Mr. Mohammed Kaddoura, Austria*
VAE in Central Europe

Mr. Gábor Hunya: His presentation from the session two has been rescheduled to this part. He is the director of VAE Aktiengesellschaft ... in Austria. And he is going to present, I think, his company's experience in Eastern Europe. We will have a discussion on this specific topic after the presentation so that we can then move to the privatisation problem. Mr. Kaddoura, the floor is yours.

Mr. Mohammed Kaddoura: Ladies and gentlemen, can you hear me? I am very delighted to have the opportunity to introduce VAE to you this afternoon and also to present our experience, 10 years of experience in the Central European market and states. My name is Kaddoura and I am president and CFO of VAE. Before I start with my presentation about our experience in Central Europe, I would like to present our company. Just so you can understand the nature of our business.

So, VAE is a niche engineering company, operating worldwide. VAE competence is based on nearly 150 years of tradition. What is our business? Our core business is the design and the manufacture of high-tech performance turnouts, switches, and turnout components for the international railroad industry. These are high-tech products, which allow trains to move from one set of tracks to another.

We are international players, with around 70 percent of our business (being) generated outside Austria. We have 2 Austrian and 15 foreign production operations, as well as a massive export business. And, most important, we, as VAE, are a market leader worldwide. We are the largest company in the world to specialize on the turnout sector, achieving a turnover last year of over 4 billion shillings. Our success in this market is the result of our global leading technology.

The range of our products comprises three main categories:

High-quality turnouts,

Special electronic devices, and

Rail movement joints.

Let me explain to you what kind of products these are. The core business is the production of turnouts for railway, tramway, and underground and related turnout components, for new tracks, refurbishment, and railway maintenance. These products are fundamental for railway development.

What are the strengths of VAE in terms of turnout? The technology, the technical superiority comes from the design and the metallurgical specification. In addition, VAE produces highest quality according to the ISEO 9001 and 14 001 quality systems. And the turnouts of VAE enable high-speed tracks as well as highest exit loads with low maintenance requirements.

* Mr. Kaddoura held his speech on the beginning of the first session. It is moved to this place according to the session issues

The second sector comprises electronic products and we have two main products in electronics. This is Roadmaster 2000. Roadmaster 2000 is a totally new development. Just to explain to you what that product is - up to now, maintenance men inspect turnouts visually and by doing measurements of wear on core parts. This system, Roadmaster 2000, contains special transducers and microelectronics in the turnouts to monitor operating conditions and wear continually on a central control unit. Trend calculations allow preventive maintenance, help (to) save maintenance costs and time and all these lead to (a) better performance of turnouts and increase operational availability.

And the next electronic products are the hotbox detector and the blocked braes detector, (which) are situated on both sides of the track as fixed installations. They protect boxes and brakes against overheating. The fixed detectors control the moving trains by comparing the temperature of the boxes and brakes and measuring the air temperature. These systems trigger an alarm in case of overheating or higher temperatures stopping the train immediately.

And the last product in these categories is the rail movement joint. These products solve the special problems that result from the strain on rail tracks on bridges, which result, on the other hand, from substantial movement of the bridge. The rail movement joints allow the rail to move, taking into account traffic, load, speed, temperature, and the severe weather conditions. In other words, the rail movement joints are an extension compensation system that ensures that the train always remains in contact with the rails. We supplied this product (for) the bridges of the new Hong Kong airport and before that (for) the Great Belt Bridge in Denmark. In the Hong Kong project, VAE installed the most important rail movement joints in its history. For the **Sing Ma** Bridge – this bridge is 2200 meters long with a span of 1366 meters and 80 meters above sea (level and) is the longest suspension bridge in the world, carrying road and rail traffic. And the **Cap Chamun** Bridge is an 880 meters long cable stage bridge with a main span of 400 meters. VAE was commissioned by the Hong Kong government to assume the responsibility for the construction testing, delivery, and installation of the so-called rail movement joints in both bridges – **Sing Ma** and **Cap Chamun**. Trains are allowed to cross the bridges with speeds of up to 140 kilometres per hour, although, for example, the Sing Ma bridge can move up to 2.2 meters as a result of temperature and (of) storms up to 300 kilometres per hour.

A short word on our shareholders. Between 1992 and 1994, VAE was privatised in three phases and is now listed on the Vienna Stock Exchange. Major shareholders are VOEST-ALPINE Schienen, the world's market leader in rail business and VOSSLOH, the world's market leader in rail fastening systems. Together, they hold 90 percent of the share. The rest of about 10 percent are still owned by private and institutional investors in Austria and abroad.

This year, the group turnover will be around 4 billion shillings or 290 Euro.

Europe is our major market, accounting for 67 percent of the sales. We are well established here and hold the number one position in Austria, Switzerland, Germany, Spain, Portugal, and the Central European countries. North America accounts for 25 percent of group sales and is one of our most exciting opportunities. The Pacific Rim and the rest of the world, I mean North Africa and Asia, accounted for 4 percent of sales. And the remaining 4 percent of sales is generated mainly through project-wise business, in the Middle East and Africa and South America.

We employ around 2850 people worldwide, in the whole VAE group.

Now the question. Why did VAE go the way of internationalisation? Why internationalisation? VAE has excellent products for the railway demand of the world. But Austria is a small country and has a small market. To operate on a global scale from a production site in Austria is really very difficult.

So, by the end of the 80s, VAE recognized the limits of growth for our plant, for our factory in Austria. Therefore, we have developed a strategy, we have developed a philosophy, the so-called internationalisation philosophy. The main message of this philosophy – 'Think globally, but act locally.' A range of reasons has encouraged VAE to take that road of internalisation And one of the most important reasons is to open up new markets, which were not accessible to us, for example, (the) Central European market. The second reason is better contact to clients, to the customer. (The) third one - the problems created by financing in hard currencies, unstable exchange rates. And, one of the most important reasons - the long distances, transport distances, and, therefore, high transport costs. And, as you can see and you can feel, there is a restrictive import policy in a lot of countries.

So in 1990, VAE started its international expansion. Today, 17 production companies in Western and Central Europe, North America, Africa, and Australia secure the company's worldwide business. We have a worldwide market share of around 32 percent.

Now, I turn to Central Europe. Why Central Europe and how did we approach Central Europe? There are a lot of reasons for VAE, for its engagement in Central European markets. I want to mention here the main reasons for our engagement in this market. First of all, the geographical location of VAE – the Central European countries are all in the neighbourhood of Austria. Second, the nearness to clients, to the customer. Third, the level of wages and salaries, which in some instances can amount up to 30 percent or 40 percent of the total costs of the product. The weak national currencies and unstable exchange rate - because of (these factors) all these countries cannot really import good material and good components - and the (possibility of) offering value added in their own country.

The situation for VAE when we entered into these markets, where the countries of Central Europe have a dense and high-frequented railway network - but the technological standard of that track was very modest. Turnouts and switches had been delivered from Russian works, from Russian factories, or from railway-owned national workshops with very old machinery and very low technological standard. And the financial situation had not allowed them to modernize the railway networks with imported components. So, to bring VAE's high-tech turnout technology to Central Europe - (this) could mainly be done through the takeover of existing turnout factories in (the) form of joint ventures or by founding new joint ventures, new plants, new factories, also in (the) form of joint ventures - we started with our strategy in the early 90s. (Today), VAE has 5 joint ventures in Central Europe:

1992 – launch of a joint venture with the Hungarian State Railways

1995 and 1996 – launch of joint ventures with the State Railways of Latvia and Lithuania

1998 – acquisition of the majority share of the turnout plant in Romania and, also in 1998, we started with our joint venture with the Bulgarian Railways in Bulgaria.

In addition to these joint ventures, we have the so-called cooperation agreements in Poland and Czech Republic, which secure and complement VAE's internationalisation strategy in remaining Central Europe. Generally speaking, our Central European partners invested, most of them, (in) assets like land, building and machinery, in these joint ventures. And the role of VAE was to invest mainly (in) technology and cash. And technology - that was the main and really very important issue - to enable them to have better products. And cash - to modernize all the assets they brought into these joint ventures.

Now, to the joint ventures themselves.

The first one is the Hungarian Company. The name of this company is VAMAV. This name is (derived) from the names of the two partners – VAE, this is VA and MAV, so both together combine to (make) VAMAV. Hungary is a neighbouring country of Austria. Historically, relations and (a) traditionally good neighbourly relations make Hungary (an) interesting investment country for Austrian companies. Hungary is a small country like Austria, with (an) area of 93,000 square kilometres and 10 million inhabitants. The dense railway network of 7,600 kilometres presents an interesting market place in the centre of Europe. The Hungarian railways have an important transit position. So, Hungarian VAMAV was the first joint venture in Central Europe The Hungarian State Railway authorities – the MAV, and VAE are fifty-fifty partners. The factory is (located) in the north of Hungary and, before 1992, before we started with this joint venture, it was fully owned by the railway authorities. The participation of MAV – the railway authorities - represents machinery, building, and land. VAE participation was in cash and technology. Cash to modernize the machinery, buildings, and offices and the whole infrastructure. Today, turnouts with real high-tech standards are produced not only for the Hungarian Railways but also for city transport and for the whole industry in that region.

The second (set) of joint ventures comprises VAE Riga and VAE **Legatecha** in the Baltic States. In the small Baltic countries, VAE founded two joint ventures in 1995 and 1996. One in Latvia and one in Lithuania. Both factories supply the Baltic Rim with modern turnouts, replacing the old-fashioned former Russian standard. The three countries – Estonia, Latvia, and Lithuania – former parts of the Soviet Union have a total area of 175,000 square kilometres, but only 8 million inhabitants. In total, the three railway networks (stretch across) only 5,300 kilometres. But the role of the Baltic railways is much more important than the figures show. The Baltic Rim is a transition corridor between Russia and Western Europe. VAE owns a 94% share in the Latvian company, the remaining 6 percent are owned by (the) Latvian railway authorities. And, in Lithuania, the share of VAE is 66 percent, for VAE, and 34 percent for the National Railways of Lithuania. Both companies are completely new. An older industrial infrastructure, the supply of railway infrastructure in this region was provided mainly by Russian producers. Today, Estonia is also a client of our two Baltic factories. Clients do not only include the three railway companies but also the tramways and industry and ports. Export go to countries of the former Soviet Union like Byelorussia and, also, to Northern Europe like Finland and Sweden, from these two factories.

The third joint venture is VAE **ABCOROM.** And this represents an exception, because VAE **ABCOROM** is a private public company listed at the Bucharest Stock Exchange. The most important shareholder was the Romanian state, other shares were in private hands, mainly in the hands of the staff. In 1998, VAE bought the state-owned shares and now holds 80 percent of the shareholders capital. Romania is one of the most important Central and Eastern European Countries. More than 22 million people are living on 238,000 square kilometres. A railway network stretching across 11,300 kilometres serves the national transport system and also has a corridor function. At the start of this operation, the **ABCOROM** Company was not only (a) producer of turnouts. Many other sectors were its focus. But VAE sold and ceded all these sectors to other companies so that now VAE **ABCOROM** is specialized in railway track products and focusing on these highly sophisticated products. With modern machinery, a very experienced staff now produces for the Romanian market and some export activities to Turkey, to Slovenia, to Slovakia, and other small countries. So, the main customers in Romania are the Romanian State Railways and the urban transport system and the industrial complexes like ports, mines, and so on.

Now to the fourth one, VAE Sofia. Bulgaria is one of the small Central European countries - 8 million inhabitants on 111,000 square kilometres. The length of the railways is 4,300 kilometres. Bulgaria has an important transition function – from Western and Central Europe to Turkey. The Bulgarian state railway company, BDZ, owned a factory, a very old factory for turnouts in Sofia. To secure innovation in Bulgarian track production, they founded a 49/51 joint venture with us, with VAE. The BDZ contribution was the plant and that of VAE was in cash and technology. VAE Sofia is VAE's latest engagement in Central Europe but, for sure, not the last one

There are some interesting markets and we hope that we will have news from VAE about new joint ventures in this region in the very near future.

In 1991 – the year before internationalisation started - to give you really a picture about (this), I would say, the positive development of VAE in this region.

Mr. Gábor Hunya: Excuse me. You have about three minutes. Please, we have to hurry up.

Mr. Mohammed Kaddoura: Ok. Fine. So, investment. Just to tell you, we invested a total of 180 million shillings and the accumulated payback out of that is 110 million. Personally, and this is (a) very important issue for you, and this is the last part, and maybe you can give me another 3 minutes to explain to these people how the engagement really is.

The way VAE went at realising a joint venture in Central and Eastern Europe is as follows – generally VAE employs local managers for leading positions. A lot of managers come from the railway sector, experienced, with (a) good attitude to the core business. Blue-collar workers are experienced, but without (a) feeling for modern tools and also for efficiency. So, therefore, extensive training is required here when you really enter in a joint venture. After starting a new company, VAE provides technical support for (the) implementation of the group's high-tech technology through Austrian engineers for one or two years. Support is also given by an Austrian financial controller. Sometimes, it takes us one year, sometimes, it takes us two or three years and, sometimes, it takes us five years. VAE always has a majority share in these companies, or in case of fifty-fifty joint ventures, the leading role in technology and marketing will be left to VAE. A board of directors consisting of VAE members and the railway supervises the local management.

Partnership with the railways in these joint ventures has advantages and disadvantages. So what are the advantages really, mainly? The railways are partners and clients and, therefore, (you have) corporate identification with the joint venture. You can talk to experts who understand the business. The client railway has access to all the information, like cost and price policy. (The) railway has access to the modern technology of VAE.

Now, what are the disadvantages? The railway people do not understand that VAE pays better salaries in joint ventures than the railways themselves pay to their (own) staff because of financial problems they are permanently facing. Decision-makers are really too slow sometimes, so reliability is not perfect. They do not fulfil their plans. In the beginning they are too enthusiastic in (the) planning and far away from reality. You have to bring them to reality. And some of them are still thinking in quantities but not in qualities.

And, this is really the last minute. Now to (our) real experience. During negotiations with a partner, we have remarked the following. Negotiations partner sometimes have a lack of knowledge and do not understand the aims. Assets like buildings or machinery are often in a very poor condition, but seen as (a) worthy contribution coming from partners. Evaluation based upon earning potential is very often unknown. Partners prefer the evaluation of the net asset value. The legal situation sometimes shows some gaps and is often unclear. I am talking about the situation some 10 years ago. Now the situation is becoming much better. The possibility of financing a project is often overrated by the partners, by the people generally. Our experience within the region shows the following tendencies from North to South. Generally, we can say, the person is willing to learn. People are well educated and masters of improvisation. Salaries and wages are very low. But economic know-how is very often missing. There is small availability of skilled people for controlling and EDP. Sometimes, there is resistance against new technologies and (a) new integrated system.

My conclusion for that - our company has been successful in Central Europe but many other companies are not happy with their engagement in that region. And I know many flops. The way Central Europe has caused some small problems for VAE from time to time. But in the end, satisfactory solutions have been found for every case. We think that the major part of our success has been the human aspect. We have always respected people as they are in this region and have tried to change them very smoothly. We have always fulfilled our promises and we have transferred technology immediately, and also, step by step, transferred added value from the Austrian operations to the joint ventures. And, last but not least, we (provided) perfect services technology-wise. Thank you very much.

/applause/

Mr. Gábor Hunya: Thank you very much. Mr. Kaddoura may take a few questions. If you have very precise, to the point, to the topic, short questions, please, raise your hands. Yes please.

Mr. Masasyuki Kondo: Thank you Mr. Chairman. I am Professor Kondo, ...University of Technology. Thank you for your presentation. As I understand, your competitiveness lies in technological superiority. So, I would like to ask two questions. (The) first question is, how much effort did you put into the transfer of technology, factory equipment? Did you replace all the equipment and machinery when you started the joint venture? And, the second (question) is, how much on-the-job training is provided to your new workers? That is the first question. The second question is that I understand that you mostly have joint ventures with small enterprises or a medium-size enterprises. So, what kind of government assistance did you get from the recipient country like Bulgaria or Hungary? Something like that. And, what did you want, what kind of government action did you need when you started the joint venture, especially regarding technological transfer? Thank you.

Mr. Mohammed Kaddoura: Thank you very much. The first question is the training of the people and technology. When we came, when we built up these joint ventures, and I remember the situation in Bulgaria, it was really a disaster to see the factory, in what shape, old machinery, the way work was done in an inefficient way – a disaster. So, when we built up this joint venture, as I mentioned in my presentation, the main task of VAE was to bring the technology. Within a very short period of time, we had to achieve the level of technology, which we use for our worldwide production, but using the low salaries and wages in these countries.

So, how long does it take? Really, it takes us between, I cannot say, one year, one-and-a-half years. It depends on the part of Europe. In the Baltic States, it took us less than one year. In Bulgaria, it took us more than two-and-a-half years So, it really depends on the standard of technology of the country itself. But it is our obligation and it is our task just to bring the technology to the people as soon as possible. And, as I mentioned, we sent two engineers and one financial controller or two financial controllers for a period between one year and sometimes three years. And it cost a lot of money also. You have to send the people, to equip the people, to change the machinery, to do really everything just to cope with modern industry. Otherwise, you are not going there to produce according to the standard in the country itself. You have to change everything. You have to change really everything to enable the people to produce according to your quality. This is a very important issue. And, some of these joint ventures have been realised not because we wanted to engage ourselves in these countries, but the country itself, they came to us and asked us –'Please help us we want to have the connection to Western Europe and we want to have modern technology.' Therefore, we have engaged ourselves. This is the first question.

The technology.

We did not send the design and all these things. We sometimes brought people to Austria, trained the people on the job and, also, sometimes we sent people from Austria to the factory itself. And they stayed there for a long time - really a long period of time, to train the people on the job there.

Second, the assistance from the government, I think you cannot really expect much assistance for that here. Except the tax holiday, which everybody can take advantage of, every company? You will never get an exception for yourself. So, we have asked several times, but I can't give an example where we really got good and much assistance for that one. But the people, they are really ready to help, to support. But, on a legal basis, there is no reason to say – 'I am going to invest there because I am getting assistance from the country or special assistance from the government.' Also, this is not the way VAE acts, because we go there to modernize the industry, also to make our technology accessible for this market.

Mr. Masasyuki Kondo: Thank you very much Danke schon.

Mr. Gábor Hunya: Thank you very much Mr. Kaddoura, for sharing with us your experiences in Central and Eastern Europe. And, I think it is time for us to move on to the privatisation session, which should have started quite some time ago. But, as I was advised, we can draw on our time until 17.30. So this will allow the speakers and the discussions enough time to really go into depth on this topic.

/applause/

Session 3
FDI Policy, Advantages and Points at Issue

Chairperson: Mr. Peter Havlik, Deputy Director, WIIW, Austria

Commentator: Mr. Gábor Hunya, Senior Economist, WIIW, Austria

Mr. Miklósz Szanyi

Senior Research Fellow
Institute of Economics
Hungarian Academy of Sciences
Hungary

Mr. Krassen Stanchev

Executive Director
Institute for Market Economics
Bulgaria

Mr. Adam Pawlowicz

President
Polish Agency for Foreign Investment
Poland

Mr. Florin Bonciu

Director
National Agency for Regional Development
Romania

Mr. Vladimír Benáček:

Associate Professor
Faculty of Social Sciences, Charles University
Head of the PhD (Economics) Programme
Czech Republic

Mr. Alan Sitar

Advisor to the Prime Minister
Office of the Government

Mr. Miklósz Szanyi, Hungary
FDI in Hungary: Past Patterns and Future Challenges

Mr. Ivo Stanek: Good morning. This is the second day of our workshop. We are now in session three and the chair is with Peter Havlik and I would like to ask him to take the floor immediately, although, he is still engaged in some technical preparations. Good morning again and all the best.

Mr. Peter Havlik: Thank you Mr. Stanek, ladies and gentlemen. First, I would like to apologize that you have to wake up so early, but we have a very tight program this morning and also a very interesting program. I would like to start immediately with the first presentation. Mr. Miklós Szanyi from Hungary, who is a senior research fellow of the Institute of Economics of the Hungarian Academy of Sciences. So please, take the floor.

Mr. Miklós Szanyi: Well, when I prepared my presentation, I was aware of the fact that I am going to have 15 minutes at most, so I did not try to provide a full picture of the foreign direct investment in Hungary. Instead, I prepared some slides, picked out a few statistical figures for illustration, and then I decided to concentrate on three distinct topical issues concerning foreign direct investment that might be of interest to all of us. And they also demonstrate the tasks and the changes that we have ahead. So, the first slide represents some rather known figures. I do not want to take much time with this. This compares the per capita FDI stock in transition economies. When we talked about absolute levels, it turned out, yesterday already, that in Central and Eastern Europe, Poland is on top. Hungary also collected some amount of investment. Meanwhile there are other countries that were less successful in attracting foreign capital. But the per capita FDI figures illustrate probably much better the relative importance of foreign capital in these economies - the penetration of the foreign sector in our economies. So, it is still Hungary that leads the list but there are quite a number of other countries that are very close. This is certainly not a race. I would not say that anyone should be very proud of these figures and levels, but this is just a fact that there are 5 countries on this chart that have quite high (rates of) foreign penetration.

The second chart provides more detailed data on FDI penetration in the Hungarian economy, in certain branches. In the annex of my paper there is some more statistical data on the sectoral, and, I mean manufacturing, branches – the foreign share in employment, production, investments, and other figures. As you see, as is known, the Hungarian economy is very much dependent on the performance of foreign-owned companies and I would like to continue with these topical issues stemming from this fact of high penetration. So, if an economy like the Hungarian one is so much dependent on, I must say, a handful of multinational companies, for example in the automotive industry and electronics... There are, basically, three, four, five large multinational companies, and the surrounding supplier network that determine the performance of these branches. So, the first issue that comes into one's mind is, if the foreign capital attraction capacity of Hungary or other countries can be maintained in the long run, or, if the companies already present would stay in these economies in the long term or, is it likely that they will settle further east or anywhere else. So, how stable are these investments and the foreign capital in these countries? So, this is the first issue.

And the paper then concentrates on the instruments that the Hungarian governments applied to attract foreign capital. And I compared the already existing mix of tools with the European Union standards. Hungary is approaching the European Union, is trying to become a member. So this is just one area where, obviously, the Hungarian regulations must fit into the European network.

In general, we may say that the basic items of the promotion system are on the same competitive basis as those of the European Union. There is one major exception where there is a deviation and this is the role of customs-free zones. It seems that customs-free zones in Hungary attracted a large share of the foreign direct investments, especially in those branches that were also highlighted yesterday – electronics and the automotive industry – where very few companies are present and where their performance is (also) very influential in terms of exports, employment, and other figures. So it is a crucial question, if, after joining the EU, the regulation of customs-free zones will change a lot so (that) they would no longer have a chance of attracting capital. Or, at least, partial advantages could be maintained and at least those companies that are already located in these areas would stay there.

Here is a chart to illustrate the role of customs-free zones. Perhaps the best figure to illustrate this phenomenon is the role of the industrial or customs-free zones in Hungarian foreign trade. As you see, it is total trade (and) not only manufacturing. So their role is absolutely crucial, as you see.

So, the paper concludes in this part that there is one major deviation from EU regulations and this is the freedom of importing production tools, meaning, investment goods. So, investment goods are also exempt from value-added tax and customs dues, which is not the case for the European Union. And, perhaps, the Hungarian negotiation team will be clever enough or good enough to make sure that the production tools already invested in will not be taxed and that customs dues will not be paid for already implemented investments. If this were possible, then I think that at least the companies already (located) in these free trade zones would remain.

The second issue is the concern if capital movements can greatly deteriorate or influence national accounts. As you know, when the Mexican and the Russian crises hit our economies, there was a sudden change in the Hungarian pattern of national accounts. The current account showed quite a substantial deficit, which earlier on had not existed, because employing imported foreign investment usually compensated for those items in the negative net accounts. So, as you see, I tried to separate those items that are closely tied to the activity of foreign capital owners from the national accounts, because statistical figures usually use the nettings, the nettings of domestic and foreign capital owner activities. So, there were some accusations in Hungary that precisely the foreign owned companies and foreign capital owner activity had created the tensions in the current accounts. If we want to get a clear picture, then we have to separate the two flows.

So, this chart illustrates the capital flows associated with foreign direct investment in Hungary in four years. The first one is the inward FDI. So, investment flows into the country. Then we have the FDI incomes. This was certainly a new phenomenon and the first explanations of this phenomenon, came from my colleagues Gábor Hunya and Sandor Richter in Vienna, who (had) already pointed out that there was some change in the behaviour of foreign direct investment. And this was, that they started to realise that there was a greater profits and profit transfers than in previous years. This is also illustrated here. As you (can) see, the darkest part of the curves increased in 1998 precisely and then remained at a relatively higher level than before also in 1999. But, the rumours also stated that there was also a hidden or covered profit transfer, namely in business and other technical services. The national accounts also included profit transfers. So, it is also provided for here. Unfortunately, for 1996, there was no available data, but as you see, the level of this covered profit transfer did not change much. So if we take these two together, the incomes repatriation of FDI and the business and technical services amount, well, there is some increase of course, but it is not that dramatic. I would not say (that) it was a very surprising phenomenon in 1998.

But if not (the) flows associated with foreign direct investment, then what was the real reason of this sudden increase of the current account deficit in 1998 ? So I also calculated some figures (for) the other two types of foreign investments, namely, portfolio investments - short-term obligations, these are the state securities, I mean government securities - and bank deposits. And, I also tried to calculate the change of the stock as well as the income transfers associated with these two types of investments. And, as you see, quite (an) interesting picture evolved. First of all, 1998 was absolutely (characteristic) of the trend. So if you take the first year, 1996, the cumulative figure was quite a dramatic negative balance and there was steady improvement. So, it really surprised me and the analysis of this trend is under way. So, I am not able to provide you with more detailed explanations of this phenomenon. But, what is important from our point of view, now, with regard to foreign direct investments, is, that the changes of stock and income flows, with regard to portfolio investments and bank deposits, was at least one magnitude higher than those of foreign direct investments. So, what is really, maybe, a reason for concern, is the short-term investments in the country and not foreign direct investment.

And the third issue, and here I will then conclude and close my presentation, are the beneficial effects. I picked only one and this is – whether regional development can be promoted by foreign direct investments or not.

I have two slides, two maps. These are the counties in Hungary and the densely dotted areas are those where you will find a relatively high share of total foreign capital investments. And it is clearly visible that this figure relates to 1994, an early stage of foreign investments in Hungary during which the northwestern part of Hungary clearly dominated. Obviously, Budapest, which is blank, was responsible for something like two thirds of all the stock. This is an exceptionally high level. The blue lines there, these are highways that already existed at the time, because as you see in the second map, it seems that highways may play a role in attracting capital.

My paper tries to conclude here that among the various attracting factors what counts most of all is the local trained and experienced labour force, a sufficient level of educational and R&D background, and also the possibility of access to these resources, that is, for example the highway system and other infrastructural systems that play a role. So, as you see, the highway system was improved or developed to some extent and it is exactly (in) the directions of the highways where the three major countryside cities, where this potential (of) high-quality labour is located - where the highways also run. And you see there is at least some development in these three areas. Meanwhile, here, the fourth one, in the southern part of Hungary, which is Pecs, where there is no highway at all. (This area) did not show any improvement.

So, my very slight expectation is that there will be a continuing spread of foreign investments in Hungary, although, they will concentrate on the regional hot spots where the production inputs are available and this will be enhanced by road construction. Thank you.

/applause/

Mr. Peter Havlik: Thank you Mr. Szanyi. I would suggest that we proceed with two more presentations and then we wrap up the discussion a little bit and then continue. The next speaker is Mr. Ádám Pawlowicz, who is the president of the Polish Agency for Foreign Investment. Please Mr. Pawlowicz, take the floor.

Mr. Adam Pawlowicz, Poland
The Most Important Factors which encourage Foreign Investors to engage Business in Poland

Mr. Adam Pawlowicz: Ladies and gentlemen, it is my honour to be here today and to share some views with you about FDI in Poland – inflow of FDI and the importance of FDI. At the beginning, I would like to stress that what I will show you today is a little bit different from the paper you have, because I included some changes and there is a new presentation. So, I would like to ask the organisers to provide the new copy to you, so that you will have the full picture. Please, do not concentrate on (the) actual paper you have been provided with, but rather on the slides and my comments, if possible.

11 years ago, exactly 11 and half years ago, the whole transformation in Central Europe started and it was Poland that started this transition from (a) communist system toward democracy and toward free market economy. First, there were free elections – first in Central Europe. And then there was the so-called shock therapy of Mr. Leszek Balzerowicz and (the) introduction of free market economy. Exactly 11 years ago Mr. Balzerowicz was making final corrections to drafts of new laws, which were (have been) implemented in Poland since January 1st 1990 and this was the beginning of the story.

Now we come almost 11 years further and we can look back at what happened in Poland and in other countries. And I think the overall picture of these changes, despite some mistakes in every country of this region, the overall picture is very positive for this region and this is a region of high potential, high growth and, I believe, (a) great future.

Poland and Polish people, Polish society set up strategic goals at the beginning. In essence, these were four: to introduce freedom and democracy; to introduce free market economy; to become a member of (the) European Union, and to be (a) member of NATO. The last one was not so obvious at the beginning, but after two, three years, there was almost (a) consensus among the political forces in Poland to set this up as a goal. Now, I am proud to say, (we have) concluded three of those four strategic goals and we are on the right track to achieve the fourth one, namely being a member of the European Union.

So, I will start with this issue – accession to the European Union and Poland The last report published by the European Commission gives a very positive picture of Poland. This report was published by (the) European Commission about two or three weeks ago. It states that Poland is a functioning market economy with an increasingly thriving private sector and (the) appropriate legal and institutional environment for economic activity, which is the basis to being a member of the European Union. Second, property rights have clearly been established and are transferable. There are no significant legal or institutional barriers to the establishment of new firms in Poland. Poland continues to register progress in privatisation and structural reforms. The privatisation program is being implemented forcefully and successfully. The banking sector has remained fundamentally sound since the mid-90s. So this is the European Commission report on Poland. This is one of the best reports we have got so far and, I believe, this is one of the highest appreciations for any Central European country, similar to (the) Hungarian and Slovenian (one).

This is the international comparison – Poland and (the) EU- as far as GDP is concerned, unemployment and inflation. These are forecasts made by (the) European Commission. As you (can) see, our strength is quite high GDP growth, almost twice as high as the EU average. In the past, we had GDP growth, which was 2.2 higher than the EU average. The drawback of the economy and the economic situation is high unemployment, which, unfortunately, is now increasing this year. Also, inflation is a bit high, but under control according to the EU Commission report and will be decreasing significantly over (the) next few years. In about three, four years, we will achieve (the) level necessary for us to become a member of the European Union, which is 5.0 percent. Poland, it was stated, is the leader in terms of foreign direct investment – a cumulative figure. There are different statistics, that difference is provided by the Central Bank on the cash flow basis, this is the so-called contractual basis. But, despite their differences, Poland definitely attracts (the) majority of investments in the region. According to UNCTAD – the United Nations Agency – one third of total FDI, which came to Central Europe, was invested in Poland.

Poland also enjoys high cumulated GDP growth when compared to other Central European countries. This is due, by the way, to the growth of productivity. When you compare the growth of productivity in all the Central European countries measured per capita, Poland ranks number one, then come Slovenia and Hungary.

These are past figures for inflation and, as you (can) see, even though the European Union put the figure a bit higher – 10.1 percent – we actually will have about 9 percent at the end of this year and inflation is decreasing.

I commented already on unemployment.

(The) Polish approach towards FDI is, I would say, at the moment rather (a) broader one. So, we do not try to focus only on FDI, but we try to establish conditions that are good for any investment, also domestic investment. So, we try to eliminate all the administrative barriers and lower taxes to lower the costs of doing business in Poland. And, what you see on this slide is (the) corporate income tax and this is not the plan, this is the law. So, every year corporate income tax in Poland will decrease. This year it is 30 percent, in the next two years it will be 28 percent, and then gradually it will go down to 22 percent. And this is one of the key approaches implemented by the government in order to create a better framework for doing business and investing in Poland.

One of the drawbacks of the economy is the trade deficit. It was mentioned already in (the) Hungarian example. Poland, I believe, has the largest trade deficit and current account deficit among all Central European countries. It is partly covered by (the) inflow of foreign direct investment and partly by so-called unregistered trade, mainly with Russia and (the) former Soviet Union. So, the trade deficit is higher, (the) current account deficit has been reduced by these two factors – FDI and unregistered trade - and, the most important figure, is the current account deficit as a percentage of GDP. It was growing until the middle of this year, now it is decreasing. So, now, we have a positive trend once more, with the current account deficit as a percentage of GDP slightly decreasing and (the) positive trend expected to continue next year. By the way, the trade deficit and current account deficit is counterbalanced by high foreign exchange reserves, which cover about seven months of our imports.

Now, I would like to focus on (the) opinion of foreign investors of Poland, which we monitor systematically on an annual basis. We wrote four reports on Poland and I would like to present (to) you some (of the) results.

These are answers to the question - 'What are the most important factors for you, to make you invest in Poland?' The survey was carried out with about 800 foreign companies in Poland. This was, of course, only a sample of the whole group of foreign companies in Poland and these are (the) answers they provided. The answer was a very important factor. If you add important factors, the figures will almost double. Almost 50 percent of (the) foreign companies surveyed by PAIZ answered that the most important, the very important factor for investment in Poland was (the) prospect (of our country's) economic growth. The second very important factor was low labour cost, then the size of the Polish market, (the) large supply of labour, namely unemployment and (the) possibility of reducing production costs. The subsequent items were also very significant: - the quality of (the) labour force, more than one third, 35 percent, and (the) prospect of becoming a member of (the) European Union.

What is important, as you (can) see on this slide, are (the) changes in the figures. And what is becoming more and more important (are the) prospects of economic growth. So, Poland is more and more perceived not only as a low-cost country, but also as a high potential economy. Almost every aspect of doing business in Poland was positively evaluated by foreign companies and, compared to the last survey in 1997 and one prior to that in 1995, the rating of negative answers decreased significantly. So, what you see here, five years ago, almost 81 percent of (the) companies were saying that regulations change too frequently. Now (it is) 30 percent. This is still (a) high figure, but you see what change was introduced in Poland in 5 years. 'Uneven applications of regulations by authorities' – three quarters, 5 years ago, and 40 percent today. 'Legal loopholes and lack of system cohesion' – once more, three-fourths, 5 years ago, and 44 percent today. So, what these continuous surveys (tell us), is that the legal framework and institutional framework for doing business in Poland is being continuously improved. And this is very encouraging, because it means that reforms undertaken by all subsequent governments are positively evaluated by foreign business in Poland and appreciated.

Maybe I will not comment on this.

Let us go to 'Labour force qualifications'. The survey's outcome was very positive As you (can) see on the slide, managers and white-collar workers received very high marks from foreign investors. 56 percent of very positive answers for managers, 57 for white-collar workers, and 40 for the unskilled labour force. If you add 'average', the exact answer was rather final. Then it amounts to more than 90 percent in terms of managers and white-collar workers. Only for the unskilled workers, the negative answers are 11 percent and this is a bit higher than for white-collar (workers) and managers. So, what I would like to stress with these figures - I compared these with my experience of talking to investors, the evaluation of the quality of (the) labour force in Poland is very positive, very high and still improving. As more people are trained and adjust to work in the free market conditions in foreign companies, (the) more and more positive (the) answers become.

Another factor, which is important and was stated at the beginning, for investments in Poland was cost. And this shows (the) actual administrative map of Poland with monthly gross salaries. It is important to note that our gross salaries increased nominally last year due to social security reform – part of the social security tax was (simply) included in the gross salary So, now the social security tax paid by (the) employer, by (the) companies is only 20 percent. It is, by the way, one of the ways of improving (the) business climate in Poland and now we have one of (the) lowest social security taxes in Europe.

So, this is the outcome, ladies and gentlemen, of this survey, which was carried out for us by a research institute. And to sum (it) up, I would say that the most important factors that incited foreign business to invest in Poland did not change very much over the last 10 years. But, what we saw, is the change of order – (the) more important (the) prospects of economic growth, the less important (the) costs of labour and the overall evaluation of (the) Polish economy and business environment in Poland. It is steadily improving. And, I believe, it will contribute to the further increase of foreign direct investment in our country. Thank you very much.

/applause/

Mr. Peter Havlik: Thank you Mr. Pawlowicz for your very interesting presentation. We shall now have the chance to hear the view of Mr. Vladimír Benáček, who is from the Charles University in Prague. He is head of the Ph.D. program at this university, so this will perhaps be an academic opinion.

Mr. Vladimír Benáček, Czech Republic

FDI, International Trade and the Adjustments to World Markets in a Small Open Economy of Transition: The Case of Czech Economy

Mr. Vladimír Benáček: Good Morning ladies and gentlemen. I am really not involved with businesses. I am not involved with the political parties. So, I tried to be independent, that is why I am at the university. And my interest is in international trade and international finance and restructuring as such.

The Czech case in FDI business is quite interesting. It is interesting from a theoretical point of view because it offers certain extreme solutions for FDI. The Czech government, after 1989, was very liberal, very conservative, and liberal-minded. And the idea of FDI was (a) secondary issue. The primary issue was the rise of a very modern capitalism out of the ruins of the communist economic system. And the build-up of the economy was based on a belief that there are enough domestic entrepreneurs. Labour is qualified enough to carry out the whole process of transformation using domestic resources.

And, as a certain externality or value added to this fantastic domestic development, there will be an FDI income, because the most important factor for FDI is a functioning, booming economy.

I do not want to say that our approach was nationalistic. It is based on certain national values and national beliefs in national prestige. And, from the very beginning, the FDI had to compete with domestic entrepreneurs. And you were able to observe a very strange phenomenon. FDI was crowded out by the competition of domestic entrepreneurs who were able to offer better prices, for example. It was based on the belief that if someone is betting, that person must be serious, because these bets are based on certain marginal future returns. This was not the case, because the belief in mass privatisation and, what Professor Sato described as an obsession with the belief in privatisation and the belief in large businesses. So, Czech Republic was a country where this belief was very strongly rooted.

And, the crowding out can be seen in the following table. So there is certain asymmetry between domestic and foreign investors and you also see the asymmetry in my table. So, if you look at the FDI inflows. Well, there are two asymmetries. This is the privatisation of (the) telecom and this is the privatisation of the banking sector. The level of FDI was quite small, I think, for the potential that we expected. FDI really had to fight very intensively with domestic firms. Even though, I do not want to say that the conditions were very bad, the conditions were the same for domestic and foreign investors. But the foreign investors, of course, preferred other countries where penetration was more favourably received by the government.

What you can see at the end is that (the) FDI increase in 1999 was huge and the next FDI entry is also expected to be huge. It is mainly because of (the) privatisation of banks, but also, the whole view on the country improved to some extent after the recessional crisis in 1997.

If I were to take a look at the FDI, I must agree with one thing. It is easy to see from the data that FDI was a real success. Already in 1994, it was clear that firms with foreign capital had roughly 35 percent higher productivity than the rest of the economy. And this productivity gap has been increasing (ever) since. And now I have an estimate showing that it can be double (the) domestic productivity level. And there were very few hostile takeovers by foreign companies, so the majority of them exhibited a very successful performance throughout the last 10 years.

If you (take a) look at some (of the) other factors influencing the foreign presence in the Czech economy, you can see that there were also quite important other flows, like portfolio flows or long-term loans. So, the presence of foreign firms in the national economy is higher than what reports officially say, I think. So, I would say that, in roughly two years, the FDI sector will absolutely be the decisive part of the economy. They will have a GDP share approaching Hungarian levels. That is roughly what is happening in (the) manufacturing sector, I think. 70 percent. Am I right? Right. And there are also substantial inflows into the non-industrial sector, especially the services and financial sector. So, the role of foreign investors changed from a certain minor role to an almost dominant position.

Maybe, I will show you a different graph for starters. It is a regression, an attempt to find out the relationship between FDI and export performance. Because what we can see, for example, is that FDI firms export more than domestic firms. The factor is approximately twice that of domestic firms. Their investments are three or four times more intensive than (that) of indigenous firms. And, let us say, if the FDI firms had a 30 percent share of labour, their profits would total approximately 80 percent of all the stocks.

So, I was trying to find out more about this dependence of FDI on exports and FDI (on) imports. This estimation is based on a time series for data on trade from SITC two-digit industries for the years 1993–97. And you can see that from (the) various theoretically feasible factors, the most important for explaining exports is the capital labour ratio. So there clearly is a visible trend to(ward) exporting labour-intensive products and FDI. So, FDI is in fact the most important factor behind exports. And then there is the ratio between domestic and foreign prices that is not rather poorly documented statistically . And these are the exports to EU.

Now, let us take a look at similar things with imports. And here we find that imports are even more decisively connected with FDI. The other factor, (the) capital labour ratio, remains also very important. (The fact) that imports are also labour-intensive is some sort of a paradox What is important, the tariff rates. (When) the tariff rate decreased in the EU, there was a very sensitive response to that from (the) domestic side. And this import absorption by FDI is enormous. Most probably, I think, the FDI firms (will) bring a balance of trade deficit to the country for a short period. So, these are the main factors and we can proceed to the other table, (to) other estimations.

This is the quality content of production imports and exports. At the beginning of transformation, approximately up to the year 1995, there was a visible trend toward exports oriented to labour-intensive products and very simple products. That is quite (an) unfavourable trend for a country that is more ambitious in the long run. But, by the end of 1997, when we compare (the) share of commodity groups - according to certain characteristics like human capital, labour, and physical capital intensity - we can see that the human capital content really increased sharply. That is good news. Another important point is that labour-intensive exports were also increasing and physical capital became less important. Perhaps, this would be a paradox in the long run.

Well, let us disregard this table for a moment and let us concentrate on the regression analysis of FDI per value added. So, I was trying to explain why FDI did not enter all industries in a uniform pattern. So, there were certain preferred industries and these are all factors that are important – the capital labour ratio, profits per labour, increasing returns to scale. So this is some sort of market imperfection or preference to monopolized industries – and the price developments. So, all of them are statistically significant with plus signs for all estimated coefficients, but we now have a different approach. FDI is approaching the capital-intensive products, which to me looks like a very rational long-term strategy. So, if we accept the approach that FDI is always correct in its decision-making, then the concentration on capital-intensive goods is rational because, in the long run, labour will become expensive, (the) exchange rate will appreciate, and you must then concentrate more on capital-intensive production. This factor cannot be a determining factor but an outcome of FDI. And, of course, increasing returns to scale, signals that FDI prefers industries where you can have certain monopolistic or oligopolistic rents. So, that is a very modern and natural trend.

What is very interesting, is that FDI is associated with industries where you have high inflation and that is very important to understand the growth of the economies in transformation. So, the growth of the economies in transformation is measured in real terms, and because there is significant inflation, you have got to adjust nominal growth in GDP to the price changes. So, this strong real growth is associated with strong nominal growth and low inflation. But, if statisticians measured inflation wrongly, then they (must) seriously (have) underestimated real growth. And because FDI and, also, exports are associated with very high inflation, this means that statisticians did a bad job. So, they assign something like inflation to very successful industries and they underestimate their growth potential, not only their growth potential, but also their real growth.

And let us make a better assumption.- If the price increase in some industry is an adjustment to the world prices, which are correlated with the changes in the quality of products, then Czech growth could be substantially higher. And once we have (a) terms-of-trade improvement the prices of exports grow faster than the prices of imports and that approximately at a factor of 3 percent per year. So, if this factor is hidden, the Czech growth may in fact be much better in real terms than what was assumed up to now.

Then, we have got the final table. It is once again (a) testing of trade and I tested the price increases, meaning the presence of inflation. And, again, I found that it is a very important factor. So, it is a major factor and, I think, we should consider this for the assessment of the future perspectives of any transformation economy.

So to conclude, I have a list of problems. Mr. Havlik, how many minutes?

Mr. Peter Havlik: Three minutes.

Mr. Vladimír Benáček: Three minutes – that is very good for that.

So – Challenges for the future

The first challenge for foreign investment is that the exchange rate in real terms will appreciate. I think this is some sort of law (that takes effect) once the Eastern and Central European Countries approach the price levels of the EU.

Then there is another very important factor – it is (the) two-speed economy – the domestic economy, that indigenous sector (which) is lagging behind. And the problem of spillovers between the FDI firms that are very successful and domestic firms. It is important that domestic firms are not lagging too far behind. So, if the lag is big, then this spillover effect has too high a barrier to (be able to) jump from the FDI industries, (from) FDI firms to indigenous firms. And, in the Czech economy that was (a) very serious problem. But I hope, that this gap is now narrowing, so we need more analysis of the domestic economy. But, I think, the increasing role of human capital is a good sign.

Then the role of the state is another important challenge. So, Eastern European economies were extremely bureaucratic and remained highly bureaucratic even during the days of transformation. This is a special case for the Czech economy. So, bureaucracy plays a very important role, the investors are complaining about it. Taxation is very high. The share of the state budget on GDP is also extremely high, if you consider especially the level of GDP per capita in commercial dollars. And then the problem of decentralisation. So, our countries now face the challenge of reorganising state administration. And let us hope that this problem of excessive centralization and bureaucratisation will decrease with time. This is closely connected with the political system.

In my opinion, the political systems in the Central and Eastern European Countries is at the core of all (the) difficulties. We are not only facing the challenge of the economic problems, but also the political system that abuses the major role of government and state in the economy.

And, last but not least, SME development. We should concentrate much more on SMEs as a servicing sector for large FDI firms and that is where the domestic capital has real chances of being competitive.

And, last but not least, incentive schemes. We had no incentive schemes until 1998. Afterwards , we introduced an incentive scheme that was correlated with the increase in FDI. So, some people say that this came on account of the incentive schemes. So, if you look, for example, at the Matsushita competitor, the new investment by Phillips into television production is in fact a larger investment than (that of) Matsushita. This incentive scheme, for example, represents a co-financing of 7 percent of the FDI total. That is not very high and I think government has certain duties to prepare the infrastructure and qualify labour and arrange (the) mobility of labour. Then, there is a tax holiday. That is another substantial preferential treatment. I think (a) tax holiday is more important from the point of view of asymmetry of approach to domestic and foreign firms.

But I think that the FDI increase in the last two years was mainly due to certain improvements in the transparency of the Czech economy. So, it is not that fantastic economy with hidden enormous problems. But, now, we see that it is an economy that has problems and that is dealing with these problems. Thank you very much.

/applause/

Mr. Peter Havlík: Thank you Mr. Benáček for your very interesting presentation I would now suggest (that) before we move to other presentations and to the, so to say, official comments, which will be given later on by Mr. Gábor Hunya, we perhaps have some comments or questions (with regard to) the three presentations, which we have heard so far. Are there any comments or questions? Yes please.

Questions, comments

Mr. Dragoljub Stojanov: There are many of them, but I do not want to ask all of them. Once, I read a Michael Porter book – 'The Competitive Advantages of Nations' – everybody knows about it. And he said in the book that those countries that rely too much on foreign direct investment, too extensively, as our countries are, run the risk of becoming the so-called factor-driven economies. The economies that depend heavily on foreign direct investments and do not pay enough attention to domestic sources of economic growth.

So, Professor Benáček said that Czech economy is becoming more and more a dual kind of economy and it seems to me Hungary, Poland, and tomorrow Bosnia, are going to follow this road. So, this is one problem – what is the future of these countries, if they depend too heavily on foreign direct investment? What is the role of domestic research and development in all of these countries? Is it developing or decreasing, or (should we) just forget about that?

And, regarding the efficiency of domestic companies, I have my difficulties. Even now in Bosnia and Croatia, I am, in (my) capacity as president of **...management ...** privatisation. I was discovering, not to my surprise, but just discovering that domestic companies have intentionally become loss makers and they intentionally produce at a loss in their companies, because in such a case it is easier for them to be privatised by domestic or foreign capital. So, basically, we are destroying our companies ourselves, domestically and internationally. So, here in the companies in operation, in Bosnia Herzegovina, in Croatia, and tomorrow in Serbia, we cannot speak about the economic development of domestic sources. This is the role of economic expectations in the process of privatisation that nobody mentioned so far. If we continue to decrease the value of domestic companies intentionally, believing that we are doing something foreigners are relying on by completing FDI, I am afraid, that very soon there are not going to be any domestically owned companies.

And, now to some mathematics and calculations. I would like to find out somehow, whether you pay any attention to the difference between GDP and GNP calculations in your countries. What I have in mind (is that) GDP may be increased due to (the) presence of foreign direct investment while it may also be decreased. So, I did not hear anybody here discussing the role of foreign capital in domestic countries. How does foreign capital influence these two variables? Thank you.

Mr. Peter Havlík: Thank you. Would any of you like to react to this comment?

Mr. Miklós Szanyi: About the question of dependence, it is too early to make any clear-cut statement on the two-tier economy. Because, in the Hungarian case at least, it was mostly the period between 1992 (and) 1996, when the bulk of foreign investment was made and the three, four years afterwards. (And this) is simply too short a period of time to expect measurable spillover effects. So, certainly, right now, there is very little evidence of positive spillovers. There is even some evidence of negative spillovers. But, I would not dare make any long-term assessments on whether this situation will be maintained in the longer run.

A good example is domestic R&D, which was also the question. There is some development in this field. I do not think that anyone could expect the domestic R&D facilities of privatised firms (to) be utilized to (their) full extent after privatisation. I mean foreign direct investment privatisation, because these companies have their own laboratories. There is no need to duplicate anything. But there was some positive change when investors simply discovered that there was quite a high potential in their companies. With the years, some of them relied on these experts, meaning that they simply had to send the most talented researchers or scientists to their headquarters, but they also located some research tasks locally. Three are even examples of (this) - for example Japanese companies that have research and development as their sole activity in Hungary.

So, they have an affiliate with 10 people, 10 researchers in Hungary and do the research, applied research, of course. It is no fundamental Nobel Prize-winning research, but they do some research work and nothing else. Production is in Japan. It is only R&D that is done in Hungary, not much of it of course.

Well, I do not want to go into the details of the other two questions, because these are more methodological in nature. The points are relevant, of course. Everyone knows that they are relevant questions, but I would rather give the floor to other presenters.

Mr. Vladimír Benáček: I would once again like to speak of the two-speed character, (the) two-speed nature of the Czech economy. If you (would) base your analysis on data from 1996 and 1997, you would come to the rather pessimistic conclusion that the indigenous sector will most probably disappear and all activity could shift into the hands of foreigners.

Well, if you are not a nationalist, this is not such a huge problem, as long as the foreigners provide employment, high wages, and growth. But I still think, that the foreign firms do not have all the advantages in their hands. You can have a theory that, genetically, Eastern Europe is inferior but I do not think so. I think this natural genetic competitiveness is present there. And finally the Czechs could perhaps become the managers for these large multinational firms for the whole world. So, domestically, we will have foreign managers and the Czech will be ruling from Frankfurt or Vienna. So, I am quite optimistic in this, but you must not have these nationalistic prejudices.

Then - R&D

It is true that (the) Czech government was systematically prejudiced against research and education. So, I think, there was (a) certain intention to liquidate this sector. It was quite a shock to discover that the efficiency of that sector, which rests in state hands, is very low and, at the same time, firms like Volkswagen have very large R&D research departments, organised privately by themselves. Matsushita also came first as an assembly plant and then they discovered that for them it is more efficient to rely more on domestic R&D content and so on. So, if the government does not support that, the foreign firms or other firms in (the) industrial sector will replace a large part of the domestic ones. But, of course, R&D is a public good and its support is necessary. So, I think it is very important for the governments to acknowledge this fact.

GDP and GNP

How about Ireland, I think Ireland is a very nice small economy with huge differences and what is wrong with that.

Mr. Peter Havlik: Thank you. Mr. Pawlowicz? Yes please.

Mr. Adam Pawlowicz: I will make very short comments on each of these questions. First – two economies – (the) two speeds of two economies - (the) foreign economy in the country and (the) domestic one. I think this might be (a) problem for smaller economies. In a country with the size of Poland, the Polish economy, it is not as big (a) problem as it might be in Ireland, for example. But the question is very frequently asked. Will we have our Polish **'specialité de la maison'** in business, will we have anything, which is the Polish industry, which we can contribute, more than (anything that) Europe could give us? And this question was often asked. So far, I think, the two industries, that to a large portion still belong to the Polish entrepreneurs and have already been privatised, are the ship industry and construction sector.

And in both of these sectors we see high growth of productivity, very efficient management, and production and services and international competitiveness. For example, private Polish shipyards (have) become global and are taking over foreign shipyards, at least they are attempting to take over. And (this) also happens in (the) construction business. So I think there is a potential and that there is no risk in some sectors of a two-speed economy. But in some sectors, of course, this is legitimate question.

R&D

My opinion about state-owned R&D is very bad. I used to work at university and I know how inefficient it was at that time. So, I think, the privatisation of this area, as you mentioned, Volkswagen or Matsushita in the Czech Republic, I think these are good examples and we also see it in Poland. For example, Intel invested only in R&D in Poland. So, this is the very positive outcome of foreign companies coming to Poland and investing in R&D activities.

And, with regard to the question of making losses on purpose, if I understood correctly, in order to speed up privatisation. It was the case at the very beginning of transformation, when the Polish post-communist managers tried to take over state-owned firms for simply nothing. So, they were making losses on purpose and they were taking the best part of the former state-owned company. They created wealth, and the rest remained state-owned. The approach was very wrong . However, I think that the aim of all privatisation programs implemented after 1991 was to change this situation. And what we see now is that it is in the best interest of (the) managers of state-owned firms to create as much growth as possible, because, then, their future salaries and their prospects of being employed by future foreign investors are higher. So, they are gradually making bigger efforts to make their companies efficient.

And, maybe one additional comment. We now see a very strange situation in Poland, because we are quite a big economy. So, sometimes, there is a situation when some people ask questions like this – should we privatise our companies with (the) participation of foreign capital, (even) if we have a company that is rather large even in terms of the European Union? And can it compete on the European market already? The case in point was the case of a major insurance company, which was privatised with the participation of a smaller company from the European Union. So, this was the question –'Why (did) the smaller company take over (the) larger company, which was state-owned?' And, these kinds of questions are asked. So this is maybe (an) additional approach to the question you raised. Thank you.

Mr. Peter Havlik: Thank you Mr. Pawlowicz. Mr. Janáček?

Mr. Kamil Janáček: I would like to add one comment to the results of Vlado Benáček's analysis. His analysis ends with 1997 and I must admit that from my bank's data - we can not use this data openly due , but 80 percent of the corporations in the Czech Republic are clients of Komercni Banka. We are either the first, second or third bank. And, according to my team's and my own analysis, there is clear evidence that after 1998, let us say, the recession of the Czech economy forced the companies to accelerate restructuring and the gap between the foreign-owned and the domestic firms narrowed down. But there is another gap emerging in the Czech economy. The gap between exporting companies, both foreign and domestically owned, and the rest of the economy. And, I think, it could be a new feature in the small open Czech economy. The companies with good prospects on foreign markets, let us say, will prosper much more than the rest of the economy.

Mr. Peter Havlik: Thank you Mr. Janáček. Yes please.

Unknown: Thank you Mr. Chairman. I would like to make comments on R&D. Resourceful research ..., but if your provide incentives to researchers, government research institutes, or university professors, that means if researchers **direct** their own business, they work very efficiently on their research. And my research topic is spin-off companies from government research institutes and institutes. And such kinds of university spin-off companies are flourishing in China. I found some examples in Malaysia and, of course, in the United States and Germany, France, and (the) UK and also in Japan. Thank you.

Mr. Peter Havlik: Thank you for your comment. If I may just add something to this issue of domestic and foreign sectors. It is a very curious situation, I would say, because we have these discussions everywhere, in Austria, in Germany, in Japan, in (the) United States. So, it seems that every nation is afraid that it will lose its domestic industry or domestic enterprises to foreign-owned enterprises. But, I do not see a big problem here. Generally speaking, especially if we talk about Europe, all these countries we have dealt with so far are striving to be members of the European Union, which is the common market, which is the common European space. And I fully agree with the statement that if foreign companies or domestic companies are providing jobs, if they are paying taxes, if they are growing, then it is perfectly OK for the economy. Let us be satisfied with this development. Ok, so, are there any other questions? Yes.

Unknown: Well, thank you very much for the very attractive presentations. I would like to know how the free countries of Czech (Republic), Hungary, and Poland will develop their IT related industries? And, before I came here, I was in Germany and (a) high official from the Ministry of Economic Affairs expected (that) there will be development of IT-related industries in Central and Eastern European countries, especially in the field of human resources. And, you said you have... high talented work forces. So, perhaps, many companies are now coming to invest in the IT-related areas. So, I want to know how the governments of (the) three countries feel? Are they trying to make some policy to challenge IT-related industries?

Mr. Peter Havlik: Ok. I would (like to) collect a few more questions. Yes please. If you could introduce yourself always, otherwise we have problems with our recordings.

Mr. Junichi Hasegawa: I am Hasegawa of Japan Bank for International Cooperation. My question is about (the) government incentive for FDIs. Particularly, maybe, I wish to ask Mr. Benáček. You introduced government incentives for FDI, that means you expect to have more FDIs in exchange for sacrificing a little bit of government revenue in case of tax holidays for example. And, very often when you introduce such a policy, you have a limited period, like 10 years, for tax holidays. My question is, when you are introducing new tax incentives for FDIs, do you consider the conditions of lifting such incentives after 10 years? Can you specify what the condition of structural change is, what the level of the FDI is that will be adequate to contemplate lifting the government incentives? Thank you.

Mr. Peter Havlik: Ok. So, who of the speakers would (like to) answer? There is one more question - Professor Nishimura.

Mr. Yoshiaki Nishimura: My question is to Doctor Szanyi. As you said, the total accumulated stock of foreign direct investment has reached a certain high level, I mean about 20 billion dollars. If this level is maintained or if it increases gradually in the future, what kind of idea do you have in terms of future dynamism for the repatriation (of) profits from Hungary? This is my question. Thank you.

Mr. Peter Havlik: Ok. We shall have some more time for discussion after the remaining presentations. So, I would like to ask you to answer very briefly because we have to proceed. Who wants to start?

Mr. Vladimir Benáček: I did not quite understand the first question. But maybe I need not answer that.

Mr. Miklós Szanyi: The first couple of questions were related to the incentives system of the country. Very briefly, I may say that it is on a competitive basis in Hungary. So investments in, for example, R&D-intensive branches are supported by various measures, including tax allowances and holidays. There are other targeted areas, regional development is also promoted, I mean investments in depressed regions and job creation is promoted and, also, export performance is a measure, which - there is an incentive to promote exports. This is strictly on (a) competitive basis and there is also a threshold level of investment.

So, this is why, in my view, although domestic and foreign investors may equally apply for these allowances and supports, it, in reality, favours foreign and big multinational investments, because there is this threshold level of minimum investment amount. So this is purely FDI promotion. Then, there are also some custom-tailored measures, which are commonly used everywhere. This is mainly infrastructure development and the provision of developed plots and areas, where investors may find the minimum level of infrastructural build-up. This is mainly locally organised. So it is not a government-sponsored activity, but local governments tried to lure some investment through these channels.

So, the second question, which was addressed to me personally, I think (the) absorption capacity of countries may be developed. So, when we had a discussion yesterday evening on whether the Hungarian economy is already saturated and whether it can not absorb that much (more) capital than it did during the past decade, I would say that, for example, highway developments and other means, other development tendencies, may increase the absorption capacity substantially. So, this 20 billion dollars plus investment stock will increase in the future This is for sure. I discussed (this) with Ádám Török, who stated yesterday that there is this absorption threshold now and then saturation. I also agree with the analysis of the Vienna Institute on changing patterns of behaviour of foreign investment enterprises. So, investments simply are not done because of pure charity. It is quite a normal phenomenon that, after (a) certain period, investments bring their fruits and the profit incomes will be used wherever the capital owner wishes to use them. So, incentive schemes, probably, should be developed further to promote (the) reinvestment of profits. But this is a completely separate issue then. So, the liberty and freedom of capital owners to use their revenues wherever they wish, this (is) a minimum level of allowance that should be provided everywhere.

Mr. Vladimír Benáček: I will answer only the question about investment incentives. This scheme has no symmetry and because the domestic large firms are definitely outsiders in this competition, this asymmetry is visible. This gives better chances to foreign investors. They are larger and they have better business plans, higher returns. So, they press more intensively for these deals that are negotiated very often (on an) individual (basis). The asymmetry is, I think, very wrong and what is very bad is the asymmetry (that works) against domestic small firms that receive no such incentives. But, if you look at what the foreign firms provide, they also provide a certain culture. And this is (an) externality that should be rewarded, because they bring something that domestic firms can never bring. So, certain know-how and the penetration of the world market. And, I think, these investors should be rewarded for this additional value added. So, from the point of view of public good, they deserve this investment. But what is more important is to change this policy in(to a) normal investment policy for all investors, including small investors. And after the FDI has attained a certain level of control of domestic economy, I think its role will be less important. So, there is a decreasing trend and if we assume that it could be 10 years, then, I think, in 10 years this scheme could be abandoned. But, in the meantime, it should be replaced by different investment policies very quickly. This means investment should be tax-deductible. There should be much less bureaucratic control over these investments. State control, generally, should decrease. And this is a political problem and I think the foreign firms should be (the) first to press the government to change the investment environment as such.

Mr. Peter Havlik: Yes, Mr. Pawlowicz would like to react also.

Mr. Adam Pawlowicz: Very shortly – tax incentives in Poland. First of all, I think, they did not create as much inequality between foreign firms and Polish firms. As we see in (the) special economic zones, one fifth, one sixth of total investment placed in special economic zones are Polish firms and Polish capital invested in special economic zones. But the trouble with the special economic zones, in my opinion, (and) this is my private opinion, is that it created (a) distortion inside Poland. So, not only asymmetry between foreign investment and domestic investment, but distortion inside Poland.

For example, let us say the furniture industry, which was quite significant in Poland. A lot of small- and medium-size companies in this industry and big firms went into special economic zones and they invested in the furniture factories. What happened? Because of the economies of scale they can set up lower prices and they (can) enjoy tax holidays once more. So, the small- (and) medium-size companies cannot compete with them. And it has an impact on the small- (and) medium-size enterprise development.

Mr. Adam Pawlowicz: The second difference is that in Poland we had a much more decentralized system, in which many incentives were negotiated with local authorities, on different levels, from the community level to the regional level. What we see now is that when there is a serious investment, the package of incentives is provided to investors. The agency run by me also tries to help foreign investors in setting up a package of incentives from the community level, regional level, and then some national /central governmental level. Thank you.

Mr. Peter Havlik: Thank you Mr. Pawlowicz. Lets proceed to the remaining presentations. The next speaker is Mr. Stanchev from Bulgaria.

Mr. Krassen Stanchev, Bulgaria
What Exists is Possible: FDI Prospects and Policies in Bulgaria

Mr. Krassen Stanchev: Ladies and gentleman it is a privilege to talk to this audience, especially after the three countries we just heard. It is also a challenge because as you may see from some of my charts, Bulgaria was not performing very well in terms of FDI. There are many reasons, but there is nothing special about Bulgaria as such. Bulgaria's receptiveness to foreign investment can be explained by going back to the immediate pre-accession period, this is the period from 1994 to 1998. The general problem was economic mismanagement. It is quite visible in the performance of real GDP. You can see that despite the recent picking up of the GDP, it is still below 70% of its pre-reform level. It will probably take three to four years to reach the level of the pre-reform years. At the same time Bulgaria had the following demand structure, which is important for foreign investment as well. If we compare the first year of reform, that was 1991, and the previous year, some good signs may be found. I think private consumption was the main driving force for GDP in 1998/99 and 2000. But there is also another good sign. Government consumption is going down and investment is re-attaining its former levels. The only interesting facts that I would like to mention here is that net exports actually declined a number of times (and acted) as a weight in the GDP driving force. But the good news for 2000 is that, for the first time after 1991, the foreign demand or exports returned to the list of GDP driving forces. Another good starting point in recent years is (given by the fact) that Bulgaria has managed to reorient itself from East to West.

Comparing Bulgaria with Slovenia for example, Slovenia had about 60% of its trade with the EU in 1992 (the year of independence), while Bulgaria had 60% (thereof) with the former Soviet Union in 1991. There was no significant development in the trade with CEFTA countries, although I used the figure for trade with these countries before CEFTA had even been created. Currently, trade with the former Soviet Union is mostly limited to the exchange of restricted amounts of goods. It makes up slightly more than 5% of the exports this year and the imports remain mostly in the area of energy resources.

Let us return to foreign investment. I guess it will play a major role in Bulgaria's development in the years to come. It already has such a role. I (will) try to compare some growth factors for different periods of the Bulgarian reforms. It is visible, although 1998 was a year with a growth rate of 3.5%. I decided to put this year in the previous period to discount the impact of the low starting point. Average GDP growth between 1990 and 1998 was almost -4% p.a., while since 1999 there has been just the reverse trend. And for this and the next year I refer to the figures of the Bank of Austria, at the figures of the Vienna Institute.

They are rather modest from my point of view. This and next year, I think, Bulgaria will reach 5% GDP growth p.a. Exports show a similar story. This (year) and last year the figure came close to 10%, however, the terms of trade are still unfortunate. But probably in 2010, Bulgaria will have relatively fortunate terms of trade. After declining to 8% in the middle of the 90s (1996), average savings to GDP have restored their level in 2000. The average figure for savings to GDP is about 13%. Gross domestic investment, which fell below 8% of GDP in 1996, has already reversed the trend and is rising gradually above the level of the previous period (1994-1997). I take 1994, because I wanted to discount the impacts of the immediate start of the reforms of investment and trade. As for FDI, I think, the trend is already reversed. For the last two years it has been roughly 4.5%, compared to the previous period, which is considerably lower. If we compare different countries - I used a calculation made by colleagues from J.A. Austin Associates (JAA) - if we compare different countries in their competitiveness prospects in the long run, we use a measurement of FDI as a ratio to the population. Presumably, a fair share of the global investment would have a country whose ratio is about one in the global context. Hungary is not a fantastic country, actually. It has its fair share, but has some room for development. The same holds true for the Czech Republic. Compared to them, Bulgaria has five times less than this benchmark. This data is from the "World Development Indicators" of the World Bank. It does not reflect total investment in the countries. They don't calculate reinvestment and much of the greenfields. They don't take into account joint ventures and acquisitions & mergers to the same extent as national statistics. There are three major sources and here is the history of privatisation in Bulgaria.

It is very telling actually. The three major channels of investment are privatisation, portfolio, and greenfields. Greenfields include acquisitions, joint ventures, and reinvestment. The major story is that, until 1997, privatisation was the major source of FDI in the country. Privatisation at the same time had its own peculiarities in Bulgaria. From my point of view, Bulgaria is the only country, which used all possible privatisation schemes, referring to yesterdays debate, but most of them were misused. The major value for FDI since 1998 is the greenfield. It is possible to make some conclusions on the current status. Privatisation is currently limited to telecommunications and power and transport infrastructures and monopolies. There are options for re-privatisation due to the sales to insiders. If the conventional or political accepted ways of liquidation of ex-socialist properties in the Czech Republic was voucher privatisation, privatisation to insiders in Bulgaria was a method such as bankruptcy. Capital markets are likely to remain underdeveloped in the mid term. Greenfield is the potential for future FDI. What exists is probably possible. Equity investment is taking good shape. (The) privatisation of former government services is another major event, high-tech greenfields as well and power production and distribution.

The basic advantages are that, for the relatively long period 1993 to 1999, Bulgaria's exports exceeded imports to its two major markets, EU and Southeast Europe. This seems to be a major motivation for the greenfield investments in 1999 and 2000. The public perception is pretty ok, foreign investment is three to four times lower than domestic investment. There is a proper banking sector infrastructure. The banking sector is 90% privately and 70% EU-owned. Thank you.

Mr. Peter Havlik: Thank you Mr. Stanchev for your presentation. Our next speaker is Mr. Florin Bonciu from Romania. Mr. Bonciu is director of the national agency for regional development.

***Mr. Florin Bonciu*:** Thank you very much Mr. Chairman. Distinguished audience, ladies and gentlemen, in my presentation, I will try to refer strictly to the title "Romania - FDI policy, advantages and points at issue". I will start by trying to give you a picture of FDI in Romania in the decade 1990 to 2000. A methodological clarification is necessary. The figures I refer to include only disbursed foreign capital, that is, capital that was actually cashed in, so no commitments.

For this decade in Romania we have about USD 5 billion FDI in greenfield investment and joint ventures and another USD 1.2 billion in privatisation. This makes a total of about USD 6.5 billion. If we add to this the commitments under privatisation contracts, then the figure is much higher - above USD 7 billion. However we calculate this figure, it is lower than figures from other countries in the region and lower than the potential of the economy. In my paper I (will) try to analyse the reasons for this FDI dynamics in Romania. There are a number of positives and negatives that determine the situation. Some attractive issues are those related to the size of the country, which is similar to the size of Great Britain. The population is about 22.5 million inhabitants, there are some major natural resources including oil, natural gas. Land is also an important resource. There is a rather diversified industrial structure. In fact, this was a problem for Romania in the sense that we had quite a large industrial base, inefficient and with overcapacity. There is also the labour force, which was mentioned by all other colleagues.

Of course there were a number of negative aspects like unequally developed infrastructure across the country, the lack of functioning market institutions and here I would point especially to the banking sector and the slow pace of privatisation and in the past year the rather volatile legislative and institutional framework. Putting this aside, I detected that, in fact, the election cycles had quite an important impact on the evolution of FDI in Romania.

Therefore, we have two periods - 1992 to 1996 and 1997 to 2000. We note that, in fact, during the first period we had a rather attractive legal framework for FDI in Romania. During that period there was a positive discrimination in the sense that foreign investors received more rights or more incentives than domestic ones. This was a political decision in the sense that in Romania the perception was that there is not enough domestic capital to relaunch the economy and therefore foreign capital should be encouraged. There were also a number of guarantees by the law about a stable legal framework for the investments made. As a result of this situation and as a result of the incentives that were given, among them the most attractive one being tax holidays for two to five years, investors were coming. But a particular situation in Romania, which is not found in the other countries, is the fact that we have a low level of investment in relative terms but a very high number of small investors. For instance, at this moment, we have more than 77,000 companies with foreign participation, most of them small foreign companies or even individuals. They came for these incentives. While I am a researcher myself and I fully understand the economic theory that says that incentives may have a distorting effect from the real situation in the market, I can tell you that incentives are important. Of course legal and political stability is essential. This is the background. You cannot compensate such things, but assuming that you have this background, then incentives are important.

During the first period, 1990 to 1996, companies that were coming, mainly came for the size of the market. Here I can mention companies in the consumer goods area like Colgate-Palmolive and Coca-Cola. Then companies that were related to infrastructure projects that were financed by international financing organisations. Here I mention companies like Siemens or ABB. And then companies that had their regional strategy and were looking at the location like Daewoo, Kraft Jakobs Suchard, Unilever, and others. What is a very particular situation for Romania until 1996 is the fact that the privatisation offer was very limited. For the whole period, the FDI in privatisation was almost negligible - like USD 33.1 million. However, I have to mention (that) a number of large contracts were in progress at that time.

In the next period, Romania in a way reversed the situation after the change of the government 1997 and the privatisation offer was very much larger, including areas like (the) telecom and banking sector, but unfortunately at the same time the legal framework became extremely volatile and legislation was changed quite frequently. The reason for that was a rather shortsighted approach of the Ministry of Finance that assumed quite a leading role in that period, that was looking at very short-term objectives of finding resources for the budget. Therefore, legislation was changed quite frequently with this view and definitely this was negatively affecting all investors, domestic and foreign alike. Indeed, during this period - 1997 to 2000 - there were higher volumes of FDI due to some privatisation projects but at the same time a number of them were delayed anyway and foreign investors were interested, but they wanted to be very sure of the legal framework, (the) legal background.

As a general conclusion for this second period I would mention that the lack of clear industrial policy, meaning let's say the selection of certain areas as key areas, and adequate policy to support that, was quite a major factor to slow the coming of more foreign investors. Then of course the very high level of fiscality to a certain point was another factor and here I would like to mention that it is not the corporate tax issue, because corporate tax is 25% in Romania, but is the fact that there are a number of taxes related to environment protection, to various funds and these are quite bureaucratic in their administration. Anyway, what I want to mention is that, in certain industrial areas, foreign investors did have an impact that can be seem in Romania and here I would mention first of all the automotive industry, where large investments were made by Daewoo, and more recently by Renault. The Daewoo investment is more than USD 800 million. In tire production Continental AG invested in a large plant, which started operation about one month ago and is one of the most modern in Europe, of Continental (Europe) of course. Then in the electronics and telecommunication sector we have quite a significant impact by companies like Siemens, who came as early as December 1990, then Solectron, Alcatel. The GSM companies, among them France Telecom and Airtouch from Canada had very high growth. In fact they have the highest dynamics for the whole region in Romania. Probably the Latins are speaking more than others. I would also mention the machine-building sector where companies like ABB, Kverner, Bilstein Compa, Koyo, and Timken were also quite large investors and they employ a large number of Romanian labourers.

I would like to conclude (by) speaking about the prospects for the near future. As everyone knows, we had elections in Romania. The new government is to be formed these days. I can say that we can expect a strengthening of the role of FDI, as the majority party for this government is the party that supports and considers that FDI is one of the key solutions for financing the re-launch of the economy. Certainly, we expect to finalize some large privatisations. Among them are the largest bank in Romania and also the airline company. Therefore, we can expect some volumes of FDI in the next year. I would stop here. Thank you.

Mr. Peter Havlik: Thank you very much Mr. Bonciu. Our last speaker in this session is Mr. Alan Sitar from Slovak Republic. Mr. Sitar is advisor to the prime minister of Slovakia.

Mr. Alan Sitar, Slovak Republic
Slovakia is Ready

***Mr. Alan Sitar*:** Ladies and gentlemen, it is both a pleasure and honour for me to be able to address you today with my short speech, which must even be shorter than I planned, because we are short on time. Allow me to start with a statement, which might not be very clear from the very beginning. It is the statement that Slovakia is ready. I understand that you might be a little bit tired and overloaded with information that you got during (the) morning (session). Allow me to keep the second part of this statement for myself until the very end of this presentation. Hopefully, you will help me guess what the second part of the statement is.

I will try to walk you, very briefly, through the following parts of my presentation. First, I will say a few words about Slovakia, the key facts. I will describe a little bit the political, economical situation and I will concentrate on the topics that you can see on your screen. Then I will come to the main topic of this session, that is, FDI. Again, I will start with the key figures, then I will show you a breakdown of FDI by industry and (a) few top investors present in Slovakia, and I will also name some investors from Japan that are already in Slovakia. The second part of my presentation will concentrate on the government approach in the field of FDI, where I will describe the incentive packages valid as of today, but also the ones which are prepared and are ready to be introduced at the beginning of next year. I would also like to introduce SARIO. This is a newly created agency whose main purpose is to promote FDI flow into Slovakia and also to promote Slovakia's export outside the country. The last part will be (a) conclusion and outlook.

I do believe that most of you are familiar with where Slovakia is and we think that it has a very strategic location between East and West of Europe. Its population is 5.4 million inhabitants, (it measures) 50,000 square meters, and the capital Bratislava is very close to Vienna. I came just this morning, unfortunately, I couldn't be with you yesterday, but it was only one hour, so it is really convenient to fly to Vienna and come to Bratislava. The current exchange rate is 50 crowns per USD 1. GDP per capita is a little bit less than USD 4000. I will be speaking more about this. And the current Standard & Poor rating is BB+, Moody's is BA1 and **Fitch** BB+ as well. First, I will start with the description of the political situation in Slovakia. The main message is that the political situation is stable. That is extremely important for all investors coming to the country. We had our last elections in September 1998 and since then a new coalition has been in power. We also had presidential elections and Mr. Schuster was elected. The current coalition holds 93 seats in the Slovak parliament, giving them 61% of all votes. (thus) we have a constitutional majority. Therefore, we really want to say that Slovakia is stable from the political point of view and is ready to accept FDI on the long-term base and perspective. These are the facts I just described. The next presidential election will be 2004, the parliamentary elections 2002. We think that last year Slovakia succeeded in doing a very remarkable turn-around and exceeded our ambitions. We are trying to catch up with the first group of countries trying to join the EU. In November 1999, we were invited to start negotiations, in February 2000, we commenced with some negotiations and, as of today, there are ten chapters that have already been concluded with the EU through these negotiations. We became an OECD member in October 2000 and we are a candidate for NATO membership, which enjoys broad political support across the spectrum of political parties in Slovakia.

You probably saw Slovakia's GDP on your screens in my colleague's presentation. You can see that Slovakia is very much in line with the countries around it, with Poland, Czech Republic, and Hungary here on the slide, except Slovenia, which is higher. As I said, the GDP is a little bit less than USD 4000 per capita. What is also very important is that it is dynamical GDP. As you can see, we have been experiencing rather strong growth since 1994. This has slowed down a little bit in the last two years, 1999 and 2000. This has changed also due to the change in the GDP calculation. We shifted from GDP growth based on the increase in foreign debt to GDP growth based on export growth. Speaking about exports, here is the breakdown by countries. What I think is important to say, is that 61% of (the) exports go directly to the EU and Switzerland and 91% of all export to OECD countries. So we are very well presented on these markets. Exports are up 14% on a year-to-year basis in January 2000. Inflation, a very important topic, has been declining steadily since 1993, there was only one jump in 1999. The reason for that is that we had (the) deregulation of the fixed prices for water and electricity. This caused a one-time jump, but we are coming back again. Government debt compared with (the) EU limit of 60%, we are very well below it. We are at 33% of GDP. The structure is 45% of foreign and 55% of domestic debt. We are working very hard to reduce this debt. As you can see, developments have not been very positive for the period 1994 to 1998. But, since 1999, the government of **Mr. Zorinda** is addressing this issue and we are reducing these numbers.

Unemployment is one of the remaining problems in Slovakia. As you can see, unemployment has been growing steadily since 1998. The reason for that is that the restructuring of the economy is running as we speak and, therefore, some jobs are being eliminated and, therefore, we are even more eager to invite more FDI to come to the country to create new jobs. As you can see, there are also special programs (that have been) introduced by the government, which we create beneficial public jobs to helping cut short-term unemployment to a level below the one you can see on the last slide.

I will not go into the details of the privatisation program. I'll just stress that it is running at full speed. In the summer, we succeeded with the privatisation of Slovak Telecom. Deutsche Bank is the investor who came at the very last stage of selling the major Slovak bank, Slovenska Sporitelna. We also have other investors coming to the country mostly trough portfolio investment as Globtel. This is a telecom company, where France Telecom is the investor and Steelmeal, where US Steel came as an investor in October this year.

This is a rather complicated chart. Due to the time pressure, I will not go into detail. You can find it in your file. The main message is that corporate restructuring is one of the top priorities of the government.

Let's now speak a little bit more about FDI. As you can see, the levels of FDI flows into Slovakia have been low. We are aware of that fact. We are lagging behind the countries around us, behind Poland, the Czech Republic, and Hungary. We are doing our best, and we are trying even harder to attract even more FDI. As you can see in the Bank Austria report, which is available outside of the room, there is a very nice projection by this bank of what FDI is expected to be in 2000 and 2001. This is the commutative FDI in the country. What might be important for you is take a look at the breakdown by industry. We consider it very important, because 47% of all FDI is dedicated to manufacturing. We strongly believe that Slovakia has a very strong history in manufacturing. We have highly skilled labour and most of the investors coming to Slovakia were very satisfied with the productivity and quality of their products produced in Slovakia.

Allow me to run a little bit faster through this part. Here are the top investors in Slovakia. They are named for your reference, so that you can in touch with them, share their experience in Slovakia, and to learn more by yourself. There is one where I will make a little stop. We feel that Japan has a presence in Slovakia, from the FDI point of view, but we think that the potential is much higher and we will strongly encourage Japanese investors to communicate with the investors who are already in Slovakia, because from the information we have from them, they are very satisfied and they are thinking of expanding their plants even further. Just to name them: **Jasaki-Didner** Slovakia, Sony, Matsushita, Panasonic, and Toyota.

As I said, we are lagging behind a little because the policy of attracting FDI has not been so popular between 1994 and 1998. So we have to catch up a little bit. Since 1998, the government introduced a proactive approach towards promoting and attracting FDI. We do this by introducing "incentive packages". The first of them was adopted in April 1998. It is the incentives investors can get today when they come to Slovakia. Again, there is a little bit more information than I have time to cover, so allow me to skip it. For your information, this is what the investor will be granted once in Slovakia, as of today.

The second incentive package was introduced in May 2000 and as we speak it is being reviewed by (the) relevant ministries in order to prepare it for the discussion in parliament. We will try very hard to have it approved by the government in January, February next year. Again, we are going (even) further in the conditions we would like to offer to foreign investors. These are the conditions, which have to be fulfilled in order to qualify. Let me just run very fast through this package. Basically, we are just trying to catch up with the conditions offered by countries around us. It is ten years of tax holidays, job creation subsidies, land acquisition subsidy, and a specific access to the industrial part programs, which we haven't developed yet, but we are moving very fast in this direction, infrastructure building subsidies, permanent local authorities assistance. We find it very important that local authorities do understand the needs of an investor and are able to address the issues that are important to the investors. And permanent SARIO assistance - SARIO as I said is the sister organisation of Checkinvest. We find it very important that an investor has one point where they can get all the help, find all the information necessary for them. This is an example (of) how the job creation subsidy will be working.

As you can see, we based it on the principle of unemployment, which is the major issue in Slovakia. Basically this means, the higher the unemployment rate in the region where the investor decides to place the investment, the higher the subsidy. By the end of 2001 we would like to have three to five industrial zones available in Slovakia. We hope to allocate them quite systematically through the country in order to allow the investors to decide where to place their investment. We will also introduce the **Institute of Memorandum of Understanding,** which will allow investors to have a very comfortable and secure situation, granting incentives in a written form. This document will be approved by the government and it will contain mutual obligations from the side of the investor and the government. SARIO, it is a freshly born child, it is an agency with the aim to provide services for foreign investors, as well as Slovak exporters, on the one-stop-shop principle, which promotes the image of Slovakia abroad. We understand that, when an investor is coming to the country, it is important for him to have someone who can help him in the pre-investment phase of his decision-making, to find all the proper information, to be able to communicate with the local authorities. All those services, all those things can now be done with this agency, which was created especially for this purpose.

The goals are three: to promote the image of Slovakia abroad, to promote and support FDI, and to promote and support Slovak exports. Again, I will not go into details for each separate goal i.e. how we will (or) would like to fulfil them. Please find it in your presentation, because I understand we are running a little bit short of time. As I said, the one-stop-shop principle is very simple. We are not trying to reinvent the wheel. We are very much trying to follow the example of organisations like "Czechinvest", for example. Again, this is a modal case of support for FDI investors. Those who are interested, please feel free to consult me later or find it in your presentation, which you have in front of you.

We feel very much, during the last few years, the growing interest of FDI investors coming to Slovakia and we are very happy about that. Plastigomenium is one of the companies, which is coming, as we speak, in these months. It is a greenfield project. They will be investing approximately 60 million Euro and creating 600 jobs. And there are the suppliers of Volkswagen who also decided to bring a project to Slovakia.

There will be a Colorado project, which you might be aware of. It will be a very large investment. Basically, it will double Volkswagen production in Slovakia. There is an interesting fact – Volkswagen from (a) statistical point of view have been practically doubling their production since they came to Slovakia in 1992. It is a very successful case.

Eisemann, Germany, brownfield project. They will be producing interior automotive components from leather and plastic. 6 million DM, 350 employees. Again, they are very happy with what they find in Slovakia.

Let's be more concrete and concentrate on Japan. For 2 or 3 weeks, I had the pleasure of visiting in Osaka, Japan and I had a meeting with a high representative of Matsushita. I was very pleased to learn that Matsushita is thinking of expanding their activities in Slovakia by locating their basically new production, which will create up to 1000 jobs. The size of the investment is not decided yet, but the decision has been already made. I am very happy about what Slovakia can offer. First of all, its skilled, available and competitively priced labour force. It is the lowest FDI in Central Europe. It looks like a disadvantage, but from another point of view, we might consider it an advantage. That's because we pay more attention to the investors that are coming and we are ready to go to great lengths in order to satisfy them, to attract them to Slovakia, knowing that competition is big.

We are back on track with all those processes that I covered in my presentation. We really think that (the) proactive approach is very important for investors, because they have the service, they have the information and they have the support in legislation they need. We are introducing competitive investment packages and we have (a) very good and long history of industrial production. And, basically, as you could see on the map in the very beginning, we are very close to (the) European Union markets.

Of course, you understand, that it's my job to promote Slovakia as well as I can, so you might be a little bit hesitant to say that what I said is one hundred per cent true. But I would like to show you a little example of how international markets view Slovakia. This is the chart where you can see the drop of the spread between German bonds and Slovak bonds during the last 2 years and we take the extremes as basically from, let's say, 360 down to 170. We think it's pretty dramatic and we think it truly reflects the situation in Slovakia and that is, I think, the most objective view you can have. We also have been wondering about what the opinion of foreign investors that are present in Slovakia is. So we asked them the question: "Are you planning to expand your investment in Slovakia?". I don't think the response needs a comment. In 1999, "yes" was the answer of 91 per cent of all investors. It means that they are satisfied, that they like what they find in Slovakia. I would like you to ask questions, if it is of any interest to you and to come and inquire yourself.

Let me reveal the secret from the beginning: "Slovakia is ready for FDI".

Ladies and Gentlemen, thank you very much. I'm looking forward to your questions.

Mr. Peter Havlik: Thank you, Mr. Sitar for your presentation, Gábor Hunya has (a) few minutes for a comment.

Commentator

Mr. Gábor Hunya: Well, Ladies and Gentlemen, if I don't have time, I would only like you to look at the publications I've written over the last few years about FDI in Eastern Europe. That is where my comment is written. Of course, it is very difficult to comment on such a diverse scope of presentations, some of them being more academic, others being more country presentations. You can see, there is a beauty contest going on in Central and Eastern Europe about who is getting more FDI. It seems that those countries with FDI in the beginning of the 90s concluded that promotion is not that necessary. You can see now, that the newcomers think that more incentives will give more returns.

Now I would like to make just a few basic comments on the more academic part. Many of the presentations showed you how much FDI amounts to in Central Europe, how much the inflow is, how much the stock is. Now, I, someone who is dealing with methodology, can tell you that one cannot compare between the countries, because very few of these countries can really follow the OECD and the aim of guidelines and really put together FDI statistics. So certainly, the data for Poland is almost two times higher than what we get when going by the internationally accepted methodology. It's also limiting our depths of analyses, because we are speaking, for example, in the case of Hungary, about the relationship between repatriated profits and inflow of FDI, but the inflow of FDI doesn't contain reinvested profits in the country. It should be there, it should be in the statistics, but it isn't, so we have a distorted picture in that way.

I think one of the most interesting issues is actually the balance of payments effect of FDI and here we heard how different approaches actually split up the whole picture, because we have in the current account a trade part, a services part, and (an) incomes part. Now, if we see only the incomes part, it is really showing that in more mature recipients of FDI you usually have new inflows of FDI, about two or three times higher than repatriated profits. This is more the case in Hungary. It is also the case in Austria.

So that is one thing. The other point that some of the papers presented is that there may be a foreign trade impact of FDI. Especially, when we observe quite a huge foreign trade gap in some of the countries during the time of fast inflowing foreign capital. That was the case in Hungary in the mid-80s, as well as the 90s, and that is the case now in Poland. And if you look at the export and import breakdown implemented by foreign and domestic companies, you will find that a major part, an over-proportional part of the trade deficit is accounted for by the production of foreign companies at this initial phase. So, it is not true that you have, you know, objectively given foreign trade balance, and then you have the FDI inflow, which is balancing it. No, it is the foreign trade deficit that is actually the largest created by the different behaviour of foreign investors. This is especially (true) in the initial phase of investments, when investors import the raw machinery, relying much more on foreign sourcing, At the more mature stage, especially in countries like Hungary, where you have more of the greenfield type of export-oriented investment, deficit to its graph is diminishing, for FDI projects are now producing export surpluses in manufacturing. So we have a decreasing-oriented gap here and we have expanding repatriated earnings, so that the current account impact is similar, but the content is different.

OK, I don't want to go into more details at this point. I just want to stress that FDI is a necessary part of the whole transformation process So let's think of the type of companies that existed prior to transformation. We have already seen in the privatisation debate yesterday that it is foreign investment that is bringing the necessary restructuring capacity and know-how capable of transforming the enterprise into a competitive one. There will be a very high dependence on foreign capital due to this. But one can really see very few other ways of succeeding to create an efficient economy in a relatively short time in Central Europe.

Thank you very much.

Mr. Peter Havlik: Thank you Mr. Gábor Hunya. Ladies and Gentlemen, now we have a coffee break after a very exhausting morning session, I would like to ask you to be here again in 15 minutes.

Session 4
Promotion of SMEs

Chairperson: Mr. Noriyuki Yonemura, Senior Vice President, Fuji Xerox Co. Ltd., Japan

Commentator: Mr. Masayuki Kondo, Professor, Insitute of Economic Research, Hitotsubashi University, Japan

Ms. Iren Petrounova

President
Agency for Small and Medium-Sized Enterprises
Bulgaria

Mr. Attila Torok*

Head of department
Ministry of Economic Affairs
Hungary

Mr. Ovidiu Nicolescu

Director
President of National Council of Romanian Private Small and Medium Enterprises
International Comparative Management Center
Romania

Mr. Józef Chmiel

Deputy Director
Research Centre for Economic and Statistical Studies
Academy of Sience (RECESS)
Poland

Ms. Iren Petrounova, Bulgaria
Promotion of SMEs

Mr. Noriyuki Yonemura: Well, we shall start Session Four with a very important subject that concerns us all - the promotion of SME. The first speaker is Miss Irena Petrounova from Bulgaria. Miss Petrounova is a senior staff member of the SME agency in Bulgaria. Please, take the floor.

Ms. Iren Petrounova: Thank you, Mr. Chairman. Ladies and Gentlemen, my presentation now will be a little bit different from the presentation I gave as a report, because that one is too big and I just want to focus on some very important things with regard to SMEs. That is because I do believe that the small- and medium-size enterprises are really a driving force for economies. And especially for countries in transition like Bulgaria, they play a really significant role.

First of all, I want to show you the number of companies that are considered small- and medium-size companies in Bulgaria. As you see, the number is growing every year and the total number of all companies is also growing. The only problem we had, when we had negotiations for (the) accession to the European Union dealing with the SME chapter, is that we didn't accept the exact definition of the European Commission. All the criteria were the same, but we accepted only 100 people for a medium-size company, because if we had accepted 250, the number of such companies would have been 99,9%.

* Mr Attila Török substituted Ms Eva Hegedus at the conference

So, you see, more than 90%. This is the official data of the employed people in medium-size companies, which is as you see 41,3 %. But actually, and I will speak about that later on. We have the so-called unofficial grey economy and although Mr. Stanchev is looking at me like this, I would say that a lot of people are actually involved in SMEs, unofficially. So, we do believe that more than 60 per cent of the working force in Bulgaria is (active) in SMEs and I also have to say that for the last three years, those are 1997, 1998, 1999, more than 130 000 new jobs have been created in Bulgaria .

Here you can see something about the sales income. As they said, officially, it's approximately 40%, unofficially, it's more than 50%. This is a small chart about the dispersion of different sectors of economy in Bulgaria. As you can see, companies in trade and (the) processing industry are most widely distributed in the country.

Why are SMEs so important not only for Bulgaria? The first thing is that they are really important for economic growth, because they are vital, they operate very well, and they can adapt to changes like those we have. Somebody mentioned the crisis last year in Kosovo, the Russian crisis, the Asian crisis, and so on. Our SMEs really adapted to these crises, although it was really difficult for them. Secondly, they are creators of jobs. Officially, we have a very high unemployment rate, approximately 17%, although I think that it is less. As I mentioned before, SMEs really create jobs, while big enterprises in Bulgaria, for the moment, don't create jobs. The SME sector in Bulgaria in 1989, in terms of private companies, was presumed to be very low. There were about 5% private companies before the changes, now we have more than 75%, and they contribute more than 60% of the GDP. What is very important for countries like Bulgaria is that small- and medium-size companies are a real factor for the political stability of the country. Maybe you know that Bulgaria has introduced a currency board, which is a major factor for the recent development of the country and for the fact that Bulgaria has reached a really firm macroeconomic stability. This is unbelievable if you have seen the charts of the foreign speakers in 1996 and 1997, because we had a huge inflation rate and since 1998/9 we have (been boasting) inflation (rates of) 2, 3, 4%, which is nothing compared to the data before. This macroeconomic stability is extremely important for the companies and especially for SMEs. Before 1997, there was no consistent policy regarding SMEs. We started with the development of (a) national strategy and a working program for implementation. We have also adopted a special SME law. I don't think that this strategy and working program are the best, now that I read them, and I see what we have done. Of course, we have to work very hard on new goals and initiatives. The biggest discussion was whether we needed incentives for SMEs and whether we needed special preferences or (if) we should create a favourable institutional environment.

Honestly speaking, when I listen to all the speakers, I see that they have introduced a lot of incentives for foreign investments. I'm really wondering why we didn't do the same, but I do believe that SMEs actually really need this environment, because very often I hear companies say "Don't do something for us, just don't destroy our efforts to work in this country." So we are really focusing our efforts on this environment. Here you can see some of the results of these strategies and laws. But what I think is most important for the SME sector is the improvement of the legal environment. We started negotiations with the European Union and the European Commission and we are actually creating new laws and amending a lot of the old laws. This is very good on the one side, because we have legislation, that is, let's say in line with European Union legislation. However, the problem is especially with SMEs, because the laws are changing so often and so fast that SMEs cannot follow the changes and the amendments and it's really a great burden. But I think that the future will be very good for them. What I consider to be most important is that the legislation should be very clear, extremely equal for everybody – foreign investor, domestic investor, SMEs, big companies, and so on - and it should also be very transparent.

We have a problem in our country because we have a very big (body of) secondary legislation created during these forty-five years. That's why we are working very hard on the administrative burdens, barriers, and all these licenses and permits that exist, because we can reduce, for instance, licenses. If the procedures are either very difficult, or they are not clear, or the SMEs cannot find them very easily, it's a big burden for them. We are now trying to create administrative structures and administration, which really work for the businesses in the country.

I think this is the biggest problem, because very often we read in the reports of the European Commission or World Bank that there is a high level of corruption in Bulgaria, and so on. Of course, everywhere, all over the world there is corruption. But I would not call it corruption. I would call it bureaucracy. I think this is the way the small person who is appointed to a position thinks. And sometimes they don't only treat the SMEs badly but also big businesses and normal people, just to show what the strength of their position is. That's why, I think, if we make the administrative procedures and the laws very clear and transparent, we will reduce a lot of the corruption or, let's say, bureaucracy.

I think that one of the major problems SMEs are facing now is access to finance. Access to finance was extremely difficult in Bulgaria, especially in 1996, 1997, 1998, because Bulgaria faced (a) huge bank crisis and we have closed a lot of banks. Also, because of the high inflation rate, as I said, access to finance was extremely difficult. It is still difficult, because of some very strict bank regulations. Besides, there are not many possibilities for companies to prepare appropriate business plans and to present them properly in the banks. That's why, of course, we worked very hard on this. The government created a bank called "Promotional bank". I am sitting in the board of the bank and this "Promotional bank" operates with SMEs. Of course, the beginning was difficult, but I think that we are working very hard now and much better than before. Now, let me tell you what we have created with this bank. In Bulgaria there is a lot of capital, but this capital is not accessible to companies on a long-term basis.

That's why we have tried to create some schemes for long-term investments of 7-10 years. And what is good for the companies is that we have also worked on exports schemes and schemes in tourism. So, I think, that we have been relatively successful in this aspect. Also, we have worked very hard with DBRD, EIB, and other banks, so there are other schemes, and Bulgaria is accessible for Bulgarian and foreign investors. We also created successful macro-credit schemes, so I think that in this aspect we worked very hard and it will, I do believe, be felt by the businesses very soon.

One point, which is very important, is access to information. I consider this program to be the biggest one, although businessmen don't think so. As I said, there is a lot of money in Bulgaria, there are a lot of programs, schemes, possibilities, and pre-accession funds, (such as) SAPART, PHARE etc. but people do not know the exact conditions. The problem is that the information is available, but they cannot find (a) way to it. So this is our goal – to create a special network between the SMEs associations, branch unions, and organisations in order to provide this information to the people. Here you can see that we work with existing training centres and soon we will work on original and branch programs and other development schemes. Also, in Bulgaria you can find the so-called "equity-in-investment funds", which is an interesting opportunity for people who do not have enough capital according to our bank law. I think, in the future, Bulgaria should use such "equity capital funds" not only for the development of (the) SME sector but also for other sectors such as high-tech and other progressive sectors.

One thing, which is not mentioned in my report, and I think it is very important, is education. We don't have special lectures in our schools and universities about the importance of SMEs. I mean not only SMEs, but I'm speaking about entrepreneurial spirit and culture, and I do believe we should focus on this, because it is very important to feel through education the free spirit of an entrepreneur who is contributing not only to his wealth but to the wealth of the country. Maybe you know that Mr. Romano Prodi said (that) the new goal of the European Commission was to provide every school in the European Community with computers and Internet access by 2002. I don't think we can do this in our country, but it will be a goal just to follow the changes.

Especially for business, the competitive issue is very important. Bulgaria is a small country and I don't think our companies are fully prepared for the accession to the European Union. When we speak about things like quality standards ISO9000, for example, there is really a limited number of companies in Bulgaria that have these certifications. That is important, because without these certifications they cannot export into the European Union. So you can see that there are a lot of things that should be done. We have to focus on high-tech development, and now we are working on technology parks and business incubators. The Parliament is discussing a special law on high-tech. We have many good specialists, and now, when Germany and Austria open their doors for high-tech specialists, they might leave Bulgaria and we'll lose them. As you know, a lot of money was put into their education, so it will be a loss to us.

I want to conclude and to say that I do believe that Bulgaria is working very hard on SME issues and that we have the support of JICA and other Japanese organisations. We have trained a lot of people in the centres of JICA and I want to thank (them) for this. I know that Japan has very good experience in SME development and we have adopted a lot of things. Unfortunately, we don't have enough money to apply everything they do, but I think that we are on the road to developing the SME sector.

Thank you for your attention!

A Japanese representative: Thank you very much Ms. Petrounova. I am very impressed that you have recently established an SME agency as a specialized organisation.

Mr. Noriyuki Yonemura: And the next speaker is Mr. Nicolescu from Romania. The task of Mr. Nicolescu is to present the National Romanian Assembly.

Mr. Ovidiu Nicolescu, Romania
Romanian SMEs

Mr. Ovidiu Nicolescu: Ladies and Gentlemen, more gentlemen than ladies, unfortunately. Let me first of all thank you for the invitation addressed to me. I'll present to you some publications regarding some very important subjects. Secondly, I would like to congratulate the organisers, because there is a special section for SMEs at such an important conference. Maybe the explanation is that the organisers are mainly Japanese and I know that there is a Japanese saying "Small is beautiful". We are pleased that the small and beautiful is reflected in our session in the very comprehensive subject regarding the transition to market economy. If the organisers of this conference had been Romanians, they would have used another saying, which reads: "It's not important to be the biggest, the most important is to be the best".

Now, I want to tell you that my paper is based on two types of approaches. I prepared this paper not only as a professor and a researcher in the field of SMEs but also as president of the most important governmental association of SMEs – The National Council of Romanian Private Small and Medium Enterprises, which has 68 branches across all (the) regions of Romania and thousands of SMEs.

The objectives that I'll try to attain in this paper are three. First, I would like to present to you a general overview of the Romanian SME situation. Secondly, I would like to reveal some important characteristics of Romanian entrepreneurs, because it's very important, when talking about SMEs, not to forget the main actors – the entrepreneurs. Each SME reflects the entrepreneurs. Finally, I will try to present some perspectives regarding the evolution of SMEs, taking into consideration the development and the evolution toward an integration into the European Union and what happened in Romania and also taking into consideration that our economy is evolving to a knowledge-based economy.

It is very important that, in the future, we don't only look at our situation and the international situation, but also at what is happening to (the) economy. And this evolution to a knowledge-based economy will create a lot of opportunities for business, which had not exist before.

My last preliminary remark is the following: My paper is not a promotion paper and for that reason you will find in it the difficulties we face. I think that such a conference in Vienna, with such distinguished participants, should first focus on (the) presentation of problems and only after this on (the) promotion of good performances. Here you have the general situation of Romanian SMEs in figures. In Romania more than 760,000 SMEs are registered . In fact, only 401,000 are working. The difference is due to the fact that in Romania it is more difficult to get out of a small business than to enter one. The bureaucracy is very complicated.

Secondly, I want to show you what the situation of SMEs (is like) in each of the major branches of economy from two point of views – from the point of view of turnover and from the point of view of employees. The figures are from the end of 1999. As an industry, SMEs generated about 35 % as turnover in 1999 and 36 % as employees. More recent statistics show that in 2000 the percentage of turnover is 52-53 %. Agriculture is presented almost only by SMEs. In construction, over 86 % for employees and more than 94 % for turnover. In trade for employees, more than 90 % and for turnover more than 60 %. Tourism and services are almost all privatised. This means that we can conclude that SMEs in Romania represent the greatest part in terms of turnover and employees in all the major branches of economy now. Whether this is good or bad, depends on what we are looking for.

Here we can see the situation regarding the repatriation of SMEs in different fields of activities. The situation is typical for all the regions. The majority share is in trade and services, after that come industry and construction.

Now, I have some figures regarding the dynamics of creation of new SMEs. If you look at these, you can observe a very interesting situation. We can see that there are two years in which the number of SMEs was really very high. The explanation is that there existed some very important incentives for SMEs in these years. After that, the number of new enterprises declined to a certain extent, but such a decrease is normal after the initial boom. You can see that, in the recent years, the number of newly-created enterprises is around 40 000 p.a. and I can tell you that for year 2000 it was almost the same. The preliminary figures for the first nine months of this year show that more than 30,000 new enterprises were created. If we take into consideration the SMEs that leave the business, we'll see that the rate of net increase is about 20-25,000.

Statistics are very important, but qualitative analysis is also very important. We established a list of negative factors for SMEs based on our analyses. I would like to emphasize some of them. One major problem in Romania is that we have a lot of space and equipment in private and state enterprises that is not used. There is a lot of capital, which could be very useful for SMEs. Unfortunately, this field is difficult to access. More important is the fact that SMEs have difficult access to credits, especially for investment and development. What's more, we have a high level of fiscality. Last year, it decreased to a certain extent, but if we look generally, fiscality is pretty high. One very important fact is that there are not enough incentives for investment and development and another one is that, in Romania, the attitude toward private SMEs is different from that to state and public companies. It's unofficial. Let's take, for example, the field of fees. If you were a state or public company, you would not pay your taxes, and if you were a private company, you would have to pay them. For that reason, the most vital state and public companies don't pay all their taxes and they have supplementary resources for development If a private company doesn't pay, they block its bank account. So you can see, private companies do not receive the same treatment as public or state companies. Some very large state companies have big debts to the Romanian budget and they use these means as supplementary resources, which is impossible for SMEs.

It is important to see the strengths, the main resources, and opportunities for Romania SMEs. There is a lot of space, (there are) a lot of buildings, a lot of infrastructure in Romania – in state and public companies - which is not used. According to some calculations, more than 40% of the state companies' space and equipment are not used and part of it is in pretty good shape. The Romanian entrepreneurs are another important Romanian resource. They are very hard working people. I'll show you later some figures based on empirical research.

Another important resource is education. The (level of) education of (the) Romanian population is very good and I'll link this with the good level of (the) teaching and training system. This is good from a certain point of view, while from another it is not so. I want to tell you that in Romania we have important collateral problems. For example, in the last two years, more than 50 % of the graduates in their third year at the informatics and automatic faculties in Romania left our country and emigrated to (the) USA and Canada because of their very good level of education. Thus Romania and many SMEs lost these resources. We also have some important natural resources and another important point is our relatively large internal market – about 23 million inhabitants.

Finally, I would like to present to you ... No, I will stop here regarding the general situation.

And now I want to present to you some general characteristics of Romanian entrepreneurs. What I am presenting here is based on empirical investigation carried out with the help of parent programs of (the) Chicago Institute and Polytechnic Institute of Cambridge University. I'll show you a selection of the characteristics of Romanian entrepreneurs, which are important for gaining a better understanding of what is going on in our country.

First of all, we have characteristics regarding age and sex. Most of the Romanian entrepreneurs are pretty young. More than 55 % of them are less than 40 years old. That shows that they are very active and that they have good prospects of development. As regards sex, three of four entrepreneurs are men and only one is a woman.

More important is the level of training. As we could see from the first figure here, more than two thirds of the Romanian entrepreneurs have university degrees. Some even have postgraduate training and that is essential for our development. If we look at their background training, we can see that almost half of them are engineers and a considerable part of them are economists, but, of course, there are also specialists from other fields.

That shows the fields of experience entrepreneurs have before they start private businesses. A majority has worked in industry, another part in trade, construction and services, but the most surprising fact, I think, is that more than 40 % of the Romanian entrepreneurs have not worked in the economic field. Maybe you would like to know in what field they have worked? I want to tell you. They were active in trade unions, in the Communist party, in (the) police, in the judiciary, and so on. What is the explanation for that? I think that this is typical not only for Romania. The explanation is that those entrepreneurs, during (the) Communist time, found other special fields to prove their entrepreneurial skills (in), like the organisations I mentioned above. I have to point out that we did some other investigations and they are very performance-oriented. I don't exactly know the methods, but they are very performance-oriented. They have more personal and family security, full self-achievement, and only at fifth position do we find, of course, higher earnings. It's a pretty good motivation and that is reflected in the performances.

We tried to find out how much they worked and the results have been very surprising to us, because, as you can see, almost half of them work more than 60 hours. And to work more than 60 hours weekly is pretty high. Also, almost 40% of them work between 41 and 60 hours and only a few of them work less than 40 hours. It was very surprising when we found out that the majority was active in industry. The explanation is that small business industries do not have enough capital to work all the time. They are good, they produce, but they partially use their time and resources because of (a) lack of capital.

And then, we wanted to see what their priorities for development will be for the next two years, how they see the future. We found out that their first preoccupation, their first priority is to add new products and services. After that, to sell on new markets, to improve their human resources, to hire new specialists, to improve their technical basis and management of international systems and to use professionals as consultants.

Finally, I want to present to you the results of another empirical survey that focused only on Romanian entrepreneurs who export goods. On the basis of this research, which was carried out together with Cambridge University, we prepared a robot portrait of the Romanian exporter. The portrait exhibits the following characteristics: the typical Romanian exporter is a married man, (an) engineer, about 46 years old, he has more than 26 years (of) experience in a company, on average he speaks two foreign languages, he intends to improve his training, on average he has attended two postgraduate courses, and has gained experience abroad.

Finally, let me present a few things to show you how the competitiveness of Romanian SMEs can be enhanced through innovation based on (a) political approach... we have no time for the perspectives, I guess.

Our approach is based on the following premises. SME problems are regional, dynamic, and interrelated. This means that we should have a multidimensional perspective. In order to have a good perspective, it is important to use a systematic approach based on at least three things: First, the specific conditions in each country. Second, the implication of internalisation and globalisation, and, third, though not last, recording of the knowledge-based economy.

It is important for Romania to pay attention to three main processes – the process of privatisation, the process of restructuring, and the process of SME development. These three processes are primary for the development of market economy. We want to emphasize this because, unfortunately, in my country, people pay more attention to privatisation and restructuring and less to the development of SMEs.

There is a very strong correlation between these processes. As regard the SMEs development, we have established some priorities and the most important is that we should create (a) favourable environment for SMEs based on a national strategy.

I want to emphasize that in order to be successful, it is important to have a vertical integration of the strategy. First of all, it's important to have a good economic national strategy and I want to tell you that the Romanian national strategy presented this spring to the European Union was very realistic. It is important to have a national strategy for SME development, but that's not enough. It is important to have a specific policy to enhance the innovation of SMEs. In Romania and other East and Central European countries it is worth paying special attention to SME in the high-tech field, because the future of each country depends mainly on the evolution of high-tech companies and it is important to have a specific policy to stimulate the innovations in this field. I had the opportunity to visit Japan twice this year. I was very pleased to see what the Japanese did last year and I think that such initiatives should be widespread in our country.

I'll ask you for one more minute. We have (a) strategy, but, at the same time, I think there should be some very concrete measures. For many SMEs, the first thing is to improve SME management, because entrepreneurs are very good from (a) technical point of view, sometimes very good from (an) economical point of view, but in the fields of management and marketing there are some problems. Secondly, we need to have financial stimulation, financial incentives. The experience of Romania and other countries shows that when you have incentives, there is rapid development in this sector, which is of interest to the entire population.

In Romania, we still have a few hundred large state companies that have not yet been privatised and, in my opinion, they are difficult to privatise, because not enough foreign capital has been provided. In this case, it is important to use the specific form of entrepreneurship – infrapreneurship. This means to develop a specific form of entrepreneurship inside large state and public companies, taking into consideration the role of information. The development of (an) information network, like the one initially launched at the OECD conference in Bologna, is very important. The problem of development of entrepreneurial culture is essential.

In order to help SMEs, it is important to have strong SME organisations. It is also essential for SMEs to have representatives in all (the) main governmental economic bodies. In Romania, most of the people who work in governmental economic bodies have worked in large state companies before, so they have the culture of large state companies but do not understand SMEs and do not pay enough attention to them.

Finally, I would like to tell you that the negotiations in the field of SMEs, the negotiations between Romania and the European Union have already started. (The) European Union considers Romanian regulations for SMEs good, but, unfortunately, not all (the) laws are (being) applied. I could tell you more, but finally I would like to tell you only two things. First, the Romanian SME sector is the most dynamic sector, despite the fact that it sometimes faces difficult problems. Second, there is a big potential in this field, and now we have a very clear vision of what should be done. In order to do what needs to be done, the existence of international cooperation and international exchange of information is essential.

Thank you very much.

Mr. Noriyuki Yonemura: Thank you very much, Professor Nicolescu. I didn't realise your people were working so hard – entrepreneurs working 60 hours a week. I will introduce the next speaker from Hungary. Originally, we expected Miss Eva Hegedus, assistant at the Ministry of Economic Affairs. Unfortunately, she cannot participate. Instead we have Mr. Torok, head of (the) department, Ministry of Economic Affairs and Financial Development. Thank you very much, Mr. Torok.

Mr. Attila Török, Hungary
Small Business in Hungary

Mr. Attila Török: Ladies and Gentlemen, it is a great pleasure for me to have the opportunity to give(you) an overview of small businesses in Hungary. And, first, briefly, I would like to present to you some basic facts about the Hungarian economy itself. As you can see on this graph, the economy has been growing quite fast since 1994. The average growth rate is around 5 %, and although this pace is quite fast, the GDP per capita is about one half the average of European Union countries. I suppose you (have) heard more about capital investments in Hungary in the previous sessions. I suggest (adding) one (more) chart. You can see that Hungary was quite successful (in) attracting FDI. If we measure it per capita, it is the highest in this region and it surely contributed to the acceleration of growth.

In recent years the restructuring of (the) economy has caused huge changes in the ownership structure of the economy through capital investment. You can see that about 80 % of the production companies are now owned by domestic companies and foreign owners and the share of the state is only 10 %, whereas it was 50 % in 1992.

The next chart shows the integration of Hungary into the European Union. It's about the export structure, and you can see that, last year, more than 80 % of Hungarian exports were directed to developed countries. From this amount, more than 75 % went to the European Union. It's even a higher figure than the that of some European Union member countries. And now I turn to the SMEs and I start with the definition and there are two conditions. One is about the staff. The staff should number less than 250 and the turnover should be no higher than four billion forints, which is about 15 million euros. We call companies with a staff of less than 50 small enterprises, and those with less than ten people micro-enterprises.

So, the importance of SMEs is based on different points. Maybe the most important thing is that they employ the majority of the work force and the other thing is that they are quite flexible because of their size, so they can meet specific market needs and some of them have special novelty potentials.

That's just an illustration of the first factor, so you can see that more than two thirds of the employees are employed by SMEs and 36 % are employed by very small micro-companies. There is a similar chart on GDP distribution. Here the situation is more balanced, because half of the GDP is created by large companies and the other half is created by small and medium micro-companies. There are some typical problems of SMEs, which are, I suppose, quite similar in all the countries of this region. The most important is the lack of financial resources and the other which is linked to that – the low amount of sets, which can be, used to secure, for example, loans. And, as the professor from Romania said, mentioned, sometimes the management skills are not so good in these companies.

As I said, the limited access to financial resources is perhaps the biggest problem. In the case of bank loans, it's obvious that the transaction costs are proportionally higher because of the small size. Besides, these companies usually don't have (a) very long history, so it is an additional business risk. There is a sort of special thing, which may not be the same in most developed countries, and that is that the law statements sometimes reflect lower profits, because these companies sometimes try to avoid taxation.

However, the importance of SMEs is obvious. So there are some direct and indirect ways for the government to support these companies. The direct way is through different kinds of support for the budget. One form in Hungary is the so called "economic development budget appropriation", (of) which half is intended to support manufacturing investments. These are usually not such small investments – about 50 million forints. So, last year, the SMEs had one third of this support. This is non-repayable assistance (for) up to 20 % of the investment. There is also a budget appropriation, which is especially devised for SMEs. It's financed by the budget, and there is co-financing by the PHARE program. It has three main goals, and one is interest subsidy for investment loans. It is also possible to get interest subsidy for leasing advanced equipment so all companies can get the newest technology. The last part is the small enterprise credit program, which I will mention in details later .

And these are the institutions that provide the financial support for small businesses in Hungary – the Hungarian Foundation for Enterprise Promotion, the Credit Guarantee Company (and there is a similar company which concentrates on agricultural credits), the Hungarian Export and Import Bank, and the Hungarian Import Export Credit Insurance Companies. They concentrate, of course, not only on SMEs, but there are also some special facilities that help SMEs find international partners to sell their products (to), and the last one is the Hungarian Development Bank.

I would like to mention briefly some facts about these institutions. First, about the Hungarian Foundation for Enterprise Promotion. They have a rather wide range of activities, which includes some advising, but I would like to concentrate on the financial activity. They have quite a popular facility called Microcredit. It's for very small companies, micro-companies, and the amount of the loan is limited to three million forints. The interest rate is the national bank base rate, which is comparatively low, compared to that of bank loans. The SMEs must have 20 % own source for that loan.

The next one is the Credit Guarantee Company, which mainly supports small enterprises. In case of small loans (of) up to ten million forints, they can give (a) guarantee for 90 % of the loan and what is really important for the small companies is that the process is very fast. Usually, they can decide in five days, in one week practically. The fee of the guarantee is also quite low. It is 0.5 %, it is negligible.

The Rural Credit Guarantee Foundation was created about ten years ago with PHARE aid. And in this case the size of the loan can be greater. It is especially for agricultural activities, for companies with (a) maximum staff of 25 people. It is re-guaranteed by the budget.

(The) Hungarian Export and Import Bank helps with the small and not so small companies in three different ways. They can refinance commercial bank credits for export promotion. They can give credit to foreign banks with clients intending to purchase Hungarian goods and they can also give direct credits to their clients.

Just two more slides. The (role of the) Hungarian Development Bank is a little bit different. They can give loans to SMEs to create jobs, and these activities are refinanced by European sources. They can give special loans for investment in industry and tourism, which is also refinanced by the European Investment Bank.

I would like to mention two more things, which have not been included in the printed material because it is not completely official at the moment. In the Ministry of Economic Affairs we are working on two more facilities, because in the case of small companies, even if the government gives a guarantee for the loan, banks do not want to give (a guarantee) because of the high risks. In this case, the only way is to provide capital to small companies. And now we are trying to create two kinds of facilities. One is a combined facility – loans and capital. For this purpose, we have created a company, which is owned partly by the ministry and partly by several Hungarian banks. They can provide capital for relatively small companies, but not for completely new companies. Completely new companies are in an extremely difficult situation and in their case even venture capital funds are reluctant to give capital. We are also planning to introduce a new system for these cases next year. For both facilities, we use examples that we examined in Japan. So I would like to thank JICA, because I personally spent some weeks in Japan earlier this year.

Thank you for your attention.

Mr. Noriyuki Yonemura: Thank you very much Mr. Törok for your precise explanations about what you have been doing in Hungary. The next speaker is from Poland Mr. Chmiel. Mr. Chmiel is a deputy director of (the) Research Center for Statistics and Economic Analyses of Poland.

Mr. Józef Chmiel, Poland

Problems of Development of the SME Sector in Poland during the 1990s

Mr. Józef Chmiel: When observing the development trends of (the) Polish economy in the years from 1990/91 to 1997 one can clearly distinguish two subperiods. The first one encompasses the years 1990/91 – 1994, when, after the introduction of the principles of market economy, industrial production of state-owned enterprise started to decrease abruptly. The complete liquidation of a large number of state enterprises and the decrease in production in average-sized companies led to an increase in the unemployment rate from 6.5 % in 1990 to 16 % in 1994. The stage of transformation taking place in the years, 1990-1994, was characterized by the rapid growth of the number and the significance of SMEs, primarily in three domains – trade, construction, and manufacturing - the growth of which was limited to a couple of rather more traditional branches. The direction of development of (the) SME sector in the years of transformation is, of course, not a surprise. The period of real socialist economy came to an end in our country. And (the) unfulfilled demand for rather elementary products and services started to be fully satisfied by private SMEs, which were more flexible than large enterprises.

The SMEs occupied the appropriate markets, especially the markets where the technological processes were not too complicated, the capital required for the establishment of an enterprise was not too high, and the possibility of satisfying local demand made production profitable.The earliest stages of transformation of (the) Polish economy ended more or less in 1994. The Polish economy began to grow at a rapid pace. The investment outlays born by the SMEs rose from USD 3 300,000,000 in 1994 to almost USD 7,500,000,000 in 1997. This was caused, in particular, by the intensive inflow of foreign capital. In the new economic conditions, the role of the SME sector changed in comparison to the preceding period. This, however, did not slow down the development of the SME sector, but contributed to the change toward SME expansion.

The number of actually functioning SMEs, the so-called active SMEs, increased in the period 1994-1997 by slightly more than 40 %. Yet, in particular, the domains of economic activity, the rate of increase of the number of active SMEs differed significantly. Generally, we can say that, (in) the years 1994-1997, the rate of increase of the number of SMEs in the traditional domains of economy, like manufacturing and trade, was significantly lower, while it was much higher, in relative terms, in areas with a domination of services.

In this picture, the red line represents the whole SME sector and the pink line and the blue line industry and trade respectively. You can see that these two lines are below the red line. This means, of course, that the rate of growth in traditional sectors was lower than the whole services sector.

In the years 1994-1997, the number of active SMEs in typically service-oriented sectors of economy, namely in state and business services, increased by 65 %. This section provides services to other firms in such areas as technical leader counselling, marketing, management, and computer services. It is commonly pointed out by the specialists dealing with the role and the significance of SMEs that, in the economy of long-term development, especially of small enterprises, (the) modernization of very rare functions is not possible without a strong sector of firms providing services to other firms.

The significance of (the) SME sector for the Polish economy can be easily assessed on the basis of data concerning employment. The number of unemployed people in the enterprise sector increased in the years 1994-1997 by 5.7 %. Yet, while the number of people employed in large enterprises decreased by 7.2 % in that period, the number (of) people employed in the SME sector increased by 15.1 %.

As can be concluded from the presented data concerning employment, SME jobs were not only secure in the years 1994-1997, when a lot of people lost their jobs due to the restructuring or liquidation of large state-owned enterprises, but SMEs also created new jobs (for) those in a young and productive age.

Due to this, (the) unemployment rate, (which had) amounted to as much as 16.4 % in 1993, had dropped down to 10 % by 1997. Simultaneously, in the same period, the contribution of SMEs to the GDP value has been increasing, reaching a rate of over 45 % in 1997. The gross value added produced by the SMEs has been increasing more rapidly than that produced by other economic agents, including large enterprises. It was precisely due to the activity of SMEs that the value of GDP calculated in constant prices was more than 26 % higher in 1997 than 1990, and it was even higher than in 1988, the year considered to be the best with respect to the period of real socialist economy.

Now, some words on the state of the SME sector in 1998. In 1998, the economic situation in Poland worsened somewhat in comparison to the preceding years. The GDP in constant prices increased in 1998 by 4.8 % while in 1997 it increased by 6.8 %. The primary cause of this worsening of the economic situation was undoubtedly the financial crisis in Russia, which took place in August 1998. At the end of 1998, the number of active SMEs totalled at least 1,722,000. The number of active SMEs increased in 1998 by 9 %. This rate of growth in 1998 was two times lower than the rate in the preceding years. You can see 9 % in 1998 and 18 % in 1997. There is an essential decrease in the rate of growth of SMEs in the majority of the domains of economy, with the exception of manufacturing and transport.

You can see the pink and the brown lines. At the end of 1998, the number of people employed in SMEs amounted to approximately 5,890,000. The SMEs secured jobs for almost 65 % of all employees in enterprises. At the end of 1998, the number of people working in enterprises was 0.4 % lower than in December 1997. This lapse in the upward trend of employment in enterprises since 1994 was brought about by the decrease of the number people working in large firms, which was not quite compensated by the increase of the number of people employed in SMEs.

As I mentioned before, the value added produced by SMEs in 1997 equals 45 % of the GDP In 1998, the share of SMEs in the GDP was above 48 %. The regional setting of SMEs is a very important problem. The potential of (the) SME sector in the individual Polish provinces is characterized by the number of SMEs per 1,000 inhabitants. On a very high level of generalization, it can be said that the indicated value decrease toward the East, with the location of the Vistula River, which clearly discriminates with respect to the number of SMEs per 1,000 inhabitants. The location of the Vistula River is approximately there.

There are a number of voivodships, for instance (the) Lublin voivodship, the Subcarpatean voivodship, the Warmian-Masurian voivodship, or the Podlasie voivodships, where the number of SMEs per 1,000 inhabitants varies between 33 and 36. At the same time, in the Masovian province, where the capital of Poland is (located), the indicated value was 56 per 1,000 inhabitant and for the (entire) country the average number was 45.

At the end, I will discuss the areas of SME development. In spite of (the) higher rate of growth in the number of SMEs in the years 1990-1997, the SME sector is in fact encountering several obstacles and limitations to its development, which can be overcome due to (the) advantageous economic situation. As I have mentioned already, the economic situation worsened somewhat in 1998 and there is nothing that would indicate any initiating progress. Various obstacles are encountered by entrepreneurs and faced by SME owners and that limits the growth of (the) Polish economy. These obstacles are harder to overcome than those in the period 1995-1997. The numerous surveys conducted recently indicate the existence of multiple barriers countering the development of the SME sector. The entrepreneurs usually mentioned high taxes first as a main obstacle for SMEs, followed by low demand, complicated financial and legal regulations concerning the principles of conducting business, and (a) lack of cheap credit. The fifth rank is occupied by (dis)advantageous policy conducted by the Government with respect to SMEs and (the) lack of support from local authorities. The subsequent obstacles mentioned by almost exactly half of the entrepreneurs are unfair competition on the side of large domestic and foreign firms, (a) lack of information about the influence exerted by the integration of Poland into the European Union and the situation of SMEs, and the difficulties in acquiring valuable skills and policy.

In my opinion, the (present) lack of access to inexpensive credits, in combination with high taxes and labour cost regulations are disadvantageous for the employees. They are the main obstacles for the development of the SME sector under the general economic conditions, which are not good.

Now for my concluding remark. (The) Polish economy on the threshold to a new century faces two great challenges. The first is to respond to the competition of a uniting Europe (and this) in connection with Poland's expected accession to the EU. The second challenge is related to the necessity of securing jobs, especially for the young of the demographic boom of the 80s, (who are now) entering the labour market. The experience of Poland and other countries demonstrates that new jobs can now be created virtually only in the SME sector. Hence the question arises, whether Polish SMEs will be able to cope with the conditions of a generally unsound economic situation and under the pressure of SMEs from European Union countries. The Polish SMEs might not be able to stand up against the challenge without more extensive support from the Polish government and the local authorities than that extended until today. Thank you for your attention.

Mr. Noriyuki Yonemura: Thank you very much, Mr. Chmiel. Now we found that quite similar objects are emerging in this region. Now I call for a comment, Mr. Masayuki Kondo from Japan. Mr. Kondo is professor in Kochi university.

Commentator

Mr. Masayuki Kondo: Thank you, Mr. Chairman. I now belong to the Graduate School of Entrepreneur Engineering. I hope the name of the school is new to you. The name conveys the atmosphere in Japan. Now, the Japanese government is trying to create new entrepreneurs. Today, all speakers who presented data mentioned financial issues. Of course, finance is important. It's like the blood for the human body. Some presentations also referred to governmental procedures and regulations – something like that. And what is related to that field issues. Now, think of boxing as a metaphor. Let's say you have a boxer – in our case little finance – wearing fancy pants and (with a) nice guard and the fighting ring and the rules are very well established. What happens if that boxer is not skilful. He is just lousy and he would be knocked down very soon.

So now I think you understand the importance of technology. Some companies, who presented themselves yesterday, told you that comprehensiveness relies on technology. As for the presentations, I believe Professor Nicolescu presented very comprehensive strategies and related policies. Ms. Petrounova also referred a little to (the) technical policy issue in the promotion program. Mr. Chmiel didn't talk about the entire issue of entrepreneurs – about the technology issue of SMEs. Mr. Török did not mention technological issues exclusively, but I read a very good brochure on Hungarian SME technological policy. (The) Hungarian government is struggling to support SMEs in their technological development.

Now back to my slides. So, finance may be essential for survival, but stage technology is also very important for survival. If SMEs want to be superior on the market, they should know that technology is very important, essential, I would say. I believe we have a consensus that SMEs are very important for the national economy. That is partly because SMEs constitute an import industry, the export industry, etc. and partly because SMEs are a force of employment opportunities, economic prosperity, etc, etc. However, the bottom line is to survive, simply to survive and prosper. It must be complicated globally.

Unfortunately, as far as Japan is concerned, we were very fortunate, because at that time we were able to close our markets and provide subsidies. Now, providing subsidies or establishing a trade barrier is less and less welcome and accepted in the international community. So, what shall we do? Yesterday, some presentation mentioned labour productivity. First, I would like to speak briefly about productivity. The OECD uses a different terminology.

So, without increasing capital and labour, the question is how to increase output, or value added, or GDP, or whatever. The solution is, of course, technology. And when we think about labour productivity (small Y), (any) increase is determined by technological progress and also by the increase of capital. When Krugman talked about the future of East Asia and the economic development of the region she was quite right, because the development of East Asia at that time was mostly due to a capital increase. Of course, some argue that the data she added were misleading, but essentially she was right. So, in this regard, technology is also important and we again ask ourselves what shall we do? For technological development we need several frameworks and some institutional development as well as finances. Human resource development is also needed, but I would like to make two comments on the technological policy. One, is that (the) technology policy paradigm is shifting like this. I don't have enough time to explain all that, but you can take a look. The second comment is that technical policy depends on the stage of development – different countries, different standards.

So you must be very careful when formulating technology policy, but I believe that your countries have a very high level of technology, (a) high technology development potential and, also, (as) many presentations have mentioned, you have (a) good education system. And I'll give (you) more good news. This is the graph for Japan. At the medium stage of economical development, technological progress is usually achieved easily and maybe in the process of developing your countries your gains will be smaller and smaller. But when you form the right technological strategy, you will gain a lot. Thank you for your attention.

Mr. Noriyuki Yonemura: Thank you very much. I encourage your contribution. We have (a) few minutes before lunch and I'll ask one or two people to comment and ask questions. Yes, please.

Questions, comments

Mr. Ikufumi Tomimoto: Thank you very much. My name is Tomimoto from (the) JICA office and, first of all, I would like to (express my) appreciation (about) your participation and contribution to this rather important conference. My question is for Mr. Török and Ms. Petrounova, respectively from Hungary and Bulgaria. Since most of you attended the JICA training course in Japan on SME promotion, what do you think about the applicability of Japanese policy for SME promotion to this year's country setting? The reason I ask this question is that there are a lot of debates inside the Japanese Aid Community about the applicability of the Japanese model to European countries. It is somewhat different from the approach of the World Bank and some Western donors that mainly promote the private initiative, while, according to the Japanese model, actually, governmental sectors are involved in many activities for (the) promotion of SMEs. So what do you think about the applicability of the Japanese model to the actual setting in your own country?

Mr. Noriyuki Yonemura: Thank you very much! Please give your short answers.

Ms. Iren Petrounova: Actually, I think the courses are very applicable, although the situation in Japan and in the other countries is not the same. We learned (about) the history of SME promotion and that was very important, because we now understand where and why it was successful or unsuccessful. Some mistakes were made. I could mention (the) textile industry in Japan, which was promoted despite China's strong competition, and so on. So, I think that it is very useful for us, especially when you speak about subcontracting, large companies, small companies, and the whole development of the system is very useful, although we cannot apply all the things concerning guarantees, credit lines that you have in Japan. Thank you.

Mr. Török: I think the situations in Japan and in Hungary are clearly not the same. In Japan, there is a well-developed financial system, different kinds of financial institutions to help SMEs, and we cannot do the same. However, there are different things that we tried to use in Hungary. For example, in Japan I observed that there are different kinds of institutions that provide financial and management advice and different kinds of such services. This policy exists in Hungary, but we have to develop it. That's one area. There is another area, which is also not so expensive, and we can apply it. (The) creation of different computer databases, which can be used through (the) Internet to build financial connections within SMEs and also between SMEs and foreign companies. There are some other things. For example, the Just-In-Time method for subcontractors, which is maybe a big potential in Hungary, but it depends on several technical factors and (on) how exactly subcontractors can determine their production. I think, in general, it was useful, even if we obviously cannot apply all the techniques.

Mr. Noriyuki Yonemura: OK. I think there's one more question.

Mr. Hiroshi Togo: Togo from Japan Bank for International Cooperation. Well, my question is a little bit similar to the first question, but from a different angle, as a financier. We are supporting SME development by providing (a) policy in the various countries based on two steps. When I meet with my customers and discuss the topic, honestly speaking, I am very confused about the definition of SMEs and its meaning. Well, (the) objectives of SME policy and (the) business scope are unclear. Our operational program and type of intermediary financial institution might be different, based on this scope of business and SME policy. That brought about discussions. The objective of the first SME development support is to create jobs and to encourage entrepreneur objectives, which cover the whole sector, including the service sector. And the second discussion is a narrower discussion. SMEs are defined as a supporting industry in the manufacturing sector and at the same time they are considered an FDI incentive. So, today, I would like to ask the representatives of the countries the following question : In what field is the main objective of the SME policy? And also - what are you focusing on when you consider the SME definition? Thank you.

Mr. Noriyuki Yonemura: And again, please be brief.

Ms. Iren Petrounova: Professor Nicolescu does not want to answer the question. As far as I got the question, you asked me about the strategy of development and support for SMEs in the country and I think that we already answered that. The most important thing is to create a favourable environment. Every one of us adopted the SME definition of the European Union and the following criteria: employees, number of assets, turnover, and independence of the companies. So I don't think that the biggest goal is to create employment only, because SMEs also contribute to economic growth and the GDP. I think the fact that they contribute 99% of all enterprises shows that their development is very important and so is every aspect we have spoken about, access to credit, information, training, and so on. You even said that you had problems with SMEs coming to the bank and explaining their needs. This is also a goal for the development of (the) SME sector and we are working hard on that.

The tax policy is very important and, as regards SMEs, we are trying to decrease taxes, because we do believe that if they have more money available, they will invest in long-term assets, and labour productivity will grow, and that will be for the benefit of the country.

Mr. Ovidiu Nicolescu: I want to make only a few remarks. In Romania we have elaborated, as I already mentioned, a special strategy for SMEs. This strategy for SMEs is based on two things. First we identify the weaknesses of the Romanian SMEs, we identify the strengths of Romanian SMEs, we identify the opportunities and the strengths of the environment of Romanian SMEs and based on that, we project a strategy, which contains eight objectives and twenty-one measures. We think that this strategy is pretty good. But there are two things. First to establish a correlation between the SME strategy and the national strategy, and there are some problems with that.

And, second, as my colleague from Bulgaria said, it is very important that we start to implement the strategy in a very systematic way, based on the priorities that have established it. Of course, in this field some international implications, like transparency, know-how funds, should be very useful. For example, in my country, we should be interested in the possibility of sending some of our specialists to the JICA courses in Japan. So far we have not done so. Thank you very much.

Mr. Török: Just two more sentences. In Hungary, our problems are slightly different, because as I told you, we attracted quite a lot of FDI capital so that now the result is almost a new economy. One part is very developed and the other is less developed, therefore, one goal of the SME policy is to help smaller companies to become subcontractors and to have the technology transferred to smaller companies. Reducing unemployment is not a primary goal, because, actually, the unemployment rate is 6.3 %, well below the EU average. Thank you.

Mr. Noriyuki Yonemura: Thank you very much for your patience. Please join me in thanking the speakers. Thank you very much. And now lunch is served in the next room. We'll start the next session at two o'clock. Thank you very much.

Session 5
Roles of Government and Private Sector

Chairperson: Mr. Shinji Fukukawa, Intellectual Collaboration Group, Japan

Mr. Masatake Wada

Professor
Teikyo University
Japan

Mr. Valentin Pavel

Director
Asia and Oceania Division
Ministry of Industry and Commerce
Romania

Mr. Masatake Wada, Japan
The Selection by Market and the Role of Government

Mr. Shinji Fukukawa: Welcome to session five, during which we are going to discuss the role of the government in the private sector. I am very pleased that we can welcome two excellent speakers. The first speaker is Professor Masatake Wada from Japan. He is professor at Teikyo University, Department of Economics in Japan. He worked as an advisor for the Polish government for the last three years and, I should say, he is half Polish. And so, of course, he is going to speak about the experience of (the) Japanese administration, because he worked for the Ministry of International Trade and Industry for nearly thirty years, but his presentation and remarks will represent the Polish view also. Professor Wada, please.

Mr. Masatake Wada: Thank you, Mr. Chairman. I worked for the Polish government for three years and, personally, I like Poland very much, but today I want to make a comment as a third person from an Asian country. Anyway, I spent three years in Poland, from March 1997 to March 2000, this year. As an advisor of the Minister of Economy in Poland, I advised on industrial policy-making. I also worked in the Japanese government for many years, as the chairman just introduced me, and I was involved in making and implementing industrial policies.

My stay in Poland gave me a great chance to re-examine the role of government in free market economy, and my conclusion is that the government has an important role, as far as the national economy is concerned, when the private sector has not been developed strongly enough. I think this is the exact situation in the countries in Central Europe. And the government, in such a situation, should have a clear future vision for the economy and keep a strong will in realising this vision. When the private sector is not strong enough, the government should supplement the role of the private sector in the economy and make up for its weaknesses.

A heavy dependence on the choice of markets may sometimes bring us unexpected and unfavourable results. This is my brief conclusion but, anyway, after the economic reform in 1990, the Polish government adopted the typical classical free market system as its economic framework. The role of the government in microeconomic activities was reduced drastically. So, what happened in Poland after the start of the new liberalisation policy and what is the result of the market's decisions? Is it a desirable one, one that the Poles expected?

Today, I would like to discuss some changes in the Polish microeconomic structure under the free market economic system, (which have occurred) in the past ten years, from the point of view of industrial policy, and I'll pick up five subjects (the) change of industry structure, (the) change of industrial organisation, (the) choice of foreign investors - what industry sector the foreign investors would prefer and choose - the market conditions for SME development - I would like to stress the importance of the sector approach for SME development - and R&D activities in Central Europe after liberalisation.

I'd like to start with (the) industry structure. What happened to the structure after liberalisation, especially in Poland? Polish industry structure has changed since 1990 and the share of the manufacturing industry and development of trade, finance and insurance and service industries is shrinking. This kind of change was (only) natural under the new economic circumstances, because the new economy needed to develop these industries and, therefore, a lot of business changes were introduced in these fields.

Secondly, in the structure of the manufacturing industry we can see the reshaping of the old structure, which had been based on heavy industry. The industry of daily-required goods and durable consumer goods started to develop rapidly (only) later. But I'd like to examine the more precise analyses of what happened in some specific industries. I just want to pick out the textile industry as a model. What kind of structure changes can be observed in the textile industry? Before the economic reform, Polish textile industry had a full-scale supply structure It imported cotton and wool as raw materials, spun them to thread, after that it knit and sold clothes and other finished textile products. Poland also had a textile machinery industry, which could supply the necessary machinery for domestic needs. However, this structure was dramatically changed. Now, the fully sustained structure has changed. The textile companies import thread and cloth and concentrate their activity on knitting and sewing. Nevertheless, the domestic market for clothes has been taken over by cheap imported goods, so that top Polish manufacturers have to export their product to the European Union market. Unfortunately, the brand names of top Polish manufacturers are not established in the market and they do not have strong sales channels and networks on the market either. This means that they have to depend on (the) OEM system under the brand names of foreign famous upper companies.

As for textile machine industry, they lost their domestic market for spinning and weaving machines because of the reduction of market (size). And as for the sewing and knitting machines, they cannot compete against imported ones and are giving up the domestic market too. This means that (the) Polish textile machinery industry has almost collapsed in these ten years. This structure change in textile industry is attributable to the liberalisation of foreign trade and this policy caused (the) Polish textile industry to find its new position in the liberalised market.

I think that Poland abandoned the well-established, self-supplied system and also that the textile industry selected only the knitting and sewing part out of all (the) textile-related industrial activities. I think that this is the reality of market choice and that (we have) a new division of labour in the Polish textile industry under the free market system.

It is very difficult to evaluate this change. Is this change good or bad, favourable or unfavourable for the Polish industry? Probably the Polish people should decide whether this is good or not, but I personally think that the change in industry structure is not good for the future of top industries in Poland. If the top industries in Poland want to be competitive on the world market, they should be supported by the supporting industries, like the sewing industry, or spinning industry, or machinery industry. However, they abandoned these peripheral activities and they only went for the sewing and knitting activities Anyway, I don't want to evaluate this change in industry structure.

The second issue I want to introduce is the change in industry organisation. Industry organisation has also changed greatly. The monopolistic supply system had to disappear and (a) competition policy was introduced. Before the reform, competition in the market had been deliberately avoided. Foreign trade was strictly controlled. This kind of non-existence of competition had been gradually changed in the 1980s.

(The) industrial association was resolved and many of its members found themselves outside of the association's control and, furthermore, each factory subsumed in one and the same company also became an independent company. The market was thus divided into small pieces and the companies could not gain scales of production.

Today, it is said that one of the most urgent problems to be solved is this fragmented industry organisation in Poland. They are wondering how the fragmented power companies, sugar factories, vodka factories, construction firms can be consolidated for survival under the current severe market conditions. From the view point of Japanese industrial policy, how to form the desirable industry organisation, is one of the most important subject (matters), and, in the case of Poland, the government did not take initiatives in this area and depended on the market's choice. This means that foreign companies will decide the future of Polish industrial organisation. The Polish government was not able to establish a clear vision of (the) industry structure. Contrary to that, foreign investors have their own clear strategy to gain a substantial market share in (the) Polish market.

The markets of many industry sectors such as cement, beer, sugar, and some chemical products are already divided and controlled by foreign investors. Anyway, I just wanted to say that the Polish government did not take any initiatives, from my point of view, to make desirable, from my point of view, industry organisations by themselves, and the market's choice (did) bring this kind of reality.

The next subject concerns the industry sectors preferable for foreign investors. We discussed foreign direct investment (FDI) in the morning session, and the importance of FDI for the development of the economy is very clear. But sometimes they have a preferential selection for certain industry sectors. So, again, if we depend too much on FDI, the future industry structure will be defined by the choice of foreign investors.

Today, it is thought that FDI is the best way to solve economic problems such as (the) lack of capital for modernization, obsolete technologies, weaknesses in marketing, old management system, and so on. FDI can offer all the necessary resources for modern management in a package. The Polish economy came to depend on FDI for economic modernization. Especially since 1994, FDI in Poland has been growing gradually and, for the last two or three years, Poland attracted the largest foreign investments among Central European countries.

During the early 90s, FDI in Poland was dominated by small- and medium-size companies from neighbouring European Union countries, but after the economy became successfully stabilised, foreign large companies began to invest in Poland. At first, in the fields of daily necessities such as beer, tobacco, fast food, detergents, confectionery, and so on and then diversified their investment priorities to consumer durables such automobiles and electronic products. Foreign investors made decisions about their investments on the basis of a worldwide management strategy. Usually foreign investors did not show interest in capital goods industries like (the) machine industry. I attached some graphs at the bottom of this paper and you can see the FDI share in the manufacturing industry, which, compared to all (other) industries, is not so high – maybe less than 10 %. It means that FDI has some preferential investment areas. And they are also not willing to foster (the) parts and components industries, since they can input them easily. (The) capital goods industries will be left without foreign investment and, we must remember that the growing foreign trade deficit is mainly attributed to the huge input of capital goods.

So, to some extent, we have to foster the capital goods industries, but it is rather difficult to foster them by inviting foreign investors. I think, I need some comparative analyses between the Central European countries – not only Poland but also Hungary, the Czech Republic, and Slovakia. But probably this tendency is right.

After the change of administration in 1997, changes were made to the privatisation policy. The privatising process was accelerated and this policy seems to be successful. Of course, there are many cases in which appropriate foreign investors could not be found. However, FDI is inevitable for Polish economic development and, if so, Poland will first of all have to strengthen its power against foreign investors.

The fourth subject is (the) SME (sector). I just want to mention the unfavourable market conditions for the development of manufacturing SMEs. In Poland, we were able to see and imagine a very huge number of SMEs after the end of the planned economic system. It is known that the majority of newly born SMEs during the earliest stage of transition were trade and services companies, which had not developed under the former economic system. As for the manufacturing industries, the entry barriers are high compared to (those of the) trade and service industries.

I can also point out unfavourable market conditions for (the) development of technologically specified SMEs. Under the planned economy, it was difficult for technologically specified SMEs to exist because of in-house manufacturing systems that prevailed and were adopted by large state(-owned) companies. State(-owned) manufacturing companies are apt to produce not only assembled and finished products, but also the parts and the components themselves. So these market conditions are unfavourable for the development of newly born SMEs, especially in the manufacturing sector. So, probably we have to change these very fundamental marketing conditions.

I also have to point out the lack of favourable local markets that would help the development and growth of SMEs. Under the planned economy, the domestic market was highly standardized and so the domestic market was very, very equal – no specialties. The Polish government also adopted (a) very rapid liberalisation policy for international trade. So, (the) Polish government has not been able to establish favourable market conditions for SME manufacturers to grow. SMEs in Poland are not given sufficient time to prepare themselves and improve their competitiveness to cope with large foreign companies and imported goods. Market conditions are very important when we think about the future development of SMEs. So, to some extent we need to examine the market needs and take the sector approach when making the industrial policy for SMEs.

The last issue is R&D activity. I just want to say a few words. We saw the drastic reduction of our expenditure in Central European countries after the reforms, but the area with the biggest reductions was applied research. Many Central European Countries thought that applied research should be carried out by the private sector and only basic research should be supported by the government. However, I think this is a serious misunderstanding about the role of the government in R&D activity. If (the) private sector has not developed strongly enough in the country, we cannot depend on the private sector for applied research. The role of (the) government is to supplement the weakness of (the) private sector and, as such, the government should support (the) R&D activities of (the) private sector or conduct applied research itself.

The only thing I can say is that, if we decided to leave everything to the choice of the market, we have to be very careful about the results and we have to make efforts to get the best possible result. Through these efforts we can discover (what) the real role of the government is in the transitional period, and we should not be too naive about the results of the market choice.

Thank you very much.

Mr. Shinji Fukukawa: Thank you very much. The second speaker in the session is Mr. Valentin Pavel from Romania. He is Director of the Asian and Oceanic division of the Ministry of Industry and Commerce in Romania. He has also (been) stationed in the Japanese embassy and so he should know about the economic situation in Japan. Well, Professor Pavel, now the floor is yours.

Mr. Valentin Pavel, Romania
Role of Government, Private Sector and Private Organizations

Mr. Valentin Pavel: Thank you very much, Mr. Chairman. I would like, first of all, to thank the organisers of this conference for inviting me to attend this conference.

In order to save time, I would like to enter the subject starting with some general considerations regarding the role of government in the private sector and private organisations. Ladies and gentlemen, the government provides many economic functions that affect the way in which exchange and (the) allocation of resource are carried out in (an) economy. Basically, the government can provide the legal structure that encourages or discourages economic activities. The government attempts to stabilise economy by smoothing out the ups and downs in business activity.

During the post-war period, the developed countries started from the mechanism of free market that functioned spontaneously and moved on to a mechanism, which functioned mainly in an organised manner. Developed countries achieved intensive scientific and technical progress that had important positive effects on economic efficiency, incomes, and (the) population's consumption. In comparison with the good evolution of the developed countries, the European socialist countries experienced economic decline due to an economic system characterized by super-centralized and bureaucratic planning.

After the removal of the monopoly of the Communist Party's power in the European socialist countries, the option for new political forces in these states was justified in view of their orientation to market economy. (There was) also the necessity of replacing the economic system. This mechanism was almost blocked with the mechanisms similar to the one used by the developed countries.

Many people believe that the only way to attain economic efficiency is by competition. One of the roles of government is to serve as a protector of a competitive economic system. Through the privatisation and creation of new enterprises it tends to remove the monopoly of state property and ensure the predominance of private property in all economic branches. The post-socialist transitional period is defined as a mixed economic system, because the elements of centralized management by the state are mixed with elements of the market economy. Consequently, the functioning mechanism of economic and social life is much more complex than both the economic system that existed in socialist countries and the economic system in developed capitalist countries.

In most European, ex-socialist countries this situation was not taken into account. It is considered that transition from planned to market economy should occur by means of the total liberalisation of prices, wages, profits, currency, and external relations. As a result, financial blockage has severely influenced almost all companies in these countries. The way out of this situation is impossible to find with(out) reconsidering the economic system used in the course of transition.

It is necessary that such (an) economic system centred upon the market and the economic rules should occur not as a spontaneous process but as a process with the involvement of state economic authorities and all (the) citizens. Let's say something about property rights and entrepreneurship. Property rights and the legal structure in a country are closely tied to the degree to which individuals use their entrepreneurial skills. In ex-socialist countries, privatisation is often considered a fundamental premise for the establishment of democratic political regime. Privatisation cannot be limited only to this role, since this process has many implications on the structure of the entire economic and social life in each country. Privatisation plays the main role in (the) restructuring of the property system on which socialism was based. The monopoly of state property was set up as the basis of the political system of the proletarian dictatorship. However, this monopoly produced inefficiency in the economy, since the enterprises and citizens themselves had been frustrated by the government ownership policy, a fact that made the entire people's property be considered as no one's property.

In modern market economy, activities are consciously and predominantly suggested by the adequate use of objective laws, by most economic operators, and the state. The combination within the economic system of the market and the state's economic role explains, to a large extent, the success of developed countries during the post-war period.

Let me say something about the increase of the role of market (and) the underestimation of (the) state's role. The most important way for the government (to) influence the economy is through the government plan. We are living now in an age of free market economy, globalisation, and regulations - (they) are worse or everybody sleeps. The concept of no government intervention is (becoming) more and more obsolete. Developed countries adapt to free economic markets with some level of government intervention. Even Adam Smith promoted the idea of British flow protection., Nowadays, governments cannot ignore the necessity of their intervention in economy to produce marching and strategic industries and to lead to economic growth. The government should facilitate conditions under which competition is more efficient and help promote it when it's not so efficient.

The functional mechanism of socialist economy was centred on a super-centralized and bureaucratic plan. Within this system, the role of the market and the objective economic laws were considerably limited. In spite of the existing production commodities, the economic system consequently lead to a deeper blockage. A fact that contributed to the fall of Soviet-type socialism. The transition in ex-socialist countries involved, in the foreground, replacing an economic system based on the super-centralized plan by an economic system centred upon the market, which could be similar to the economic system in developed countries. As a consequence, important steps were taken in the organisation of iso-market categories – the labour force market, the capital market, and the monetary market.

Along with the citizens' assimilation of the necessary knowledge and an adequate participation in the markets, (an) increase of the market role in the functioning of our economic life is to be expected. The markets create a direct link between those who look for products, services, labour force, capital and currency and those supplying these elements. In parallel with the positive effects, the functioning of markets also produces some negative effects like speculation – the tendency of some economic operators to dominate and thus break the legal and moral norms within the relations between citizens.

Taking into account the main role of the market within the economic system in developed countries, I can say that the state's role has substantially increased. It tended to enhance the positive effects of the market and limit the negative ones. The democratic state should play an active and positive economic role in a modern market economy. I believe that the state's role should spread in the following directions. First, adjustment of the frames of economic activities. Second, (the) state's intervention to fix a situation where the market fails. Third, the redistribution of incomes. Many laws were elaborated and studies were carried out by adequate institutions to investigate the functioning of the market economy, thus ensuring the satisfaction of individual and group interests in various economic activities

In the modern world, it is impossible for the government not to make decisions regarding the way in which competition must be organised within the market. At the same time, state institutions should focus their attention on the elaboration of certain rules regarding economic competition according to the overall purpose of society. There should be sustained efforts on the part of the state to stop the decline of production, so that it may balance the ratio between demand and supply. If the ground necessary for competition still does not exist between the economic operators that act in each branch, consumers are constrained to accept almost any commodity. That is why it is necessary for the state to be involved substantially by means of both its economic powers and certain programs, not only by increasing production, but also by restructuring according to the needs and the opportunities of the country.

The state should provide the general climate for economic activities and be able to encourage companies to improve quality and reduce costs. Without progress in this direction, products will not be competitive and there is even the risk of losing important segments of the domestic market to foreign commodities.

It is essential that the state organise the process of privatisation in such way that this process leads to both (an) increase in the private sector of the national economy and to the formation of competitive, viable companies. This would secure a favourable ground for competition in each industry and increase the initiative and the responsibility of economic operators.

Coming back to Romania, I'd like to say that, since 1990, Romania has been implementing an ambitious program of transition to an economy based on private ownership and free competition. Today, the country is steadily moving toward a full market economy. After 1990, it was estimated that, in Romania, an economic system based on the market would be secured without any gross interventions of the state. The underestimation of the role played by the state in modern market economy had negative effects on our transition toward such (an) economy. The main elements of the reform process included price and foreign trade liberalisation, (the) privatisation of state-owned property, development of free trade and (a) healthy financial system, including bank activities, insurance companies, and capital market. The inadequate involvement of the state in the process of privatisation even deepened several problem issues that had arisen in our national economy: the extensional anarchy and the multiplication of antisocial factors in all fields of economy.

The state can and should determine the extension of competition in (the) Romanian economy by adopting and using the legislative and the (existing) institutional framework. It is necessary, through economic legislation and economic institutions, for the state to make sure that all economic operators deal with the extension of their activity, the increase of their profits on a healthy basis, the increase of labour efficiency, the reduction of costs, and the improvement of (the) qualitative and source commodities structure.

The government has encouraged the development of the private sector. In fact, more than half a million private companies have been set up and now they provide more than 45 % of the GDP and employ more than one third of the active labour force. Moreover, the private sector accounts for more than 40 % of exports, 70 % of consumption, and 45 % of services.

Imports and exports were also liberalised and new fiscal and monetary policies were promoted to control budgetary deficit and inflation. Confidence in national currency has increased due to the positive real interest rates offered by banks and the stabilised exchange rates on the domestic hard currency market. Romania has also been aiming to attract major inputs of foreign capital, technology, and management expertise (so) as to redefine and improve its competitive advantages. In order to increase foreign investment, the Romania government has promoted an active policy of attracting capital by setting up (a) favourable institutional framework and adequate legislation. The consolidation of the domestic investment environment is an absolute priority in our policy in order to attract foreign capital. It will be important to liberalise economic activities and remove the obstacles and bureaucratic hardships that foreign investors need to overcome when negotiating and operating on the Romanian market. In that context, essential changes were made in order to comply with the requirements for Romanian integration into the Euro-Atlantic political strategies and economic institutions.

In Romania, the national economy suffers because the state did not get involved as much as was needed. Therefore, weak industries were almost killed by outside competition without any sort of governmental protection, by controversial privatisation of state-owned enterprises and by the lack of legal activity to prevent frauds, bribes, and corruption.

Beside privatisation, the restructuring of unprofitable companies is also an important task. The government has issued new regulations to generate the positive cash flow of such companies, reducing and finally eliminating inter-company aerials and developing profitable economic activities without state support. The main objectives of privatisation, as part of the overall economic reform program, are to create profitable private companies, to raise funds for restructuring and rehabilitating productive companies, to establish the commercial entrepreneurship of management practices, which are to be followed by those companies, to provide the background of an efficient capital market, and to educate (the) Romanian public for the operations of (a) capital market in a market economy.

High priority in the government program was given to (the) restructuring of companies. (By) implementing this objective, the government got close to international financial institutions and the European Union in order to achieve progress in this area. With the aim to stimulate enterprise reform in 1996, the parliament endorsed the competition law that was meant to protect, maintain, and stimulate competition in the context of promoting consumer interests. The Ministry of Finance is responsible for the administrational state of monopolies. The prices and tariffs for the products and services of state monopolies are to be supervised by the government and approved by the Office of Competition. So, before coming to the end, I'd like to say that having started after 1990, the privatisation program of the Romanian economy has led to an increase in the capability of companies to meet market requirements and (to) adjust their behaviour to the rules of competition set up by the main policy makers, and legislators have tried to keep a balance between the domestic reality and international practice The internal pressure of the workers and the interest of the potential strategic investors are, last but not least, among the great variety of privatisation techniques and scientific approaches and for the speed of consistency and continuity. Thank you very much.

Mr. Shinji Fukukawa: Thank you very much Professor Pavel. Perhaps this issue about the role of government in the private sector and private organisations is correlated to FDI, the support for SMEs, and some other issue that we have already discussed. Perhaps many participants coming from countries other than Japan and Romania have something to say. The floor is now open. If you have some questions or comments, you are welcome.

Mr. Józef Chmiel: I would like to add some comments to Mr. Wada's paper. I can generally agree with him on what Poland needed, but (the) restructuring of particular industries, especially in the first stage of transformation, I'm afraid, was impossible. The first reason for that is the unstable political situation. In the first four years of transformation, Poland had three governments and even in the framework of the last coalition, which ruled 1994-1997, Poland had three prime ministers. Prime Minister **Yezhebuzek** stayed in power longer than the previous prime ministers.

The second reason is the contradiction between the agents of the plan for restructuring the industry. Poland had a good plan for (the) steel industry, but in the framework of this plan, one steel company felt itself a winner and another a loser. For this reason, they did not agree on continuing with the plan, because according to the agents, (the) steel plan was profitable for some companies and unprofitable for others. In the vodka industry, the situation was the same. There, we had (a) conflict of interests between the enterprises. The restructuring plan continued only in the coal industry. In the framework of this plan, the government closed several unprofitable coal mines, moved workers from one coal mine to another, and gave money to some workers to begin a new professional life in some other field. Poland needs such plans for restructuring in many areas. For example, in sea transport and (the) energy supply industry. And, I think, that people like Mr. Wada help us start these plans in particular ministries. Thank you very much.

Mr. Masatake Wada: Thank you very much for your comment. I understand what you are saying and, of course, I understand the current political and economic situation in Poland. Poland signed (an) association agreement with the European Union and it joined GATT, WTO, and OECD. This kind of movement represents industrial policy measures. Nowadays, (the) Polish government has difficulties taking initiatives to intervene or to guide the private sector. However, from my point of view, there is still room for the industrial policy to take some initiatives for the future industry structure and the future national economy in Poland. Also, the Polish experience, these ten years, could give some suggestions to other Central European countries. So my presentation just points (out) such kind of peculiarities. Thank you.

Questions, comments

(Unknown): I would like to point out, in a few minutes, why I think the debate over economic liberalisation and intervention approach as an economic policy is quite out of space in a transitional economy. Transition is about creating markets, so whatever you are doing, you are reducing and, above all, changing the role of the government in the economy. So, if you haven't realised that from the outset, you are misguiding these countries. The second point is that this debate usually takes a kind of ghost boxing attitude. You pointed out "Leave everything to the market", as if there had not been any government. OK, there are some exceptions, but certainly not in Central and Eastern Europe that has never left everything to the market – just the opposite and just because markets did not exist in the beginning. So I feel the debate is quite much out of space in our area.

Now about industrial policy. What you were suggesting here – picking the winners – was a losing point in this debate. And I must tell you that if we (were to) recreate today's debate for Central and Eastern Europe in the 1990s, we could see that picking up the winners is now impossible, because those who were the winners in the former economic system either do not have the grounds to survive or it is ambiguous whether they can survive under the market conditions. So it is the selection process ruling the market that tells (us) what will be going on in the future.

Now I have a third problem. You are saying that the government must have a vision and will to carry it through. I think that this does not take into consideration the deep political transformation and the rather confused state of civil servants and governments in national economies under stress. So, if you look at the recent EBRD reports and World Bank reports, you will find out that one of the region's basic problems are the weak public governments. So, because of structural factors, because of corruption, the governments are not really capable of setting real targets. I think that they need a lot of restructuring reforms and they need to improve their capacity. But it could certainly be misleading to transplant the mess they have in decision-making to the incumbent private economy.

And now let's come back to Romania. This is what actually happened in Romania in the last ten years. Although I did not understand most of the points in Mr. Pavel presentation, in my opinion Romania has been a country with a very slow rate of actual transformation and with big state involvement. For example, the act of leaving aside half of the economy for privatisation in the beginning and so on. The state has actually been against competition, because it has allowed taxation of the public sector. It is also taxing the private sector, as was pointed out earlier. I think this is a kind of gradual destruction, as one of the Romanian former policy advisors pointed out. So it is in fact the Romanian example that is against a kind of approach that makes the importance of the state presence and that locates this kind of state presence.

Mr. Shinji Fukukawa: I'm sorry to say that the time is rather limited and there are only three minutes left. First I want to collect the questions and after that I'll ask the speakers to answer them. Any more questions? One, two, three, four ... That's all. Yes, please stand. Briefly please.

(Unknown): Not a question, just a comment. That was the statement of the Romanian colleague who called it "pathological gradually" and he meant that one simple thing – Let's face facts. There is one country among those presented here, and currently (a) European Union accession country, which had these shifts between different ideologies. In the middle (of the) 1990s, Bulgaria re-established our so-called vision of a stronger government involvement and eventually we had high inflation. We had two options – either to skip the local currency and monetary policy and vote for complete currency substitution or to introduce a currency board. The story is well known. Even Yeltsin, when he was running for president and afterwards won, was threatening the Russian public with the Bulgarian example. It was the same situation with Constatinescu in Romania. Everybody was referring to the Bulgarian example as the worst case possible and we had implemented just one little thing – price control. At the end of 1991, we had 10% of the prices in the consumer basket under control. At the end of 1995, we had 15%. Complete government involvement here and there.

Now the second thing I'd like to comment. We take one thing instead of another. I guess the real problem was the weak government. Yesterday, Janoush Lavandovski mentioned that. The weak state – which is weak in terms of enforcing property rights and contracts and not weak in terms of making policies, because policies are made in two ways – transparently as in the mid-1990s in (the) Bulgarian government or intransparently as in late-1990s (in the) Bulgarian government) – takes stakes from different parts of the economy. So the clear problem is the weak government in these two aspects – contract enforcement, laws of the game – and, of course, private property rights, including bankruptcy.

Mr. Shinji Fukukawa: Yes, please, very briefly.

(Unknown): We don't have (the) state at all, we have no problems with (the) state. We have problems with markets, which do not exist, do not function. Our institutions are not developed and so on. The story is long. The case of privatisation in Bosnia is a perfect example of the absence of state and the effects of that. I beg for your attention just for a moment. Privatisation in Bosnia and Herzegovina is (implemented) to the extent allowed by the ethnic problems. There are three ethnic groups – Croatians, Serbians, and Muslims. The territory is divided between these three groups. The political leaders of those ethnic groups privatise state companies and what is the effect of that? If a company is privatised within, for instance, the Croatian ethnic group (it's the same story for the Muslim and Serbian ethnic groups), it means that the newly appointed manager will dismiss all the workers from (the) other ethnic groups. So the company becomes clearly Croatian, or clearly Muslim, or clearly Serbian. This is a factor that you don't have in all (the) other economies. This is one example. There are plenty of other examples, because in Bosnia there is a currency board, which means that, in fact, Bosnia does not have any possibility to influence its own economic life. There is a monetary policy, balance and financial policy, foreign exchange policy, and other kinds of policies. So Bosnia functions like in the nineteenth century, with no exchange, with no standards, with no growth.

So, basically the questions for Mr. Wada, I've just noticed him not far from here, could be: should we restructure our economy or not, should we have strategies for economic development or not, should we pay attention to (a) national social security network and unemployment or not, should we build (an) institutional market economy or will it be built spontaneously, should we have industrial policy or do we not need this, should we have foreign exchange control of short capital movement or not, should we have research and development investments or do we not need these, should we pay attention to income redistribution or we should prefer having a market economy? Should we rely only on the free market, more or less on some places, or are we going to have (a) political economy of development, regardless of the fact that Bosnia does not have a government but that's another story.

The most important question for me – since we have (had) our brains washed after all (the) economic presentations regarding the role of government in the free market and in the private sector and so on – is how can we have, if we want (to), a clear, smart, productive, smart and honest government, how we can accomplish one? And the second and more important for me is: what is the role of the government in the process of globalisation of the whole economy? Do we still need a government, is a government possible? What is the role of the government in a globalised world economy? And finally, if we don't have the ability to establish an efficient government in the globalisation process, what does that mean for all of us and why?

Mr. Shinji Fukukawa: OK. Yes?

Mr. Jan Mladek: My name is Mladek, Director of Department of Finance, Czech Republic. I would like to comment on the role of government in the whole process. In my opinion, the first problem is that the whole question is badly defined, because a proper definition of the problem is half the solution. Various discussions were going on between the lines (on) whether the role of the government should be bigger or smaller. In my opinion, the main mistake was made at the very beginning. It was not said clearly that the task is not to minimize the role of the government but to redefine the role of the government and to minimize it later on. Instead, some very simple slogans (were used), like the one of the America Indians that the only good civil servant is the dead civil servant. That was the ideology that prevailed in the first half of the 1990s.

Nowadays, the European Union Commission is writing a report about the Czech Republic, (saying) that the performance of the civil service, the enforcement of laws in the whole system, and the fight against economic criminality are problematic. They are right. Unfortunately, they have contributed to the creation of the problems, because they don't realise that they are connected with the early advice that was given to post-communist countries – to privatise as quickly as possible. If you give advice to privatise as quickly as possible, it is very clear that it cannot be done within the moral framework or within the legal framework and without creating groups of special interests – in our case rather disadvantageous kinds of interests. It means that you are undermining the position of the state. So, for the future, the real new challenge is really to define the role of the state in order (for) the state to serve the market economy.

And one small addition to industrial policy search. As I said already, because those countries in Central Europe are committed to EU accession, they have a rather limited scope for industrial policy and they can implement some elements of the industrial policy. Probably it's very much desirable, but it is not realistic to expect that they will perform industrial policy in a scope like the one in Japan and South-East Asian countries. Thank you.

Mr. Shinji Fukukawa: Thank you. And the last question?

(Unknown) : Thank you, Mr. Chairman. I have one question and two comments. The question is how do you see the division of labour between the three levels of government – European Union, national government, and local government? That's my question. And my comments are these. Regarding its role, the government is responsible for national welfare and social security, everything, and the government can choose market mechanisms as one of the policies to use. That is my comment on the role of government and market mechanisms. The second comment regards industrial policy. Some economists define industrial policy as a policy to pick up winning industries, but that is a very narrow definition. The industrial policy also includes product improvement, quota improvement, metrology standard. These industrial policies surround the whole industry. Thank you very much.

Mr. Shinji Fukukawa: Yes. Mr. Pavel and Mr. Wada.

Mr. Valentin Pavel: Maybe I shall not succeed in answering your questions, because I think that the subject is very complex and the time is too limited to treat this subject right. But anyway, I think that the government should play a significant role in this stage of transition of our economies and especially the Romanian (economy). And speaking about globalisation, we still need a government in this complex process. We'll even need a strong government. We need to have clever people in the government because the main role of the government is to promote the laws, which lead to the development of the national economy, and also to administrate these laws after their approval by the parliament. Speaking about the European Union, the national government, and the local government - the local government must administrate the economy of local communities and it must adopt some rules to regulate the behaviour of such local communities. Of course, there are differences between the local community and the other types of communities. They should have a role in managing and accommodating the local community to the development strategy of national economy. As far as the European Union is concerned, if you are speaking about the fact that some specific powers of the state should be delegated to the European Union after full accession of these countries, I can say that many countries are members of the European Union and they still have state government and maybe they will still need it in the future. This is my opinion. Thank you very much.

Mr. Shinji Fukukawa: Professor Wada?

Mr. Masatake Wada: I just want to make a brief comment, not to answer. I was a little bit depressed about your comment on the role of government. You pointed out the difficulties in forming a strong, clear and capable government in your country, but probably the power of government is supported by the citizens. And, if you can make clear the national interests, probably the government or the organisation should take care of realising national interests. The programs in your countries are probably the most important. They are (there) to make clear the national interests. What is national interest? In Japan, it was rather easy for us to see the national interest of the 1950s and 1960s – in modernisation, rationalisation, economic growth, and recovery of construction. But, in your countries, this kind of national interest is probably difficult to define. This means that the government role is also difficult to define. That is my comment.

And as for the relations between (the) European Union, national government, and local government, it is very different for the various countries. I'm not familiar with other countries. I'm just familiar with the structure of Poland and in Poland. - Probably Mr. Chmiel should talk more about that. As for the recent government, just the structure is changing. That's because of the pressure (exerted) by the European Union, and now the local government is playing a very important role for the communities and the economy. Some part of the power of the central government is now shifting to the local government, but it's now a transitional period. You know the original was changed two years ago, and now the European Union power is larger and larger. Thank you.

Mr. Shinji Fukukawa: Thank you very much. I'm sure that time is very limited, and in spite of your lovely discussions now, we are twenty minutes behind schedule. I am sorry to say that we have to close the session, but after a ten-minute break we are going to have (a) sixth session. I thank the participants, and I'd like to thank the two speakers that delivered their presentations.