Public Disclosure Authorized

Public Disclosure Authorized

WPS 1326

POLICY RESEARCH WORKING PAPER

1326

Banks, Capital Markets, and Corporate Governance

Lessons from Russia for Eastern Europe

Gerhard Pohl
Stijn Claessens

The need for financial sector reform in the formerly socialist economies was recognized from the start, but views about how and when to proceed diverged. Too often, complex western models have been prescribed prematurely. Banking reform has progressed further in Russia than elsewhere, which supports the view that market factors should be allowed to do more in the transition than they have.

The World Bank
Europe and Central Asia, and Middle East and North Africa
Technical Department
Private Sector and Finance Team
July 1994

Summary findings

The financial sector should be active in enterprise restructuring in the transitional economies, and should help channel resources to the private sector. What will best help the sector achieve these tasks: gradual reform or radical reform?

Liberalization and privatization are the most urgent tasks transitional economies face. But for market reform to succeed, reforms of banking and capital markets must keep pace with enterprise reform and privatization.

Central and Eastern Europe have pursued a gradual approach to financial reform, splitting the former state bank (or "monobank") into a central bank and several large state-owned commercial banks, eventually to be privatized. Russia has taken a more radical approach, creating many new private commercial banks that have already taken over most of the business from state banks.

The reform of banks and capital markets in transitional economies should not be modeled too closely on patterns in western economies, with their large institutions, complex financial instruments, and extensive regulation. A simpler process is required, compressing in a short period the historical development of financial systems — starting with small banks and accepting imperfect regulation and supervision as a fact of life.

Systemic risks remain manageable if financial institutions are small and numerous enough. A system with many private banks is more likely to produce a financial sector that plays an active role in enterprise restructuring, channels resources to the private sector, and thus accelerates restructuring and economic growth.

Historical comparisons confirm the benefits of such a liberal, weakly regulated banking system.

This paper — a product of the Private Sector and Finance Team, Europe and Central Asia, and Middle East and North Africa Technical Department — is part of a larger effort in the department to analyze developments in the financial systems of transition economies. Copies of the paper are available free from the World Bank, 1818 H Street NW, Washington, DC 20433. Please contact Luz Hovsepian, room H8-093, extension 37297 (16 pages). July 1994.

The Policy Research Working Paper Series disseminates the findings of work in progress to encourage the exchange of ideas about development issues. An objective of the series is to get the findings out quickly, even if the presentations are less than fully polished. The papers carry the names of the authors and should be used and cited accordingly. The findings, interpretations, and conclusions are the authors' own and should not be attributed to the World Bank, its Executive Board of Directors, or any of its member countries.

Produced by the Policy Research Dissemination Center

Banks, Capital Markets and Corporate Governance: Lessons from Russia for Eastern-Europe

Gerhard Pohl
and
Stijn Claessens

THE WORLD BANK

The opinions expressed are those of the authors and do not necessarily reflect those of the World Bank. We would like to thank participants in seminars at the World Bank, the European Banking Forum, Prague, March 21-23, the CEEPN workshop on Linking Bank Rehabilitation with Enterprise Restructuring and Privatization, Budapest, June 24-25, and Millard Long, Nils Fostvedt and Anil Sood for their comments.

Banks, Capital Markets and Corporate Governance: Lessons from Russia for Eastern-Europe

Summary

The financial sector in transition economies should play an active role in enterprise restructuring and channeling resources to the private sector. What type of financial reform is best suited to achieve these tasks, a gradual approach or a fundamental approach?

Liberalization and privatization are, without doubt, the most important and urgent tasks in transition economies. If market reforms are to be successful, banking and capital markets reform needs to keep pace with enterprise reform and privatization.

In Central and Eastern Europe, a gradual approach to financial sector has been pursued, splitting the former state bank, or "monobank", into a central bank and several large, state-owned commercial banks, to be privatized eventually. A more fundamental approach has been pursued in Russia where a large number of new private commercial banks has been created which have already taken over most of the business from state banks.

Banking and capital market reforms in transition economies should not be modelled too closely on today's patterns in Western economies with large institutions, complex financial instruments and extensive regulation. Rather, a simpler process is required, compressing the historical development of financial systems -- starting with small banks and accepting imperfect regulation and supervision as a fact of life. Systemic risks remain manageable if financial institutions are numerous and small enough. A large number of private banks is more likely to lead to a financial sector which plays an active role in enterprise restructuring, channels resources to the private sector, and thus accelerates restructuring and economic growth. Historical comparisons confirm the benefits of such a liberal, weakly regulated banking system.

Banks, Capital Markets and Corporate Governance: Lessons from Russia for Eastern-Europe

Economic reforms in transition economies means market reforms

Despite massive resources mobilization and high investments, socialist economies have experienced dismally low growth of living standards (see, for example, Easterly and Fischer, 1994). The main reason was the gigantic misallocation of resources. Hierarchical decision making led to irrational production patterns and an ill-adapted capital stock. Unclear responsibilities and conflicting signals for managers led to poor performance, a lack of initiative, slow technological progress, and low productivity.

The ultimate objective of reforms in transition economies is clear: higher economic growth and welfare. The main vehicle is market reforms, including liberalization of prices, removal of administrative controls, privatization, and legal and institutional reforms (see further, for example, Gelb and Gray, 1991). Each of these is a momentous undertaking, none of which can succeed without simultaneous progress in the other areas. But, privatization is the linchpin. Not only need firms be privatized, but, equally important, gradually dismantled into a large number of much smaller firms. This will take more than an initial "mass" privatization process and will only happen if poorly performing enterprises are forced to spin-off assets and lay-off workers. Financial institutions have to play a crucial role in this process. Early -- and fundamental -- financial sector reform is thus a key prerequisite.

Financial reform in transition economies

Right from the start of the transformation of socialist economies, there has been widespread recognition that fundamental financial sector reform in transition economies is required.[1] In practice, different financial sector reform strategies have been followed. In Central and Eastern Europe, a gradual approach has been pursued, splitting the former state bank, or "monobank", into a central bank (with the usual monetary and regulatory functions) and several large commercial banks, inheriting most of the assets and liabilities. Financial reform has mostly been limited to better accounting and auditing, better government regulation and supervision, and some financial restructuring (recapitalization). It was hoped that this would lead financial intermediaries to play a positive role in the restructuring of enterprises and new lending.[2]

Unfortunately, this has proven to be insufficient, and sometimes counterproductive. Instead of lending to new and successful firms, bank managers have continued to lend to large unprofitable enterprises or financed government deficits. The overhang of bad old loans -- non-performing loans account for as much as 30 percent -- means that the net worth of many banks in Eastern Europe is a large negative number, in spite of sometimes repeated infusions of capital by governments.[3] Few banks have played an active role in the restructuring of loss-making firms, largely because these banks are still state owned and hold the majority of assets.[4]

Gradual banking reforms have not succeeded. Even more than for other enterprises,

private ownership of banks is critical and a direct stake of managers desirable. While loss-making production enterprises sooner or later have to adjust, banks can go on lending to insolvent enterprises until both are in deep trouble.

A more fundamental approach to financial sector reform has been pursued in Russia.[5] The old state banks have shrunk and an entire class of new commercial banks has been created, not burdened by old loans and old management practices. More importantly, the new bank managers and owners have a direct stake in the financial success of their banks and are more likely to allocate resources to productive purposes.

We argue, also in light of historical evidence, that financial sector reform in Russia presents a useful model for Eastern European countries. We first describe the Russian reform in detail and then compare it to the East-European approach.

Much progress in micro-economic reforms in Russia: little in macro-economic stabilization

Since the break-up of the Soviet Union in December 1991, the Russian economy has undergone profound economic changes: the command economy has largely been dismantled, many prices have been liberalized, the exchange rate has been floated, private property rights have been expanded, trading monopolies eliminated, and a large number of enterprises have been privatized. Most progress has been made in micro-economic areas, particularly privatization and the replacement of administrative allocation by markets.

However, political and economic reforms have also brought enormous economic and social dislocations, often because of policy inconsistencies. Old command structures have been dismantled before new structures or rules were put in place or even agreed. An advance in some areas has often led to unforeseen consequences, accelerating, widening or, sometimes, delaying reforms somewhere else. A case in point is the loss of macro-economic control during 1992 and 1993 that led to high inflation and rapid depreciation of the ruble.

It is too early to say whether the Russian reforms will succeed. The transformation of the Russian society into a democracy and market economy is a far greater challenge than nearly anywhere else. Nowhere else has central planning been taken as far, nowhere else were economic structures as centralized and distorted as in the former Soviet Union (see the World Bank, 1992 and IMF 1993). But in comparison to Russia's much more difficult starting point, considerable and unexpected progress has been made. The unsuccessful attempts at macro-economic stabilization to date should not be allowed to cloud the judgement. Neither Germany nor Japan were able to attain price stability during their massive economic reallocation following the war. Hyperinflation facilitated then a new start by wiping out old debts. The same is true now in Russia. With structural reforms in place, there is a realistic chance for stabilization now to succeed.

Banking reforms in Russia happened very early and unintentionally

During the socialist period, the state bank (Gosbank) had responsibility for money supply, clearing and settlement, accounting and auditing, and public budget management. Initially, all investment funding came from the budget, but Gosbank was not really a bank. Rather, its role was to serve as the state's accounting and auditing arm. Later, more investment funding was provided on credit, with the Savings Bank (Sberbank) collecting savings from households and the Construction Bank (Stroibank) lending these funds to enterprises. However, investment decision-making did not really change and the Construction Bank mainly supervised implementation of projects decided by the planning authorities.

In 1987-88, under perestroika, a "two-tier" banking system was introduced by carving out all commercial banking functions from Gosbank and creating three sectoral specialized "commercial" banks: Agroprombank, Promstroibank and Jilsotzbank (agriculture, industry and services, respectively), similar to elsewhere in Eastern Europe. Even more important was a new law which authorized the establishment of cooperative banks: the number of banks mushroomed from only five in 1987 to over one thousand in 1990.

The first democratic elections at the republican levels in 1990 led to a reform movement and increasing conflict with the more conservative Union government. In the sphere of finance, the Russian parliament passed several laws in 1990, effectively challenging the power of the USSR Gosbank within the Russian territory. Enterprises were permitted to establish banks and

to chose their main bank freely. The three state banks changed their legal status to joint-stock banks and several split into many regional banks with enterprises as shareholders. The number of banks expanded rapidly to over two thousand in 1993.

While the new commercial banks were de-facto independent and responsible for their lending decisions, they initially controlled only a small part of the financial resources: the current account deposits of enterprises. The largest source of credit continued to be household deposits at the Savings Bank and directed credits of the central bank (which were onlent through the remaining state banks). But this was short-lived: rapid inflation since 1992 has sharply reduced the real volume of credit and accelerated this transformation.

Starting with perestroika, nominal wages increases exceeded the production of consumer goods. Market-clearing was achieved by shortages and forced savings, creating a monetary overhang. With the liberalization of prices and the switch to a market economy in 1992, market-clearing was achieved through increased prices. Lacking appropriate wage and credit restraints, enterprises simply passed-on cost increases, workers obtained compensating wage increases, and the central bank issued more credit to keep enterprises afloat. Inflation accelerated and financial disintermediation followed. By 1992 credit expanded by over 800 percent and inflation by 2300 percent. The consequence was a rapid decline in the real value of financial claims. By late 1993, inflation had eroded the value of household savings to less than 2 percent of GNP, compared to 37 percent in 1990 (Table 1). The balance sheet of the Russian banking system became limited to short-term deposits, which were increasingly held at

commercial banks. Today, the government's ability to finance expenditures and enterprise losses through a large inflation tax is sharply reduced.

Table 1

(percent of GDP, unless otherwise noted)

	1986[a]	1987[a]	1988[a]	1989[a]	1990	1991	1992	1993
Domestic Credit	65	67	72	73	91	46	22	15
Claims on Government	9	15	26	32	55	7	4	3
Claims on Enterprises and Households	56	52	46	41	37	39	18	12
Money	51	57	61	64	80	62	31	16
Currency Outside Banks	9	10	10	11	12	9	4	4
Ruble Deposits	42	47	51	53	67	43	14	6
FX Deposits	0	0	0	0	1	11	13	6
Memorandum								
Nominal GDP (R. Billion)[b]	806	830	878	952	639	1928	37811	323693
Exchange Rate (Ruble/US$)	0.68	0.58	0.61	9	23	169	415	1247
Implied Per Capita GDP[c] (US$ at market exchange rates)	4088	4887	4977	–	–	–	614	1747

[a] Data for the USSR.
[b] December GDP annualized.
[c] For the years 1989-1991 no data for GDP per capita are reported as there was not a well functioning foreign exchange market.

The new Russian banks: small, but entrepreneurial

The two-thousand new commercial banks are either entirely new banks -- so called "zero" banks -- or regional spin-offs from the three sectoral state banks. By now both "zero" and "spin-off" banks are represented among the largest commercial banks (Table 2). For example Inkombank is a zero-bank, Mosbusinessbank a former Zhilsotsbank branch, and ICB in St. Petersburg a former Promstroi branch.

"Zero" banks were usually created by groups of enterprises, sometimes with only a small number of large enterprises as shareholders (so called "pocket" banks), sometimes with hundreds of shareholders. The heavy concentration in bank shareholding has been reduced over time.

Even before privatization, the banks acted independently and were de-facto the most market-oriented sector in Russia. With the mass privatization program for enterprises, most banks are now majority privately owned.

Table 2: Assets of Russia Banks
(as of July 1, 1993)

	Total Assets	
	Rb billion	% of GNP
Specialized Banks	14,366	12.1
of which:		
Vneshtorgbank	7,597	6.4
Rosselkhozbank	3,984	3.4
Sberbank	1,926	1.6
Promstroibank	1,273	1.1
20 Largest Commercial Banks	14,479	12.6
Total Assets Banking System	41,304	34.9
Total Credit to Non-Banks (net of interbank credit)	17,697	16.4

Many enterprises have switched their accounts to the more successful banks and have often also become shareholders. Ownership in "zero" banks is usually fairly concentrated, with the five largest shareholders controlling as much as half of the shares.[6] Ownership of "spin-off" banks is more diversified, with the largest shareholder accounting for 5-10 percent of equity, and the largest five for about 25 percent.

The new banks act as corporate treasurers to their owners and customers. Many enterprises continue to rely on their banks to monitor their own financial conditions and to prepare financial statements.[7] In addition, banks provide payments services, deposit accounts, short-term working capital loans, etc. Some sixty banks had general foreign exchange licenses in 1993 and served as correspondent banks to handle foreign exchange transactions for enterprises and other banks.

There are few limits on the scope of activities that banks can undertake. They can engage in deposit-taking, lending, investments, securities trading and underwriting. Portfolio diversification, liquidity, capital adequacy and other prudential regulations exist but are liberal. Banking supervision in Russia remains weak, and regulations are poorly enforced. Due to high inflation, minimum capital requirements were at times very low and permitted de-facto free entry into banking.[8] Recently, international accounting and loan loss provisioning requirements have been introduced and will eventually improve the ability of the Central Bank to supervise banks.

The new Russian commercial banks remain small by international standards. The largest commercial banks have a staff of two or three thousand, a balance sheet total of about $1-3 billion and a total share capital of about $50-150 million (Table 3). As a consequence of high inflation, the three sectoral state banks have rapidly shrunk in real terms. Only Vneshtorgbank (with large foreign exchange assets) and Rosselkhozbank (with most of the directed ruble credit) still exceed the largest private banks.

Table 3: Indicators for 20 Large Russian Commercial Banks
(Averages)

Employees	1,000
Branches	20
Assets	$ 450 million
Net worth	$ 40 million
Foreign exchange assets	$ 230 million
Capital/asset ratio	15% (range: 2-40%)
Loan/assets ratio	34%

The new banks operate mostly on a regional (oblast) basis, with the larger banks handling international transactions for the regional banks. In every major city there are a handful of banks competing, with many more in Moscow. But strong relationship banking prevails, as enterprises have to shift practically all their ruble business if they want to change banks.

The small size of banks in Russia and their regional orientation is probably an advantage at this time. The small size largely eliminates any systemic consequences of bank failures, a

realistic possibility given the limited supervision capacity and a poor lender of last resort. With poor communications, unclear legal rights and remedies, and limited managerial skills, the local focus enable banks to reduce risks. Extensive branching would entail substantial monitoring and control risks. Some of the larger banks have started to branch out and some mergers have happened, but even the largest banks have less than fifty branches, most within their region.

Privatization, banking and corporate governance

The mass privatization program, started in 1992 has been the most significant element of Russian economic reforms. It involved, first, the sale of many small firms and assets by local government through auctions, leases, management buy-outs and similar means. Second, for large enterprises, a mass privatization program was introduced, transferring ownership to managers, workers and the population through voucher auctions.[9]

In response to political pressures from a strong managerial lobby, managers and workers were allowed to obtain large blocks of shares at highly preferential conditions. As a result, privatization became a huge success, at least in terms of enterprises privatized. By the end of 1993, over 8,000 enterprises had been privatized, employing nearly 9 million employees, or 44 percent of the industrial labor force, and one-thousand medium and large enterprises were being privatized each month. By mid-1994, three-quarters of the Russian industrial workforce will be working in privatized enterprises.[10]

Workers hold around half of the shares, managers about 10 percent, and only another 20 percent of the shares have been sold to the population at large through voucher actions.[11] With limited outside ownership, firms are effectively controlled by managers and workers and are likely to maintain a strong collective character. The greatest danger with so much inside control is that enterprise governance deteriorates in a Yugoslav workers' collective, with inappropriate incentives, low productivity and low profitability. Whether it will come about will depend, in part, on whether workers will be able to sell their shares to strategic investors. Managers have tried to restrict sale of shares by workers (e.g., by controlling share registers, limiting voting

rights). But this has been averted by a government decree in 1993, requiring independent share registries for enterprises with many employees. Worker-owners can now sell their shares freely and are likely to do so.

Japanese or German practices labor practices, with lifetime employment and a strong voice of labor in the management of enterprises, represent the most optimistic outcome -- and perhaps the model to follow. While managers have a strong position, they will have to tread carefully with respect to restructuring measures. Large reductions in the workforce appear unlikely, unless a privatized firm runs into financial difficulties. This need not be an insurmountable obstacle to restructuring. If subsidies or external funding are not forthcoming, troubled enterprises will be forced to reduce wages, eventually prompting a good part of the labor force to leave. Since the social safety net is largely provided by enterprises, open unemployment is likely to remain low, but with large wage differentials between profitable and unprofitable firms.

Improved corporate control will largely come about as a result of factor market pressures. With the present low level of financial intermediation, banks have very little leeway (and incentive) to keep troubled enterprises afloat. Unprofitable and unviable enterprises will thus not receive any new resources and will need be liquidated. For these enterprises, banks will mainly be the undertakers to the dead. In exchange for supporting viable enterprises with negative current cash flow -- through debt or equity injections -- banks will require significant changes in ownership. Similar, the creation of new ventures will strongly depend on bank financing. Banks are thus likely to become the main agents for capital and outside control over managers, including ownership changes. Corporate governance will then be "state contingent:"[12] managers of profitable enterprises will remain unchallenged and de-facto owners, while banks (or other potential rescuers) will assume ownership and oversight roles for unprofitable enterprises. Unless limited by regulatory intervention, this will probably entail a development along the lines of Japanese post-war experience.

One of the consequences could be rapid emergence of cross-ownership links between banks and enterprises. Indeed, this has already happened. If Japanese experience is a guide, it could

also involve a rapid decline of worker ownership, as workers sell out to institutional investors, such as banks, insurance companies or investment funds.[13] Given the strong concentration of financial skills in the banking sector, such an outcome would be highly desirable.

The emergence of some sort of a capital market is essential. This could take the form of a securities market Anglo-Saxon style. However, in view of the paucity of financial information, this is unlikely to be the case. Banks are likely to become the main monitors of enterprise performance. The speed of banking development is thus likely to become a major determinant for the speed of restructuring and productivity growth in Russia.

Lessons from Russia for Eastern-Europe

Banking reform in Eastern Europe has not much moved beyond the perestroika reforms used in Russia before 1990. This is unlikely to generate a situation in which banks will take a lead role in active enterprise restructurings and lending to the new private sector. Many of the old state banks are likely to go on as in the past, lending money passively either to enterprises with little future or to the government, and little enterprise reform will take place.

Banks have to take the lead role in enterprise restructuring, mostly by saying no to request for new resources, and only in few cases saying yes. If efficient enterprises and markets are to emerge, financial sector reform needs to keep pace with privatization as without thorough banking reforms enterprise reform will remain incomplete. Even more than for enterprises, good corporate governance of banks is crucial. To turn around the management culture of the state banks is probably more difficult than to create an entirely new banking sector.

An accelerated approach to banking reform in Eastern Europe is thus called for. Russia presents a useful model for East-European countries. The dismantling of the old state banks and the emergence of new commercial banks not burdened by old loans and old management practices in Russia is much more likely to lead to a financial sector which plays an active role in enterprise restructuring and channels resources to the private sector than under the East-

European, gradual approach to banking reform.

Under an accelerated approach, the remnants of the former state banks would be converted into fiscal agents for the government and a whole new banking system would emerge in parallel with the old banking system. Enterprises that are not yet privatized (or liquidated) would continue to bank with the old state banks until they are privatized or liquidated. Privatized enterprises would take their banking business to new banks.

Under this vision, many small and entrepreneurial banks would arise through entry and spin-offs. Large banks are not needed now. The former socialist countries suffer from too many, too large enterprises. Large investments, if needed, can be made from the internal cash flow of large enterprises. What is needed is many small investments in new enterprises, spin-offs or joint ventures to finance marketing and distribution, or quality and productivity improvements. Small banks can provide the short term working capital, payments services and equity investments in new ventures needed. Eventually some of these banks will merge, but only when legal infrastructure and management practices permit. Small banks are also more appropriate during the transition, as their failure does not pose systemic risks and banking supervision will for the time being be at best highly imperfect and at worst corrupt.

In the short-term, the most powerful technique banks will have for enforcing corporate governance will be to pull their credit lines. In the medium-term, equity will be come important and the banks should therefore be universal banks. For one, in the risky economic and financial environment of the transition economies, equity stakes paradoxically entail lower risk than commercial loans, other than small amounts of working capital.[14] Furthermore, equity stakes also confer direct control over management, and possibly more rapid intervention when things go wrong.

Other than Russia, the most direct precedent and model can be found in the early years of the second industrial revolution, the late 19th and early 20th century. Many new joint stock banks were then created to undertake the financing of new industrial ventures. In most

countries, these banks were even less regulated and supervised than in Russia today. While many banks failed, this did not pose systemic risks -- quite to the contrary, this was essential to the efficient functioning of the capital market. However, there is one significant difference between then and now. Then was a time a rapidly rising scale-economies and the emergence of large industrial organizations. The problem in transition economies now is the opposite: to reduce gigantic organizations to a more human and manageable scale. Many small investments are now required, which requires familiarity with local circumstances.

References

Aoki, Mashiko, 1994, "Controlling the Insider Control: Corporate Governance Issues In Transitional Economies," mimeo, the World Bank.

Böhm, Andreja and Vladimir Kreacic (eds.), 1991, Privatization in Eastern Europe: Current Implementation Issues, ICPE, Ljubljana.

Boycko, Maxim, Andrei Schleifer and Robert Vishny, 1994, "Privatizing Russia," Brookings Papers on Economic Activity, Fall, No 2.

Brainard, Lawrence J., 1991, "Eastern Europe: Creating a Capital Market," in Richard O'Brien and Sarah Hewin (eds.), Finance and the International Economy, No. 4, The AMEX Bank Review Prize Essays.

Easterly, William and Stanley Fischer, 1994, "The Soviet Economic Decline: Historical and Republican Data," World Bank Policy Research Paper, no. 1284.

Gelb, Alan H. and Cheryl W. Gray, 1991, "The Transformation of Economies in Central and Eastern Europe: Issues, Progress, and Prospects in Socialist Economy Reform," Policy and Research Series, 17, The World Bank.

Hinds, Manuel, 1990, "Issues in the Introduction of Market Forces in Eastern Europe Socialist Economies," EMENA Discussion Paper, No. IDP-0057, The World Bank.

IMF, 1993, Russian Federation, Economic Surveys, No. 8.

Miyajima, Hideaki, 1994, "The Privatization of ex-Zaibatsu Holding Stocks and the Emergence of Bank-Centered Corporate Groups in Japan," mimeo, the World Bank.

Phelps, Edmund, Roman Frydman, Andrzej Rapaczynski and Andrei Schleifer, 1993, "Needed mechanism of corporate governance and finance in eastern Europe," Working Paper No. 1, EBRD, March.

Roe, Alan, 1992, "Financial Sector Reform in Transitional Socialist Economies," EDI Policy Seminar Report, No. 29, the World Bank.

World Bank, 1992, Russian Economic Reform: Crossing the Threshold of Structural Change, World Bank Country Study.

1. For early analysis see Hinds, 1990, Gelb and Gray, 1991, Brainard, 1991, and Böhm and Kreacic, 1991. A recent analysis is Phelps, Frydman, Rapaczynski and Schleifer, 1993.

2. For a proposal along these lines see Brainard, 1991.

3. In a worst case scenario, the total net worth of all former state banks could be a negative 5-20% of GDP, depending on the level of debt outstanding.

4. Newly entering foreign banks have mostly focussed on foreign trade related activities and have done little lending to domestic enterprises. And lack of domestic capital has prevented the emergence of new domestic banks.

5. A few other countries, mostly in the former Soviet Union (e.g., Estonia), have pursued a similar approach.

6. Central Bank of Russia regulations require that banks have at least three shareholders, and no shareholder can hold more than 35% of a bank or credit institution.

7. This is not unusual. Japanese firms relied initially on their banks for financial management and services, as financial skills were scarce.

8. At times, the minimum was significantly less than US $10,000. An increase to ECU 5 million (and indexed) is to be phased-in over the next several years.

9. For more details and data see Boycko, Schleifer and Vishny, 1993.

10. Data from Boycko, Shleifer and Vishny, 1993.

11. The state property funds hold the remaining 20%.

12. See Aoki, 1994.

13. The dismantling of the "Zaibatsu" conglomerates in Japan in the late 1940s also involved large employee ownership that was later reduced as workers sold their stakes (Miyajima, 1994).

14. Equity stakes can compensate losses with large capital gains. Commercial loans, by contrast, offer only downside risks and are appropriate only if losses can be held to very low levels. At high default rates, required intermediation margins become so large that only speculative or fraudulent borrowers will be willing to take loans at such high real interest rates.

Policy Research Working Paper Series

	Title	Author	Date	Contact for paper
WPS1306	Capital Flows and Long-Term Equilibrium Real Exchange Rates in Chile	Ibrahim A. Elbadawi Raimundo Soto	June 1994	R. Martin 39065
WPS1307	How Taxation Affects Foreign Direct Investment (Country Specific Evidence)	Joosung Jun	June 1994	S. King-Watson 31047
WPS1308	Ownership and Corporate Control in Poland: Why State Firms Defied the Odds	Brian Pinto Sweder van Wijnbergen	June 1994	M. Kam-Cheong 39618
WPS1309	Is Demand for Polluting Goods Manageable? An Econometric Study of Car Ownership and Use in Mexico	Gunnar S. Eskeland Tarhan N. Feyzioglu	June 1994	C. Jones 37699
WPS1310	China's Economic Reforms: Pointers for Other Economies in Transition	Justin Yifu Lin Fang Cai Zhou Li	June 1994	C. Spooner 30464
WPS1311	The Supply Response to Exchange Rate Reform in Sub-Saharan Africa (Empirical Evidence)	Mustapha Rouis Weshah Razzak Carlos Mollinedo	June 1994	J. Schwartz 32250
WPS1312	The New Wave of Private Capital Inflows: Push or Pull?	Eduardo Fernandez-Arias	June 1994	R. Tutt 31047
WPS1313	New Estimates of Total Factor Productivity Growth for Developing and Industrial Countries	Vikram Nehru Ashok Dhareshwar	June 1994	M. Coleridge-Taylor 33704
WPS1314	The Significance of the "Europe Agreements" for Central European Industrial Exports	Bartlomiej Kaminski	June 1994	M. Pateña 37947
WPS1315	Global Tradable Carbon Permits, Participation Incentives, and Transfers	Bjorn Larsen Anwar Shah	June 1994	C. Jones 37754
WPS1316	Preserving the CFA Zone: Macroeconomic Coordination After the Devaluation	Shantayanan Devarajan Michael Walton	June 1994	C. Jones 37699
WPS1317	Estimating the Efficiency Gains of Debt Restructuring	Jeremy Bulow Kenneth Rogoff Ning S. Zhu	July 1994	R. Vo 33722
WPS1318	Exchange-Rate-Based Stabilization in Argentina and Chile: A Fresh Look	Miguel A. Kiguel Nissan Liviatan	July 1994	M. Divino 33739

Policy Research Working Paper Series

	Title	Author	Date	Contact for paper
WPS1319	The Financial System and Public Enterprise Reform: Concepts and Cases	Asli Demirgüç-Kunt Ross Levine	July 1994	B. Moore 35261
WPS1320	Capital Structures in Developing Countries: Evidence from Ten Countries	Asli Demirgüç-Kunt Vojislav Maksimovic	July 1994	B. Moore 35261
WPS1321	Institutions and the East Asian Miracle: Asymmetric Information, Rent-Seeking, and the Deliberation Council	Jose Edgardo Campos Donald Lien	July 1994	B. Moore 35261
WPS1322	Reducing Regulatory Barriers to Private-Sector Participation in Latin America's Water and Sanitation Services	Barbara Richard Thelma Triche	July 1994	M. Dhokai 33970
WPS1323	Energy Pricing and Air Pollution: Econometric Evidence from Manufacturing in Chile and Indonesia	Gunnar S. Eskeland Emmanuel Jimenez Lili Liu	July 1994	C. Jones 37699
WPS1324	Voucher Funds in Transitional Economies: The Czech and Slovak Experience	Robert E. Anderson	July 1994	F. Hatab 35835
WPS1325	The Economics of Research and Development: How Research and Development Capital Affects Production and Markets and Is Affected by Tax Incentives	Anwar Shah	July 1994	C. Jones 37699
WPS1326	Banks, Capital Markets, and Corporate Governance: Lessons from Russia for Eastern Europe	Gerhard Pohl Stijn Claessens	July 1994	L. Hovsepian 37297
WPS1327	Is the Debt Crisis History? Recent Private Capital Inflows to Developing Countries	Michael Dooley Eduardo Fernandez-Arias Kenneth Kletzer	July 1994	S. King-Watson 31047
WPS1328	The Use of New York Cotton Futures Contracts to Hedge Cotton Price Risk in Developing Countries	Panos Varangis Elton Thigpen Sudhakar Satyanarayan	July 1994	D. Gustafson 33714