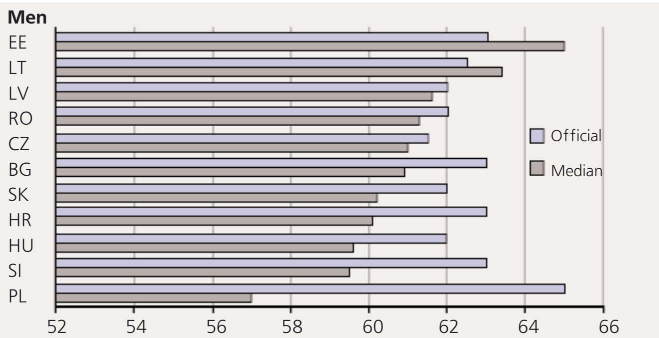
Skill Shortages: An Emerging Challenge

Skill shortages have become one of the top business concerns, and are increasingly seen as a constraint to future firm growth. On average in the NMS every third company found that lack of skilled workers is an important obstacle to business growth, especially in expanding companies. In Latvia, Lithuania, the Czech Republic, Poland, Romania and Hungary the skills of available workers were seen as an important obstacle to firm activity by 35 to 45% of all firms.

The substantial skills mismatch may mean that skills acquired under central planning became obsolete, but also may suggest that education systems are not effective in producing workers with the kinds of skills needed in modern economies.

In addition to skill shortages, labor shortages have also been rising recently, in particular in the booming construction industry, but also in manufacturing. It is skilled workers for whom demand has increased the most but who are in shortest supply. Outmigration to EU15 countries has contributed to labor shortages and to wage pressures.

Graph 2. Official and Actual (Median) Retirement Age in EU8+2, 2005



Source: Romans (2007), MiSSOC Database, National Strategy Report on Adequate and Sustainable Pensions (2006), Bank staff calculations

Policy Options

To address the emerging labor market challenges the countries need to increase the effective labor supply, that is the supply of workers that have incentives to actively seek employment, and skills that enable them to take newly created jobs. To do so they need to move in three directions:

- Improve labor supply incentives through reforming the social security systems and enhancing the opportunities for flexible work arrangements. The two target groups are youth and older workers. Labor force participation by young workers may be raised through enhancing labor market flexibility, introducing the youth sub-minimum wage (around 80% of the adult minimum wage) in countries where the statutory minimum wage is relatively high; and targeted reductions in social security contributions. Measures to raise the labor force participation of older workers include first and foremost limiting early retirement.
- Improve worker skills through reforming the educational systems so as to make them more responsive to labor market demands. Reforms aimed at improving worker skills include providing solid foundation for continuous learning to as many students as possible; expanding life-long learning opportunities to adapt to rapid technological change, and linking training to trends in the industrial and occupational profile of labor demand.
- Import labor with skills that are in short supply by opening labor markets to foreign workers. This is a fast way of dealing with labor and skills shortages.

Policies to address the factors causing labor shortages need to be tailored to country-specific conditions. While in some countries reforms should focus more on improving worker skills, in others they should focus more on removing labor supply disincentives created by the social security systems or on enhancing labor market flexibility.

The report was prepared by a team of World Bank economists in the region led by Jan Rutkowski. Full text of the World Bank EU8+2 Regular Economic Report published in September 2007 is available at: www.worldbank.org/eu8-report. **BT**

Regional Unemployment and Human Capital in Transition Economies

High wage floors support the high regional unemployment disparities

Stepan Jurajda and Katherine Terrell

Why are differences in regional unemployment in post-communist economies so large and persistent? For example, in 2001 the Czech district of Most was facing a 20% unemployment rate, while the nearby Kladno district had 10% unemployed and Prague-West, which neighbors on Kladno, had less than 5% of the economically active population jobless. In existing research, institutional deficiencies, such as underdeveloped housing markets, have been typically blamed for the finding of weak labor migration's ability to equilibrate cross-regional unemployment differences.

We search for a different explanation motivated by two observations. First, the transition from central planning to markets is occurring in an era of skill-biased technological change. Indeed, recent cross-country and cross-industry research suggests that global shifts in labor demand towards skilled labor are important for national unemployment levels in post-communist economies. Second, transition economies inherited large regional differences in human capital endowments.

Regional Variations Increased Over Time

Our study starts by pointing out that regional variations in skill endowments in transition countries are wide in comparison to developed European economies and have increased over time. There are large differences among local areas in the share of college-educated workers (see Graph). In any country, one would expect to find an inordinately high share of college-educated individuals in the capital city, given the concentration of universities, cultural amenities valued by the highly educated, and public institutions staffed with a highly educated labor force. However, we find an extensive variation in the share of the college educated population even outside the capital city. For example, in 2001 in Bulgaria, the share of the adult population with a college education ranged between 7% and 17% outside of the capital city, and in Ukraine, between 9% and 19%. Moreover, the increase in the share of college educated workers was faster in areas that began the transition with more college-educated workers.

This pattern could reflect a dynamic that explains the persistent dispersion of regional unemployment rates. Complementarities between skilled workers and between capital and skills could motivate skilled labor and capital to flow to regions where skilled labor is plentiful, rather than where it is scarce. Skilled-biased labor migration could reinforce and exacerbate regional differences in unemployment, explaining the lack of equilibrating migration found in other studies.

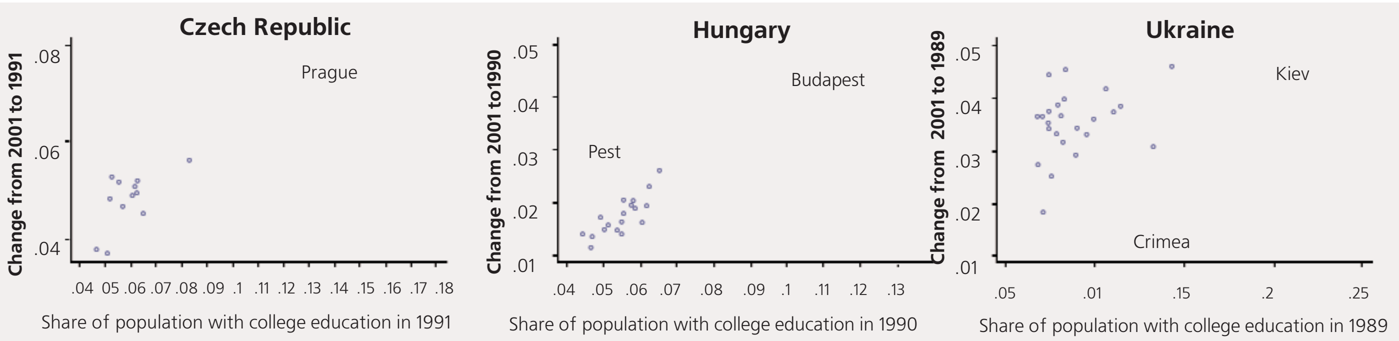
Alternatively, the early-transition regional distribution of skills could be related to initial regional shocks to labor demand. When local demand for labor collapses, low-skilled workers may be less likely to migrate and hence more likely to remain unemployed than high-skilled workers, whose opportunity cost of not working is higher. This would exacerbate the level of unemployment of the unskilled in areas with a large share of unskilled workers, creating more dispersion in the unemployment rates of regions.

Skilled Migration Higher Than Non-Skilled One

To explore these mechanisms, we use regional (NUTS-3 level) and worker-level data from the Czech Republic, Hungary, Bulgaria and Ukraine to measure the explanatory power of regional skill endowments for regional unemployment. We also study the related capital and labor flows and potential skill complementarities.

First, variation in regional human capital explains the lion's share of the variation in regional unemployment rates in transition economies. This is not only because of the national unemployment differences across skill groups, but

Divergence in Regional Shares of College Educated at NUTS3 Level



Note: Data is at the NUTS-3 regional level. NUTS are the Nomenclature of Territorial Units for Statistics, level 3 corresponds to counties/regions/districts also because the unemployment rate among the least skilled workers is substantially lower in regions endowed with high shares of college-educated workers. We also show that the persistence of regional unemployment over time is especially strong among the low-skilled.

Next, we study cross-region migration by skill using the data from the 2001-2003 labor force surveys. We find that low skilled workers are less likely to migrate than high skilled workers, who tend to migrate to regions with a relatively high concentration of skilled people and low unemployment. Similarly, we find that foreign direct investment tends to flow to regions with high skill levels, although this evidence is weaker when capital cities are excluded.

We then ask about the two potential mechanisms that could explain these labor and/or capital flows and the patterns of regional unemployment by education groups: (i) the presence of complementarities and (ii) differences in the response of skilled and unskilled individuals to regional demand shocks, which may be driven in part by centralized labor market institutions.

We find little evidence for complementarities using an identification strategy recently employed in US research, which relies on the historical location of colleges to identify exogenous variation in regional skill endowments.

The Role of Labor Market Institutions

Do labor market institutions contribute to the lack of migration of unskilled workers and lack of convergence of regional unemployment rates? The social safety net with its minimum guaranteed income level (effective minimum wage) may discourage work in regions affected by negative productivity shocks and lower the variance of the wage of less skilled workers across regions, lowering the benefits from migration. Consistent with this argument, we find that in the more developed labor markets of Central Europe the regional variance of the wages of low skilled workers is much lower than the variance of the wages for high skilled workers. On the other hand, unemployment among the highly educated varies much less across regions than unemployment of the least skilled workers. This comparison is less stark in Bulgaria and Ukraine, where social safety nets are less comprehensive.

Thus, high wage floors in Central Europe seem to lower the incentives for less skilled workers to migrate and support the high regional unemployment disparities.

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Employment Trends in Non–EU ECA Countries

The rather good economic performance seems to finally impact on employment-to-population ratios. The downward trend, observed ever since the breakdown of the Soviet system, finally stopped and a slight increase of the ratio has been observed in recent years. The male employment-to-population ratio in 2007 was 0.4 percentage points higher than ten years ago, at 63.8%. Women's ratio in 2007 was 0.5 percentage points higher than ten years ago at 45.6%. Employment-to-population ratios for young people also seem to have reached a turning point with an upward trend in recent years, but they are still only at the same level as ten years ago, a rather low 36%.

Unemployment rates continue to be high with only a very slow downward trend which, of course, further discourages people to participate in labor markets. The unemployment rate for the whole region was 8.5% in 2007, unchanged from the previous year. The youth unemployment rate was at 17.3 per cent in 2007. The region has traditionally not seen big differences in unemployment for women and men, and for the overall unemployment situation women actually have a lower unemployment rate than men. But, in the youth cohort, women face a higher unemployment risk than men, which was not the case right after the transition took place. This should be seen as a warning sign that gender equality in labor markets has started to deteriorate.

The main tasks for Central & South-Eastern Europe (non-EU) & CIS countries are to reverse high unemployment and low employment rates so that there is better use of the potential offered by the working age population. This will only be possible if macroeconomic policies are launched that boost investment and decent job creation and if labour market and social policies contribute to the inclusion, especially of young people, and to poverty reduction. Given that economic growth, so far, has neither led to considerably lower unemployment nor to less risky employment situations, it is not surprising that the region faces big emigration flows. The level of migration is of increasing concern because of the exodus of well-skilled nationals, which may reduce the capacity for long-term economic development. This is particularly troubling given that the youth share in the working-age population, which was already very low in comparison to other countries, will further decrease. If not identified as a major concern the ageing and decreasing of societies will turn into a constraint for further development in the region. The challenges for labour markets, social security systems, pension policies, health care, savings and consumption patterns are enormous.

Source: Global Employment Trends-2008, the International Labour Organization, http://www.ilo.org/global/What_we_do/Publications/lang--en/docName--WCMS_090106/index.htm **BT**

Wages in Russia: Evolution and Differentiation

The growth in wage inequality and the wage race will most probably continue in the medium term

Vladimir Gimpelson, Rostislav Kapelyushnikov

An analysis of the Russian wage formation shows that its key distinguishing feature is a high degree of flexibility. Reaction to economic shocks is manifested above all in the change of the price of labor while the level of employment is little affected. In periods of economic decline a minority do not lose their jobs, but all workers see their wages drop. The benefits of growth, in turn, translate themselves not so much into the creation of new jobs as into overall growth of wages. Whatever jobs are created are mainly in the informal sector of the economy. Thereby, economic growth increases segmentation in the labor market.

This model "saved" low-productivity jobs in the Russian economy in the most difficult periods of the 1990s thus helping to keep unemployment at a relatively low level. However, the stability of such a model in the future is far from guaranteed.

A Unique Wage Structure

The high degree of wage flexibility stems directly from the unusual structure of the wages themselves. In Russia the share of the fixed (guaranteed) part of pay has been and remains very low by international standards, at about 50-60%. Accordingly, much of the remuneration is variable and is made up of bonuses, benefits, lump-sum payments, etc. At the same time the share of the "non-wage" component in the structure of labor costs is no longer disproportionately large and is approximately at the same level as in most developed or post-socialist countries.

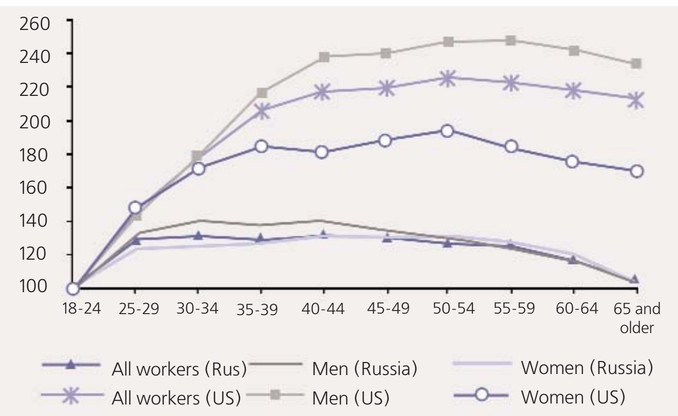
In terms of overall wage inequality, Russia is among the most unequal countries in the world. Russian wages are not only flexible, they are closely related to:

- the region, which is the key differentiating factor because of the high cost of migration and low level of labor mobility;
- the sector of industry to which the enterprise belongs;
- the professional status of the worker;
- the financial and economic performance of the enterprise.

When setting wages Russian employers proceed from the economic situation at their enterprises rather than the national wage scale or the situation in the local labor market. Such factors as gender, age, employment history, and education contribute only little or not at all to wage inequality.

A comparison of the wages of more experienced and less experienced workers makes paradoxical reading (see Graph). In Russia the upward trend of the individual's wage curve ends by the age of 35 and workers at the most productive age earn only 30-40% more than young people. This can be compared with a 2-2.5 times difference in the US where relative wages may also continue to grow until the age of 55. Obviously, the Russian mechanism of wage-setting is greatly distorted. A large proportion of the knowledge and skills acquired by the older generations in the planned economy have been dramatically devalued and these losses of human capital are unlikely to ever be made up.

Age–Related Changes of Relative Wages in Russia (2005) and the US (2004) (Wages of 18–24 Age Group = 100%)



Minimal Importance of Minimum Wage

For most of the transition period in Russia the minimum wage has been so low that its impact on the labor market has been barely noticeable. Nor were low-productivity workers pushed out of the labor market as normally happens in developed countries and post-socialist countries. These workers kept their jobs, but had to accept a very low pay — often much lower than the official poverty line. The fact that a huge mass of unproductive (and low-paid) workers stayed in the labor market was an important factor behind the dramatic drop in labor productivity and, on the other hand, a significant growth in wage inequality. It cannot be ruled out, however, that the attempts to raise the minimum wage that have been stepped up in recent years may result in low-productivity workers being pushed out of the labor market.

Possible Future Scenarios

The persisting gap in wages is currently accompanied by another important trend: a faster growth of real wages compared to labor productivity.

Russia has yet to work out institutional mechanisms for curbing wage inflation. In the countries of continental Western Europe such a mechanism is provided by the coordination of the wage policy between employers and the trade unions aimed above all at protecting the interests (and maintaining the competitiveness) of the most competitive sectors.

The high level of wage inequalities, while contributing to a high turnover of manpower also spurs the wage race. Besides, it is a disincentive for employers to invest in personnel training while encouraging them to "poach" workers from their rivals. The result may be further growth of wages not matched by higher labor productivity.

There is a high probability that both trends will continue in the medium term. They will inevitably leave an imprint on all the other aspects in the country's economic development which until recently has seen a growing labor supply. But the situation is changing rapidly and within a few years the Russian economy may face a constantly shrinking workforce.

At the same time, the continued high rate of economic growth in Russia would mean that labor demand will constantly increase. A combination of these opposite trends — steady decline of labor supply and steady growth of demand for labor — will inevitably send wages upward.

The progressive growth of the cost of labor may undermine the competitiveness of many Russian enterprises on the international and domestic markets. The sectors that produce tradable goods will be particularly vulnerable. In the future the shrinking and highly inelastic labor supply may become the major constraint on the growth of the Russian economy.

Policy Recommendations

The government's actions to bridge wage inequalities could proceed in two main directions:

- Strengthening the mechanisms of market selection would speed up the "sifting off" of inefficient enterprises with low-valued labor. That would stimulate the reallocation of workers into competitive sectors with a higher price of labor, and would thus bridge the gap in wages.
- A lowering of administrative barriers and the costs of migration would speed up the flow of labor from low-wage to high-wage regions. An increase of wages in sending regions and a decline of wages in receiving regions would eliminate interregional differences and thus reduce the overall wage inequality.

Vladimir Gimpelson is the Director and Rostislav Kapelyushnikov is Deputy Director of the Labour Studies Center of State University — Higher School of Economics, Moscow. The article is based on Chapter 8 and the Summary chapters of the book "Wages in Russia: Evolution or Differentiation" (SU — Higher School of Economics, 2007), edited by the authors. BT

Russian Labor Market Flows in Transition

The transition from a command to a market economy caused a significant reallocation of resources, especially of labor. Based on micro-level data from 11 rounds of the Russian Longitudinal Monitoring Survey covering the years 1994-2006, we estimate labor market trajectories in Russia with special attention to flows between state and private sector and upward and downward occupational mobility. In particular, we estimate conditional probabilities at each point in time for a person to move between different labor market sectors: work for wages, self-employment/entrepreneurship, unemployment and out-of-the-labor-force. Within work for wages, we identify those working in the public sector or at state enterprises with no private participation versus those working at private or mixed-ownership enterprises. In addition to the private/public division, we introduce a distinction between having a high-qualification job versus a low-qualification job. Our main findings are as follows:

- The public sector was shedding labor throughout the period, with the major flow being to jobs in the private sector. The share of males staying within the public sector declined from almost 80% in 1990 to 27% in 1994. This trend continued in the period 1994-2000 with almost a half of all males leaving the public sector. The share of females staying in the public sector diminished during the early 1990s and then stabilized but at a higher level compared to males. This is consistent with other pieces of evidence that point to the fact that many families in Russia diversify risks across sectors with males working in the private sector and females working in the public sector.
- The private sector strengthened dramatically during the period and substituted for the public sector. The share of both males and females working in the private sector reached about 60% in recent years. The flow from unemployment to work in the private sector increased from 15% to 25% for males and from 10% to 17% for females after 2000. This is another indication of the fact that the private sector overtook the public sector in Russia, and more unemployed found jobs in the private sector compared to the public sector. As transition proceeded, more graduates started their careers in the private sector or in self-employment.
- Self-employment served as a buffer in the period of financial crisis. The stock of self-employed in the economy in 2006 reached 3-4% of the working age population for males and 2-3% for females, which is rather low by international standards. Self-employment and entrepreneurship attracted labor from wage jobs, especially in the public sector. The most intensive changes took place in the early 1990s while after 2000 the in and outflows balanced out. The stability of self-employment also increased dramatically and now, following one year of self-employment, almost 50% of males and 60% of females stay self-employed for a second year in a row.
- The transition-related movements of people with the same qualifications between the public and the private sectors are especially pronounced among those in mid and low qualification jobs. About 20% of males and 15% of females in low position jobs in the public sector moved to the private sector. The reverse movement declined steadily throughout the period and resulted in halving the share of people holding low position jobs in the private sector from almost 20% in 1995 to 10% in 2005.

Source: CEFIR/NES Policy Paper No. 28 "Transition Patterns in the Russian Labor Market: 1994-2006" by Irina Denisova, Marcus Eller, and Ekaterina Zhuravskaya. BT

Labor Supply Behavior in the Czech Republic

Labor supply in countries with high labor force participation rates is less sensitive to wages

Alena Bicakova, Jiri Slacalek and Michal Slavik

In many planned economies — including Czechoslovakia, East Germany, and the Soviet Union — labor force participation was obligatory during Communism. Although a gradual withdrawal from the labor market occurred after the change of regime, labor force participation rates in many transition countries, in particular among women, remain high, when compared to mature market economies such as France, Germany and the US (see Table).

Using 2002 household income survey data, we estimate the wage elasticity of labor force participation using two different definitions of wage: gross wage, ignoring the tax and benefit system, and the effective net wage, which takes into account the taxes paid and benefits received. We interpret the difference between the two specifications as a behavior-based measure of welfare system disincentives, which we consider to be more preferable for policy discussions than the traditional ex ante make-work-pay indicators.

Behavior of Czech Labor Supply is Comparable to Other Market Economies

We find that a 1% rise in the gross wage increases the probability of working by 0.16 and 0.02 percentage points for women and men, respectively. When we substitute the gross wage with the effective net wage, these semi-elasticities fall to 0.06 for women and 0.01 for men. Under both specifications and for both genders, wage sensitivity of the labor force participation decreases with earnings. Gross wage elasticity in the top wage quintile is lower, by 47% for women and by 85% for men, than the elasticity in the bottom wage quintile; the corresponding differences for the effective net wage are similar: 83% for men and 41% for women.

Measured as the difference between the marginal effects for the gross and the effective net wage specifications, the welfare system disincentives are greater for women than for men and vary only a little with wages. The marginal effect of the effective net wage on labor force participation is lower than the effect of the gross wage by 65% and 57% for women and men, respectively. The disincentives vary between 52% and 57% for men and between 63% and 67% for women across the five wage quintiles and tend to be a bit lower for the rich.

Labor supply behavior in the post-transition Czech Republic is comparable to the one in mature market economies in other aspects as well. While other sources of household income reduce labor force participation of both genders, being married and having young children has an adverse effect only on women's decision to work.

Pre and Post-Transition Participation Rates (percent)

	Men		Women	
	1988	**2005**	**1988**	**2005**
Czech Republic	97.0	94.8	93.1	81.6
Slovakia	96.9	93.2	88.8	82.5
Russia	96.2	92.5	91.7	86.3
Germany*	90.6	93.3	60.8	80.0
France	95.6	93.6	71.2	80.3
United States	93.5	90.7	72.7	76.7

Notes: Participation rates (ratios of economically active to total population) for individuals between 25 and 54 years of age.
** 1988 figures exclude the German Democratic Republic.*
Source: ILO, http://laborsta.ilo.org/.

Our estimates of the wage elasticity of labor supply are at the lower end of the range of values documented in previous research that was mostly focused on the mature market economies.

The small size of our estimates is consistent with other empirical evidence that labor supply in countries with high labor force participation rates, such as in the Czech Republic, tends to be less sensitive to wages. We therefore expect a limited response of labor supply to wages also in other post-transition countries which have retained high labor force participation rates since the Communist period.

Policy Implications

Our findings suggest that changes in taxes or benefits resulting in changes of the effective net wage will have the greatest impact on individuals at the bottom of the wage distribution and also on women (rather than on men).

Policy measures aimed at enhancing labor supply should therefore primarily target these groups and focus on income taxes at the lowest tax brackets and on the potential disincentives of unemployment benefits and benefits to low income families. Under the current benefit scheme, major changes in labor force participation should not be expected in response to changes in tax levels because the estimated effects are fairly small even for the most wage-elastic individuals.

As part of the changes in the Czech welfare system, tax reform implemented in January 2006 extended the range of the lowest tax bracket and decreased the tax rate in the lowest two brackets from 15% to 12% and from 20% to 19%, respectively. Its focus on the reduction of disincentives due to the tax burden of the individuals with wages in the lowest quintile of the wage distribution is in line with our finding that it is low wage individuals who are likely to respond to the changes in the effective net wage the most.

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Gender Wage Gap in Belarus

The slow transition process has not been gender neutral, and the gender wage gap is on the rise

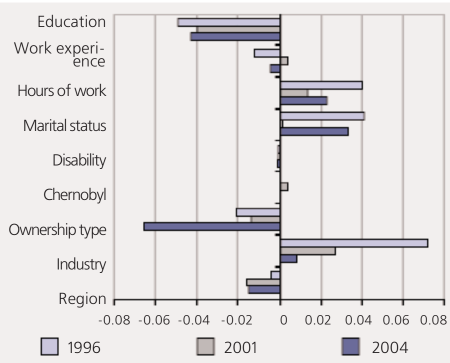
Francesco Pastore and Alina Verashchagina

In all transition economies women have been one of the weakest groups in the labor market and the ones who have had to pay the cost of increasingly hard budget constraints for the state, firms and households. As the state has progressively reduced its presence in the economy, it has also reduced expenditures on income support schemes for maternity and the provision of childcare facilities. Privatization and market competition have also reinforced firms' preferences towards hiring men over women. Thus, economic transition has increased the opportunity cost of child rearing, forcing women to substitute market for non-market work. This might have reduced the productivity of women and, therefore, also the relative demand for women's labor.

In Central and Eastern European countries, firms have been constrained by stronger labor market institutions and wage setting mechanisms, so female relative wages have remained stable, while female participation has reduced. In the CIS countries, however, labor market institutions appeared to be weaker and for a long time the state was taking on the cost of social distress by maintaining higher than acceptable levels of employment and a living wage for all. This has pushed firms to reduce female wages, rather than employment. As a result women might have been able to reduce their effort and productivity due to a smaller reduction in labor supply, but in exchange for greater relative wage losses.

Belarus can be seen as an extreme case of the CIS model of transition, where the so-called model of "market socialism" prevailed, and firms had to keep the entire workforce. Soft budget constraints and the absence of bankruptcy risks for firms translated into incentives for women to maintain practically the same level of labor supply. Indeed, from 1996 to 2004 female participation was high at over 80% — at Soviet-era levels. Consequently, women had to accept wage reductions. This explains why in the face of remarkably stable participation rates of women, the gender wage gap (GWG), in terms of both total, net monthly and hourly wages has more than doubled. What are the causes of such deterioration of women's position in the labor market?

Contribution of Observed Characteristics to the GWG



Note: Using log of net monthly wage as dependent variable.
Source: own estimates using BHSIE.

Factors Driving the Gender Wage Gap

To explore the issue, we develop a simple analytical framework and test it using data from three rounds of the Belarusian Household Survey of Income and Expenditure (BHSIE) conducted in 1996, 2001 and 2004. Our sample includes only the working age population holding a paid job.

Several offsetting factors appear to be at work. Sizeable positive shifts have been observed as to the educational level of employed women: university and secondary school graduates have slowly but continuously crowded out women with lower levels of education. Moreover, women's attainments in education have been increasing at a faster rate than men's. However, the shifts in the industrial composition of employment by gender have been striking. While in 1996 men and women were almost evenly distributed across sectors, a massive process of horizontal segregation has led an increasing number of women to move out of the highly valued so-called "material production", as well as IT and communications — a sector providing some of the best-paid jobs in the country. At the same time there is as increasing presence of women in low-wage public service jobs concentrated in traditionally female dominated sectors, like education and health.

The results suggest that the higher and increasing educational level made women able to "swim upstream" and to more than offset unfavorable changes in the structure of employment until 2001 (see Figure). Furthermore, the redistribution of women towards low-paid industries and their concentration in the state sector had an opposite effect of wages, jointly driving the increase in the GWG.

Conclusion

Despite the apparent stability of the female participation rates in Belarus, the slow transition process has not been gender neutral and has hit women harder than men. Our findings suggest that, although lower than in Russia and Ukraine, the gender wage gap is on the rise in Belarus.

Gender differences in pay are not only unjust, they are also detrimental to the functioning of the economy, as they can lead to poverty and social exclusion. In Belarus, the contribution of working women to the well-being of the household is decisive, therefore if they face difficulties in finding good jobs, households run a serious risk of falling into poverty.

The policy priority should be on increasing the competitiveness of women in the labor market, by for example, controlling the gender distribution in educational establishments and adjusting the education system to the changing needs of the economy. Working out schemes allowing women to combine motherhood and work, including expanding part-time job opportunities, would help to prevent the devaluation of female labor.

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Informal Employment and Labor Market Segmentation in Ukraine

Formal employment is by far the most favored destination for workers

Hartmut Lehmann, Norberto Pignatti

Ukraine has found itself in a prolonged transition recession for most of the 1990s. Reform efforts have been inconsistent and incoherent, making Ukraine one of the "laggards" among the transition countries. Only towards the end of the period did reform efforts by the government lead to positive growth of GDP.

Using the Ukrainian Longitudinal Monitoring Survey (ULMS), a nationally representative survey of the Ukrainian working age population, we investigate to what extent the informal sector plays a role in labor market adjustment in a transition economy. We define informal employment or informal economic activity of the self-employed as employees without a formal contract and self-employed activity that is not registered. Workers in formal employment relations are treated as formally employed salaried workers, even if they might receive part of their wages in an informal fashion, as undeclared "envelope payments".

From the data, we observe that the employment structure has significantly changed between 1991 and 2004 (see Table). The agricultural and industrial sectors lost employment shares (even if agricultural employment was still relatively large compared to many transition economies) while the services sector grew. However, the "laggard" status of the Ukrainian economy is clearly reflected in the low share of employment in privatized and new private firms. For comparison, in Central European countries, by 1997, the average employment share in the private sector was 65%. Very striking is also the low share — in international perspective — of the self-employed: 4% compared with 13% in both the Czech Republic and Hungary, 16% in Poland and 6% in Russia.

While in a centrally planned economy much of production took place in large conglomerates, the employment share of workers in relatively small firms was accelerating in Ukraine between 1997 and 2004. By 2004, nearly half the workforce was employed in firms with less than 50 employees.

A Segmented Labor Market

According to conventional wisdom growth in an economy translates into the expansion above all of formal employment relations. However, the strong growth of the Ukrainian economy between 2003 and 2004, which brought with it a substantial fall in the unemployment rate, did not result in an expansion of formal employment. Instead, the fall in unemployment was entirely driven by growing informal employment relations.

The analysis undertaken with the help of transition matrices, however, points to the existence of a segmented labor market in Ukraine. Our findings indicate that most workers try to enter formal employment and seem to use unemployment as well as informal dependent employment as waiting stages for entry into formal dependent employment. The flow analysis also demonstrates that at all ages workers line up for dependent formal employment, which is by far the most favored destination. At the same time, some workers are forced to take up informal salaried jobs, while a minority engage in informal jobs of their free will.

Our wage analysis further confirms labor market segmentation. In particular, our analysis points to a segmented labor market for dependent workers. This segmentation includes formal jobs, "upper tier" informal jobs that are well remunerated but have restricted access, and a majority of informal jobs that workers are forced to take up but bring no gain when workers move into them. Whenever possible, workers move from these latter jobs to formal employment relations.

There is less segmentation in urban self-employment, as returns to both formal and informal self-employment are of the same magnitude. The difference-in-differences analysis that compares earnings outcomes of stayers and movers also confirms our contention that informal self-employment in urban areas is voluntary since movement into this type of employment is associated with large gains in earnings. In rural areas, informal self-employment is above all linked to subsistence agriculture with the extremely low returns inherent in this type of economic activity.

Employment Changes by Sector, Ownership and Size, 1991–2004

	Sector (% share)*			Ownership (% share)**			Size (% share)	
	Agriculture	Industry	Services	Privatized	New Private	Non-Agricultural Self-Employed	Firms with over 100 employees	Firms with less than 50 employees
1991	15.98	32.01	47.21	1.59	1.26	0.33	33.77	23.54
1997	16.30	26.21	52.89	11.73	8.33	2.02	41.36	30.13
2004	13.59	23.07	59.18	19.59	20.09	4.36	53.98	43.52

*Notes: * Excluding public administration share. ** Including public administration employees.*
Source: ULMS.

Hartmut Lehmann is a Professor of Economic Policy at the University of Bologna and Program Director of the IZA research area "Labor Markets in Emerging and Transition Countries". Norberto Pignatti is a Research Fellow at the Department of Economic Sciences of the University of Bologna. The study can be accessed at http://ftp.iza.org/dp3269.pdf (IZA Discussion Paper No. 3269). **BT**

Informal Employment in Bosnia and Herzegovina

Highly educated people, stuck in low-skill informal jobs, run the risk that their skills will be eroded

Gorana Krstic and Peter Sanfey

According to IMF estimates, real GDP in Bosnia and Herzegovina (BH) trebled over the period 1996-2004. However, there is still great uncertainty about the size of the Bosnian economy, GDP growth, unemployment, etc. as official statistics fail to take account of informal activities, which are generally believed to be widespread throughout the country.

We study the degree of flexibility in the labor market and the role of formal versus informal activities for reducing poverty and inequality and enhancing life satisfaction in BH. Our analysis is based on panel data from the Livings Standards Measurement Studies taken between 2001 and 2004.

Perhaps the most remarkable observation from the data is the dramatic increase, by nearly ten percentage points, in the labor force participation rate between 2001 and 2004. The data also show how significant the informal sector remains — representing nearly 43% of total employment in 2004, although its size as a percentage of total employment has fallen between 2001 and 2004. Compared to the formal sector, monthly earnings in the informal sector are on average about 30% lower.

Mobility is Surprisingly High

We find that the degree of movement, even in one year, from one category of the labor force to another is surprisingly high when compared to other transition countries. The informal sector is a significant source of labor mobility, providing more job opportunities for the unemployed and inactive but also having more job destruction than the formal sector. For example, almost two-thirds of those who lost or left a job between the two surveys had a job in the informal sector in 2001.

More educated people are the most likely to move from informal to formal employment. For instance, workers who completed college (in 2001) were 30% more likely to move from informal to formal employment, relative to those with secondary education. Across sectors, workers in the service sector were most likely to move from informal to formal employment; and those in agriculture least likely.

Formal Employment is Better at Reducing Poverty

Our findings indicate that informal employment helps to reduce poverty but by much less than formal employment. Transitions to formal employment were associated with a higher probability of escaping poverty relative to staying in informal employment. More than 65% of workers who moved out of poverty between 2001 and 2004 remained or became employed in the formal sector. Informal workers were less likely to escape poverty over this period relative to formal workers and saw lower consumption increases than formal workers. In fact, it is the formally self-employed who faced the lowest poverty incidence, suggesting that formal self-employment may be an important route out of poverty.

Those who made the move from informal to formal jobs gained significantly in terms of increase in earnings, with average monthly earnings for this group rising by 26% (in nominal terms) over a three-year period.

Higher Inequality

Using various inequality measures we establish that, firstly, earnings in formal employment were higher than in informal employment in 2001 and 2004, and the ratio between the two increased slightly over that time. Secondly, inequality in both sectors declined over time. Thirdly, inequality was higher in both periods in the informal sector relative to the formal sector, possibly due to the relatively high minimum wage, which is enforced in the formal but not in the informal sector.

The Least Happy

Looking at how subjective estimates of well-being are correlated with different labor market positions in 2004, we find that workers in formal employment showed higher levels of satisfaction than informal employees. The formal self-employed reported the highest levels of satisfaction. With the sole exception of the unemployed, informal employees were the least happy among the working-age population, even when controlling for differences in income.

Conclusions

Should we care about the large size of the informal sector, and if so, what can be done about it? Even though the informal sector represents an important safety net for many individuals and families, there are good reasons for the authorities in BH to try to bring these people into the formal economy. The main reason is that informal economic activities often act as unfair competition for those who play by the rules, and they also represent a loss of tax revenues to the state, implying a higher burden for others. An additional benefit of bringing people into formal employment is that this may lead to an improvement in the accuracy of BH's (up to now) notoriously unreliable real economy data.

Our results on self-employment suggest the need for further efforts to promote entrepreneurship and the creation of micro-enterprises. Many highly educated people are stuck in low-skill informal jobs and run the risk that their skills will be eroded over time and therefore options to move to better-quality jobs in the formal sector will be reduced. A much better option for some is to open their own businesses.

Peter Sanfey is a Lead Economist at the EBRD and Gorana Krstic is a Senior Economist at the Economics Institute, Belgrade. Full text of the paper can be accessed at: http://www.ebrd.com/pubs/econo/wp0101.pdf (EBRD Working paper No. 101). The paper has been published in Economic Systems, vol. 31 (2007), pp. 311-335. **BT**

How Do Active Labor Market Programs Work in Romania?

The programs offer tangible benefits to specific sub-groups and should be targeted accordingly

Nuria Rodriguez-Planas

After initial economic contraction in the early 1990s, Romania experienced a second period of economic decline in 1996, which was mainly caused by a lack of enterprise restructuring. The recovery was slow and did not produce significant results until 2000. Since then, the economy has grown at an average of 4-5% per year. Growth was accompanied by the fall in registered unemployment from 11.5% in 1999 to 9% in 2001.

To help the unemployed during the transition period, as early as 1991, the Romanian government adopted passive labor programs, such as unemployment benefits. In addition, in 1997 it launched active labor market programs (ALMPs). Two programs offered on a relatively large national scale were:

- *Public Employment Services* (PES), which offered counseling, job search and placement assistance, and
- *Small-Business Assistance* (SBA), which provided counseling in developing and implementing a business and often included financial assistance.

Since the primary objective of both programs was to get the unemployed workers back into jobs that were, at least implicitly, as good as previous ones, I examine the direct effects of the two programs, that is, workers' reemployment probabilities (in paid or self-employed jobs), and their earnings at the new job. I also determine which population groups these programs work best for, and relate these differences to different institutional set-ups and theoretical explanations.

The evaluation is conducted using rich survey data and matching methods. The analysis is based on a 2002 survey of 2,610 persons who registered at the Employment Bureau during 1999. About two-fifths of the sample was ALMP participants, and the rest were unemployed non-participants who were registered as unemployed around the same time and in the same county as participants. The data allowed us to observe earnings and employment status at least 24 months after the programs had started.

ALMPs are Superior to Non-Participation

Consistent with recent empirical evidence in developed, transition, and developing countries (see references in Bibliography), the analysis shows that participation in either program was successful in getting the unemployed back to work. Compared to non-participation,

- PES improved participants' economic outcomes in all dimensions. It increased the probability of being employed at the time of the survey by 8.45 percentage points (or 20%) and improved the likelihood of being employed for at least six months during the two-year period 2000-2001 by 6.22 percentage points (or 9%). It also reduced the accumulated number of months participants were unemployed by almost two months (or 17%); and it increased average current monthly earnings by 57,000 lei (or 22%) and average monthly earnings during 2000-2001 by 87,000 lei (or 28%).
- SBA was also quite successful, although not in all dimensions. It increased by 8.38 percentage points (or 12%) the likelihood of being employed for at least six months during the two-year period 2000-2001; and it reduced the accumulated number of months participants were unemployed and receiving unemployment benefit payments by almost 15%. However, SBA did not seem to increase the average monthly earnings of its participants relative to non-participants — perhaps because entrepreneurs are more likely to under-report their earnings than wage and salary workers.

When comparing the relative effectiveness of the two programs, I find that in terms of the accumulated employment effects, PES was superior to SBA. Moreover, SBA participants would have been better off had they participated in PES instead, as PES would have increased their likelihood of being employed for at least 12 months in the period 2000-2001 by 17.02 percentage points (or 25%).

Targeting Different Groups

The analysis of the suitability of these programs for different population subgroups (age, region of residence, education, unemployment duration, and gender), as well as the channels through which the programs worked shows that:

- In economies with large informal job-search channels, PES are relatively more effective for workers with little access to those channels — such as young workers, and those living in rural areas.
- In economies with segmented labor markets, SBA programs work better for workers with less access to the primary labor market sector, such as less-qualified workers and those living in rural areas.
- However, if the policy decision is whether to offer PES or SBA to unemployed workers in transition countries, PES are better suited for workers without a high-school degree and SBA programs are more effective for workers with a high-school degree.

Cost-Effectiveness

A comparison of the costs per client with the economic benefits reveals that the cost per client served was 123,740 lei for PES and 179,150 lei for SBA, while the predicted earnings over the 2000-2001 amounted to an annual sum of 1,047,840 lei for PES, and 4,783,200 lei for SBA. Thus, in both cases, benefits cover by far the cost per client served, indicating that both programs were cost-effective.

Given the small cost differences between the two programs, and benefits of each program for certain sub-groups of the unemployed, the policy recommendation is to target each program to those sub-populations most likely to benefit from participation.

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Russian Migrants to Russia

Migrants chose the region in Russia where their skills were most in demand

Olga Lazareva

The collapse of the Soviet Union gave rise to massive population movements among the newly independent states. Ethnicity was a major determinant of migration among the former Soviet Union (fSU) countries. The biggest of these movements was migration of ethnic Russians and Russian-speaking people from the former Soviet republics back to Russia. According to a census, 5.2 million residents of Russia, or 3.6% of its population, said in 2002 they had lived outside the country in 1989. Almost all of them moved to Russia in the early and mid-1990s. The majority of migrants arrived from Kazakhstan (1.4 mln), Ukraine (0.8 mln), and Uzbekistan (0.6 mln).

Compared to typical international migrants, Russian immigrants to Russia had fewer assimilation problems, as they were either of Russian nationality or spoke Russian as a native language. Moreover, they had received a comparable education (as educational standards were uniform across the Soviet Union) and had a similar cultural background. They also faced smaller informational barriers as they could acquire information about their destination more easily.

While the decision to leave was in a sense forced upon migrants by political changes, they still had a choice of where to settle in Russia. Russia's more than 80 regions vary dramatically on many economic and social characteristics, including labor market conditions. Regional distortions in supply and demand for various skills have persisted over time due to high interregional barriers to movement of labor and capital.

Using Russian Longitudinal Monitoring Survey data from 2004-2005 (which allow us to identify immigrants), I test whether migrants sorted themselves across regions according to the relative demand for their skills on the regional labor market, i.e. where they could expect to get the highest payoff for their skills. If this was the case, we would expect migrants to compete for jobs with fellow immigrants rather than with locals. Hence, their labor market outcomes should be affected by the number of other immigrants in the location.

The data show that almost all Russian regions received some immigrants from the fSU. A relatively high number settled near the Russian border with other former Soviet republics. This is not surprising, given smaller distance and information-related costs and higher cross-border commerce opportunities. One of the highest concentrations of migrants is observed in the oil-rich Tymen region, which offered many job opportunities in the thriving energy industry. Moscow and St. Petersburg received a relatively small number of migrants due to restrictive local migration policies.

So what affects the share of migrants in the region? My analysis suggests that a higher share of Russian immigrants in 2002 is found in regions that had:

- low unemployment rate in the mid-1990s;
- better regional infrastructure, in particular, greater availability of housing;
- smaller distance to other fSU republics (bordering regions).

Brighter Prospects in Small Immigrant Communities

How then does the size of immigrant population in the region affect the labor market position of immigrants relative to local population? It should be noted that according to the data Russian migrants are on average slightly younger than the local population, but hardly differ in terms of education, skill level and other individual characteristics.

The regression results show that when there are few migrants in the region they are more likely to be employed compared to locals. Specifically, in the regions with few migrants their employment probability is over 99% while the employment probability for a local resident of similar age, schooling, and labor market experience is around 95%.

This effect gradually declines with the growing share of migrants in a region and eventually becomes negative. In the regions with the highest shares of migrants the immigrants' predicted unemployment rate is over 12%, which is three times higher than the unemployment rate for local workers with similar education and experience. It should be noted that employment probability for local residents does not depend on the size of the migrant population in the region.

Wages Higher for Migrant Skilled Workers

When considering four broad skill categories: manager, professional, skilled and unskilled worker, I find that:

- migrant skilled workers on average earn more than local skilled workers with a similar level of education and experience;
- migrant managers earn less compared to local managers, which may indicate migrants' lack of sector-specific or location-specific knowledge that may be important for a manager;
- wage premiums for migrant workers mainly exist within sectors.

Thus, the evidence indeed suggests that migrants chose the location where their skills were most in demand and where they had little competition with locals for available jobs. In other words, they filled some regional labor market niches left vacant by the local population. With the arrival of more migrants with similar skills, however, the competition among migrants intensified and their employment probability declined.

In the presence of barriers to interregional migration in Russia, the inflow of Russian migrants has probably had some equilibrating effect on regional labor markets. At the same time, better employment opportunities for migrants in the regions with smaller migrant communities and persisting wage premiums for some skill groups among migrants indicate that there still exist substantial barriers to migration among the regions, and this preserves large regional disparities and results in an inefficient labor market structure in Russia.

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Remittances: Recent Trends and Development Implications

Remittances are a large, stable and countercyclical source of external financing in many poor countries

Dilip Ratha

This article describes recent trends in migrants' remittances to developing countries and provides an overview of the implications of remittances for development. It concludes by outlining some new technologies for remittance transfers and the regulatory and other challenges that have still to be overcome.

Recent Trends

Remittance flows to developing countries are estimated to have reached US$240 billion in 2007, up from US$221 billion in 2006 and more than double the level reached in 2002 (see Table). This amount, however, reflects only transfers through official channels — the true size of remittances received by developing countries including unrecorded flows through formal and informal channels is believed to be in excess of US$300 billion, or nearly three times the size of official development assistance.

Latin America and the Caribbean remains the largest recipient of (recorded) remittances, but the growth of remittances to this region has slowed markedly in recent months. Remittances received by Mexico grew by only 1% during 2007, compared to over 20% annual growth in 2002-06. The slowdown in Mexico is partly due to the weak job market in the United States, especially in the construction sector as well as the recent increase in enforcement efforts. Apprehensions along the US-Mexico border have declined by nearly 50% from the level in 2000, indicating a decline in the number of migrants trying to enter the United States without proper documentation. The deceleration in the growth of remittances is less marked in rest of the Latin America and the Caribbean region. Interestingly, while the US remains the major destination for Latin American migrants, there appears to have been a shift towards Spain and other European countries in recent years.

Countries in South Asia and East Asia are experiencing robust growth in remittances. Remittances rose by 13% in the Philippines and by over 20% in Bangladesh and Pakistan in 2007. High oil prices and strong economies in the oil-exporting Middle Eastern countries are contributing to strong demand for migrant labour. Many of these remittance-receiving countries are also experiencing an appreciation of their currencies relative to the U.S dollar (and also relative to currencies linked to the US dollar such as the UAE dirham) which is reducing the purchasing power of remittance recipients. While remittances to Mexico, India and the Philippines increased by 38%, 44%, and 48% respectively during 2004-2007 in nominal U.S dollars, after accounting for the appreciation of these countries' currencies against the U.S dollar and domestic inflation, the respective increases were by 19%, 13%, and 3% during the three year period. Recorded remittance flows to Sub-Saharan Africa are very small and a large share of remittances appears to be through informal channels.

In 2007, India, Mexico, China and the Philippines were the top four recipients of remittances. The top ten recipients list also includes several high-income countries such as France, Spain and Britain — these countries receive remittances mostly from the other high-income European countries. As a share of GDP, however, remittances to these countries were about 0.5% or less in 2007. In contrast, remittances as a share of GDP are the highest in smaller countries such as Tajikistan, Moldova, Tonga, and the Kyrgyz Republic, where remittances exceeded a quarter of the GDP (see Figure).

Global Flows of International Migrant Remittances (US$ billion)

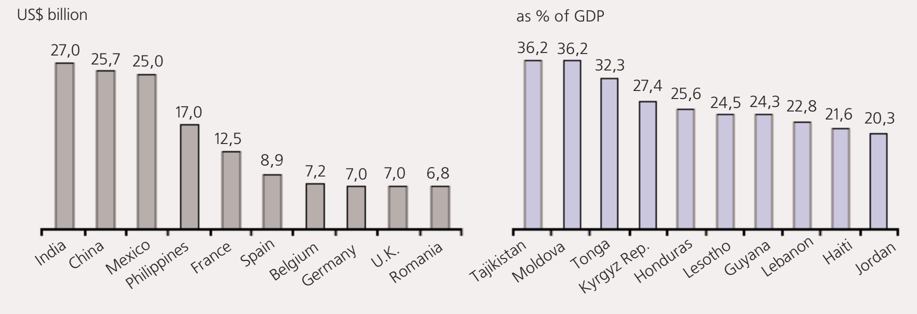
INFLOWS	2002	2003	2004	2005	2006	2007e	*Change 2002-07*
Developing countries	116	144	161	191	221	240	107%
East Asia and the Pacific	29	35	39	47	53	58	97%
Europe and Central Asia	**14**	**17**	**21**	**29**	**35**	**39**	**175%**
Latin America and the Caribbean	28	35	41	49	57	60	115%
Middle-East and North Africa	15	20	23	24	27	28	86%
South Asia	24	30	29	33	40	44	81%
Sub-Saharan Africa	5	6	8	9	10	11	116%
Low-income countries	32	39	40	46	56	60	88%
Middle-income countries (MICs)	84	105	121	145	166	179	114%
Lower MICs	55	68	76	90	102	112	103%
Upper MICs	29	37	45	55	63	67	136%
High income OECD countries	53	60	67	68	72	74	40%
High income non-OECD countries	1	2	3	4	4	4	298%

Source: Authors' calculation based on data from IMF Balance of Payments Statistics Yearbook 2007. Remittances are defined as the sum of workers' remittances, compensation of employees, and migrant transfers – see www.worldbank.org/prospects for data definitions and the entire dataset.

Implications for Development

Remittances are a large, stable and countercyclical source of external financing in many poor countries. Remittances as a share of personal consumption expenditure rose in Indonesia, Mexico and the Philippines following financial crisis and in Central America following natural disasters. Remittances have provided a lifeline to the poor in Haiti and Somalia, in countries affected by political conflict.

Top Recipient Countries



Sources: See Table.

Cross-country analysis shows that a 10% increase in per capita remittances is associated with a 3.5% decline in the share of poor people. In Nepal, remittances are believed to have reduced the extent of poverty by 3-5 percentage points over the last decade. Remittances may have reduced the share of poor people in the population by 11 percentage points in Uganda, 6 percentage points in Bangladesh and 5 percentage points in Ghana.

Remittances are also associated with increased household investments in education, health, and small business investments. In Mexico, Guatemala, Nicaragua and Sri Lanka children in remittance recipient households have higher birth weights and better health indicators than other households. Remittances from the United States accounted for about one fifth of the capital invested in microenterprises in urban Mexico.

Remittances can improve financial access for migrants and remittance recipients. Increasing access to bank accounts for migrants and their families back home would not only provide them a lower cost and more secure remittance channel, it would also enable them to save more. Banks, private firms and microfinance institutions in Mexico, El Salvador, India, Peru, and the Philippines offer transnational consumer loans, mortgage loans, and microfinance products.

Remittances can improve the access to international finance of the countries of origin. Large banks in some countries (e.g., Turkey, Brazil) have used their access to foreign currency-denominated remittances as collateral for raising international bond financing at lower costs and longer maturities. Preliminary estimates suggest that countries in Sub-Saharan Africa alone can potentially raise, annually, US$1-3 billion by reducing the cost of international migrant remittances, US$5-10 billion by issuing bonds to the overseas diaspora, and US$17 billion by securitizing future remittances and other future receivables. These mechanisms can be used to raise funds for development projects such as low-income housing, or power and water supply.

New Opportunities and Challenges

The remittance industry has experienced a shift in remittances from informal to formal channels and remittance costs have fallen in recent years. Average remittance costs in the US-Mexico corridor, one of the largest remittance corridors, fell dramatically by nearly 55% between 1999 and 2004, but appear to have levelled off lately. The cost for send-

Migration in Europe and Central Asia: Some Facts

Population in Europe and Central Asia, millions, 2006	460
Labor force, millions, 2006	210
Urban population, % of population, 2006	63.8
GNI, US$ billions, 2006	2,421
GNI per capita, Atlas method, US$, 2006	4,796
GDP growth, avg. annual %, 2002-2006	6.2

Emigration, 2005

- Stock of emigrants: 47.6 million or 10.0% of population
- Top 10 emigration countries: Russia, Ukraine, Turkey, Kazakhstan, Poland, Serbia and Montenegro, Uzbekistan, Belarus, Bosnia and Herzegovina, Azerbaijan.
- Identified destinations: high-income OECD countries (28.5%), high-income non-OECD countries (5.3%), intra-regional (57.6%), other developing countries (0.2%).

Skilled Emigration, 2000

- Emigration rate of tertiary educated (top 10 countries): Croatia (29%), Bosnia and Herzegovina (29%), Macedonia FYR (21%), Albania (20%), Serbia and Montenegro (17%), Slovak Republic (15%), Romania (14%), Estonia (14%), Poland (12%), Hungary (12%).
- Emigration of physicians: 19,555 or 1.3% of physicians trained in the region.

Immigration, 2005

- Stock of immigrants: 31.1 million or 6.5% of population (compared to 190.6 million or 3.0% for the world)
- Female as percentage of immigrants: 57.2% (compared to 49.6% for the world).
- Top 10 immigration countries: Russia, Ukraine, Kazakhstan, Turkey, Uzbekistan, Belarus, Poland, Croatia, Serbia and Montenegro, Czech Republic.

Remittances, 2007

Top five remittance recipients: Romania (US$6.8 bn), Poland (US$5.0 bn), Serbia and Montenegro (US$4.9bn), Russia (US$4.0 bn), Bosnia and Herzegovina (US$1.9 bn).

Source: Migration and Remittances Factbook compiled by Dilip Ratha and Zhimei Xu, the World Bank, www.worldbank.org/prospects/migrationandremittances. **BT** ing money between developing countries (South-South remittances) continues to remain high.

The remittance industry has also seen the introduction of cell phone-based remittances and several pilots involving remittance-linked financial products. In the Philippines, G-Cash and SMART provide deposit, credit and money transfers through mobile phones. In Kenya, Vodafone through its subsidiary Safaricom, has launched a mobile banking service M-PESA which has more than one million clients. In India, Visa has linked up with some of the major commercial banks to extend its domestic card-to-card transfer service to mobile phones. Western Union and the GSM Association have also announced a pilot project for mobile phone remittances.

Regulations to stop money laundering and counter the financing of terrorism appear to have become a constraint to reducing remittance costs, especially for smaller remittance service providers and mobile operators dependent on correspondent banks. Many countries are now considering simpler prudential regulations for remittance service providers. Many governments are also beginning to realize that exclusivity contracts between national post offices and a single money transfer company stifles competition and in the end, hurts poor migrants and their families. It is time now for policymakers to find ways for harmonising telecom and financial services regulations.

This article draws on "Leveraging Remittances for Development" Policy Brief by Dilip Ratha, Migration Policy Institute, Washington DC, 2007 (www.migrationpolicy.org/pubs/MigDevPB_062507.pdf), and "Remittance Trends" 2007 brief (http://siteresources.worldbank.org/EXTDECPROSPECTS/Resources/476882-1157133580628/BriefingNote3.pdf) issued by the Development Prospects Group, the World Bank. Dilip Ratha is Senior Economist and Manager of the Migration and Remittances Team at the Development Prospects Group of the World Bank. Thanks to Uri Dadush, Sanket Mohapatra and Sonia Plaza of the World Bank for discussions and K.M. Vijayalakshmi and Zhimei Xu for collaboration and data collection. **BT**

Debt–Financed Migration in the 21st Century

Illegal migration is a problem of growing scale and importance. The most conservative estimates amount to tens of millions of irregular immigrants worldwide; in the US only, this number stands at 12 million. The International Organization for Migration believes that half of all new entrants into developed economies are illegal.

According to the United Kingdom Home Department, 75% of illegal migrants use the expensive services of smugglers. Given increasing international wage differentials, unstable political circumstances and the importance of financial constraints in most source countries of migration, the demand for human smuggling services may rise further.

Migrants and their families often cannot self-finance costs that can reach or even exceed US$50,000 (estimated China-US smuggling fees) and, hence, put themselves in debt. According to surveys among illegal Chinese immigrants 90% had to borrow money to pay the fee. Smugglers and other intermediaries finance the costs of transportation, provide forged documents and assist in entering the country of destination. The debt repayment is taken out of migrants' wages in sweatshops and restaurants that are related to these intermediaries. The migrant thus provides his labor as collateral to the smuggler or the smuggler's business partners until the debt is paid back.

As long as a migrant is employed in the illegal sector, the debt-holders can enforce the contract through coercion. This is more difficult when a migrant works in the legal sector of the economy, where s/he receives some protection from the host country's legal system. Thus, migrants who move successfully to the legal sector can default on their debt payment. But, at the same time, they become visible to law enforcement agencies and bear higher risks of being deported to the source country.

Our theory of financial contracting between wealth-constrained migrants and intermediaries examines the effect of various policies on illegal immigration and finds that:

- Stricter border controls decrease overall immigration, but may result in an increase of debt-financed migration, as they may induce illegal migrants to move from self-financed migration to debt/labor contracts.
- Stricter deportation policies increase rather than decrease the flow of illegal migrants, as migrants are less likely to try moving to the legal sector of the economy and there are, therefore, less defaults on debt repayments. Financing migrants becomes more rewarding for intermediaries and, hence, that the flow of migrants financed by debt/labor contracts increases. At the same time, the net present value of migration for wealthier self-financed migrants decreases, which reduces their inflow. Migrant skill composition deteriorates, given the strong positive correlations between wealth and skills in developing countries.
- There can be complementarities between employer sanctions and deportation policies. With intensified employer inspections and sanctions, deportation policy becomes a more effective tool for decreasing migration.

What about the effect of amnesties on decisions to migrate? Since each amnesty raises expectations for future amnesties, it results in higher incentives to migrate, especially for the highly skilled. On the other hand, anticipating that immigrants may obtain legal status through amnesty, intermediaries will refuse to lend. Hence, amnesties will decrease low-skilled migration and improve the skill composition of incoming migrants.

Guido Friebel is Researcher at Toulouse School of Economics, France and Professor at the University of Frankfurt, Germany. Sergei Guriev is Professor and Rector at New Economic School, Moscow, Russia. The authors' paper "Smuggling Humans: A Theory of Debt-financed Migration" is published in the Journal of European Economic Association, December 2006. **BT**

The two pieces below discuss the impact of the ongoing financial crisis on the emerging markets in Europe, and these countries' prospects in the medium term.

Robert Shiller, Yale University: "Crisis is an Opportunity to Advance Financial Markets"

The financial crisis that has started in the US and spread to other countries is the biggest in decades. Failures of banks and building societies in the US, Germany, France, and the UK (the bank run on Northern Rock was the first in the UK since 1866) point to the severity of the situation. About one million homes in the US are now in default, and the number is rising. No country should feel immune from the crisis, as it has started to come around the world.

I believe this crisis is caused by human psychology and a boom mentality, speculative excess and the correction of that. In just nine years from 1997 to 2006 home prices in the US nearly doubled, and in some cities, such as Los Angeles or New York, prices went up by 3 to 3.5 times. At the same time, construction costs in the US actually went down in real terms; the population was growing steadily; interest rates had been falling for 20-30 years, and real rents stayed unchanged (so demand for housing services did not increase).

Interestingly, these events occurred simultaneously in many countries, both developed and developing. This is no coincidence, as this indicates that the economy is globalizing and a certain way of thinking tends to become pervasive amongst everyone as humans communicate so much with each other. Many people in different countries believe that real estate prices can only increase as there is only so much land, the population is growing, and so is the economy. But why should housing be a good investment? It has to be maintained, it depreciates, goes out of style... While there had indeed been a lot of land speculation before, the popular view that investments in homes are the best way to secure one's future is a new one.

In the recent boom the BRIC countries have played a role. Their rapid growth spooked people in developed countries, as well as spreading anxieties about how to fit in to the new capitalist world.

Financal markets can indeed be improved to better deal with some of these psychological problems, such as social contagion and wishful thinking. The current crisis is providing us with the opportunity to advance our financial markets. After the 1929 stock market crash the US took some radical measures, by for example creating a Securities and Exchange Commission, Federal Deposit Insurance Corporation, Fannie Mae, and Home Owners Loan Corporation. These are all government institutions that supported the financial markets and made them work again. This time this is not as bad a crisis, but it should also be dealt with properly.

Despite negative events recently, there is a number of very positive things going on in the financial markets, including:

- great advances in financial theory;
- advances in behavioral finance in the past 20 years;
- a revolution in information technology;
- the democratization of finance, i.e. making sophisticated financial instruments available to more people.

Yet we need better markets for risks that really matter to people, such as personal income risks, longevity risks (the risk of outliving one's wealth), and mortgage risks (i.e. a decline in home price). We can also expand the scope of markets for energy, and manage the risks of GDP decline by issuing GDP-linked securities. There is enormous potential for improvement in human welfare from radical financial innovation in these areas.

Robert J. Shiller is Professor of Economics, Yale University, and Co-Founder and Chief Economist, MacroMarkets LLC. The piece is based on his presentation at New Economic School in Moscow in March 2008. **BT**

Neven Mates, IMF: "Convergence will Continue, Albeit at a Slower Pace"

What impact will financial turmoil in some developed countries have on economic growth in Europe?

Europe will not be able to avoid the effects of global shocks. Historically there has always been a spillover effect of US economic slowdown onto the European economy. For one percentage point drop in growth in the US the growth in Europe will slow down by on average 0.5 percentage points. We expect that growth in the advanced European economies will decline by 1.25 to 1.5 percentage points in 2008 and will weaken further in 2009.

Emerging European economies may be more vulnerable to a global slowdown than the advanced economies. The direct trade effect from a sharp downturn abroad is likely to be significant because countries in the region are highly open, with exports accounting for 30-80% of GDP. Moreover, the heavy dependence on foreign capital leaves the region exposed to an abrupt retrenchment of capital inflows. The appreciation of the euro and the sharp increase in headline inflation, driven by food and energy prices, is adding to the troubles. In emerging European markets GDP growth is projected to decline from 6.9% in 2007 to 5.5% in 2008 and 5.2% in 2009.

Thus, growth in emerging economies will remain quite robust and the convergence towards more advanced European peers will continue, although at a slower pace.

What are the main challenges for the emerging market economies?

Tighter integration with the more advanced European economies has allowed emerging European economies to grow considerably faster than countries with similar income levels in other regions. A very good growth performance over the last five years was achieved thanks to technological progress and increasing investment. Besides, there has been a very strong link between growth and financial deepening.

Yet, many emerging economies in Europe have current account deficits and levels of external debt that, as a share of GDP, are considerably higher for their income levels than the rest of the world's. This increases vulnerabilities to external shocks — risks that have been rising considerably with the ongoing global financial turbulence. In some of the countries, primarily in the Baltic countries, Bulgaria, Romania and Slovakia, the current account deficits are excessive.

In many cases, loose fiscal and monetary policies have contributed to large current accounts deficits and increases in external vulnerability. On the positive side, foreign direct investments contributed a lot to financing the current account deficits. Besides, it was domestic demand rather than real effective currency appreciation that was the main reason for this worsening of current account deficits. This suggests that it will be less difficult to reverse the current account deficits and improve the situation without major changes in real exchange rates.

What should policy response be?

The challenges facing policymakers in advanced economies are to restore confidence in the financial system and minimize the impact of the financial sector crisis on the real economy, while maintaining inflation credibility and safeguarding long-term fiscal sustainability.

In emerging European economies, policies need to focus on reducing vulnerabilities and strengthening the resilience of the financial system. Our policy recommendations for the emerging market economies in the region can be summarized as follows:

- Enact structural reforms to increase potential growth by ensuring fair market competition, reducing the role of the state in the economy, improving the business environment, cutting red tape, reforming the judiciary, and progressing in the EU harmonization process in EU-candidate countries;
- Implement policies to ensure macroeconomic stability, address external imbalances, and reduce vulnerabilities, including tightening monetary policies, and advancing fiscal consolidation;
- Implement policies to strengthen the financial sector and create buffers to help adjust to shocks, including prudential measures. Establishing credit registries and strengthening non-bank financial sector supervision would substantially increase the effectiveness of these measures.

Based on presentation of the April 2008 IMF report "Regional Economic Outlook: Europe — Reassessing Risks" by Neven Mates, the IMF Senior Resident Representative in Russia. **BT**

Economic Outlook: Regional Perspective

Real GDP, Consumer Prices and Current Account Balance in Selected ECA Countries
(annual percent change unless noted otherwise)

	Real GDP			Consumer Prices (Annual Average)			Current Account Balance (% of GDP)		
	2007	2008	2009	2007	2008	2009	2007	2008	2009
Estonia	7.1	3.0	3.7	6.6	9.8	4.7	-16.0	-11.2	11.2
Latvia	10.2	3.6	0.5	10.1	15.3	9.2	-23.3	-15.0	-10.5
Lithuania	8.8	6.5	5.5	5.8	8.3	6.1	-13.0	-10.5	-8.8
Czech Rep.	6.5	4.2	4.6	2.8	6.0	3.5	-2.5	-3.0	-2.8
Hungary	1.3	1.8	2.5	7.9	5.9	3.5	-5.6	-5.5	-5.1
Poland	6.5	4.9	4.5	2.5	4.1	3.8	-3.7	-5.0	5.7
Slovak Rep.	10.4	6.6	5.6	1.9	3.3	3.1	-5.3	-5.0	-4.7
Bulgaria	6.2	5.5	4.8	7.6	9.7	6.0	-21.4	-21.9	-18.9
Romania	6.0	5.4	4.7	4.8	7.0	5.1	-13.9	-14.5	-13.0
Russia	8.1	6.8	6.3	9.0	11.4	8.4	5.9	5.8	2.9
Ukraine	7.3	5.6	4.2	12.8	21.9	15.7	-4.2	-7.6	-9.7
Kazakhstan	8.5	5.0	7.0	10.8	17.1	8.3	-6.6	-1.7	-1.0

Source: IMF World Economic Outlook April 2008

Rolling Out the Red Carpet: Invest–ment Promotion and FDI Inflows

Investment promotion is viable option for developing countries that wish to attract FDI

Torfinn Harding and Beata Smarzynska Javorcik

Countries around the world compete fiercely to attract foreign direct investment (FDI). Policymakers, especially those in developing countries, hope that FDI inflows will bring much-needed capital, new technologies, marketing techniques and management skills. Foreign investment is expected to create jobs and increase the overall competitiveness of the host economy.

Technological progress which allows firms to split various stages of production, declines in transport and communication costs, increasing openness of countries to foreign capital, and international trade have increased the attractiveness of spreading the production chain across various geographic locations. This phenomenon has led to a spectacular increase in global FDI flows thus giving more countries an opportunity to become part of the global production chains. But it has also intensified competition for FDI.

In response, many countries have set up investment promotion agencies (IPAs) as a key part of their strategy to attract foreign investors — there are more than 160 IPAs at the national level and over 250 at the sub-national level. In 2004, the total spending of the 82 IPAs that reported their budget figures in the recent IPA Census reached almost a billion dollars; a quarter of this amount was spent on investment promotion (see Table). In addition, some IPAs are empowered to provide support in the form of tax holidays or other quasi-fiscal measures.

The main purpose of investment promotion is to reduce the costs of FDI by providing information on business conditions and opportunities in the host economy and by helping foreign investors cut through bureaucratic procedures. Investment promotion activities encompass: advertising, investment seminars and missions, participation in trade shows, one-to-one direct marketing efforts, matching prospective investors with local partners, helping obtain permits and approvals, preparing project proposals, conducting feasibility studies and servicing investors whose projects have already become operational. As obtaining information on investment opportunities in developing countries tends to be more difficult than gathering data on industrialized economies, investment promotion should be particularly effective in a developing country context.

How Inward Investment Promotion Works

Investment promotion can affect the choice of foreign investment site at all stages of the decision-making process. The process of site selection usually starts with drawing a long list of potential host countries. Such list typically includes 8 to 20 countries which can be thought of as belonging to three groups:

- most popular FDI destinations in the world,
- countries close to the existing operations of the investor, and
- emerging FDI destinations (i.e., countries that the investor may not be initially very serious about but which represent "out of the box" thinking).

Size of Investment Promotion Budget in 2004 by Income Group

Income group	FDI promotion budget in 2004 Median	FDI promotion budget in 2004 Mean
High income	US$1,214,708	US$9,447,493
Upper middle income	US$487,480	US$1,376,448
Lower middle income	US$342,319	US$983,926
Low income	US$304,349	US$534,864

Notes: Based on 19 responses for HI, 15 for UMI, 18 for LMI and 14 for LI .
Source: IPA Census 2005.

The inclusion of the third category presents an opportunity for IPAs to increase the chances of their country being listed via advertising, trade shows or pro-active contacting of potential investors. The long list is then narrowed down to about five potential sites based on the trade-off between costs and the quality of business environment. As this is usually done without visiting sites under consideration, the accessibility of the information about potential host countries plays a crucial role. IPAs that provide up-to-date, detailed and accurate data on their websites and IPAs that are willing to spend time preparing detailed answers to investors' inquiries and customize these answers to the needs of an individual investor can increase the chances of their countries being included in the short list. A visit by the investor to the host country, which is the next step in the process, gives IPAs the opportunity to emphasize the advantages of locating in their country, answer questions, show off potential investment sites and facilitate contacts with the local business community. IPAs can also play a role in the final stage of the process by providing information on investment incentives and offering help with the registration process.

Does it Work?

Is there any indication that investment promotion leads to higher FDI inflows? To examine this question, it is helpful to rely on the fact that the majority of IPAs target particular sectors in their efforts to attract FDI, as it is believed that more intense efforts concentrated on a few priority sectors are likely to lead to greater FDI inflows than less intense across-the-board attempts to attract FDI. If investment promotion is effective then we expect to see that priority sectors experience an increase in FDI inflows after targeting starts relative to non-priority sectors during the same time period.

The detailed information on priority sectors and the timing of FDI targeting activities in developing countries combined with the figures on flows of US FDI, disaggregated by host country and sector, suggests that investment promotion efforts are associated with higher FDI inflows to developing countries.

Priority sectors receive more than twice as much FDI as sectors not targeted by IPAs. While the magnitude of the effect may seem large, it is not implausible. If we consider only positive flows of US FDI to developing countries, the median sector-level flow to a host country was equal to US$11 million during the 1990-2004 period. Thus, the estimated effect of investment promotion translates into an additional annual inflow of US$17 million for the median sector-country combination. A quick look at the amounts multinational corporations actually invest in developing countries reveals that FDI inflows of that magnitude are not uncommon. For example, in 2005 Wal-Mart planned to open 70 new units in Mexico with an expected investment of US$736 million and in 1995 Pepsi announced a US$55 million investment in a snack-food company in South Africa, while Boeing McDonnell Douglas invested US$31 million in the Czech Republic in 1998.

One may be concerned that IPAs choose sectors that already receive a lot of FDI as their priority industries in order to show good results. This is, however, unlikely. In 67 of 97 IPAs surveyed in the Census, the agency board was not at all involved in choosing priority sectors. Moreover, our conclusions hold even if we exclude countries that reported in the Census that the targeting decision was based on the past success or failure in attracting FDI to the sector. In addition, we find no evidence suggesting that targeting took place in sectors with relatively high or low inflows in the years preceding targeting.

If investment promotion works, we should also see that agencies following the best practice model are more effective. For instance, it is generally believed that a quasi-government status is the most appropriate IPA setup. Quasi-governmental bodies benefit from their links to the government when assisting investors in getting regulatory approvals and lobbying authorities on behalf of foreign companies. At the same time, they have more flexibility in planning their activities and are not bound by government pay scales and hiring and firing practices, which makes them better positioned to engage the private sector and respond quickly to changing market conditions. As expected, our analysis confirms that quasi-governmental bodies are more effective at attracting FDI than subunits of ministries.

Our final observation pertains to the concern of government officials that policies in competing countries might divert FDI inflows. Anecdotal evidence suggests that many large foreign investors narrow their attention to a few potential sites in neighboring countries and then let the host country authorities bid on tax, financial or other incentives they want to offer. Our data presents evidence in support of this view. We find that investment incentives offered by other countries in the same region are associated with lower FDI inflows. This competition is limited to a geographic region as there is no evidence of such competition taking place among countries with the same level of income, but located in different regions.

What the Research Means for Policy

Our observations have two policy implications.

- Investment promotion is a viable policy option for developing countries that have a sound business climate and wish to attract FDI inflows. In the presence of knowledge externalities associated with FDI subsidizing provision of information is an appropriate policy action.
- Regional competition in tax incentives point to potential benefits of regional coordination in this area.

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Impact of Ukraine's WTO Accession

Ukraine's WTO membership may bring 5.7% increase in real GDP in the long term

Veronika Movchan

On February 5, 2008 the General Council of the WTO approved the accession package of Ukraine, thereby successfully completing almost 14 years of negotiations. Ukraine applied for the membership in 1993, when most of the country's commodity trade was conducted with non-GATT/WTO members. The situation has changed dramatically since then. According to the State Committee of Statistics of Ukraine, in 2007 the country's commodity trade with WTO members accounted for over 62% of exports and 58% of imports. Ukraine's major non-WTO trade partners remain the CIS countries, primarily Russia, Belarus, and Kazakhstan, currently also negotiating the WTO membership.

The long negotiations ensured that a lot of changes embedded in Ukraine's accession agreements have already been introduced. This includes passing strict intellectual property rights protection legislation, harmonizing the Ukrainian system of standardization and conformity assessment, adopting the new Customs Code, and bringing import tariffs for almost all manufacturing products in line with Ukraine's tariff proposal.

Post-Accession Changes

What will change after Ukraine becomes a WTO member? Most importantly, import tariffs will be bound at quite a low level. For agricultural products, this means a reduction of the average tariff rate by a quarter to 10.66%. The maximum binding tariffs are envisaged for sugar (50%) and sunflower seed oil (30%). The average binding rate for industrial goods will be 4.95%, which is one-fifth above the current average tariff for these products. Also, specific and mixed tariffs pervasive for most agro-food products will be replaced by more transparent ad-valorem tariffs.

In addition, Ukrainian export tariffs will be gradually reduced and quantitative export restrictions will be eliminated. This is expected to boost exports, and increase domestic prices on some products, e.g. oilseeds, and grain.

Membership in the WTO will improve access to external markets for Ukrainian exporters. As to the immediate benefits, the quotas on exports of steel products to the EU will be eliminated. Import tariffs faced by Ukrainian producers in WTO member countries will be reduced to the most favored nation level regime if previously full tariff rates were applied. It is estimated that the reduction will affect approximately one-fifth of the Ukrainian export value.

Additional 2.6% Growth

We estimated the economic impact of Ukraine's WTO accession using the computable general equilibrium model for Ukraine. The model was a 'small open economy' model covering 38 sectors. Its distinctive feature was the special treatment of service providers, allowing the impact of the reduction of FDI barriers in services to be modelled.

Several scenarios were considered, including:

- the reduction of barriers to foreign service providers of telecommunication and financial services;
- tariff reform simulating the reduction of tariffs on imports according to the commitments made by Ukraine;
- improved market access for Ukrainian metal and chemical products, and agriculture.

According to our estimates, Ukraine's WTO membership will be beneficial for the country, bringing additional 2.6% growth in real GDP and 7.2% increase in welfare over the medium term. In the long term, when capital will adjust to a new steady state, the gains will be even larger: 5.7% increase in real GDP and 15% rise in welfare. The liberalization of tariff protection will stimulate imports, accounting for almost half of a 5.1% import increase over the medium term. Higher imports will dampen consumer prices and increase the variety of products on the market, positively affecting the welfare of households. Exports will increase by 4.1% in the medium run, driving up the real wages in the economy.

The decomposition of the gains shows that:

- Liberalization of the FDI barriers in services accounts for most of the gains in real GDP and in welfare through increases in the available service variety and total factor productivity. In the medium term, service liberalization leads to a 1.5% real GDP growth and 4.8% increase in welfare, especially affecting non-poor households.
- The contribution of import tariff reform, primarily a reduction of tariff protection in agro-food sectors, is the second largest. It accounts for a 0.8% gain in real GDP and 1.1% rise in welfare over the medium term.
- Improved market access for metal and chemical production, and agriculture causes 0.3% increase in real GDP and 1.3% gain in welfare in medium term, though this scenario has the largest labor adjustment effects on the economy.

Export-Oriented Manufacturing Benefits the Most

As for the sector effects, the estimates show that export-oriented manufacturing sectors like metal and chemical production will benefit the most, as well as industries supplying inputs for these sectors, e.g. extraction of non-energy materials and coke production. At the same time, considerable contractions will occur in the food processing and automotive industry where tariffs are reduced the most. Also, agriculture production will be adversely affected, though the negative shock of the reduction in tariffs will be to a large extent compensated by better access to external markets. In business services, especially in financial intermediation, the number of foreign firms will significantly increase, and output will grow. Also, hotel and restaurant businesses will significantly expand their output thanks to cheaper inputs and higher demand.

Although the WTO accession will benefit the economy as a whole, making it more competitive and allowing cheaper prices and higher variety of products for consumers, some production factor adjustments will be necessary. In particular, it is estimated that 1.1% of skilled employees and 1.8% of unskilled will have to find new jobs. Thus, the strengthening of active labor market policies will be required to ensure the smooth adjustment of the economy.

Medium-term Impact of the WTO Accession on Selected Sectors, %

	Aggregate output	Exports	Imports	Skilled employment
Agriculture, hunting	-0.8	15.3	5.9	-2.1
Coal and peat	8.5	3.6	12.5	7.5
Food-processing	-13.0	-9.0	95.4	-14.3
Textile and leather	-9.5	-8.8	1.2	-10.4
Coke products	13.0	11.0	15.8	7.9
Chemicals, rubber and plastic products	5.0	5.6	-0.2	3.5
Metallurgy and metal processing	14.2	14.9	-1.4	12.3
Machinery and equipment	-5.3	-6.2	0.8	-7.6
Trade	1.3	2.6	0.5	-1.8
Hotels and restaurants	4.7	6.6	0.9	3.0
Telecommunication	3.2	0.7	20.6	1.9
Financial intermediation	2.4	0.9	15.4	1.5

Veronika Movchan is Academic Director of the Institute for Economic Research and Policy Consulting (Kyiv, Ukraine). The CGE model was developed by the consortium of three institutions: Copenhagen Economics, Denmark; Institute for East European Studies. Munich, Germany; and Institute for Economic Research and Policy Consulting, Ukraine, within the framework of the project "Analysis of the economic impact of Ukraine's WTO accession" (2005), Dutch Grant No. TF 050270. Some changes to the model were made in 2006, within the project "The assessment of the economic impact of the establishment of the FTA between Ukraine and the EU" conducted on request of the Ministry of Economy of Ukraine. **BT**

Russia's Foreign Trade Outlook

Russia may significantly increase its exports to some developed countries

Natalya Volchkova

International experience shows that the industries with the best development potential are those that use a similar set of resources compared to the sectors in which a country already has competitive advantages. This is the starting premise of our forecast for potential areas of diversification of Russian exports. Proceeding from the current export structure we have identified industries with potential for export development. The study is based on COMTRADE (UN) data and uses the methodology of Hausmann, Hwang and Rodrik (2006).

The structure of the Russian export basket in 2005 was similar to the basket of a country with a per capita income of almost US$11,000 (in current prices) whereas the actual per capita income in Russia was a mere US$4,500. Thus, the Russian export basket revenue index in 2005 was more than double the per capita GDP, which suggests that the country has a good outlook of economic growth through access to world markets.

However, compared to other CIS countries Russia's export basket revenue index was the lowest, which is explained by Russia's biggest per capita GDP among these countries. According to our calculations, Kyrgyzstan has the biggest growth potential among the CIS countries, followed by Moldova, Ukraine and Azerbaijan. A substantial excess of the export revenue index over per capita GDP in developing countries is positively linked to future economic growth as exports can serve as the locomotive of development.

Although the export structure in Russia, like in other CIS countries, can be described as fairly advanced, Belarus and Ukraine seem to have better prospects for export diversification.

What are the export goods in which Russia has a competitive advantage that it has not yet tapped? We found that Russia has considerable potential for exporting to the CIS such goods as aluminum and aluminum alloys, coniferous timber, nitric mineral or chemical fertilizer and newsprint.

Trade Flows Shift to Asia

According to our forecast until 2020 based on the gravity model of trade in nominal 2000 prices, Russian exports will grow by 1.7 times and Russian imports will double during this period, while the share of trade in GDP will remain stable at around 47%. The geography of Russian trade will change during the period because of the growth of the Asian region and the CIS markets compared with the developed markets in Europe and North America. According to our forecast, the share in Russian exports (see Figure) to:

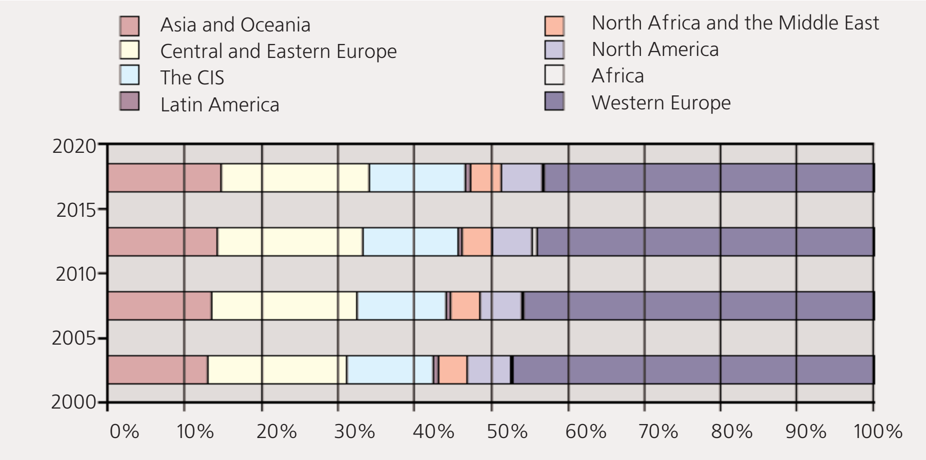
- Western Europe will drop from 47% to 43%,
- North America will remain at 5.5%,
- Asia and Oceania will grow from 13% to 15%.

The biggest changes will occur in the export of low- and medium-tech goods, whose share of exports will grow from 25% to 29%.

The analysis of the geography of Russian imports reveals a similar picture. The share of imports from Western Europe will drop from 50% to 43%, while of those from North America will remain practically unchanged at about 3%. Asia and Oceania will increase their share to almost 22%. The share of hi-tech goods in total imports will increase by 1.5 percentage points to 18.5%.

The results of our analysis show that Russia may significantly increase its exports to some developed countries, such as Norway, Australia, New Zealand, Iceland and Japan, and to many small countries in Africa, Oceania and the Caribbean.

Geography of Russia's Exports: A Forecast until 2020



Policy Recommendations

An obvious economic policy measure aimed at a more effective diversification of the Russian export basket (and indeed those of other CIS countries) can be a revision of its tariff and non-tariff regulations to bring them in line with the probability of the emergence of new export goods in this basket.

Russian trade and domestic economic policy must be aimed at:

- stimulating the export of those goods for which there is untapped export potential;
- prioritizing the production of those goods, whose export would contribute to the faster economic growth of the country.

Natalya Volchkova is Senior Researcher and Konstantin Kozlov is Researcher at CEFIR, Moscow. The results of the project "Prospects for the Development of the Foreign Trade of Russia and the CIS Countries with Third Countries (EU, South Asia, China and others), are available on request from the author: nvolchkova@cefir.ru. **BT**

Closing the Productivity Gap in Ukraine

Further privatization and competition-enhancing reform will stimulate greater dynamism

Christian Gianella and William Tompson

Productivity growth in Ukrainian industry was remarkably strong during 1999-2004 but slowed in 2005-2006. Performance in manufacturing has been particularly impressive: output rose by roughly 10% per year during 2001-2006, while employment fell by approximately 15% over the period.

Intensive labor-shedding contributed significantly to the rise in productivity, at least until 2003. This was undoubtedly a direct consequence of more active restructuring of firms, at a time when Ukraine was "catching up" on reforms. During 2000-2005 the gross job turnover ratio, defined as the sum of hiring and firing over total employment, rose steadily, from 45% in 2000 to 58% in 2005. Since 2004, industrial employment has stabilized and productivity growth has slowed, which suggests that this phase of relatively "easy" restructuring is over.

While there has recently been some progress in making entry easier, impediments to entry, exit and restructuring remain substantial. Empirical analysis confirms that Ukraine has particular problems with exit. Firm-level data for Ukraine show overall firm turnover rates in manufacturing to be rather low by OECD standards — about 10% in 2002-2005, as against 15-20% typically found in mature market economies.

Given such low levels of entry and exit, it is no surprise that product markets in Ukraine are highly concentrated and heavily regulated. The Herfindahl-Hirschmann indexes (HHIs) that we have calculated are higher than the indicators for Russia in every major sector. Concentration levels have risen in key export sectors recently, including metallurgy, chemicals, machine-building and food, while they have declined modestly in the construction materials and light industries.

We find that market concentration has a negative and highly significant impact on labor productivity growth: a one percentage point decline in the HHI is associated with an increase in labor productivity growth of 0.2-0.3%.

High levels of market concentration and weak competition are partly a product of Ukraine's inherited economic structure, but they are also, in large measure, the result of misguided policies. To be sure, competition law is now much improved and, on paper at least, it is broadly in line with international norms, but anti-competitive policies and practices are still widespread.

Product–Market Reform

Competition-enhancing product-market regulation (PMR) reform can help raise productivity growth through a number of channels, including the direct impact of competition on both market efficiency and technical efficiency, as well as its indirect impact via the role of competition in spurring innovation. Reforms that liberalize entry are also likely to spur fixed investment in some sectors.

The PMR review of Ukraine, undertaken in 2007 by the OECD Secretariat, has arrived at four broad conclusions:

- the level of overall product-market regulation was higher than that of any OECD country in 2003;
- the burden of product-market regulation is well above the OECD average with respect to all three major components of the aggregate indicator: state control, barriers to entrepreneurship and barriers to trade and investment;
- overall, barriers to business growth appear to be more constraining than barriers to entry;
- regulatory process is in some respects as much of a problem as the substance of regulation.

However, it should be borne in mind that the PMR review assesses formal regulatory policy settings, which have improved substantially in Ukraine, while the implementation of these policies remains incomplete and inconsistent.

Analysis of the specific PMR indicators finds that:

- recent efforts to improve conditions for entry have had a marked positive effect; yet start-up procedures remain costlier and more time-consuming in Ukraine than in most of the region;
- the regulatory impediments to growing businesses of any size remain extremely onerous, especially those associated with licensing and permits;
- the size of the public sector remains too large, with about 48% of the country's capital stock in the hands of the state or municipal authorities, and a further 10-11% in public-private ownership. Yet although the problems associated with such a large population of SOEs are widely recognized, privatization has effectively been stalled for the last few years.
- Pressure to restructure or wind up many inefficient firms is limited by the widespread availability of explicit or implicit subsidies to favored enterprises. Direct support from the state to industry is estimated at 1.7% of GDP in 2007.

Further Privatization Needed

Closing the productivity gap between Ukraine and the more advanced economies will require increasing efficiency of resource allocation and efficiency of production. Strengthening competition can contribute a great deal to the achievement of both these ends. Our econometric analysis of the relationship between competition and enterprise performance in Ukraine finds that:

- concentration has a negative impact on labor productivity growth;
- import competition has a positive impact on domestic firms' productivity, with the stronger effect in sectors with lower foreign penetration.

Ukraine's stalled privatization process is particularly regrettable in view of mounting evidence that it has improved enterprise productivity and efficiency. Further privatization could play a major role in stimulating greater dynamism and flexibility, particularly together with competition-enhancing regulatory reform: in the case of privatization to domestic owners total factor productivity increases by between 10% and 25%, during the seven years following privatization.

Christian Gianella and William Tompson are Senior Economists at the OECD Economics Department. The views expressed here are those of the authors and should not be attributed to the OECD, its Executive Board, or its management. Full text of the OECD Economics Department Working Papers No. 574 is available at www.oecd.org. **BT**

World Bank Supports Strengthening Public Financial Management in Ukraine

On January 8, 2008 the World Bank's Board of Executive Directors approved the Public Finance Modernization Project for Ukraine the amount of US$50 million. The objective of the project is to strengthen public financial management in Ukraine by improving operational efficiency and transparency. Enhancing the transparency, efficiency and effectiveness of public financial management is an important element of the institutional modernization plan of the Government of Ukraine and has been on the agenda of successive governments since the beginning of the decade. Important progress has been made, including the establishment of a Treasury system, the abolishment of National Bank direct financing of the government, the adoption of a new Budget Code and budget classification system, the creation of an internal audit function and the improvement of the availability of fiscal information. Despite impressive economic growth and prudent fiscal policy, there are still significant institutional challenges to address for improving public service delivery. The development of the integrated public financial management system and supporting further reforms in budget planning and execution will have positive effects on the timeliness and predictability of public expenditure, including the areas relevant to combating poverty. Arrangements for improving information dissemination to civil society supported through the project will strengthen governance and accountability across the executive, and mitigate governance risks. For more information, visit: *http://go.worldbank.org/6LU90EZVZ0*

Developing Countries to Cushion Rich-Country Slowdown in 2008

A World Bank report says that resilience in developing economies is cushioning the current slowdown in the United States, with real GDP growth for developing countries expected to ease to 7.1% in 2008, while high-income countries are predicted to grow by a modest 2.2%. "Global Economic Prospects 2008," an annual Bank report, notes that world growth slowed modestly in 2007 to 3.6% compared with 3.9% in 2006, a downturn due largely to weaker growth in high-income countries. In 2008 global growth is expected to be 3.3%. A weaker US dollar, the specter of an American recession and rising financial-market volatility could cast a shadow over this soft landing scenario for the global economy, the report says.

In the first half of 2007, industrial production sped up across the developing regions, notably in East Asia (20%, year over year). Robust production data are also reflected in GDP results. China, India, and Russia were instrumental in driving up output. GDP in Europe and Central Asia is expected to grow by 6.7% in 2007, and then slow to 6.1% in 2008 and 5.7% in 2009. Inflation has risen in several countries, tied to sustained strong domestic demand and rising food and fuel prices (made worse by drought in Bulgaria and Romania). Signs of overheating are evident in Bulgaria and the Baltic states. In Turkey, an easing of monetary policy is expected to strengthen domestic demand, leading to a pickup in growth, and a continued large current account deficit. For more information, visit: *http://go.worldbank.org/XV5QISSB60*

World Bank Supports Scientific Excellence and Research Commercialization in Kazakhstan

On January 15, 2008, the World Bank's Board of Executive Directors approved a US$13.4 million loan for the Kazakhstan Technology Commercialization Project. This project will strengthen Kazakhstan's science base by introducing international peer review for research funding based on scientific merit and commercial potential and connect improved research and development of scientific groups to national and international technology markets. In the past, Kazakhstan was known for its scientific excellence and substantial scientific capacity; with 41,000 research scientists at its peak, Kazakhstan used to be an important center of research and development in the Soviet Union. However, the number of research personnel declined dramatically and by 2004 only 17,000 researchers continued to work in the sector. Between 1993 and 2002 virtually no new scientific equipment was acquired in Kazakhstan and very little has been since, with the remaining equipment either obsolete or worn out and in urgent need of replacement. The project, with an overall value of US$75 million, is co-financed by the Government of Kazakhstan in the form of US$61.6 million. For more information, visit: *http://go.worldbank.org/HQF5H3QP40*

World Bank Supports Health Sector Reform in Kazakhstan

On January 15, 2008, the World Bank's Board of Executive Directors approved a US$117.7 million loan for the Kazakhstan Health Sector Technology Transfer and Institutional Reform Project. The project will help introduce international standards and build long-term institutional capacity in the Ministry of Health and related healthcare institutions in support of key health sector reforms pursued by the Government of Kazakhstan. For a country with rapidly increasing income, Kazakhstan's health indicators could be improving more quickly. High rates of tuberculosis and high indicators of infant, child and adult mortality, cancer, tobacco and alcohol-related diseases represent major challenges to Kazakhstan's current health system. Several reform programs have been attempted over the last 10 years but, until recently, have moved slowly. "Improving the health system in Kazakhstan is essential to achieving the objective of becoming one of the 50 most competitive countries in the world," said Sergei Shatalov, World Bank Country Manager for Kazakhstan. For more information, visit: *http://go.worldbank.org/GNBZ25RHK0*

Support for Reform of Technical Safety Regulations in Georgia

The International Finance Corporation (IFC) has teamed up with the Government of Georgia to help improve the technical safety of potentially hazardous enterprises. The reform agenda includes improving how the technical inspections of businesses such as gas stations, mining enterprises, elevators, and hoisting mechanisms are conducted. It also introduces new risk-based inspections and the outsourcing of some functions to private inspection facilities. To assist the government in this reform, the IFC has drafted an action plan that will transfer on-the-spot inspection functions to private companies, making them responsible for the safety of inspected enterprises. For more information, visit: *http://newsletters.worldbank.org/*

"Youth Voices" Group Suggests Strengthening Cooperation with Similar Groups from Nine Other Countries

A World Bank's initiative — the Youth Voices Group — is getting actively involved in the review and monitoring of the projects implemented with the World Bank's support in the Republic of Moldova. The group's involvement aims at the following priorities: social inclusion of youth, strengthening of cooperation and inclusion of young people from Transdniestria in youth activities accomplished on the left bank of the Dniester river, fighting against corruption — particularly within the education system, environment protection and global warming, and participation in the Country Partnership Strategy development. On January 22, the Youth Voices Group had an opportunity to talk to senior World Bank officials. The topics raised by the youth targeted issues of group cooperation with other similar groups from the South-East and Central Europe. For more information, visit: *http://go.worldbank.org/A0CXI4H6L0*

World Bank Offering US$4 Million in Grants for Innovations in Agriculture

The 2008 Global Development Marketplace (DM2008) competition was launched on January 22, 2008, offering US$4 million in grants to social entrepreneurs with innovative ideas that have potential for high impact in promoting sustainable agriculture. The competition this year is asking participants to focus on solutions to agricultural challenges in developing countries such as linking small-scale farmers to markets; improving land access for poor farmers; and promoting the environmental services of agriculture in addressing climate change and biodiversity conservation. Global DM competitions are held every 12 to 18 months. Since 1998, they have awarded more than US$30 million to nearly 300 projects worldwide. For more information, visit: *www.developmentmarketplace.org.*

Housing and Communal Services Reform Initiative Receives World Bank Support

Russian consumers in at least 10 cities will benefit from a pilot program to improve housing and communal services due to a partnership between the Russian Federation and the World Bank, which today approved a US$200 million loan for a Housing and Communal Services Project in Russia. The project will test a competitive grant mechanism to cities that increase market mechanisms in housing and communal services (heating, power, water, sewage and sanitation) and also strengthen social protection of vulnerable consumer groups. The competition to participate in the pilot program will be open to cities ranging in population from 90,000-600,000 people and that meet minimum criteria of financial performance by the municipal administration and communal service providers. For more information, visit: *http://go.worldbank.org/ZCTKC2O380*

OECD, World Bank to Step Up Co-Operation on Sustainable Growth, Climate Change, Innovation and Other Topics

The Organization for Economic Co-operation and Development (OECD) and the World Bank have agreed to step up their co-operation in a number of key areas, including efforts to promote sustainable and inclusive growth in emerging economies, the economics of climate change, aid for trade, innovation and the design of comprehensive country frameworks for investment. The announcement follows a meeting of senior officials in Washington D.C. on 5-6 December 2007, including at a joint OECD-World Bank seminar on "Sustainable and Inclusive Development: Going for Growth" with the participation of OECD Secretary-General Angel Gurria and World Bank President Robert B. Zoellick. For more information, visit: *http://go.worldbank.org/Y7EX5WRHJ0*

International Comparison Program Preliminary Global Report Compares Size of Economies

The International Comparison Program released new data showing the world economy produced goods and services worth almost US$55 trillion in 2005 and that almost 40% of the world's output came from developing economies. Carried out with the World Bank and other partners, the preliminary global report provides estimates of internationally comparable price levels and the relative purchasing power of currencies for 146 economies. One of the major findings of the report is that 12 economies account for more than two-thirds of the world's output. Seven of them are high-income economies (United States, Japan, Germany, the United Kingdom, France, Italy and, Spain), and five are developing or transitional economies (China, India, Russia, Brazil, and Mexico). The five largest developing economies account for more than 20% of global output and over 27% of the world expenditures for investment purposes. Additional details can be found at *www.worldbank.org/data/icp.*

Helping Smaller Businesses in Central Asia

Central Asian countries have made considerable progress in transitioning to market-based economies, yet most of them still suffer from high unemployment and poverty. To help, the International Finance Corporation (IFC) is using investments and advisory services to support private sector development, with an emphasis on the poorest countries and those eligible for public sector loans from the Bank's International Development Association. These include Azerbaijan, the Kyrgyz Republic, Tajikistan, and Uzbekistan. A major focus of its strategy in the region is to support micro, small, and medium enterprises, which form the economic backbone of most of the countries and are crucial to the region's development and economic growth. More information: *http://www.ifc.org/ifcext/media.nsf/Content/Central_Asia_Feb08* **BT**

World Bank Publications

Information and orders: the World Bank, P.O. Box 960, Herndon, VA 20172, U.S.; tel.: +1-703-661-1580, fax: 703-661-1501, http://www.worldbank.org/publications, email: books@worldbank.org, or visit the World Bank InfoShop at 701 18th Street, N.W., Washington, D.C., tel.: +1-202-458-5454

Dilip Ratha , Zhimei Xu
Migration and Remittances Factbook 2008
February 2008
ISBN-13: 978-0-8213-7413-9

Nearly 200 million people, or 3% of the world population, live outside their countries of birth. Worldwide remittance flows are estimated to have exceeded US$318 billion in 2007, of which developing countries received US$240 billion. The true size, including unrecorded flows through formal and informal channels, is believed to be significantly larger. The publication presents the numbers and facts behind the stories of international migration and remittances, drawing on authoritative, publicly available data. It provides a snapshot of statistics on immigration, emigration, skilled emigration, and remittance flows for 194 countries, and 13 regional and income groups.

Kyrgyz Republic Poverty Assessment
Poverty Reduction and Economic Management Unit, Europe and Central Asia Region
September 2007
http://go.worldbank.org/3I3G9FM4C0

This report, which has been prepared by the World Bank in cooperation with the National Statistical Committee, provides an assessment of poverty in the Kyrgyz Republic using the most recent data available. It attempts to answer three questions about the Kyrgyz Republic: What is the profile of a poor person? How has economic growth affected the level and composition of poverty? How has labor contributed to changes in poverty? The report finds that although income poverty fell during 2000-2005 at a rapid pace from 63% to 43% of the population due to economic growth, further poverty reduction remains a very real challenge for the government. Any serious poverty reduction strategy will overlap significantly with a strategy for growth. The proposed poverty reduction strategies include: encouraging the channeling of a greater proportion of remittances to investment and job creation; designing a rural anti-poverty strategy, as the majority of the poor live in rural areas and work on farms; conducting regional investment climate surveys to better understand the differential rates of regional development; and reform of the education sector linking secondary and post-secondary education with labor market needs.

Adam Wagstaff, Rodrigo Moreno-Serra
Europe and Central Asia's Great Post-Communist Social Health Insurance Experiment: Impacts on Health Sector and Labor Market Outcomes
WPS4371, October 2007

The post-communist transition to social health insurance in many of the Central and Eastern European and Central Asian countries provides an opportunity to answer some of the unresolved issues in the debate over the relative merits of social health insurance and tax-financed health systems. Using panel data from 28 countries for the period 1990-2004 the authors find that, controlling for any concurrent provider payment reforms, adoption of social health insurance increased national health spending and hospital activity rates, but did not lead to better health outcomes. The authors also find that adoption of social health insurance reduced employment in the economy as a whole and increased unemployment, although it did not apparently increase the size of the informal economy.

Caryn Bredenkamp, Michele Gragnolati
Sustainability of Healthcare Financing in the Western Balkans: An Overview of Progress and Challenges
WPS4374, October 2007

This paper explores the major challenges to the sustainability of health sector financing in the countries of the Western Balkans — Albania, Bosnia and Herzegovina, the Former Yugoslav Republic of Macedonia, Montenegro, Serbia and the province of Kosovo. It focuses on how the incentives created by the different elements of the healthcare financing system affect the behavior of healthcare providers and individuals, and the resulting inefficiencies in revenue collection and expenditure containment. The paper analyzes patterns of healthcare expenditure, finding that there is some evidence of cost containment, but that current expenditure levels — while similar to that in EU countries as a share of GDP — are low in per capita terms and the fiscal space to increase expenditures is extremely limited. It also examines the key drivers of current healthcare expenditure and the most significant barriers to revenue generation, identifying some key health reforms that countries in the sub-region could consider in order to enhance the efficiency and sustainability of their health systems. Data are drawn from international databases, country institutions, and household surveys.

Paul R. Masson
The Growing Role of the Euro in Emerging Market Finance
WPS4381, November 2007

More than eight years after the introduction of the euro, impacts on developing countries have been relatively modest. Overall, the euro has become much more important in debt issuance than in official foreign exchange reserve holdings. The former has benefited from the creation of a large set of investors for which the euro is the home currency, while demand for euro reserves has been held back by the dominance of the dollar as a vehicle and intervention currency, and the greater liquidity of the market for US treasury securities. Fears of further dollar decline may fuel some shifts out of dollars into euros, however, with the potential for a period of financial instability.

Maurizio Bussolo, Rafael E. De Hoyos, Denis Medvedev, Dominique van der Mensbrugghe
Global Growth and Distribution: Are China and India Reshaping the World?
WPS4392, November 2007

Over the past 20 years, aggregate measures of global inequality have changed little even if significant structural changes have been observed. Using the World Bank's LINKAGE global general equilibrium model and the newly developed Global Income Distribution Dynamics tool, the paper assesses the distribution and poverty effects of a scenario where these trends continue in the future. Even by anticipating a deceleration, growth in China and India is a key force behind the expected convergence of per-capita incomes at the global level. Millions of Chinese and Indian consumers will enter into a rapidly emerging global middle class — a group of people who can afford, and demand access to, the standards of living previously reserved mainly for the residents of developed countries. Notwithstanding these positive developments, fast growth is often characterized by high urbanization and growing demand for skills, both of which result in the widening of income distribution within countries. These opposing distributional effects highlight the importance of analyzing global disparities by taking into account income dynamics between and within countries.

Marianne Fay, Donato De Rosa, Catalin Pauna
Product Market Regulation in Romania: A Comparison with OECD Countries
WPS4402, November 2007

Less restrictive product market policies are crucial in promoting convergence to higher levels of GDP per capita. This paper benchmarks product market policies in Romania to those of OECD countries by estimating OECD indicators of Product Market Regulation. These indicators allow a comprehensive mapping of policies affecting competition in product markets. Comparison with OECD countries reveals that Romania's product market policies are less restrictive of competition than most direct comparators from the region and not far from the OECD average. Nonetheless, this achievement should be interpreted in light of the fact that this approach measures officially adopted policies. It does not capture implementation and enforcement, the area where future reform efforts should be directed if less restrictive policies are to have an effective impact on long-term growth prospects.

David Tarr
Russian WTO Accession: What has been Accomplished, What can be Expected
WPS4428, December 2007

This paper summarizes the principal reform commitments that Russia has undertaken as part of its World Trade Organization (WTO) accession negotiations, providing detailed assessments in banking, insurance, and agriculture. The paper assesses the gains to the Russian economy from these commitments, based on a summary of several modeling efforts undertaken by the author and his colleagues. The author compares Russian commitments with those of other countries that have recently acceded to the WTO to assess the claim that the demands on Russia are excessive due to political considerations. He explains why Russian WTO accession will result in the elimination of the Jackson-Vanik Amendment against Russia. Finally, he discusses the remaining issues in the negotiations and the time frame for Russian accession as of the fall of 2007.

Erwin R. Tiongson, Ruslan Yemtsov
Bosnia and Herzegovina 2001-2004 : enterprise restructuring, labor market transitions and poverty
WPS4479, January 2008

This paper takes stock of labor market developments in Bosnia and Herzegovina over the period 2001-2004, using the panel Living Standards Measurement Study/Living in Bosnia and Herzegovina survey. The results provide strong evidence that there are indeed significant differences in labor market transitions by gender, age, education, and geographic location. Using the panel structure of the multi-topic survey data, the authors find that these transitions are related to welfare dynamics, with welfare levels evolving differently for various groups depending on their labor market trajectories. The findings show that current labor market trends reflecting women's movement out of labor markets and laid-off male workers accepting informal sector jobs characterized by low productivity will lead to adverse social outcomes. These outcomes could be averted if the planned enterprise reform program creates a more favorable business environment and leads to faster restructuring and growth of firms.

Other Publications

Peter J S Duncan
"Oligarchs", Business and Russian Foreign Policy: From Yeltsin to Putin
WP 83, UCL, October 2007, http://www.ssees.ac.uk/wp83sum.htm

The paper investigates the role of private and state-controlled business in the formation and implementation of Russian foreign policy since the collapse of the Soviet Union. The extent to which the 'oligarchs' and business more generally followed their own interests in their external relations or acted as tools of the Russian state is a particular focus. Under Yeltsin, business had followed its own interests, which sometimes conflicted with Russian foreign policy and sometimes reinforced it; but after Putin's attacks on the oligarchs, business seemed more integrated into policy implementation, while still following its own interests where they did not conflict with those of the state, as is suggested by a discussion of Gazprom's foreign policy role.

Ruben Enikolopov, Maria Petrova, Ekaterina Zhuravskaya
Television and Political Persuasion in Young Democracies: Evidence from Russia
CEFIR/NES WP 112, December 25, 2007, www.cefir.ru

Governments control media in much of the developing world. Does this have an effect on political choices of voters? The authors address this question using exogenous variation in the availability of the signal of the only independent national TV channel in Russia during the 1999 parliamentary elections. They find that the presence of an independent source of political news on TV significantly decreased the vote in favor of the government party and increased the vote in favor of the opposition parties. Moreover, the difference in TV coverage significantly changed voting behavior even controlling for voters' inclinations just one month prior to the elections. These effects are larger than those found in established democracies.

Richard Pomfret
Using Energy Resources to Diversify the Economy: Agricultural Price Distortions in Kazakhstan
CASE Network Studies and Analyses No. 355, December 2007, http://www.case.com.pl

The agricultural sector in Kazakhstan experienced declining output throughout the 1990s, partly because relative prices shifted from being distorted in favor of farmers to being distorted against them. After the end of the decade public policy shifted towards support for (or less discrimination against) agriculture, boosted by a billion-dollar Agriculture and Food Program for 2003-2005, which was made possible by booming oil revenues. The paper provides estimates of producer support for the main agricultural products in Kazakhstan, and analyzes the consequences of shifts in farm support policy. The author produces the negative estimates for export goods (wheat and cotton) in 2000-2001, which suggest substantial behind-the-border trade costs; and the shift from negative to positive support for major agricultural products.

Andreja Jaklič, Joze P. Damijan and Matija Rojec
Innovation Cooperation and Innovation Activity of Slovenian Enterprises
LICOS Discussion Paper 201/2008, January 2008, http://www.econ.kuleuven.be/LICOS/DP/DP2008/DP201.pdf

The authors explore the importance of innovation cooperation for the innovation activity of Slovenian enterprises, what kind of innovation cooperation is the most "productive" for innovation activities, and whether the location and foreign ownership of innovation cooperation matter. Estimations confirmed external innovation cooperation as one of the most important incentives for innovation activity, after R&D spending. However, a significant influence is only confirmed for domestic innovation cooperation. The efficiency varies by type of partners: while inter-firm innovation cooperation significantly increases the probability of innovation, this is not the case regarding cooperation with universities and R&D institutes. The impact of innovation cooperation differs by distance, with the contribution of EU partners to innovation activity being the highest (higher then that of domestic partners).

Book Reviews

Saul Estrin, Grzegorz W. Kolodko and Milica Uvalic (eds.)
Transition and Beyond
Palgrave Macmillan 2007
IBN-10: 0230546978

Papers by various researchers included in the volume are grouped into three sections: the socialist legacy; transition from socialism to capitalism; and beyond transition. They provide an up-to-date evaluation of the transition, as well as insights and discussion on current phenomena such as globalization and complexity. Specifically, the following topics are explored: main characteristics of central planning; productivity in the Soviet Union and other socialist countries; division between the new EU member states and less successful former Soviet Union countries; the determinants of success in transition; skills and human capital in transition countries; financial transition in Central and Eastern Europe; the evolving role of financial policy; the optimal transition path, and globalization. Additionally, four country studies focus on transition in two different regions: Slovenia and Serbia from the former Yugoslavia, and Russia and Belarus from the former Soviet Union.

Stephan Barisitz
Banking in Central and Eastern Europe 1980-2006: From Communism to Capitalism
Routledge 2007
ISBN-10: 0415428815

The book overviews the development of the banking systems in Central and Eastern Europe and the CIS over a period of about 25 years: from the beginning of the 1980s up to late 2006. Taking into account historic changes, particularly the emergence of independent states after the collapse of communism, all relatively large countries (in terms of population) are dealt with: Hungary, Poland, Czech Republic, Slovakia, Bulgaria, Romania, Croatia, Russia, Ukraine, Belarus, Kazakhstan, and Uzbekistan. The study analyzes and compares the evolution of legal foundations, banking supervision, a bank's major sources of assets, liabilities, earnings and related changes, banking crises, restructuring, rehabilitation programs, the role of foreign-owned banks and FDI. Finally, the book discusses perspectives and challenges of banking in Central and Eastern Europe in the light of the expanding EU and further enlargement of the euro area.

Nina Bandelj
From Communists to Foreign Capitalists
Princeton University Press, 2008
ISBN-13: 978-0-961-12912-9

The book explores how 11 post-socialist countries address the very idea of foreign direct investment (FDI) as an integral part of their market transition. The inflows of foreign capital after the collapse of communism resulted not from the economy, as is commonly expected, but rather from the active involvement of postsocialist states in institutionalizing and legitimizing FDI. Using a wide array of data sources, and combining a macro-level account of national variation in the liberalization to foreign capital with a micro-level account of FDI transactions in the decade following the collapse of Communism in 1989, the book reveals how social forces not only constrain economic transformations but also make them possible. The author presents a sociological treatment of the process of FDI. She demonstrates how both investors and hosts rely on social networks, institutions, politics, and cultural understandings to make decisions about investment to deal with the true uncertainty that plagues the postsocialist environment. BT

World Conference on Intellectual Capital for Communities

May 22-23, 2008, Paris, France

Following on from previous conferences, the fourth meeting of the World Conference explores the challenges and opportunities stemming from today's increasingly knowledge-based economy. This year's conference examines, among other topics: intellectual capital in a historical perspective, metrics and standards, spatial issues (city planning and knowledge, global/local tensions), societal and organizational design. The event is designed as a platform for the exchanges of views, to promote learning among key stakeholders from around the world, and to consider an agenda for transnational and trans-institutional research and action for the future.

More information:
http://go.worldbank.org/1MN9DA1JW0

Annual Bank Conference on Development Economics

June 9-11, 2008, Cape Town, South Africa

ABCDE 2008 will for the first time unite the global and the regional ABCDE in one single event. This year the conference will follow a new format — except for several roundtable debates and keynote addresses all sessions will run in parallel blocks of:

1. Comparative sessions with an African, South Asian and global focus, offering critical perspectives on two of the most populous developing regions.
2. Specific sessions focused on various aspects of growth (globalization, human development, political economy), by external organizations identified through an open competition.

More information and registration at:
ww.worldbank.org/abcdesouthafrica

The Challenge of Globalization

25-29 June, 2008, Istanbul, Turkey

15th World Congress of the International Economic Association is organized by the Turkish Economic Association. The themes of the congress, among others, will include:

- Financial globalization with imperfect financial markets
- Financial globalization and emerging markets
- Financial globalization and global imbalances
- Business cycles in emerging markets.

More information:
ttp://www.arett.ru/.files/2142/IEA%20announce.jpg

CEU Summer School: "Integrity Reform – Strategies and Approaches"

June 30 — July 9, 2008, Central European University, Budapest, Hungary

The course will familiarize participants with the core ingredients of a strategic and critical approach to effective and sustainable corruption control and organizational integrity. Drawing on interdisciplinary academic perspectives and lessons learned from practice, the course represents an effort to analyze corruption and anti-corruption, straddling law, economics, public administration, public sector ethics, as well as politics, statistical and ethnographic approaches. Topics covered include cross-cutting issues such as definitions, measurements and research methodology, and also distinct areas such as access to information, fiscal transparency, and risk assessment and management. The course seeks to give equal emphasis to public sector reforms as well as to social accountability as actionable rights essential to democratic governance.

For further information queries can be directed to the SUN office by email (summeru@ceu.hu), via skype (ceu-sun) or telephone (00-36-1-327-3811). Also see the web site: http://www.sun.ceu.hu/02-courses/course-sites/integrity/detailed.php

Patterns of Transition and New Approaches to Comparative Economics

28-30 August, 2008, Moscow, Russia

The 10th bi-annual conference of the European Association for Comparative Economics will be held in association with the State University — Higher School of Economics, Moscow. Themes of the conference will include:

- Patterns of transition;
- New approaches to comparative economics: globalization in comparative perspective;
- Comparative economic development;
- Institutions and comparative economic systems;
- Comparative studies of the firm;
- Education and the labor market;
- Public policy and the policy process;
- Innovation systems and path dependency.

More information:
http://d1.hse.ru/lingua/en/conf/eaces2008/index.html

23rd Congress of the European Economic Association

27-31 August, 2008, Milan, Italy

Universite Bocconi will host the next joint European meeting of the European Economic Association and the Econometric Society (EEA-ESEM). The European Economic Association and the Econometric Society are international scientific organizations dedicated to the promotion and dissemination of contemporary economic research, including theoretical, empirical, and policy-relevant contributions. Membership in both the EEA and the ES is open to all interested persons and includes reduced registration fees at the EEA/ESEM meeting. Economists and professionals working in related fields, including those who currently are not members of the European Economic Association or the Econometric Society, are invited to submit theoretical and applied papers in all areas of economics for presentation at the congress.

More information:
http://www.eea-esem2008.org/index.php **BT**

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