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SOCIAL ASPECTS AND FINANCING OF INDUSTRIAL RESTRUCTURING

Discussion paper*

Part I

1. Introduction[1]

1.1 Basic Definitions

At the *national (or economy-wide) level*, restructuring refers to the process whereby the shares of certain sectors in GDP, employment, exports, etc., increase, while the shares of other sectors fall. Such restructuring can be stimulated either from the *demand side* - such as the usual changes in the pattern of demand that accompany increases in per capita income; or from the *supply side* - due to large changes in cost structure (e.g. impact of energy price increases) or significant changes in key technologies (development of plastics, development of electronics).

In most of the former socialist countries embarking on transition, there is an additional factor underlying the need for extensive, national-level restructuring, which can be summed up in the term, *initial conditions*. What this signifies is the presence of many firms and branches developed under the socialist planning system which, for diverse reasons, suddenly became uneconomic once the early stages of transition brought about substantial price and market liberalization, together with massive changes in the international trading environment. These troubled sectors might sometimes be in heavy industry, or in other sectors where location decisions were not soundly based, or where technologies and/or markets have moved on. For some countries,

* The present paper was prepared for the UNECE Secretariat by Prof. Paul Hare, School of Management, Heriot-Watt University, Edinburgh, United Kingdom. The views expressed in this paper are those of the author and do not necessarily reflect the views of the UNECE Secretariat.

1 Part of this introduction is drawn from a previous paper written for UNECE in early 2002, Hare (2002), with some shortening.

how to deal with branches facing such difficult conditions is perhaps the greatest challenge of the whole transition process, one that is politically highly sensitive.

In a normally functioning economy, national level restructuring is going on all the time, regardless of government policies. However, as we shall see below, it is possible for deliberate policy intervention either to inhibit restructuring, or to accelerate it. In any case, what is special about transition economies in this context is the sheer scale of restructuring that needs to be undertaken in a relatively short period.

Sectoral restructuring occurs when, due to changes in the structure or level of demand, or changes in cost conditions, a sector of the economy finds itself producing the wrong mix of products, or producing the right products with the wrong technology. In that case, unprofitable products must quickly cease production or be modernised, new products have to be designed and introduced, and the technology used to produce the better products must itself be modernised. Again, governments can intervene to assist or to inhibit such adjustments, or they can simply elect to provide a suitable environment of rules and incentives within which "normal" market forces can bring about any needed adjustment.

Regional restructuring refers to the somewhat parallel situation when a town, province or larger region finds itself in severe economic decline, usually due to an economic structure in which declining sectors/activities are significantly over-represented as compared with the national average economic structure. Russia, for instance, has many one-firm towns (e.g. Vorkuta - coal) for which problems in that one firm can spell economic and social disaster for the area concerned. In such circumstances, it is no help to know that elsewhere in the country, there might be other regions where new businesses are taking root, and where economic activity is increasing strongly. For the badly affected areas, the key questions are: (a) how to manage a process of decline; (b) how to find alternative, viable economic activities for the area or for the local people. As has been observed in several transition economies, restructuring at this level is unavoidably political, and again, extremely sensitive.

Enterprise-level restructuring is, of course, the key to everything, since whatever form of restructuring we care to discuss, what actually happens in the economy always takes place in individual enterprises. Taking a somewhat broader perspective than that often adopted in this field, and drawing on Hare (2001), restructuring at this level can be thought of as composed of three components:

° The entry of new firms or the relative growth of high productivity firms;

° The restructuring and re-organization of existing firms; and

° Exit from the market by failing firms, or the decline of low productivity firms.

The balance between these components varies from country to country, and over time in any given country, but all are important. As far as new firms are concerned, for instance, it is vital to have high rates of entry since the experience of most countries is that up to 80 per cent of such firms fail within 3-5 years. Hence to find the successful firms of the future, the few that will become large enough to employ thousands of people, lots of entry is needed, accompanied by the rapid and orderly weeding out of those that cannot make money. Of course, many of these new firms will simply start small and survive by staying small, exploiting some local market niche to enable them to do so. In total, such small firms provide a large amount of employment in most developed economies as well as in the more successful transition economies. But in the less successful transition economies there are still far too few small businesses.

According to Roland (2000, p234), the restructuring of an existing firm can take *defensive* or *strategic* forms. The former refers to restructuring that involves cutting out loss-making activities, measures to cut costs, shedding some labour, and so on. These are, in essence, survival tactics for a business under pressure.

In contrast, the latter - strategic restructuring - refers to much more forward-looking measures to re-shape the business by introducing new products, modernising production processes, identifying new markets, and the like. It requires substantial entrepreneurial expertise as well as access to technology and finance.

Sometimes restructuring is interpreted in purely financial terms, such as when governments or banks choose to write off some or all of the accumulated debt of an enterprise, or convert debt into equity, as part of a rescue plan. Such *financial restructuring* raises many practical difficulties that lie outside the scope of this paper, such as how to design schemes in such a way that the beneficiaries have strong incentives not to engage in further debt accumulation, but instead to undertake the needed *real restructuring* of their businesses. In practice, I would generally favour policies - both by banks and governments - that consistently and credibly harden the budget constraints faced by ailing enterprises, with financial rescue operations of the sort just referred to seen as an occasional, last resort option.

Last, restructuring is frequently perceived as an issue precisely because there is a widely held presumption that where it is needed, *government intervention* is called for. In a sense this is bound to be so, in that government policies and the legal/institutional framework established by governments determine the environment within which all firms must function. It is a more open question, though, whether and when more direct government intervention will be justified.

1.2 Outline of the Paper

The focus of the present Regional Forum is on social aspects of restructuring and their financing, in the light of the definitions just outlined. By "social aspects", what we mean is the likelihood that industrial restructuring might result in many people losing their jobs in circumstances where new jobs are hard to find. In extreme cases, such job losses can devastate entire communities, and even in "more normal" situations what new jobs there are might be in different sectors. Hence one can envisage a variety of social costs in the wake of an initial restructuring "shock", followed by the need for retraining/re-education, possibly some assistance to support labour mobility, measures to encourage faster rates of new business formation, and so on. All of these measures cost money, hence immediately raise questions about how large the costs might be, who ought to pay, and how.

Accordingly, the remainder of this paper will be structured as follows. Section 2 will clarify what is meant by the social aspects of restructuring and give some examples to illustrate why dealing with them might be difficult. Section 3 examines the financial outlays associated with the identified social costs and considers various views of who should pay for them. Taken together, these two sections therefore spell out the core agenda of the Regional Forum.

Section 4 highlights some key trade-offs in the restructuring process, starting from the observation that many countries, not exclusively, but especially countries from the CIS, have bowed to political pressures and allowed restructuring to be delayed, ostensibly for social reasons. While acknowledging that this is an appealing line of argument, I shall argue that in the longer term it is exceptionally costly. Section 5 continues the argument by identifying a few aspects of restructuring that seem to me to be unusually problematic for transition economies, especially for those that are not on track to join the EU in May 2004. These aspects include the special problems faced by small states, and those faced by rapidly declining regions within larger states. Section 6 concludes with a list of major findings about the social aspects of restructuring and their financing, plus a short list of suggested policy recommendations.

2. Social Aspects of Restructuring

Restructuring is rarely perceived as a serious social problem when there are lots of suitable alternative jobs available in the area concerned, or in circumstances where people can easily move elsewhere to find work, and are willing to do so. Hence to understand the social aspects of restructuring, it is crucial to be aware of the constraints that either limit local/regional job availability, or limit individual/family mobility to seek jobs available elsewhere. Suitable policies are then needed either to overcome these constraints, or to help people find ways around them. In addition, in promoting restructuring it is important to be sure that the problem has been analysed correctly, since otherwise the restructuring is likely to be done badly. It is often best to rely on market signals to provide the necessary guidance, but in such a case it is evidently vital that the prices are “right”, and that neither demand nor supply sides of the market in question face avoidable, artificial constraints.

Some examples will help us to identify the key constraints. The examples are all based on places and activities that I have either visited or studied extensively at various times.

Example 1. Coal in the Russian Far North

Harsh production (and living) conditions, the long distance from major coal users, and much higher freight charges than formerly make coal production in the Far North much less economic than it appeared to be in the past. Workers’ savings have been largely eliminated by inflation in the early 1990s and again after the 1997-8 financial crisis, hindering their mobility, and alternative local jobs are scarce. It is worth investigating whether current freight charges are economically well founded, though even so, deep-mined Vorkuta coal would still be in competition with surface-mined coal from more central regions of Russia (see Hare, 1998).

Example 2. Water and Energy in Central Asia

Upstream states have more water than they can use, but they can hold it behind dams and generate electricity or they can sell it to downstream states for irrigation, buying back electricity and other energy. In recent years, these transactions have been based on barter deals, using prices that are most likely not justified by the underlying cost structures. In the presence of such unreliable price signals, it is not clear whether downstream states should undertake less irrigation and/or whether upstream states should generate more electricity throughout the year. Hence there may well be a need for significant restructuring, but without better pricing the nature of the need cannot be identified correctly.

Example 3. Steel in Ukraine

This is an instance of a branch that faces a substantial decline in domestic demand as well as increasingly difficult international trading conditions, whether with the EU or with CIS partners. Traditionally, much production in Ukraine and the neighbouring countries was very steel-intensive, and steel production itself is energy intensive, too. The latter point implies that more rational energy pricing drastically affects the economics of steel production, most likely requiring, in the longer term, conversion of production to newer technologies that use energy more efficiently. Hence just as in Western Europe, the industry has to be down-sized sharply, with production most likely concentrated in as few as two or three large plants of economic size. In a case like this, the overall economics of restructuring might not be much affected by the designation of the particular plants that should survive, but it is wholly predictable that reaching the key restructuring decisions will be a strongly politicised process. Local communities will use what influence they can bring to bear in order to protect “their” steel plants. If there is a restructuring option that makes the social costs of restructuring a bit lower than they might otherwise be, that might be a reason for choosing it; but in principle, such arguments should not be allowed to delay or halt the whole process.

Example 4. Wine Production and Marketing in Moldova

Much wine production was carried out through large, state-owned wineries, with a great deal of the resulting product exported to Russia and Ukraine. These exports are now very difficult due to higher transport and transit charges, problems with customs regulations and the like at border crossings (not excluding a degree of corruption). At the same time, exports to the EU face quantitative restrictions as well as technical problems to do with product quality, reliability of supply and so on. In other countries that produce wine successfully, most of the best wine is produced in small to medium vineyards, typically under family management and control, with sales and marketing often done on an area or regional basis. Hence for Moldovan wine to be successful in the future, one would have to envisage major restructuring to form a number of smaller vineyards (most needing significant technical modernisation), together with more centralised marketing, quality control and certification, bottling and labelling. This is complicated enough, but it will not succeed without far more assured access to markets than Moldova currently enjoys.

Example 5. Real Estate Services in Tomsk, Russia

The point of mentioning this is simply that such services barely exist - this is a sector that needs to grow substantially. In most of Russia the housing market is barely functioning, with many people still unsure of their property rights, little mortgage finance available to support purchases, and few services available to help those wishing to buy and sell property. Many transactions occur through informal, personal connections, to the disadvantage of all parties. Real estate services are just one of many services needed to facilitate mobility in Russia. To enable such services to function there is a need for: (a) proper, professional training courses; (b) financial market development so that mortgage finance is available; (c) legal development so that people in default can be turned out of their houses (without such security, normal practice in developed OECD countries, lenders will never be willing to lend); (d) effective advertising through the local press and other media.

Issues Identified through the Examples

Some of the issues that were highlighted in the above short descriptions of restructuring might seem somewhat removed from the principal theme of the present UNECE/ILO Forum. However, I would argue that their neglect is likely to lead to some very bad restructuring decisions, probably imposing social costs that are unnecessarily high or that occur in the wrong places. Hence it is important to pay attention to these issues, and for ease of reference they are listed here:

° ***Getting the key prices right***. As examples above illustrated, restructuring decisions can easily be seriously wrong if key prices are not sensible. The basic principle should be that prices must cover costs and provide suppliers with an adequate profit, without any exceptions or special treatment for any customers (whether state-sector or private, and regardless of size and political influence). Prices should also be set and paid in monetary terms, not using barter or other non-monetary means of conducting transactions. Further, if businesses are to be kept alive for social policy reasons (and see below for more discussion on this point), it must be through direct and explicit subsidies, rather than indirectly via price distortions. The basic principle in all this should be that of transparency.

° ***Access to markets***. The extent and nature of restructuring needed in a given industry or sector will depend on the extent of access to markets. If the industry/sector concerned only supplies the domestic market, then this entails the lifting of internal trade barriers (still rather widespread in large countries such as Russia, where a good deal of regional protection is still in place). If the products of the sector are internationally traded, then the same issue arises at that level. Formally, the CIS countries constitute a free trade area, but this can hardly be considered an operational reality. EU trade barriers are important in some sectors, including with countries with which the EU has established Partnership and Cooperation Agreements (PCAs), and local content rules in these agreements are often unnecessarily restrictive.

° ***Assessing demand***. It is often tempting to imagine that the domestic demand for the products of a given branch will pick up again following a sharp decline, or that exports will soon recover. Such arguments are frequently used to delay or stop restructuring, on the grounds that the existing capacity will shortly be "needed". Unless exceptionally well founded on some serious analysis of the markets concerned, however, arguments like this are nearly always in the nature of wishful thinking, and should be strongly resisted.

° ***Politicisation of restructuring***. This is virtually unavoidable in practice. However, political resistance to needed changes should not normally be allowed to stop the whole process of restructuring; and sometimes, there might be a restructuring option that enables the social costs to be somewhat lower than they would otherwise be, and if there are no other counter-arguments, that would be a good reason for choosing it.

° ***Development of services to households***. The example of real estate services was used above, but it could equally have been *employment services* (incl. training, job information both locally and in other regions, recruitment, etc.) or *business support services* (e.g. information packs on how to set up a business, one-stop shops to make the process quick, easy and cheap, technical and financial advice connected with new businesses, etc.). In the absence of such services, major restructuring will prove to be much more costly than it needs to be. Both state (mostly local and regional levels of government) and private providers can play their part in delivering these vital services.

Suppose, now, that we have a situation where substantial restructuring is needed. What are the social costs associated with this process and how do they arise? There are, in fact, several possibilities, depending on the local circumstances. Given this, what follows will be clearer if I simply list some of the principal cases.

Case 1. Closure of a firm that provides many local services

This is very common, and has often been discussed under the heading of the "one-company town". What it refers to is the fact that many firms in the former Soviet Union not only produced whatever product(s) they were set up to make, but also delivered such services as basic health care (through polyclinics and the like), housing for the workforce, recreation facilities, primary schooling, kindergartens, and so on. In practice, local authorities did little but provide the street lighting!

Hence closing such a firm would give rise to three types of social cost: (a) the cost of redundancy compensation, when that applies; (b) the cost of subsequent income support and other types of support for those who become unemployed; and (c) the alternative cost of providing social services formerly supplied by the closing firm (and sometimes, this might mean the costs associated with simply withdrawing such services and not providing them at all).

Case 2. Closure of a firm providing no local services

This is much simpler than Case 1, since the social costs of closure are then just the type (a) and type (b) costs identified above.

Case 3. Downsizing a firm to cut its cost base and make it more competitive in the market

Under socialist conditions it is well known that many firms were grossly over-manned, in the sense that with better management, better organisation of the production processes, even firms operating with their existing technology could find ways to produce their output using many fewer workers. Many potentially sound firms, operating in the more competitive environment of a market-type economy, come under increasing pressure to cut back the workforce, or to *downsize*, to use the standard American euphemism for the process.

When they do so, the main restructuring costs are those associated with types (a) and (b), identified above.

Case 4. The impact of restructuring on a region and/or sector

When several large firms in an area, or several within an important sector, need to close or downsize within a fairly short period, additional social costs arise that extend beyond what we have considered so far. These are (d) the costs of assisting workers to migrate to other regions where jobs are more plentiful; (e) the costs of retraining workers to fit them for alternative occupations; and (f) the costs of encouraging new firms to move into a given area (incl. completely new starts and firms that choose - or can be persuaded - to relocate).

Six types of social cost

To sum up this section, therefore, we have identified *six types of social cost* likely to be associated with a substantial programme of industrial restructuring. These are:

(a) redundancy compensation
(b) income support for the unemployed
(c) provision of local public services
(d) assistance to migrate
(e) assistance with retraining
(f) encouraging new businesses to start up.

Taken as a whole, this is formidable list, and one cannot be too surprised that governments are often inclined to delay or even prevent restructuring - usually failing to appreciate the high costs of a different sort that then arise (see Section 4). Making provision for all of (a) to (f) evidently entails substantial institutional reform and development, some general aspects of which were discussed in Hare (2001). We now turn to examine how to pay for restructuring, and the awkward question of who should pay.

3. Financing the Social Costs of Restructuring

In a developed OECD country, the typical assignment of responsibility for the above cost types (a) to (f) would be: (a) the firm (possibly with some public support if there is a publicly funded redundancy scheme in operation); (b) the national government, through its social security policy; (c) local authorities; (d), (e) and (f) national and regional levels of government.

In transition economies, especially those in the CIS where many reforms have progressed more slowly than in those states due to join the EU in 2004, and where industrial restructuring has also been delayed, this assignment of costs might not yet prove workable. In any event, the countries concerned need to take some fundamental decisions concerning how large various elements of the costs can feasibly be, given their overall budgetary constraints and their ability to collect tax revenues.

Cost type (a), redundancy payments

Most firms in transition countries will prove unable to fund remotely reasonable redundancy payments. They will not have made any provision to do so, and most countries have no workable public scheme to help them. A few countries, including Russia, have in the 1990s passed laws declaring that firms making workers redundant must pay them compensation in amounts depending on their years of service[2], but to my knowledge such schemes are pretty meaningless in practice, since firms about to go into liquidation have no available resources, and nor does anyone else. The situations in which redundancy payments might actually be made include those where a foreign firm takes over an incumbent and provides its own (external) funds to support downsizing the workforce. For the longer term, of course, it makes sense to develop policies on redundancy compensation very much along the lines of OECD member countries, but I suspect that in most of the CIS, not much redundancy will be paid out in the present round of major restructuring. Hence although the likely scale and speed of restructuring suggests that cost type (a) ought to be large, my judgement is that it will not be. In the longer term, as the pace of restructuring slows down somewhat, it will become more feasible to implement more generous redundancy programmes.

Cost type (b), income support for the unemployed

Cost type (b) really comprises two elements: unemployment compensation (UC) and (true) income support (IS). UC is generally paid for a fixed period (six months to a year) to those meeting whatever contribution conditions are set by the government concerned. Sometimes the amount paid out in UC is related to the former wage, sometimes it is a fixed payment. Either way, it is usually set at a higher level than the basic rates of IS, and is often regarded as an entitlement by workers, since their own social security contributions (linked to their former wages) are, in effect paying for it. This is why in many countries, unemployment compensation is often termed unemployment *insurance*. It is usually paid out for a fixed period, partly to keep down the aggregate budgetary costs, partly to provide the unemployed with incentives to seek alternative employment within a reasonably short period. Such incentives, of course, are only effective in conditions when other jobs are available.

The second element of cost type (b), IS, usually has some form of means test associated with it, rather than a contribution condition, since the purpose of income support is typically to alleviate poverty by providing a basic income to those in need. Again, incentives to work are usually provided by requiring those of working age and not disabled to declare their continuing availability for work, and sometimes even requiring them to accept jobs deemed to be “suitable” by the authorities (on pain of losing all or part of their benefit for a period).

Needless to say, when unemployment is high and poverty widespread, the budgetary cost of UC and IS taken together can be substantial. In practice it is often kept down by a combination of factors: for UC - stringent contribution conditions, short periods of payment, inefficient administration so that few succeed in making a claim; and for IS - strict eligibility criteria, low levels of benefit, inefficient administration. While these factors do indeed keep down the public expenditure costs of UC and IS, they do nothing to alleviate the real social costs, since the people concerned are still unemployed, still poor. Many of the costs, however, remain hidden from view.

Cost type (c), local public services

Financing the provision of local public services, has proved quite difficult to manage properly in several transition economies. In principle, one would advise firms undergoing restructuring to start by hiving off any services to workers they currently provide as a by-product of their main productive activity. Such services

[2] The standard pattern in the UK, for instance, is that firms must pay redundancy at a rate equal to one week’s wages per year of service. In practice, many firms pay more than that in order to secure trade union agreement to a major restructuring scheme.

should ideally then be taken over either by the relevant local authority, in the case of services normally provided free at the point of delivery (e.g. primary schooling, basic healthcare), or by new private or collective providers (e.g. private nurseries, housing associations to manage public housing, etc.). While this approach has often worked well in more developed countries, and in some of the Central European transition economies, it runs into severe problems in other countries for several reasons. The most important of these are:

° Hiving off services to local authorities assumes the latter have a budget to cover their costs. In large, multi-level countries like Russia, this has not been the case. Even today, public finance reforms to provide reliable budgets at the local level - based on an assessment of local needs for services - is the exception rather than the rule, though important steps have been taken in the right direction.

° A related point is that without comprehensive public finance reform, many smaller local authorities rely on tax revenue from "their" firms in order to cover their costs. That works well in a stable environment with little or no restructuring, but in conditions where major restructuring is going on it can turn a local difficulty (due to unemployment resulting from firm closure) into a major local crisis (as funding for local services also dries up). There has to be an absolutely clear separation between the fate of local firms, and the state of the local public finances.

° When local incomes decline due to a major firm closure, those services formerly provided by the firm which the local authority cannot or does not wish to provide will face a collapse in demand - realistically, the local population will simply not be able to pay much for services they previously obtained for free or at a nominal price. Hence the initial firm closure exerts a negative multiplier effect upon the local economy.

° Moreover, the fall in demand for the now privately provided services is quite likely to affect women relatively unfavourably. For instance, although nurseries notionally benefit the whole family, in practice they are means of social policy that facilitate women's engagement in the workforce, so when nurseries become too expensive it is typically women who end up staying at home to undertake childcare.

Taking these points together, the local public services aspect of restructuring, which might have seemed fairly straightforward to handle, can be seen to be more like a political minefield. Few of the slower reformers among the transition economies have managed it particularly well.

Cost type (d), assistance to migrate

Cost type (e), assistance with retraining

Cost type (f), encouraging new businesses to start up

When policymakers and their advisers discuss the social costs of restructuring, they usually refer to the items (a), (b) and (c) that we have just discussed. However, I have included these last three items, (d), (e) and (f), for the sake of completeness, even though they are more often thought of as part of a wider industrial policy, rather than as a social cost of restructuring *per se.* Accordingly, I make a few remarks about these items here, but later in the paper I shall not have much more to say about them.

Regarding (d), there is naturally little point in assisting someone to migrate if there is no job awaiting them "at the other end" of the proposed move. Otherwise, the authorities are merely moving social costs from one place to another, with no overall gain to show for their efforts. This means that effective migration assistance must be linked to jobs in the receiving areas, in which case one might ask why the firm or organisation seeking new employees does not contribute to the costs of re-location for incoming workers. Such a contribution to removal costs is quite standard for firms in many of the OECD costs, though the contribution normally only covers the costs of shipping furniture and personal items, rarely much more. In transition economies, by contrast, one would expect to see measures to assist incoming workers find housing, surely a critical factor in the absence of a well functioning housing market, and with little private mortgage finance available in any case.

So thinking about assistance to migrate suggests the need for better provision in terms of:

° information about jobs available elsewhere;

° assistance to find suitable housing in a new area.

Especially in the very large transition economies such as Russia, Ukraine and Kazakhstan, these forms of assistance could prove very beneficial.

On (e), the main point to make - a rather negative one, unfortunately - is that retraining of displaced workers rarely finds them new jobs very quickly. Very often, as confirmed by the long experience of many other countries, new jobs tend to go to younger people (and in places where women previously had few job opportunities, to women) and to incomers to the area. For instance, a 45 year old unemployed steelworker will often find the process of adapting to new types of employment practically impossible, and many simply never make it. Thus the retraining of such workers is not only costly, but quite often ineffective. What this implies is that restructuring the economy of an area formerly dominated by one or a few declining branches of industry, especially heavy industry, is a process that will occupy at least a generation, one that will prove very painful to many displaced people, and unavoidably so. I am not aware of any “quick fix” for this difficult and politically delicate problem.

Training opportunities should certainly be available everywhere. They should focus on old skills that are expected to continue in high demand (such as joinery, plumbing and the like) and on new skills that are increasingly generic across a wide range of growing sectors, especially in services (basic IT skills are the obvious ones, here). What should not be continued is the training of people in skills best suited to branches in strong decline or in technologies that are known to be outmoded, such as traditional welding, metal cutting using very low technology machine tools, and so on. Training for the sake of training is simply a waste of resources (even if it keep a few more trainers in jobs - for I would rather argue that the training process itself probably needs to be restructured!).

Last, regarding (f), it would be hard to find anyone who disagreed with the idea that encouraging new businesses to form is likely to assist restructuring. Going beyond such platitudes to making it happen in practice is far more difficult, however. Interestingly, most transition economy governments already claim that they have good policies in place to provide for a supportive, business-friendly environment, and surveys carried out by the World Bank and EBRD provide a little evidence for such claims - in the limited sense that these surveys confirm that between 1999 and 2002 the business environment did improve when assessed according to a number of different criteria (see discussion of the BEEPS surveys in EBRD, 2002).

However, two important caveats should be borne in mind: (i) the survey results do not claim that the business environment is especially good, only that it has become “less bad” than before, in other words that there is some movement in the right direction; there is still a good way to go; and (ii) the survey only looked at firms actually operating in the countries concerned, since firms that never started up could hardly be included. But to assess the business environment more objectively, what we should really be studying is the rate of business start up, and the rate of job creation associated with new starts, bearing in mind the normal experience of more developed countries that most new firms only have a short lifetime. Hence a dynamic business sector would be characterised by very large rates of business formation, high rates of attrition and business turnover, and at any one time, a large stock of functioning business.

Ideally, it would be useful to have good comparative data on these matters, but what there is is both patchy in coverage, inconsistent across countries, and complicated by the informal economy (so many active firms are not officially registered). Nevertheless, even the very rough data that does exist strongly suggests that a country such as Russia ought to have at least five times as many firms as it appears to have at present. This observation implies that the Russian business environment is markedly less conducive to enterprise than the authorities would insist. It also implies that measures to foster a massively faster rate of new business formation across the country would render many of the supposedly highly sensitive and politically difficult social aspects of restructuring far less problematic - and costly - than they presently appear to be.

Overall, we have implicitly accepted the traditional assignment of payment obligations in this section, while pointing out some of the very real practical obstacles preventing early and comprehensive implementation of the various measures we envisage to assist countries in managing and keeping down to the lowest feasible levels the social costs incurred under headings (a) through (f).