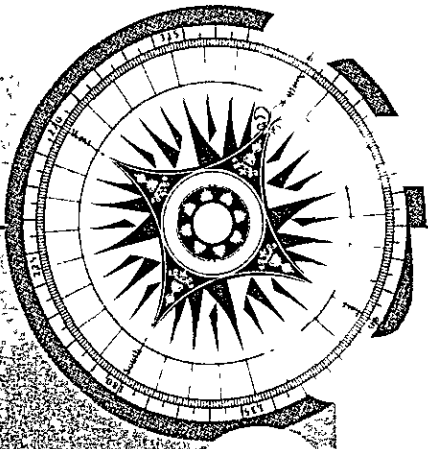


Appendix

International Conference on the 10-Year Review of Transitional Economies and Challenges in the next Decade

International Conference on the 10-Year Review of Transitional Economies and Challenges in the next Decade

Appendix



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International Conference

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Appendix

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The organizers extend their heartfelt thanks to all of the participants
and concerned parties who made this conference successful

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Welcome Address by Japanese Ambassador to Austria

H.E. Akio Ijuin, Japan
Embassy of Japan, Vienna

Excellencies, Distinguished Participants from the Business and Academic Communities, Representatives of International Organizations, Ladies and Gentlemen,

It is a great honour for me to have the opportunity to welcome you to this conference today.

Since the fall of the Berlin Wall in 1989, the Central and Eastern European countries have been making strenuous efforts to consolidate market-oriented economies within a democratic framework. For this purpose, various measures have been implemented, such as market liberalization, administrative reform, acceleration of privatization, promotion of domestic industries, and corporate management reform. Japan has played a role in supporting the transition efforts in the region. Japanese direct investment in Central and Eastern Europe already amounted to about 2,7 billion USD at the end of 1999 and it is expected to increase with the improvement of business conditions there. The Japan International Cooperation Agency (JICA) has invited more than 3 thousand trainees from Central and Eastern European countries and sent more than 600 experts there in the framework of official technical cooperation since 1988. In addition, the Japan External Trade Organization (JETRO) has organized a number of business seminars to promote investment in this region, and trade fairs to increase Central and Eastern European exports to Japan. JICA and JETRO are the co-organizers of today's conference.

With the efforts in the Central and Eastern European countries supported by the international community, much has been done to promote the economies in transition. Most of the countries in this region now enjoy good rates of economic growth with inflation more or less under control. The consistently rapid growth seen in some countries is steadily closing the gap between eastern and western living standards. However, the processes and methods of transition differ from country to country. So, too, do the objectives involved and the measure of success achieved so far. Every country suffers to some extent from growing disparities between rich and poor, including the unemployed, the low-skilled and the elderly.

I believe that it is very important and useful to review the transition process in the past decade in order to utilize this experience for the next decade. For this reason, I am pleased that this conference is taking place in Vienna, the city most closely linked to the Central and Eastern European countries. The participants here today represent both the public and the private sectors, academic forums from the Central and Eastern European countries, and various international organizations and companies which have played a significant role in this region.

Ladies and gentlemen,

I am very grateful to the Vienna Institute for International Economic Studies (WIIW), which is one of the leading research institutions in this region, Bank Austria, which is very active in Central and Eastern Europe, and the Intellectual Collaboration Group to Promote Market Oriented Economies, all of which host today's conference, together with the Japan International Cooperation Agency (JICA) and the Japan External Trade Organization (JETRO).

I hope that the fruitful discussions at this conference, which will surely draw international attention, will facilitate the process of transition in the next decade

Thank you

Opening Remarks

Shinji Fukukawa, Japan
Chairman
Intellectual Collaboration Group

First of all, in behalf of co-sponsoring institutions and with the capacity of Chairman of Intellectual Collaboration Group to promote Market oriented Economy, I would like to thank all of you for attending this conference and sharing your expertise with other participants to this conference.

This conference is jointly sponsored by the Vienna Institute for International Economic Studies and Bank Austria which provided wide range of preparations as well as JICA and JETRO which extended significantly support and assistance. I would like to take opportunity to express my deepest appreciation to these co-organizers.

10 years have passed since former Communist countries embarked their shift to a market economy. They implemented various measures necessary for settling market economy in view of achieving better economic performance.

However, the shift to a market economy has created differences among countries involved. Some of them have gained considerable benefit, but some of them are still suffering from inactive economy. In terms of per capita GDP, generally speaking, their levels still remain lower than that of West European countries.

I believe that now it is an appropriate time to evaluate the economic performance of former communist countries moving toward a market economy, to analyze various factors which have made their policies a success or a failure and to evaluate the assistance provided by experienced countries and international institution. Those studies will certainly provide valuable tools for former communist countries to set up their strategies for challenging next decade.

I personally visited Central and East Europe countries in September 1989 when changes in political and economic aspects started to emerge. I was strongly impressed by increasing dynamism and enthusiasm to challenge the change of their system and the interchange with the West even at the time of Cold War. I notice that since the collapse of Berlin Wall, the tide of globalization has been emerging in the world including CEE countries and it may develop to the main concept of the new world order.

Frankly, Japanese government was not so positive at the beginning to extend the assistance to CEE countries, because economic relationship remained weak. But gradually the Government expanded the support to CEE countries in the field of policy implantation, export promotion and anti-pollution.

Japanese investment in this region has been behind other developed countries. However, recently, Japanese companies have become aware of the great potential and advantage in this region. For example, when it comes to the green field investment, Japan ranks third after Germany and the U.S. in some transitional countries. Even smaller and medium-sized companies in Japan have begun to show interest in investing in this region. I heard that the commercial attachés of CEECs in Tokyo are extremely busy in responding to inquiries. This also signifies it is an opportune time to hold this conference.

I believe that the most important factor for sustainable economic growth of former communist countries depends on the dynamism of private enterprises. I think it quite significant to make clear whether private enterprises have grown to be fully competitive, and whether a sound economic environment has been created for stimulating the dynamism of private enterprises. Considering that since similar 10-years review conferences are being held by many organizations and academics, we wanted to focus on "Creating a Competitive industry".

In close cooperation with Dr. Havlik, The Vienna Institute for International Economic Studies, we picked up following six items for agenda of the conference.

- 1) Review of privatization from the viewpoint of corporate competitiveness, management, development of technology and human resources.
- 2) Business infrastructure from the viewpoint of the economic performance of private companies
- 3) Implication of FDI and evaluation of FDI policy and related issue.
- 4) Promotion of SME which may provide job opportunity and act as venture business.
- 5) Role of government including macro economic management, competition policy, promotion of domestic industry and relations between the government and private sector.
- 6) Evaluation of bilateral and multinational cooperation to CEES.

The results acquired here can be of use for the rest of transitional economics to keep them build their strategies.

This time we intend to analyze those issues mainly in 6 countries, namely Hungary, Poland, Czech Republic, Romania, Bulgaria and Slovakia. Very fortunately, we may have invited top class experts from governments, academia, thinktanks and industrial organization in those countries as well as related officials of EBRD, OECD, World Bank and UNIDO, and industrialists from Austria, Germany and Japan.

I strongly expects that wide range of analysis will be provided and constructive exchange of views and ideas will be undertaken at the conference.

With the strong support of all of you who are participating in this conference, we are planning to publish a book comprising the papers presented as well as the discussions held here, with a hope that the achievements of the conference can contribute to create a future strategy of economic development in CEECs.

This is the very first trial for us to discuss the most relevant issues for further development of the transitional economies, where the participants from government, academia and industry can exchange views openly and frankly in a very informal manner.

If all of you will regard this conference also useful in the future, we would like to consider to contribute this type of dialogue in one way or another.

I sincerely expect together with co-organizers, the Vienna International Economic Studies, Bank Austria, JICA and JETRO that the two days conference will obtain forward-looking results for making CEECs catch up the trend of globalization.

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A 10-Year Review of Transitional Economies: Some Lessons

Mr. Tsuneaki Sato, Japan
Em. Professor of Economics
Yokohama City University

1. Introduction

Just a decade ago Central East European countries (hereafter CEECs) (not to speak of the former Soviet Union / FSU /) were in a big and deep turmoil. At that time an era was coming to the end, an era that involved the fate of several generations, and with it the greatest political, social and economic experiment in the 20th Century saw a tragic end. The concept of radical transition to a market economy won support (at least theoretically) in new political environment. Quite contrary to several decades ago, this time "vulgar Marxism"¹, as Kornai named it, took over. They tried to do just the opposite what their predecessors had done as fast as possible especially in changing ownership forms.

Kornai in the same paper writes: "Vulgar Marxism in this context means a simplified formula: the change of not just a necessary condition of capitalism, but a sufficient one. ²Capitalist property relations form the base that goes on to create its own superstructure: the institutions, political organization and ideology required to operate the capitalist base. The real course of history showed earlier and the post-socialist transition confirmed that the relation of base and superstructure is far more complicated than that. The mere existence of capitalist property relations is not a sufficient condition for the consolidation of capitalism. If a drastic reform of ownership should happen, to proceed the transformation of political, legal and cultural institutions, the latter may follow very slowly and painfully, *at grave social cost* ³ (*Italic- T.S.*).

So, even if it is feasible under certain conditions, it is not certain that having a rapid and drastic ownership reform before the transformation of the auxiliary institutions is the most beneficial sequence."

¹) Janos Kornai, "Ten Years After 'The Road to A Free Economy'. The Author's Self-Evaluation", World Bank ABCDE / Annual Bank Conference on Development Economics / paper, April 18-20, 2000.. He reiterated this paper at the lecture he gave at the 6th EACES Conference in Barcelona, September 7-9, 2000. He even added orally, "I think ownership reforms in China are following the Strategy A ("strategy of organic development" in privatizing SOEs- T.S.)", which he had been advocating from the outset of transformation.

²) This coincides with Sato's notion of "ownership obsession" which was more extensively discussed in Sato, T., "How Extensive Has the 'Transition to a Market Economy' Been?", *Moct=Most*, No.1, 1995.

³) The most comprehensive analysis of the costs of transformation is given in a remarkable paper by Michael Ellman "The Social Costs and Consequences of Transformation Process", Paper presented at the UN/ECE Spring Seminar "From Plan to Market. the Transition Process after Ten Years", 2 May, 2000, Geneva. Also see; Laszlo Szamuely "The Social Costs of Transformation in Central and Eastern Europe", Working Papers, No.31, Department East European Studies, University of Uppsala, Jan. 1997. In this sense transition path to a market economy in CEECs and FSU could be called a "high cost" one, while the Chinese path a "less costly" one. The "high cost" was brought about both the quick liberalization cum stabilization policies, which could not be discussed in this paper more extensively. Only Sato wishes to agree with Bruno Dallago who writes in this respect: "the costs of transformation proved to be much higher than anticipated, the processes much longer, and the economic system that came out of transformation is generally less, sometimes much less desirable than envisaged a decade ago. There are different reasons for this outcome. Certainly, one crucial reason is that – in large part because of drastic macroeconomic stabilisation and swift privatisation of SOEs – destruction was not followed – nor could it have been – by sufficient creation, both in quantities and particularly in quality." (Bruno Dallago, "The State and the Transformation of Economic Systems", Paper presented at the International Workshop on Transitional Economies, 24 –25 Nov. 2000.

Optimistic (and not very rational) expectations prevailed and people were ready to suffer for a while expecting prosperity after a certain period.. Political pendulum moved to the "right". In this, relatively favourable, social atmosphere the economic transition started in 1990-91. It turned out, however, people had to wait the expected "prosperity" still for a long time to come. As Kornai rightly noted in the same paper, "I am convinced that speed, while important, is *not* the primary measure of success... Excessive emphasis on speed leads to impatience, aggressiveness and arrogance... the expression 'mass privatization', used a synonym for give-away and voucher schemes, is the inverse of the 'mass collectivization' familiar from the history of Stalinism... I do not want to exaggerate the comparison... Nonetheless, there were similarities: the subordination of the ownership reform to political and power purposes, the horror of gradual change, the impatience, and the obsession with speed."

Though the latest EBRD "Transition Report 2000" proclaimed the completion of the "recovery period" and we see in most countries of the region the resumption of economic growth, now it seems high time for looking back the trodden path to draw lessons from the first decade of transformation and look forward to the challenges ahead in the coming new decade. Learning from mistakes committed here might be more important than self-complacency with hard-won achievements.

2. Missing Link 1: Systemic Transformation vs. Economic Growth

Now it has become perfectly clear that systemic transformation itself does not ensure economic growth. But this problem has to be seen in a broader historical perspective. From a very broad historical perspective, ever since 1989, this author have considered it as the "resumption" of "interrupted" capitalist development. Countries of Central-Eastern Europe (CEECs), not to speak already of former Soviet Union, belonged more or less to the group of late-comers of capitalist development, and had been pursuing modernization and industrialization after the capitalist model, floating between the "West" and the "East".⁴⁾ But this process of development was "interrupted" in the case Russia in 1917 and in the case of CEECs around 1948 after the World War II.

However, what these countries tried to seek after within the framework called "socialism" was not so much different as the continued pursuit of modernization-cum-industrialization in a different framework : catching up with the developed capitalist countries. Since the new "framework", which was heavily politicised, had collapsed, it is not strange at all that the "interrupted" historical development has been "resumed", which in any sense did not mean the "reversal" of historical development. It should be noted, however, that while the "interruption" was relatively easy, the "resumption" was not so easy as was expected at the outset of transformation, once a peculiar system had been formed.

In the context of aforementioned, the author wishes to stress that these transition countries are faced with *dual tasks*: systemic transformation and the unsolved task of "catching up"; the latter task having become more serious than before, since, as a result of "transformational depression" (not "recession"), the economic gap between Century has widened enormously.

⁴⁾ Ivan Berend, citing the early Twentieth century Hungarian poet-prophet, Endre Ady, writes, "The region is, in the middle of Europe, — like a ferry-boat, — sails from the East to the West, but more likely back to the East." , Ivan Berend, "The Future Enlargement of the European Union in a Historical Perspective", paper presented at the International Symposium in commemoration of the 120th Anniversary of the Hosei University, Oct.3, 2000, Tokyo

Transition countries badly need both systemic transformation and economic development. In this respect the difference between CEECs and East Asian countries, China first of all, which started its transition from a less developed country situation, is not so much of a "qualitative" character as a problem of degree. So, the argument, sometimes raised by some experts⁵⁾ that the aim of reform is different between China and CEECs, the former aiming at faster economic growth, while the latter aiming at systemic transformation itself, is quite misleading. It is a sheer simplification. Even leaving other factors aside, this factor alone suggests that CEECs need a more "active" state than in developed countries in the West with mature market economies. This may also concern the discussion of when the "transition" will be completed even for CEECs⁶⁾

3. Missing Link 2: Sequencing of Liberalisation

Probably, with no small benefits of hindsight, most people would agree that liberalisation should have been conducted consistently and more gradually, with a big prudence. In most countries, however, liberalisation of trade, including foreign trade, of prices, currency transactions were done overnight, in one stroke, and subsidies to firms was abolished or phased out, almost all kinds of private activities were permitted without relevant legal framework and regulation. Liberalisation should have been preceded by the establishment of the relevant institutions, the development and regulation of capital markets and accompanied by the strengthening of the state control and enforcement capability in a developing market environment. Liberalisation of external economic relations, in particular, went too far and too fast, which should have proceed prudently, since excessive external shocks are counterproductive for firms that were weak in terms of market response capabilities.

That was the special case with the unprecedented abolition of import barriers or with introducing excessive import competition on the domestic market. The fact that afterwards some excessive liberalisation measures had to be withdrawn in many countries in a case-by-case manner clearly testifies to the unsustainability of this policy. A clear tendency towards "primitivization" of industrial structure, which we see in many countries flooded with imported goods, is only an outcome of this policy. Again this depends largely on the ability of the state to implement a credible liberalisation policy that is progressive through time and possibly differentiated among different activities and branches.

⁵⁾ See for example, Pomfret, Richard, "Growth and Transition: Why has China's Performance been so different?", *Journal of Comparative Economics*, vol.25, no. 3, 1997, pp.25-44.

⁶⁾ See, for instance, Ivan Berend, "From Plan to Market, From Regime Change to Sustainable Growth in Central and Eastern Europe", UN/ECE Spring Seminar, 2 May, 2000., Geneva Berend argues, citing Tsuneo Morita ("The Hidden Growth Potential of EU Candidates", in: *World Bank Newsletter* □ *Transition*, Vol. 10, No.5, October 1999) □ that "if they (transition countries-T.S.) achieve a growth rate of in the range of 4.5 to 6.0 per cent annually against an assumed 3 per cent growth in the low-income countries of EU, it may take, in the best possible scenario, about 30 about 30 years □ The Czech Republic may reach that level in 10-15 years, Hungary, Poland and Slovenia in 20-25 years." In the same context, G. Kolodko rightly refers to the "necessity of equitable growth" as the missing link in "Transition Orthodoxy". Grzegorz Kolodko, "Ten Years of Post-socialist Transition: the Lessons for Policy Reforms", The World Bank, Development Research Group, *Working Papers*, No.2095, April 1999 Also see: the same author, "Globalization and Catching-Up: From Recession to Growth in Transition Economies", *IMF Working Paper*, NO. 100, June 2000.

This problem was hotly debated after the Asian financial crisis of 1997. It was even asserted that the crisis has been "created" by the IMF, as Milton Friedman said in an interview he gave to the *Hamburger Abendblatt* (Oct. 3-4, 1998). He says while the crisis in Japan is a home-made (*hausgemacht*) one, "on the contrary, in Malaysia, Thailand and Indonesia the crisis was created first of all by the IMF" ("In Malaysia, Thailand und Indonesien wurde dagegen die Krise durch den Internationalen Waehrungsfonde (IWF) erst geschaffen"). In a sense speaking for Asian countries, where criticism had been mounting that the Fund itself had contributed heavily to the outbreak of the crisis, since it encouraged governments in this region to open their markets to foreign capital, even short-term one, and then – when the capital rushed out – imposed excessively severe belt-tightening policies for loan package, thereby inviting further downturn in the economy of the affected countries—the then Japanese delegate at the Interim Committee Meeting of the Board of Governors of the IMF, on Oct. 4 in Washington, made the following critical statement, which was quite illustrative of Japanese perspective:

"What one can draw from this experience is that the Fund's traditional prescription which combines fiscal balance improvement with tightening of monetary policy is no longer appropriate in every instance. - The Fund should recognize that the modality of the market economy can be diverse, reflecting the history and culture of each country as well as its stage of economic development. In this context, the Fund should perhaps reflect on what it has done-."7)

The statement also called for an appropriate regulation over the international capital flows, short-term capital hot money in particular, and for a more attention to be paid to the appropriate sequencing in capital account liberalisation in emerging market economies.

4. Missing Link 3: Some Neglected Aspects of "Privatization"

That the swift and massive privatization has not brought about expected beneficial results, seemingly, has already been acknowledged by most experts. Ever since these countries embarked on systemic transformation, that is, their capitalist makeover, the issue of privatization of gigantic state-owned enterprises has been a central focus along with liberalization and macroeconomic stabilization. Together, these three objectives form the pillars of the Washington Consensus. But the scenario in this part of the world has unfolded differently from the privatization pattern seen in Japan and other advanced capitalist countries in the 1980s. In those economies, the integration of a handful of inefficient public corporations took place in the context of an already existing market-economy infrastructure dominated by a dynamic business sector.

By contrast, the former socialist states must rein in a sprawling state-run sector minus the existence of any market-economy infrastructure. Despite beginning from completely different circumstances, these states are in the grip of what could be termed an "obsession with ownership" which was legally understood. Consequently, their approach has regarded conversion to private ownership as a panacea while giving short shrift to the most crucial aspect of privatization: the establishment of a management framework for assuming risk and responsibility. Coupon privatization—and its failure—offers a typical example.

7) Interim Committee Meeting of the Board of Governors of the IMF, on Oct. 4, 1998, in Washington, MOF Homepage.

Privatization is usually considered to lead to improved performance of divested companies and that privately owned firms outperform state-owned enterprises. This seems to have also been conclusively proved in industrialized countries where a small number of publicly-owned enterprises were turned into private hands in the 80s and 90s. Usually this is taken to mean that privatization is badly needed in post-socialist countries and should prove to yield the same desired results. The first part of this understanding is quite right, since an effective economy is not conceivable at all under conditions that a small sector of private enterprises is encircled by dominant state-owned one, so the situation should be reversed to that public enterprises, even when they continue to exist, be encircled by dominant sector of dynamically developing private companies, thereby creating the most important competitive environment for the remaining public enterprises. The latter part of this conventional interpretation, however, often ignores the different conditions under which privatization is carried out in advanced capitalist countries and in former socialist, transition countries. As this writer wrote several years ago :

"It (privatization in post-socialist countries) is quite different from privatization seen during the 1980s in some of the developed capitalist countries, in which only a limited number of inefficient and often deficit-ridden public enterprises were affected; this at a time when a dominant part of the national economy was represented by more or less efficient and dynamic private sector accompanied by a well-established market infrastructure. To use an analogy: in the case of capitalist privatization only a small number of public enterprises have needed to be put into a 'ready-made' stage-setting; in the post-socialist case 'stage' itself has to be created from scratch onto which a colossal amount of state-owned assets is supposed to be brought. Obviously, the latter is quite another story and requires a different approach than the former."² Also this writer has warned from the outset of transformation against the "ownership obsession" (a term coined by this author himself) which was repeated in the same paper as follows: "The first stage of transformation was characterized by a strong 'ownership obsession', under which most efforts were devoted to how to change the property rights while little attention was paid to the 'management' aspects of privatization, namely, how to establish a rational model of management at the enterprise level capable of taking both risks and responsibilities." And he sees its typical case in so-called "voucher (mass) privatization". In the first phase of transformation, it was regarded that, formally, privatization process was most advanced in the Czech Republic (and in Russia !) with Poland and Slovenia in-between Hungary, which was regarded as taking a gradual approach and for that reason often "unsuccessful" in the transition performance. After the financial crisis of May 1997, the assessment turned to the opposite.

Kornai in the same paper on "Ten Years After", referring to the difference in labour productivity growth, confirmed that his Strategy A, that of "organic development", has proved viable. But, ten years ago, as he rightly writes, "it was certainly a small minority of Western academic economists who supported a strategy of organic development of the private sector."

A decade after, it has been established, regrettably with a "high costs", that a well-designed and carefully guided privatization process, which naturally takes a lot of time, ensures the creation of the much-hoped-for efficient ownership cum management structures in privatized firms, which, in turn, would promote the transformation of the remaining SOEs in a more transparent way.

² The same with footnote 2).

5. Missing Link 4 : The Role of the State

The first phase of transformation was characterized by the "desertion" or "retreat" of the State⁹⁾ During the first stage of transformation, symptoms indicating rejection of the role of the state were commonly seen throughout CEECs and FSU. These were an understandable, but not entirely justifiable, reaction to the excessive level of state intervention in the economic life in the past. Even industrial policies, which proved quite effective in the post-war reconstruction and development of Japan, and later in NIEs were identified with central planning in former socialist economies. By the mid-1990s, however, the more realistically-minded experts in the region and in the West have already realized that simply undertaking the opposite of past practice was also not a proper policy. Active industrial and trade policies have then been put on the agenda¹⁰⁾. Needless to say, institutional reforms are perhaps at least equally important as a formal privatization. No invisible hand itself can automatically guarantee a smooth functioning of market economy.

A more active state involvement and more or less targeted developmental policy approach might perhaps be required. Some transition countries are very proud of the number of their "mushrooming" small private firms. But most of them are found in service sectors. So far, few countries seem to have succeeded in accommodating the appropriate mechanism, through which domestic savings are channelled into industrial investment to accelerate modernization process. This too, however, is unconceivable without the playing the active role. Today, after ten years of transformation, the role of the state seems to acquire new dimensions. In view of the widened inequality between the "winners" and "losers" of transitional societies, and also widened gap in development between the regions of the countries concerned, the state has a lot to do in diffusing the possible tensions in the society. Social security reforms, now hotly debated not only in the West but also in countries of transition, are the special case in point.

6. Missing Link 5: Fast EU Eastward Enlargement is Rather Unlikely

The Eastward Enlargement of the European Union has been on the agenda for more than a decade by now, seemingly too long . However, if we consider that the longest accession period, the British case, lasted twelve years, while the target date of 2002 has had to be abandoned even by the most ambitious candidate countries, it is obvious that the process is, and will be, extremely protracted. On the one hand since the Luxembourg Council of December 1997 at the latest, the fact of Enlargement seems to have become a settled issue in theory. Meanwhile practical accommodation of this process proved to be harder to elaborate than most analysts would have anticipated. For the time being official optimism puts 2003-2004, expert opinion estimates 2005-2006 as the earliest point of time when the *first* frontrunner country may actually join the EU. This author is of the opinion, to use an "analogy" of 007, first actual accession would not come earlier 0007. At least it is rather clear : timing is uncertain.

⁹⁾ "Desertion" of the state was one of the major factors responsible for the much-longer-and-much deeper than anticipated "transformational depression". In this respect Grzegorz Kolodko rightly refers to the " policy failure which almost negated the intermediate control mechanism which was to be applied to the enormous state sector in turn increasing the uncertainty at the enterprise level, leading to further decline in production", which is unconceivable without an active state involvement. See: "From Output Collapse to Sustainable Growth in Transition Economies", *Institute of Finance Working Papers*, No. 35, 1993

¹⁰⁾ See for instance: Michael Landesmann's pioneering paper , "Industrial Policy and the Transition in East-Central Europe", *Forschungsberichte*, No. 156, WIIW, Wien, 1993.

On both sides of the Enlargement, initial euphoria or enthusiasm with the European Integration has subsided, and the Enlargement itself has come across the hardest pass where contradictions, rather than accord, came to the forefront. Accommodation of the interests between industries on the sectoral and regional dimensions is also a hard task, as we see in the case of Polish agriculture, closely related to the CAP reforms. Moreover, it seems to the present writer that the EU has watered down the actual Enlargement process by inviting so many "potential" candidates onto the negotiation table, a move apparently motivated by political factors.

Sometimes candidate countries blame EU side for its loss of enthusiasm and bureaucratic procedures in the negotiation, but it is not the whole story. As Laszlo Csaba writes, even in the case of Hungary, usually considered one of the top candidates, "the country is likely to forego the SAPARD pre-accession fund, since the agency administering the use of money could not be set up in due time and equipped with the appropriate competences. This is telling for the future in so far as the administrative capacity of the most advanced transition country has proved inadequate to capitalize already available EU funds. Thus in the future the gap between allocated and actually drawn funds is likely to grow, the farther east we go, the more so."¹¹⁾

This writer thinks Csaba is quite right when he refers to the "absorption capacity" even of a frontrunner country real convergence does not matter when it is relevant to the disbursing of structural funds, and nominal convergence matters in fact though not a condition of accession. The EU had better to tackle no less than three countries first to push the actual Enlargement process forward.

So, CEECs might be better prepared for a longer time when they had to wait in the entrance hall of the house of EU in order to be better prepared for the accession, while making further efforts on the way of institutional reforms.

7. Missing Link 6: South Eastern Europe

So far, little attention has been paid to the specific problems of South-East European transition countries, which are apparently falling behind Central European countries during the past decade, as most people were attracted by the political turmoil unfolded there. Now that there is some hope for improvement, we should be prepared to fill the blank in our transition economics. Here "transition orthodoxy", the "holy trinity" (liberalisation, stabilization, privatization) does not seem to give a workable recipe. In a well-known lecture Joseph Stiglitz referred to the "failure"¹²⁾ of reforms in Russia, but to a lesser extent it might be true of South Eastern Europe, to quote the statement by Daniel Daianu, formerly Minister of Finance of Romania, " People no longer understand the transition as a regime change to a miraculous state of market economy. Mistakes had been made, and - What is now evident is the need to catch up and to grow."¹³⁾ Catch up and grow, yes, but "how?" – we do not have a ready answer. It might become the trial ground for the Economics of Transition, if there are any.

¹¹⁾ Laszlo Csaba, "Ostpolitik and the Enlargement of the EU : The Challenge of the Millennium", Mimeo, October 2000.

¹²⁾ Joseph Stiglitz, "Whither Reform ? Ten Years of the Transition ", Keynote Address, World Bank ABCDE/ Annual Bank Conference on Development Economics, April 28-30, 1999.

¹³⁾ UN/ECE informal seminar on "The Economic Regeneration of South-East Europe", 3 May, 2000, Geneva

8. A Tentative Conclusion : "Transition Is not Over"

In 1996, then the prime minister Vaclav Klaus claimed that transition had been almost over and that the Czech Republic had entered a "post-transformation" stage. At that time most macroeconomic indicators seemed to support this argument. The currency crisis of May 1997, however, gave a severe blow to this challenging view. Immediately following this crisis, the tone of the world press turned to the other negative extreme ¹⁴⁾. Since then, the Czech economy has been in recession in contrast to 4-5 percent annual expansion in most CEECs, Poland and Hungary in the first place. In 1998 alone GDP contracted by more than 2.5 percent, and only from the second quarter of 1999, the decline has hit the bottom to make a modest upturn. There are many reasons for the slide, but much of the blame is placed on the way privatization was carried out. An OECD Report (1998) states that the Czech voucher approach to privatization produced ownership structures that "impeded efficient corporate governance and restructuring."

The author wanted to recall the above story, already fading away in our old memory, because first, he thinks that the West should share due responsibilities for it, giving arrogant "marks" on the performance of "their pupils", and second, now some experts from CEECs have begun to repeat the same statement ¹⁵⁾. This is not a place to give judgement whether it is right or not, but the author entertains some concern about the "recurrence" of such a statement, as it might lead to the underestimation of the "dual tasks" he referred to earlier in this paper.

This author has to recall that the biggest concern among CEECs reformers towards the end of 1980s was that if things went on the same way, CEECs might be reduced to the "peripheral" position of the world economy, not to speak of Europe. Since 1989 and from the mid-1990s in particular, the trend has shown a favourable turn-around, but still the post-1989 experience has also shown that systemic changes alone could not solve the historic challenge of "catching-up" with the West. "Transition" will be over when CEECS succeed to make a big stride in this direction, not a few steps of recovery from the "bottom" of the first half of 1990s. Together we should like to look forward to the further success of CEECs on the way of tackling with not so easy tasks ahead.

¹⁴⁾ Interestingly enough, most "cold-hearted" in this regard were those mass media which had been praising the Czech model of privatization as the top "honor student" among transition countries. For instance, Financial Times, May 14, 1997, wrote: "The slowdown is blamed on weak voucher privatization which failed to encourage the industrial restructuring necessary to enable Czech companies to compete abroad." It should be noted that Karel Kouba, a noted Czech economist, had been already stressing in 1995 the "weak microeconomic foundation of macroeconomic stabilization". See: Karel Kouba "Macro-economic Trends in the Czech Republic", in: *Reevaluating Economic Reforms in Central and Eastern Europe since 1989*, published jointly by NIRA and Kopint-Datorg, 1996, Budapest.

¹⁵⁾ Quite recently, Prof. Jenő Koltay, Director of the Institute of Economics, HAS, said in his presentation at the Institute of Economic Research, Hitotsubashi University, Tokyo, October 31, that the "transition" had been over in Hungary, while reserving cautiously "social transition" had yet to be completed.

Competitiveness of CEEC's Industry

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1. Re-shaping of CEEC industry

Central and East European countries (CEECs) have inherited a huge industrial sector from the previous period of central planning. But, because of large structural distortions and production inefficiencies, this high degree of industrialization has initially turned out to be a drawback rather than an advantage. Industry suffered over-proportionally from the 'transformational recession' at the beginning of transition. Industry, and especially its manufacturing part, declined in both absolute and relative terms owing to a number of factors such as the loss of traditional export markets, excessive liberalization, restrictive macroeconomic policies and insufficient restructuring. In the more advanced CEECs, industry was able to recover at least part of its previous position thanks to active restructuring efforts. Nevertheless, only Hungary and Poland now produce more industrial goods than in 1990. In contrast, Bulgarian and Romanian industry shrank by half during the last decade, while in the remaining CEECs the drop was still around 20% (we shall turn to the related structural changes below).³

Manufacturing value added in % of GDP

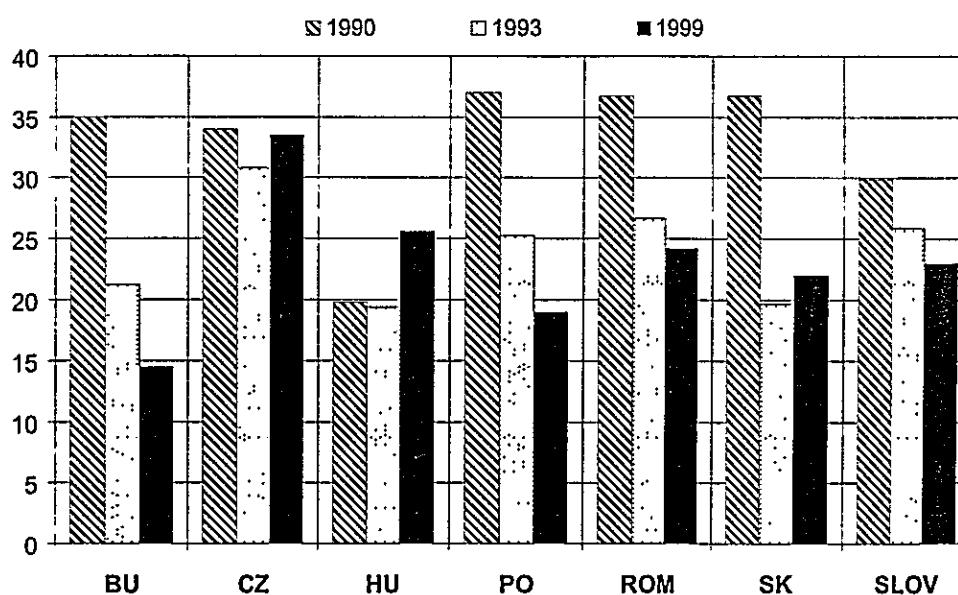


Figure 1

* The author wishes to thank Boriana Assenova and Renate Prasch, WIIW for statistical assistance.

Manufacturing employment in % of total

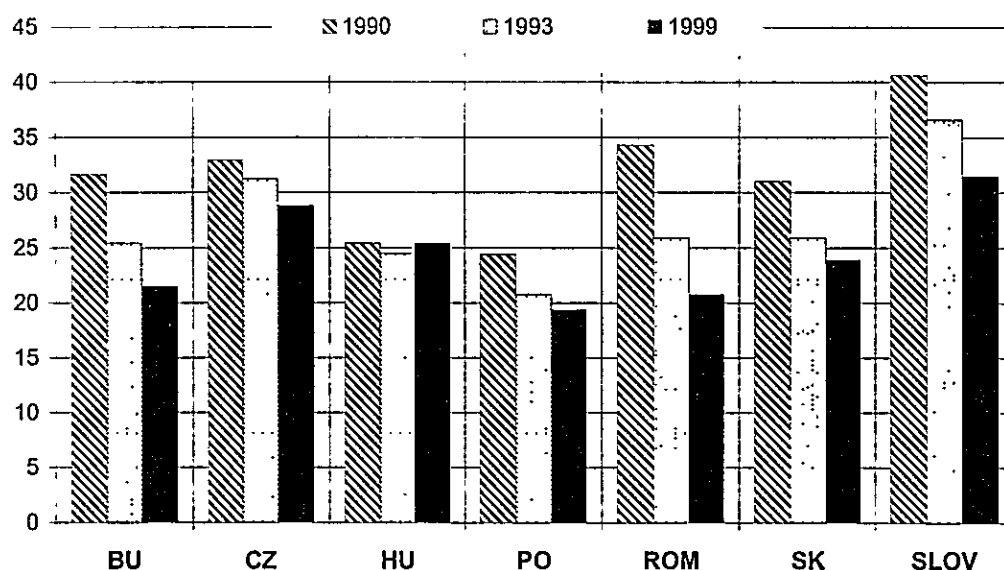


Figure 2

As a result of combined changes in the manufacturing industry and GDP, only two CEECs could restore (Czech Republic) or even increase (Hungary) the initial shares of manufacturing value added in GDP by 1999 (Figure 1). The process of industrial downsizing is still underway elsewhere but manufacturing still contributes a significant part (between 15% in Bulgaria to nearly 33% in the Czech Republic) to the GDP.

Manufacturing industry employment underwent even more dramatic developments. These changes reflect general developments in CEEC labour markets: declining overall employment, shifts from industry to the service sector and, last but not least, the emergence of open unemployment.⁴ Poland has been the only CEEC where manufacturing employment increased a bit in the second phase of transition (after 1993) and then stabilized at about 75% of the 1990 level. Employment adjustments occurred with a certain time lag due to delayed lay-offs and hardly any expansion of manufacturing jobs afterwards (again in both absolute and relative terms). In fact, losses in manufacturing employment between 1990 and 1999 amounted to 25% in Poland, 40% in the Czech Republic, Hungary and Slovenia, and to more than 60% in Bulgaria. As far as the importance of manufacturing industry as a job provider is concerned, the only exception is again Hungary which not only managed to increase the share of manufacturing employment to the initial level from 1990 (25% of the total), but even recorded a slight growth of manufacturing jobs after 1997. In the majority of remaining CEECs, the number of manufacturing jobs stabilized at around 60% of the initial (1990) level. In Bulgaria the manufacturing industry continues to decline (it dropped below 40% of the initial level last year). But manufacturing industry is still an important job provider in all CEECs; the highest employment shares in manufacturing industry are nowadays in the Czech Republic and in Slovenia (around 30% of the total – see Figure 2).

³ Unless otherwise stated, the WIIW Annual Database Eastern Europe and WIIW Industrial Database are used as the main source of data.

⁴ For more details on labour market developments see H. Vidovic, 'Recent labour market developments in CEECs', *The Vienna Institute Monthly Report*, No. 4, March 2000.

CEEC manufacturing industry in the EU context, 1998

(branch shares in total manufacturing output)

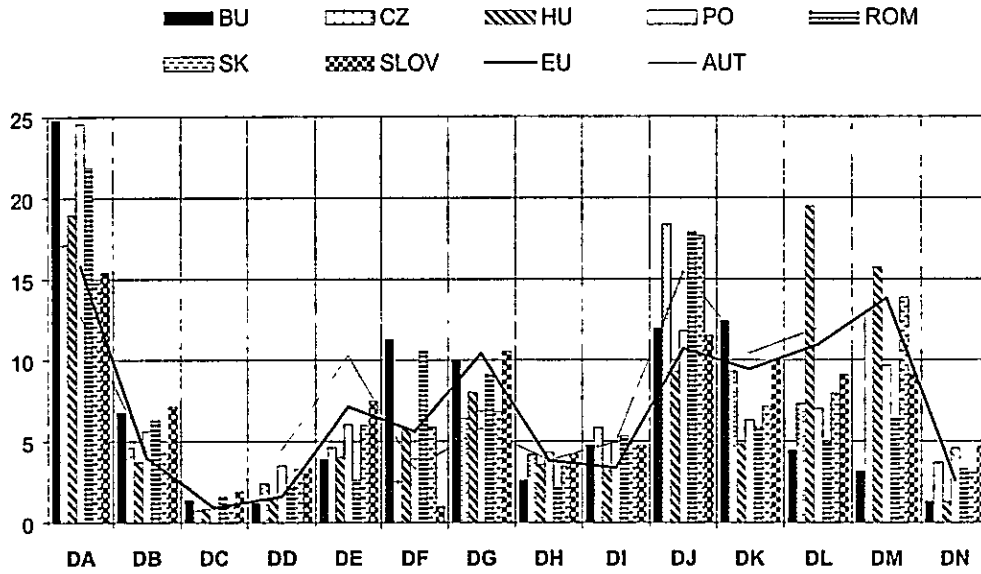


Figure 3

Deviations of CEEC manufacturing output structures, 1998

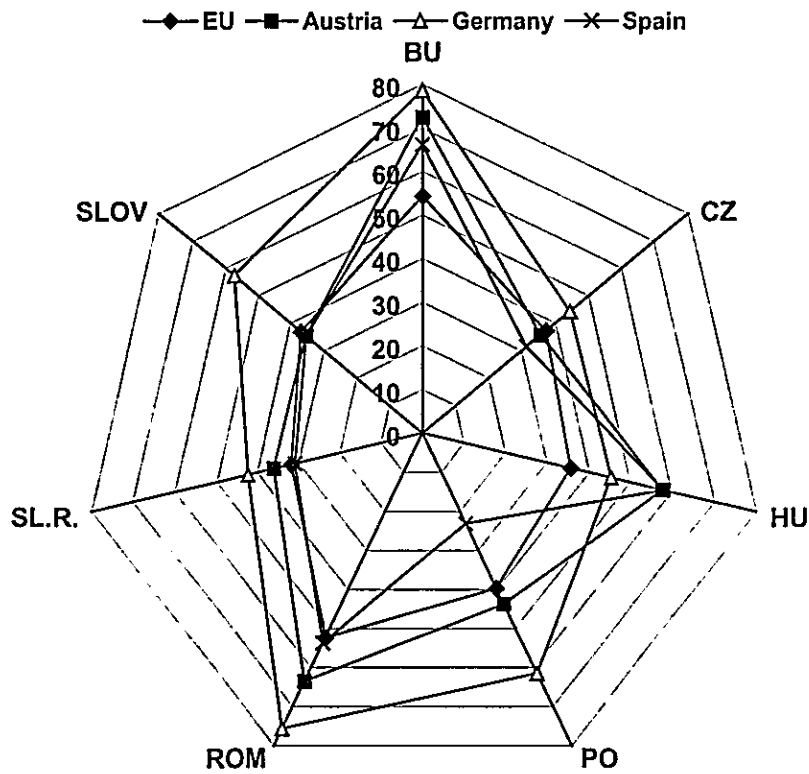


Figure 4

Note: Square roots of quadratic deviations in corresponding NACE 2 digit branch output shares (see Urban, 2000).

2. CEEC's manufacturing industry in the European context

After nearly a whole decade of downsizing and re-shaping, the structure of CEEC manufacturing industry production now fits fairly closely into the European pattern (Figure 3). Compared to the EU average industry structure, according to Eurostat data, there are now (year 1998) somewhat higher production shares of food and beverages (DA), coke and refined petroleum (DF) and basic metals (DJ) industries in some CEECs. Lower shares are observed in machinery and equipment (DK) and – with a notable exception of Hungary – electrical and optical equipment (DL). Nevertheless, the overall structural differences vis-à-vis the EU are not so great, at least for the more advanced CEECs (that is, except Bulgaria and Romania – Figure 4). The structure of Czech, Slovak and Slovene manufacturing industry is fairly similar to that of Austria (though, not so much to that of Germany). In fact, the structure of manufacturing industry output in the more advanced CEECs nowadays shows a greater similarity with the EU average structure than does Austria.

3. Productivity recovery and catching up at branch level

The varying growth rates of production and employment translate into different gains (or losses) in labour productivity (estimated as gross production per employed person in manufacturing industry). During the first period of transition (passive restructuring, until about 1993/94 – see Urban, 2000), an initial productivity drop (due to declining output and delayed lay-offs) occurred nearly in all CEECs (except Poland). However, an impressive productivity recovery started in most CEECs afterwards (only in Bulgaria labour productivity continued to decline). Hungary's performance stands out again: its labour productivity in manufacturing industry is now twice as high as in 1993. The cumulative Polish productivity improvement during the period 1993-99 exceeded 50%, somewhat more than in the Czech and Slovak Republics as well as in Slovenia (all between 40% to 50%). Productivity gains have been much lower in Romania (Figure 5).

Manufacturing labour productivity, 1999

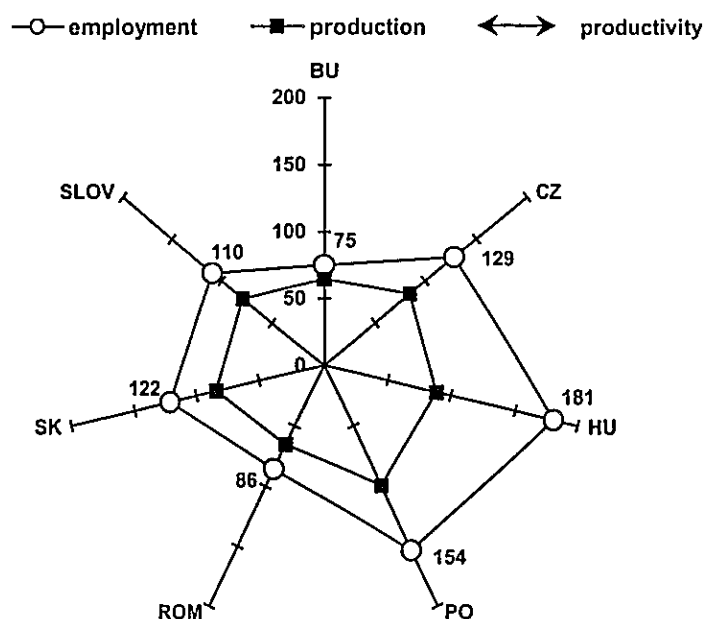


Figure 6

4. Manufacturing labour productivity in international comparison

The main difficulty in productivity comparisons form the internationally comparable productivity estimates, in particular the conversion of the national output data to a common currency. The use of market exchange rates is not appropriate for this purpose (especially for the CEECs, mainly due to their grossly undervalued currencies and fluctuating exchange rates). Alternative proxy converters are either purchasing power parities (PPP), or – much better – branch-specific unit value ratios (UVR) which compare aggregate prices of representative products. Preliminary results for the Czech Republic, Hungary and Poland from an ongoing research project, jointly conducted by the WIIW and the University of Groningen, show a broad correspondence of estimated productivities obtained with UVR and PPP for gross capital formation.⁵

⁵ Using the UVRs conversion, the relative level of labour productivity in Hungarian manufacturing was about 39% of that in Germany in the year 1996, the Czech-German productivity relation was 35% and the Polish-German relation was 25% – see E Monnikhof and B. van Ark, 'New estimates of labour productivity in the manufacturing sectors of Czech Republic, Hungary and Poland, 1996', Groningen Growth and Development Centre, University of Groningen & The Conference Board, Second Report for the WIIW Countdown Project, June 2000.

Manufacturing labour productivity, 1996

(Austria = 100)

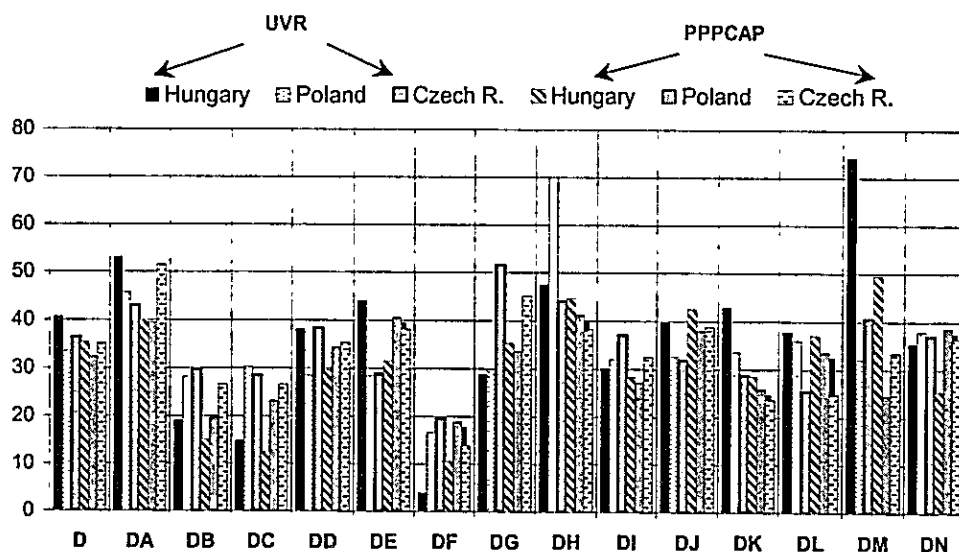


Figure 6

Indeed, a comparison with Austria using PPP for gross capital formation (PPPCAP) and German-based bilateral UVR as converters gives fairly close results (Figure 6).⁶ The estimated Czech and Hungarian manufacturing industry labour productivity was about 35% of the Austrian level in 1996, the respective Polish-Austrian relation was 32% after the conversion with PPP for gross capital formation.⁷ The corresponding results for UVR-based productivity comparison were 37%, 41% and 34%, respectively.

⁴ PPPCAP for 1996 was taken from Eurostat-OECD "Benchmark Results of the 1996 Eurostat-OECD Comparison by Analytical Categories", OECD, Paris, 1999. We assume that Austrian-German UVRs are proportional to ATS/DM exchange rate. Austrian manufacturing labour productivity was in 1996 slightly (-3.3%) lower than in Germany – see Guger, A., "Verbesserung der relativen Lohnstückkostenposition durch Euro-Kursrückgang". WIFO Monatsberichte, 9/2000, pp. 541-546.

⁷ See P. Havlik, "Trade and Cost Competitiveness of the Czech Republic, Hungary, Poland and Slovenia", World Bank Working Paper, Washington D.C. (forthcoming).

Manufacturing labour productivity (UVR-based), 1998

(Austria = 100)

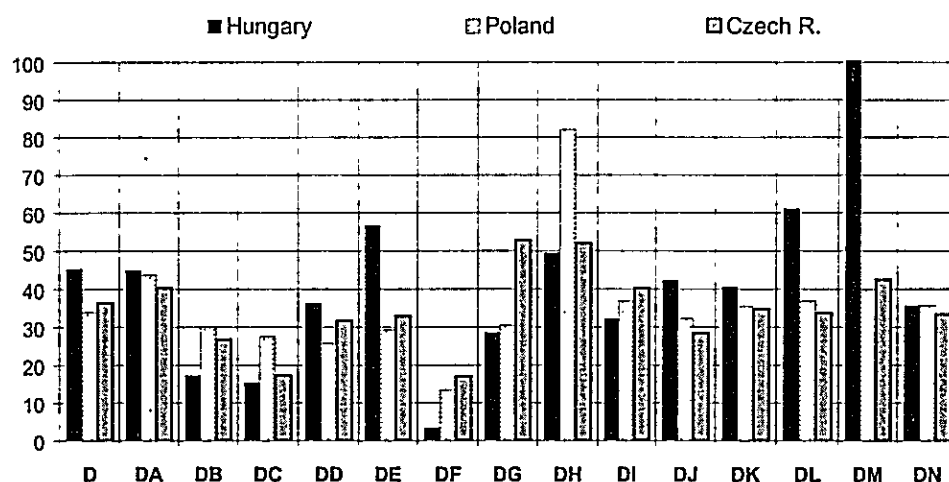


Figure 7

A closer look at individual branches, using the conversion with branch-specific UVRs, shows that relatively smaller productivity gaps were observed especially in manufacturing of food, beverages and tobacco, rubber and plastic products, transport equipment (Hungary); food, beverages and tobacco and other manufacturing sectors (Poland), food, beverages and tobacco, chemicals, rubber and plastics (Czech Republic) in 1996. Hungarian labour productivity in transport equipment industry was 74% of the Austrian level in 1996 (60% of German level), the Czech productivity in chemicals was 52% of the Austrian level (54% of German level), Polish productivity in rubber and plastic products was 70% of the Austrian level (60% of German level). On the other hand, productivity gaps in textiles and leather manufacturing (as well as in refined petroleum products) were in all three countries especially large. Taking into account recent impressive productivity improvements (+40% in Hungary, +20% in the Czech Republic, +30% in Poland between 1996 and 1999), all three countries must have by now caught up further with productivity levels in the EU.⁸ The extrapolated relative productivity levels presented in Figure 7 (extrapolated with branch-specific productivity changes from UVR-based estimates for 1996 presented in Table 6) suggest that Hungary (and especially its electrical and transport equipment industries) moved closer to Austrian productivity levels.

⁸ Taking into account that (nominal) productivity in the EU has been growing by 4.3% per year during 1988-98 (in Austria by 8.8%, in Germany by 5.2%) – see 'The competitiveness of European industry. 1999 Report', Working document of the services of the European Commission, COM (1999) 465, Luxembourg, 1999, p. x. Guger (op. cit. P. 543) gives an estimate for hourly productivity growth between 4-5% per year in both Germany and Austria during 1995-1999.

5. Emerging winner and loser branches

Overall developments mask substantial structural changes within manufacturing industry, reflecting inter alia different speed of restructuring and resulting efficiency gains or losses of individual branches. These structural changes again vary across individual CEECs and over time; the time differences partly reflect the uneven progress of industrial restructuring. Compared to the initial phase of transition, we find a new pattern of winner and loser branches emerging recently – frequently quite opposite to that from the period of passive restructuring during the early 1990s.⁹

Relative productivity gains

annual averages, 1993-1998

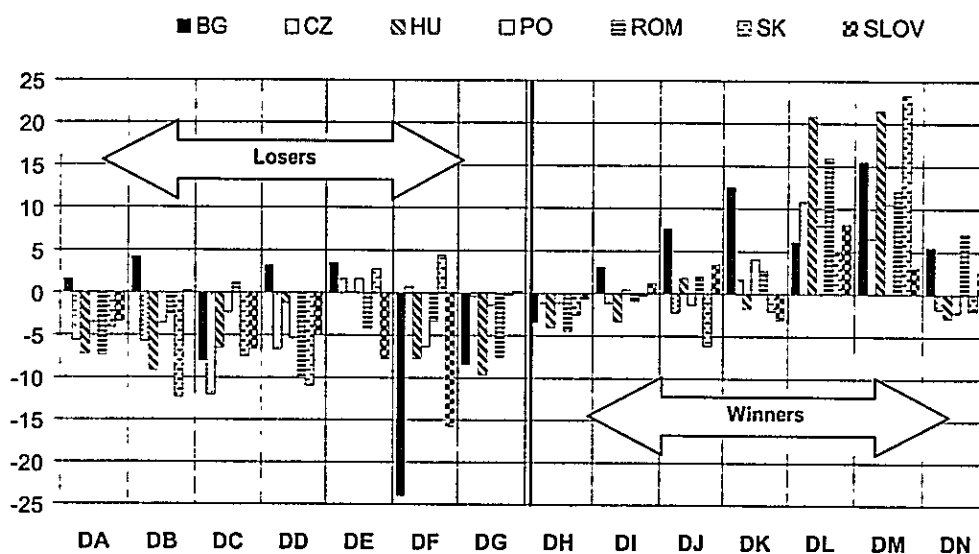


Figure 8

⁹ See W. Urban, 'Patterns of Structural Change in CEECs Manufacturing', *WIIW Structural Report* 1999.

Looking at the relative labour productivity changes in the period 1993-98 by individual branches (relative to the manufacturing industry average), one can distinguish two distinct groups of industries (Figure 8). Roughly speaking, among the winners (branches with above-average productivity gains during the period 1993-98) are in most CEECs only a few of the following industries: machinery and equipment (DK), electrical and optical equipment (DL) and transport equipment (DM) as well as (less clearly) other manufacturing (DN). Manufacturing of electrical, optical and transport equipment has been a clear productivity winner in all CEECs. In Hungary, productivity in these branches has been growing by more than 20% per year; in the Czech Republic, Poland, Romania and in Slovakia by double digit annual rates as well. On the other hand, the loser branches are frequently the manufacturing of food, beverages and tobacco (DA), textiles (DB), leather (DC), wood products (DD), coke and refined petroleum (DF) and chemicals (DG). In some cases, productivity even declined in absolute terms: apart from most manufacturing branches in Bulgaria (here productivity declined everywhere except for machinery and equipment n.e.c. and transport equipment), this happened e.g. in leather industry in the Czech Republic and in Slovenia, in the wood industry in Romania and Slovakia, etc.

6. Competitive strengths and weaknesses: evidence for selected branches

We shall now look more closely at some aspects of selected winning and losing branches in order to find out where their particular strengths and weaknesses might come from. First of all, we know that wages are still generally low in all CEECs, and this is true for all sectors of the economy. Even in 'high wage' Slovenia the average gross wage (EUR 900 per month in 1999) was only some 40% of either the Austrian or German level (at current exchange rates). Czech, Hungarian or Polish average wages range between EUR 300-400 per month (15-18% of either the German level or Austrian level) and wages are even much lower in the remaining CEECs. East-West gaps in total labour costs are even slightly bigger since direct wage costs in the CEECs usually account for a greater share of total labour costs than in most EU countries.¹⁰

A cross-industry comparison of relative wages shows that wages in the above identified winner branches are usually higher than the manufacturing industry average, whereas in loser branches wages are much lower than average. The relative wage level thus seem to be positively associated with the varying sectoral productivity performance: "successful" branches can afford to pay higher wages. A more important indicator of the cost competitiveness is unit labour costs (ULC). These are defined as a ratio of wage costs (gross wages, including indirect wage costs, in EUR at current exchange rates) and labour productivity levels (defined as gross output per employed person). Sectoral differences in ULC are affected mostly by varying labour productivity, as wages display less pronounced sectoral variation. Productivity differences, in turn, partly result from different capital intensity of individual industries, which we disregard here due to the lack of reliable data on the capital stock (we shall briefly return to this issue below).

¹⁰ Direct wage costs account for 60% to 75% of total labour costs in CEECs as compared with 50% to 60% in the majority of EU countries – see Havlík, P., op.cit.

A comparison across manufacturing industry branches, within each CEEC, shows that the winner branches tend to have lower (or at least not too high) ULC than the manufacturing industry average (Table 1). On the other hand, ULC in most of the loser branches are considerably higher than manufacturing industry average. This is largely because of (by definition) the relatively high productivity gains, shown above, achieved by winner branches and the corresponding productivity losses of losers. Moreover, these productivity losses have not been compensated by appropriate wage adjustments (despite below average wage increases in loser industries). The winner branches thus managed to keep (or even to increase) their comparative ULC advantage, despite (or perhaps because of) the fact that they offer above-average wages. On the other hand, the loser branches have high ULC despite low wages - especially due to their low productivity. Besides, they are also over-proportionally labour intensive.

Unit Labour Costs, year 1998

Manufacturing = 100

		Czech Republic	Hungary	Poland	Romania	Slovak Republic	Slovenia	Bulgaria
D	Manufacturing total	100,0	100,0	100,0	100,0	100,0	100,0	100,0
DA	Food products; beverages, tobacco	69,3	100,9	72,7	56,0	72,2	66,8	69,4
DB	Textiles and textile products	161,2	284,9	166,9	260,5	259,4	153,9	171,3
DC	Leather and leather products	230,4	271,8	158,7	154,0	245,8	149,9	165,0
DD	Wood and wood products	182,3	111,5	99,9	134,3	250,3	143,5	100,6
DE	Pulp, paper & paper prod., printing	82,1	104,8	86,5	149,2	97,8	136,1	91,0
DF	Coke, refined petroleum products	12,9	83,6	40,4	33,9	21,2	45,5	44,2
DG	Chemicals, chemical products, fibres	55,1	122,0	97,9	86,5	70,3	74,9	87,1
DH	Rubber and plastic products	121,3	108,8	87,9	106,4	99,5	103,5	108,6
DI	Other non-metallic mineral products	128,4	160,1	126,0	125,1	136,2	94,7	125,8
DJ	Basic metals and fabricated metals	120,6	101,7	109,0	71,4	107,6	126,6	75,0
DK	Machinery and equipment n.e.c.	157,8	181,2	155,1	260,1	189,4	117,3	164,9
DL	Electrical and optical equipment	103,6	63,2	102,8	97,3	157,3	132,0	148,4
DM	Transport equipment	69,5	49,6	83,7	97,9	35,9	40,3	131,5
DN	Manufacturing n.e.c.	149,6	176,2	115,0	165,1	186,0	92,3	123,3

Table 1

International comparison of ULCs in the manufacturing industry

(year 1998, PPP96 for GDP, Austria 1998 = 100)

		Bulgaria	Czech	Hungary	Poland	Romania	Slovak	Slovenia
D	Manufacturing total	17,1	30,3	21,1	28,6	19,7	25,9	68,4
DA	Food products; beverages and tobacco	15,4	27,3	24,1	27,1	12,9	24,3	59,5
DB	Textiles and textile products	24,7	41,1	45,9	40,2	37,5	56,5	88,6
DC	Leather and leather products	29,7	73,5	59,6	47,8	34,2	67,0	108,0
DD	Wood and wood products	18,6	59,9	24,4	31,0	28,1	70,2	106,4
DE	Pulp, paper & paper products; publishing	15,9	25,4	23,6	25,3	30,6	25,9	95,2
DF	Coke, refined petroleum products & nucl.	33,0	17,1	71,3	50,5	26,9	24,0	135,7
DG	Chemicals, chemical products and fibres	17,3	19,4	25,0	32,5	21,5	21,1	59,4
DH	Rubber and plastic products	15,7	31,0	17,5	21,2	17,9	21,7	59,7
DI	Other non-metallic mineral products	16,8	30,4	25,3	28,2	19,0	27,6	50,7
DJ	Basic metals and fabricated metal prod.	11,2	31,9	18,6	27,2	13,3	24,3	75,6
DK	Machinery and equipment n e.c.	21,2	35,9	27,9	33,3	36,6	36,8	60,3
DL	Electrical and optical equipment	22,8	28,2	14,3	26,4	16,0	36,6	81,1
DM	Transport equipment	30,5	28,6	15,0	32,5	28,2	12,6	37,4
DN	Manufacturing n e.c.	17,7	38,1	31,9	27,7	26,4	40,5	53,1

Table 2a

International comparison of ULCs in the manufacturing industry

(year 1998, PPP96 for gross fixed capital formation, Austria 1998 = 100)

		Bulgaria	Czech	Hungary	Poland	Romania	Slovak Republic	Slovenia
D	Manufacturing total	41,7	45,6	34,0	38,5	46,9	40,4	80,4
DA	Food products; beverages and tobacco	37,7	41,2	38,7	36,4	30,7	38,0	69,9
DB	Textiles and textile products	60,2	62,0	73,7	54,1	89,5	88,2	104,2
DC	Leather and leather products	72,5	110,8	95,8	64,4	81,5	104,5	127,0
DD	Wood and wood products	45,5	90,3	39,1	41,7	67,0	109,6	125,1
DE	Pulp, paper & paper products; publishing	38,9	38,4	38,0	34,1	73,0	40,4	111,9
DF	Coke, refined petroleum products & nucl	80,5	25,7	114,6	68,0	64,2	37,4	159,6
DG	Chemicals, chemical products and fibres	42,1	29,2	40,2	43,7	51,2	32,9	69,8
DH	Rubber and plastic products	38,2	46,8	28,2	28,6	42,7	33,9	70,2
DI	Other non-metallic mineral products	41,1	45,9	40,7	38,0	45,4	43,0	59,6
DJ	Basic metals and fabricated metal prod.	27,3	48,0	29,9	36,6	31,7	37,9	88,8
DK	Machinery and equipment n e c.	51,7	54,1	44,9	44,8	87,3	57,4	70,9
DL	Electrical and optical equipment	55,6	42,5	22,9	35,6	38,1	57,1	95,4
DM	Transport equipment	74,5	43,1	24,0	43,8	67,3	19,7	44,0
DN	Manufacturing n.e.c.	43,3	57,4	51,2	37,2	63,0	63,1	62,4

Table 2b

Sources: WIW estimates based on national statistics, OECD, EUROSTAT and UNIDO.

Tables 2a and 2b contain two sets of ULC estimates which provide ranges for a cross-country level comparison. The first data set results from national productivity figures converted into common currency with purchasing power parities for the whole GDP (PPP96). This conversion leads to higher productivity estimates and therefore to lower relative ULC levels for CEECs. The second data set uses as a convertor PPP for gross fixed capital formation which lead to lower productivity estimates and therefore to higher relative ULC. Given the above shown (Figure 6) close correspondence of the latter productivity estimates to the theoretically superior UVR-based productivity data, and assuming that a similar correspondence exists for other CEECs as well, one can reckon that ULC figures from the Table 2b are probably closer to reality – at least for the manufacturing industry as a whole.

But even when using the upper boundary range for ULC, the gaps – that is CEECs' cost advantages - behind Western Europe (here represented by Austria or Germany) are quite large: more than 30% in case of Slovenia (though some branches – like e.g. textiles, leather, wood and coke industries - may have higher ULC than in Western Europe). In general, CEEC wage gaps are much bigger than productivity gaps and this is valid especially for the more advanced CEECs and for the winner branches: Hungary's ULC in electrical, optical and transport equipment industries were less than one fifth of Austrian level, and about one third of that level in the Czech Republic, Poland and Slovakia – see Table 2b. We shall present some evidence that the winner branches may have even enjoy increasing competitive advantage below.

In a dynamic perspective, ULC can improve (that is, to decline, assuming constant capital intensity) if wages are growing slower than labour productivity. Moreover, in the international context, wage costs can be curbed also by 'competitive devaluation' (currency appreciation has the opposite effect).¹¹ In the Czech Republic, for example, the 'winner' branches are characterized by modest ULC increases (or even by their decline in manufacturing of electrical and optical equipment). On the other hand, 'loser' branches have suffered from a huge deterioration of labour cost competitiveness, especially in leather and leather products manufacturing. In Hungary, on the other hand, both winner and loser branches have enjoyed impressive ULC improvements, but the winner branches have still fared much better than the losers.

7. Revealed comparative advantage (RCA) of manufacturing industry

We shall now look briefly at the trade performance of manufacturing industry branches. Can we find a distinct pattern in the revealed comparative advantage in CEEC trade with the EU?¹² There were only a few CEEC industries with clearly positive RCA in 1998: textiles (DB), leather (DC) and especially wood (DD), as also minerals (DI) and basic metals (DJ) – see Figure 8. Most of these branches with positive RCA belong to productivity losers, and several of the winner branches in terms of productivity improvements have clearly negative RCA in most CEECs (electrical, optical and transport equipment in Hungary are the most important exceptions). There seems to be no clear productivity-related RCA pattern. Looking at changes in RCA during the last couple of years,¹³ one can see that only a few industries in some CEECs have recently experienced RCA improvements: food industry (DA) in Poland, leather (DC) in Slovakia, again the electrical, optical and transport equipment (DL, DM) in Hungary, as well as transport equipment (DM) in the Czech Republic and Slovakia (Figure 9). Again, there seems to be no straightforward relation with productivity improvements: even the winner industries frequently suffered (with some of the important exceptions mentioned above) from a deteriorating RCA. This may be related to the largely incomplete industrial restructuring as branches with improving productivity still import more than they are able to export.

¹¹ Since the exchange rate changes affect all branches uniformly (at least as far as wage developments are concerned) we do not show this effect separately. The wage data refer to wages in international currency (euro).

¹² Revealed comparative advantage is defined as $RCA = \ln [(Ex^i/m^i)/(Ex/m)] * 100$.

¹³ Average RCA during the period 1996-98 over the RCA average during 1993-95.

Revealed comparative advantage (RCA), 1998

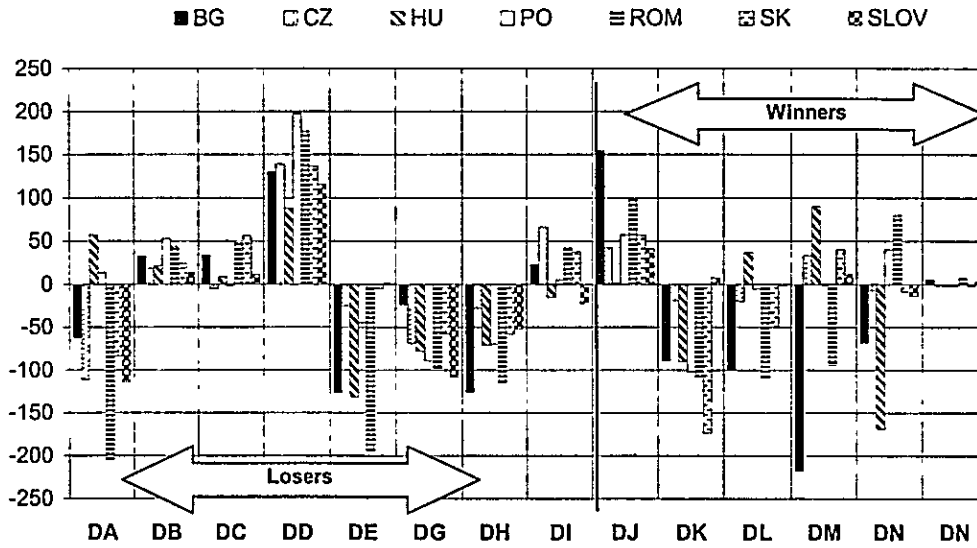


Figure 8

RCA improvements

change in %, average 1996-1998 over 1993-1995

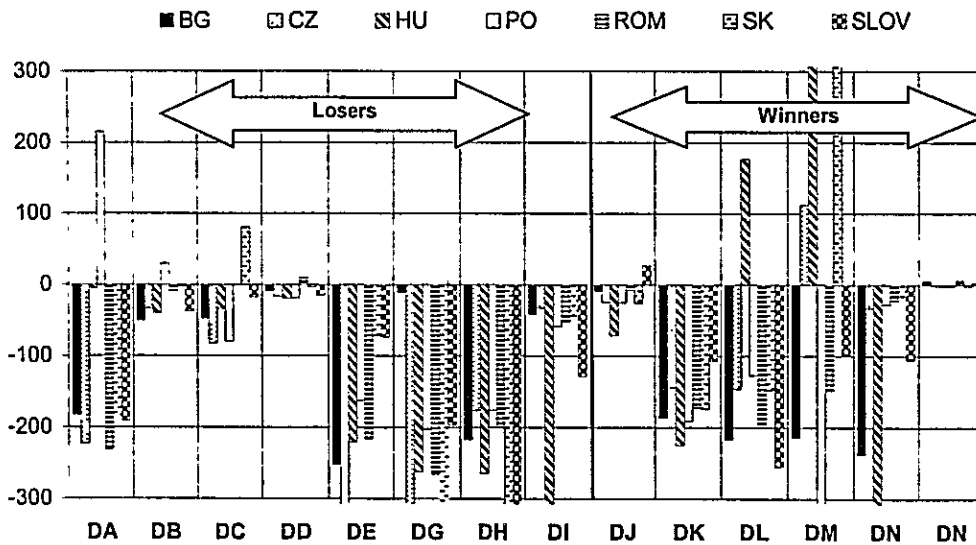


Figure 9

8. Effects of FDI on productivity, ULC and RCA improvements

The recent UNCTAD study has identified a strong relationship between inward FDI and manufactured exports performance for a number of developed and developing countries.¹⁴ The impact of FDI rises with the technology intensity of exports, especially in the case of developing countries: a one per cent rise in FDI per capita leads to 0.78% increase in high technology exports. In countries with strong national innovation systems and exports led by national enterprises (still the case in many CEECs), the question is how to cope with the pace of technical change and make inroads into markets held by more advanced countries (that is, to catch-up). Moreover, when the evolution of dynamic comparative advantage is assisted by FDI there is a problem of sustainability and upgrading, especially as wages rise and cheaper competitors appear. Last but not least, the question of spill-overs between foreign-owned and domestic sectors has to be tackled in order to avoid that isolated pockets of advancement develop while the rest of the economy falls behind.

We have investigated branch specific relationships between inward FDI stock, productivity, ULC and RCA performance for selected CEECs.¹⁵ First we note that the FDI penetration is highly uneven across individual manufacturing industry branches (Figure 10). On average, manufacturing industry FDI stock per employed person amounted in 1998 to over USD 5000 (except for Slovakia), but pulp and paper (DE), chemicals (DG), other non-metallic minerals (DI) and transport equipment (DM) industries have attracted much more FDI in most CEEC.

FDI stock per employee in USD, 1998

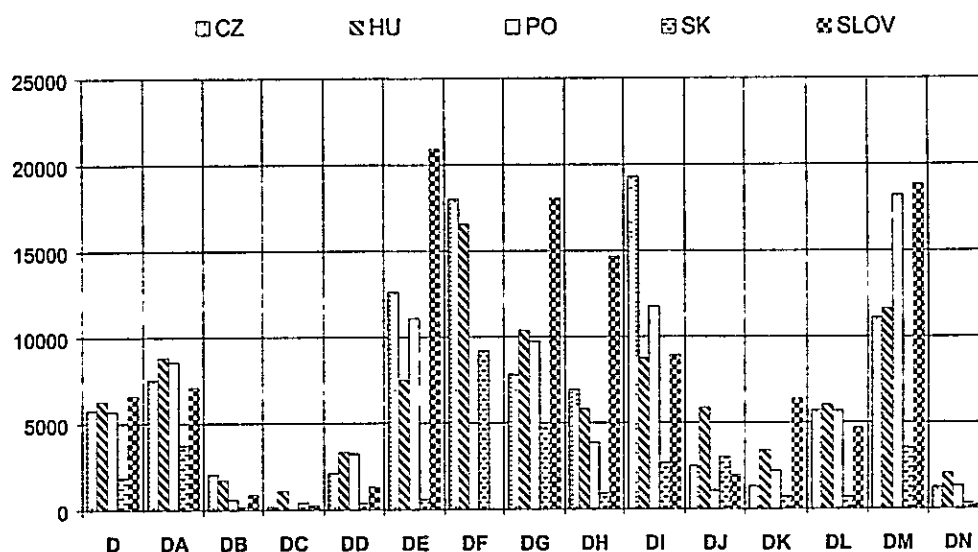


Figure 10

¹⁴ See World Investment Report. 1999 Foreign Direct Investment and the Challenge of Development, UN, New York and Geneva, 1999, pp. 244-255.

¹⁵ Branch-specific FDI data are available only for the Czech Republic, Hungary, Poland, Slovakia and Slovenia.

Generally, there is an impression that winner branches (in terms of relative productivity gains) are generally more penetrated by FDI, while there is very little FDI in most loser branches (except for food, beverages and tobacco). However, just as for RCA, there is hardly any significant statistical relationship across all five CEECs and across all branches, between FDI stock per employee and either productivity or ULC improvements in a branch.¹⁶ But in countries with higher FDI penetration (the Czech Republic, Hungary, Poland and Slovenia), there is a statistically significant and positive relationship between the FDI stock per employee and the productivity performance of the winner and loser branches: a one per cent increase of FDI per employee is associated with a nine per cent productivity improvement (Figure 11). There is also a significant relationship between the FDI stock per employee and ULC improvements: higher FDI is associated with declining ULC (Figure 12). Foreign direct investments thus clearly contribute to efficiency improvements in CEEC manufacturing, but do not (still) necessarily show up as a factor explaining the revealed comparative advantage of CEEC manufacturing in trade with the EU.

Productivity improvements and FDI per employee

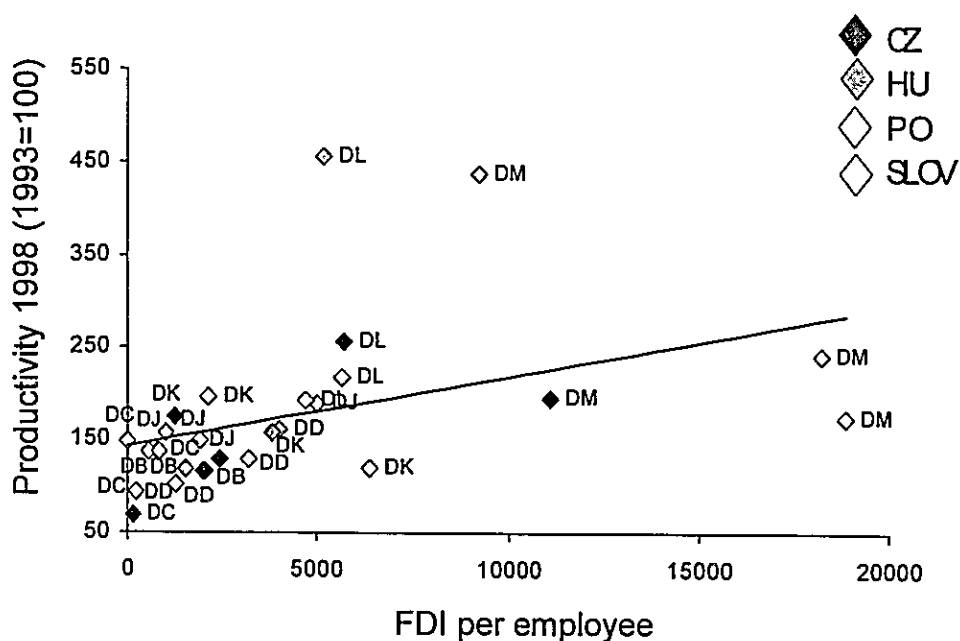


Figure 11

¹⁶ A similar conclusion was reached by Barrel and Holland who use a more sophisticated model with data for the Czech Republic, Hungary and Poland – see Barrel, R., Holland, D., "Foreign direct investment and enterprise restructuring in Central Europe". *The Economics of Transition*, Vol 8, No. 2, 2000, pp. 477-504.

Session 1

Review and Future of Privatization from the Viewpoint of Corporate Competitiveness, Management, Development of Technology and Human Resources

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Review of Privatization from the Viewpoint of Corporate Governance and Macroeconomic Impact – Poland's experience.

Mr. Janusz Lewandowski, Poland
Vice President
Gdansk Institute of Market Economics

This paper is designed to present the experience of ten years of privatization in Poland, with particular view to the emerging corporate governance structures, as well as its impact upon modernization of economic potential..

1. What is specific about the post-communist Europe privatization ?

Although privatization is now a world-wide tendency, it acquires additional dimensions in Poland and in other post-communist countries of Central and East Europe. It is a part of much wider, historical task of the reconstruction of a market economy from the ruins of central planning system. It has to be accompanied by the macroeconomic deregulation and stabilization, decentralization of the state (i.e. in Poland, delegating powers and a part of public property to 2500 local communes), demonopolization of the foreign trade, promotion of the bottom-up private enterprise, restitution of confiscated property, initiating the capital market and overall re-shaping of the legal and institutional framework. Normally, these are simultaneous efforts, undertaken under the pressure of time and people's expectations. The scale of the ownership transfers in the post-communist Europe is also different. It covers 80-90 per cent of the economy, including agriculture, financial sector, military complex built for the sake of the Warsaw Pact and municipal privatization. Additional major differences consist in the shortage of capital in the Central/Eastern Europe countries as well as. lack of the disposable income in their population, initial shortage of privatization skills and inherited, weak administration.

Privatization throughout former communist countries shares several characteristics in terms of starting point, scale, typical barriers and social constraints. However, in each country there are several distinctive features. Poland's specific traits include:

- a relatively large margin of private business. The predominantly privately-owned agricultural sector was a unique phenomenon among Comecon countries. The non-farm private sector in 1989 accounted for 10,3 of industrial production and 14 per cent of non-agricultural labour force,
- a strong trade union tradition of Solidarity and a generally influential labour force,
- rapid „small privatization” of some 2.500 enterprises in retail, construction and service industry.

What is, in turn, common and important, is the strong politicization of ownership changes, due to the scale of transfers and therefore huge re-distribution of economic and political power. This is amounting to to the social revolution, affecting almost everyone. As such, privatization is seen as the most destabilizing and potentially conflicting factor in time of painful transition. Apart from the other interesting aspects, ownership transfers in former totalitarian states provide a special case study of the interplay between politics and economics – unfortunately, not properly seen and largely underestimated in early stages of our transformation.

2. Poland's approach - the institutional framework, methods and achievements.

2.1. Framework.

The state sector in Poland encompassed some 8.500 enterprises in 1989, generating 73 per cent of the GDP. It was heavily concentrated and monopolised. Privatization is the responsibility of the Ministry of Ownership Changes (nowadays renamed as Ministry of Treasury), its Privatization Agency dealing with more routine job and 13 regional offices of the Ministry. Large-scale privatization was initiated in late 1990, when a great optimism prevailed as to the progress and social acceptance of ownership changes. It was reflected in the first programme, assuming that in the years 1991-93 some 50 per cent of all SOEs would be privatized – not realistic assumption, as has been revealed in the course of action. On the other hand, from the very beginning, it was recognized that, given the scale and complex nature of the challenge, any analogies to privatization in the West or in developing countries would be misleading. A truly innovative strategy was necessary, as reflected in the multi-track approach, and the concept of mass privatization. No one particular sector of the Polish economy has been explicitly excluded from privatization. A number of companies of strategic importance require the approval of the Council of Ministers before their transformation. Traditionally, annual targets for the Ministry and the other privatization agencies are set by parliamentary decision, voted on as a supplement to the annual budget.

2.2. Methods.

Poland's approach may be summarized as follows:

- a multi-track approach, allowing for flexible adjustment of the applied techniques to particular privatization cases (taking into account size of the enterprise, actual and projected financial performance, competitive position and interest expressed by Polish or foreign investors),
- decentralization of the procedures,
- „insider's” initiative (managers and workers leveraged buy-outs),
- employee shareholding (up to 15 per cent),
- limited and delayed Mass Privatization Programme,
- bank conciliatory procedures (debt-equity swaps).
- still unsolved problem of restitution and compensation for confiscated property.

Over the past ten years, several basic techniques for privatizing SOEs have been defined. The evolution of the diverse variants illustrates the process of adaptation to changing economic, political and social conditions. The law allows for the two fundamental, alternative methods of privatization:

- 1) Transformation of SOEs into a State Treasury corporation, either as a joint-stock or limited liability company („corporatization” of SOEs), the shares are then sold to private investors via trade sale, initial public offering or mixed methods.
- 2) Direct privatization through formal liquidation of SOEs with subsequent sale, transfer of the assets into an existing company, or its lease in part or as a whole.

Poland's variant of mass privatization – the National Investment Funds Programme was conceptually mature by mid-1991, but voted in parliament in not earlier than 1993 and implemented with delay, in 1995. The programme contained 512 enterprises, mainly medium-size and large, more than 50 per cent of them loss making, accounting for 8,5 per cent of the overall industrial production – a relatively modest programme in relation to the MPPs adopted in the other former Comecon countries. Every adult pole had a possibility to purchase one voucher, to be converted into shares of the 15 specially formed investment funds. 95 per cent of people reacted positively, purchasing vouchers, but majority of them confirmed „preference for liquidity” rule of the Central/Eastern Europe – selling vouchers and participating in the subsequent stages of the programme.

2.3. Privatization results to date.

The actual privatization appears to be slower and more politically controversial than assumed in early 1990-ies. Between 1990 and 31 December, 1999 privatization covered:

- 1454 firms via corporatization of SOEs,
- 1727 firms via direct privatization.

Additionally:

- 1641 firms were liquidated due to the economic reasons or declared bankrupt.

Therefore, taking also into account initiated privatization procedures, at the end of 1999:

- 2599 firms were still in the public register.

The strength of organized labour, as well as the vital role of management in SOEs, is reflected in the privatization statistics. The insiders – managers and employees – clearly dominate Polish property transfers in small and medium scale companies, while foreign investors prevail in large enterprises. Nowadays, Poland's transformation in general and privatization in particular, has entered the stage of the „second generation transition issues”. Privatization of so called „natural monopolies” dominates the Treasury Ministry's agenda since 1999, including former telecommunication monopoly (Telekomunikacja Polska S.A. – sold), banks and insurance (almost finished), energy system, Polish airlines (LOT – first stage accomplished) and transport infrastructure. Our privatization agenda tends to be strongly correlated with the European Union calendar of liberalization and deregulation.

3. Corporate governance and macroeconomic impact of privatization.

3.1. Corporate governance mechanism.

The question of emerging corporate governance structures was largely underestimated in the early stages of the post-communist transition. The prevailing mood of thinking favoured speed of property transfers and standard procedures, delegating restructuring task to the future private owners. Mass and rapid privatization was widely considered as an optimal solution to the post-communist etatistic challenge. How else could one divest, in a short time, the thousands of companies and break the links between economy and the state? Apart from this prevailing dogma, several East and Central European countries – Poland among them – were dominated (as mentioned above) by the managerial/workers buy-outs, shaping the corporate mechanism in small and medium size sphere. It is quite acceptable, of course, that the insiders be given an initial share in the ownership. However, there also risks of excessive managerial/workers power. There is namely, a danger of producing self-interested decisions and avoiding inconvenience such as painfull restructuring, wages controls and labour reductions.

As for employee substantial stakes, there is a special risk that they would be able to induce the managers to award them short-time gains at the expense of the long-term profitability of the enterprise. Further, with limited outsider controls over managers, private suppliers of equity finance tend to demand a premium in the cost of capital they supply, the same applying for the suppliers of debt finance. The weaker the degree of outsider control over an enterprise, the higher the cost of capital or credit can be expected. Generally speaking, inherited structure of the excessive insiders controls, strengthened in process of privatization, is not favourable to deep restructuring, so much needed in our transition economies. Mass privatization schemes also are not conducive to rapid performance improvement. Privatization to diffuse owners, with poorly regulated voucher funds doesn't create pressure to improve economic performance. These observations were strongly verified in numerous transition countries, including Poland. Consequently, in the second half of 1990-ies, quality of privatization and the resulting corporate governance patterns have attracted more attention. The quality of the transaction and its impact upon microeconomic performance appears as important as the statistics of the privatized companies. The key issue now is what new governance mechanism will be most conducive to the necessary restructuring and improvement of the competitive position of the privatized company. Thus, on our „trial and error” path, we have learned to accept that the efficient corporate governance and the proper institutional framework as the crucial issues and expected output of privatization, enhancing the results of the formal property rights transfers.

3.2. Macroeconomic impact.

Poland's economy was rising at the 5 per cent average annual growth rate in the decade of 1990-ies. Privatization is rightly seen as one of the decisive factors behind the impressive growth. On the other hand, the dynamic growth of grassroots private business – more than 2 million new undertakings since 1989 – plus the increasing tendency among foreign investors to seek a „greenfield” solution, gain in importance in the further expansion of the private economy in Poland.

The relation between privatization and overall economic performance depends upon mood of the divestiture. From the purely economic standpoint, trade sales involving foreign strategic investors are much more efficient. They entail substantial investments in the form of modernisation, restructuring and ecological improvements. They also generate essential budgetary revenue. Companies controlled by foreign investors contribute positively to the Poland's export potential. Fiat, Philips, Thomson, International Paper, GM are among the major exporters. On the other hand, this path of privatization appears more politically conflicting. In turn, privatization involving employee/ managerial LBOs is politically more accepted but the economic results of this path – as mentioned above – are dubious and much delayed. These procedures, involving insiders appeared to be 10 times as numerous as IPOs and trade sales involving real capital input. Only with time, through the consolidation of property rights and growing financial credibility, the companies privatized by LBOs improve and contribute to the modernization of Poland's economy. There is therefore, a clear trade-off between efficiency and political acceptance of various privatization methods.

The Polish example proves that the ownership transformation is very much a social process. People's perception plays a significant role. It is easier to develop conceptual schemes of privatization than to sustain them politically. Given the scale of remaining „work in progress” in Poland, both the qualitative and social aspects of privatization should be incorporated into the economic strategy – here is an important lesson which can be drawn from our case for the benefit of other transition countries.

Privatization, Foreign Direct Investment and Economic Performance in Hungary (1990-1999)

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Paper prepared for the JICA-JETRO Conference to be held in Vienna on November 30 – December 1, 2000; *First draft, not to be quoted*

1. Introduction

The Hungarian economy faced a critical situation in 1990 when the first freely elected government took office. Hungary belonged to the most indebted economies of the world with a per capita gross foreign debt of USD 3000, it was stuck in a lasting growth crisis, inflation measured on a CPI basis approached 25% per year and, last but not least, the economy struggled with immense structural problems. The sudden loss of traditional export markets in the COMECON trading block of Eastern Europe was aggravated by shrinking domestic demand and the sweeping first consequences of import liberalization for a string of domestic producers. A not insignificant number of reputed experts expressed fears that the Hungarian economy was close to collapse.

The picture is very different a decade later. Hungary cannot be regarded as a case of economic crisis. It is referred to by the European Union as the leading candidate for accession, its debt problem has more than halved if the level of per capita gross foreign state debt is considered the appropriate measure, and it has been on a steady path of economic growth since 1996. Moreover, the obsolete export structure of 1990 has been replaced by a sound new one in which the relative share of high-tech goods is above 25%. The country's export capacity in terms of US dollars went up from 10 billion to almost 25, one half of GDP. Unemployment is in the range of 7 to 8% as opposed to figures above 13% in the worst years of the early nineties.

A very good indicator of the extent to which the Hungarian economy has improved its performance during the nineties is the change of its position in the international competitiveness ranking list of the World Economic Forum. Hungary started from very low on this list: it ranked 47th ahead only of Russia and Venezuela in 1994 when it first figured on the list. Hungary's latest position was 26th in 1999, the highest in Central Eastern Europe and well ahead a couple of EU countries including Italy, Greece and Portugal. In other words, the poor competitiveness performer became a player in the Champions League of the global competitiveness game.

The obvious question is how such a dramatic change could take place within a time span of less than ten years. Good economic policies can, of course, be praised for such positive developments, but their impact would have been meagre without the contribution of economic actors. Are these the same in the year 2000 as the ones clearly very much underperforming ten years ago? Or has structural change meant that a great number of new players adapted to much higher competitiveness standards appeared in the Hungarian economy?

This working paper explores the assumption that besides the rules of the game also a significant part of the players has changed. This assumption means much more than just far-reaching privatisation, since privatisation as such changes the names and maybe the outfits of the players but they remain basically the same. In addition to privatisation, greenfield foreign direct investment is really the force that generates new market players.

2. Who have been the players?

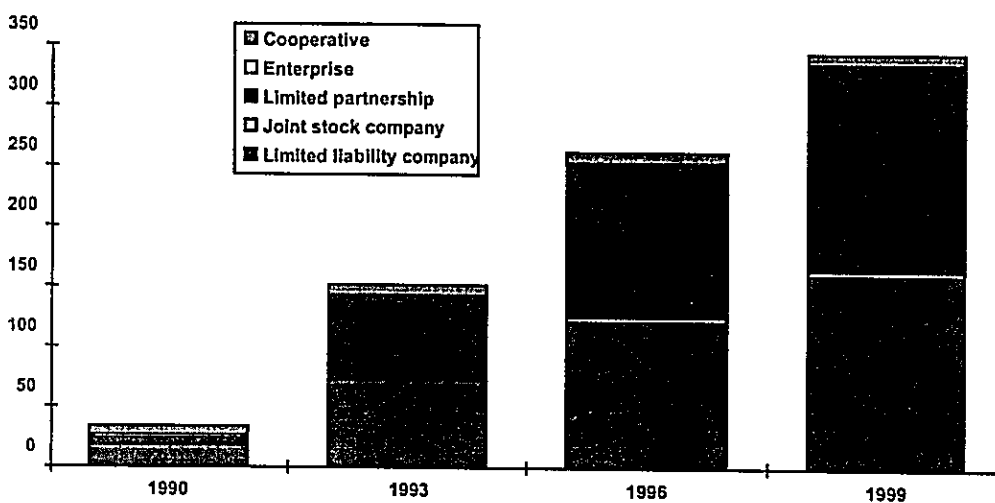
The number of market players has shown an incredible increase since 1990 in general. There were 660 139 private enterprises in Hungary at the end of 1999 as opposed to 393 450 in late 1990. The figure for 1999 is somewhat misleading since it included about 312 thousand self-employed entrepreneurs, i.e. family businesses.

Still, it is telling to which extent the formerly dominant forms of "socialist entrepreneurship" yielded the ground to modern corporate structures based on private ownership. Amongst these structures, Hungarian entrepreneurs' priorities showed a clear bias towards simpler corporate structures requiring less investment but more personal liability as in the case of corporate entities with higher degrees of financial and lower levels of legal exposures of the owners.

Graph 1 shows the development of the density of five main forms of entrepreneurship in Hungary. "Enterprise" which meant mainly, but not exclusively state-owned "socialist" enterprise in the pre-1990 past was the only category which has been slowly phased out. The sole form of non-state ownership officially encouraged before 1990, *cooperatives*, showed stagnation.

The other three forms expanded in a spectacular manner. Due to the differences in the amounts to be invested to set up one or the other, *limited partnerships* usually are small firms, *llcs* tend to be medium-size, and joint stock companies may be really important in terms of output and employment.

The number of different forms of business organisations in Hungary
(in thousand, 1990-1999)



Graph 1

Source. National Bank of Hungary (NBH) Annual Report 1999. 192.

The spectacular increase in the number of firms with corporate structures and mainly private owners has to be noted for one particular reason. It substantiates the development of what may be called (borrowing the term "*tissu industriel*" frequently used by French industrial economists) "entrepreneurial fabric" of the Hungarian economy. Even if most newly created firms are local market players without any presence on national markets to speak of, this explosion in the numbers of market players shows that competition has really gained ground in Hungarian market structures.

Overall quantitative data are not available on previous and current numbers of players in diverse market niches. One example from a strongly competitive sector sheltered from import competition might show how underdeveloped the "industrial fabric" had been if monopolistic competition is considered the dominant market structure.

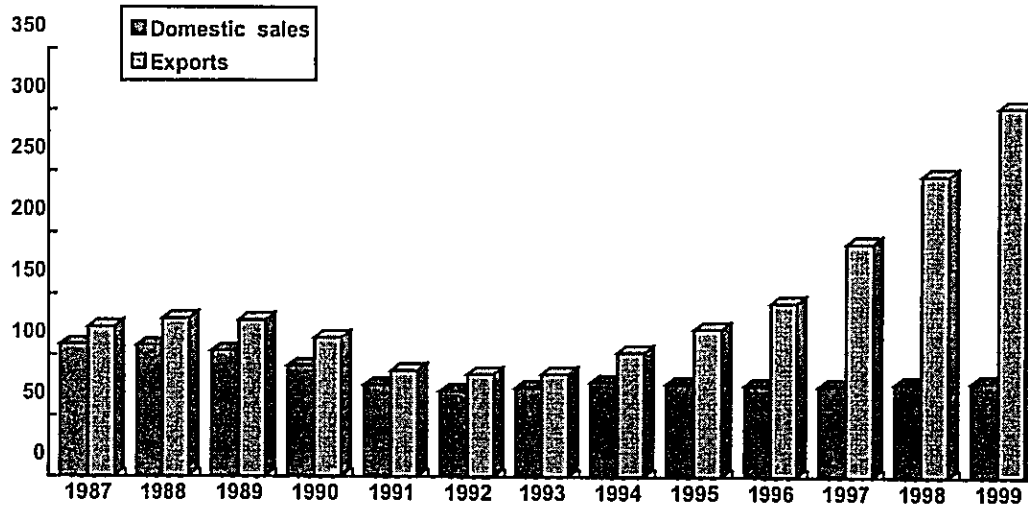
The merger of two national hotel chains was decided in 1996. Since both of them more or less covered the entire map of the country the extent to which their merger might or might not constrain competition was determined on the basis of the model of relevant markets. Two dimensions of this model were used: the geographical and the product structure dimension. The national market of hotel services was split up in 20 regional market niches (the 19 counties plus Budapest) and 5 quality categories (one to five stars). The result of the analysis of the national market of hotel services was more than surprising: *there was only one market niche (Budapest, three star hotels) in which the two partners envisaging the merger were competitors*. They were not simultaneously present in any of the other 99 market niches. This means they enjoyed strong local monopolies in a number of market niches before 1990 when no other major hotel firm existed in the country.

Hungarian market structures showed a spectacular development as a result of the interaction of several factors. The following list of these factors can be but tentative based on more of a speculative than an analytical background:

Import liberalisation: taking place between 1989 and 1991, this successful effort of eliminating import licensing made customs duties the practically exclusive tool of trade policy. While imports took substantial market shares from a string of domestic producers many of the latter did not collapse but converted themselves into trading firms. The disappearance or the shrinking of several manufacturing firms gave way to the emergence of smaller, specialized service firms as spinoffs of the former local giants. This is how one state enterprise could have a significant number of successors, in the first place in the light or the electronics industry.

A mirror process of import liberalisation, Hungarian manufacturing became increasingly export-oriented during the nineties. Graph 2 shows the astonishing speed of this trend after 1993, or three years of a crisis of export competitiveness owing to the loss of traditional export markets in Eastern Europe.

Volume changes in the domestic sales and exports of Hungarian industry (1980=100, 1987-1999)



Graph 2

Source: National Bank of Hungary (NBH) Annual Report 1999. 193.

Exports increased more than fourfold as compared to domestic sales when the entire time series is considered. This gives, however, a wrong impression since pre-1991 exports included non-competing (and mainly non-competitive) exports to COMECON member countries. The graph shows three different trends.

The *first* one is the deterioration of sales performances on all markets, testifying of the lasting crisis of the competitiveness of Hungarian industry before transition. The *second* trend is an overall sales slump between 1990 and 1993 in exports and, very tellingly, from 1990 through 1999 in domestic sales. 1993 was the year when the *third* trend, an increasingly fast improvement of export performance took its start and started to develop independently.

A comparison of the three trends in sales developments helps draw a snapshot picture of Hungarian industrial restructuring. The pre-1990 years were the ones when old structures started crumbling with entire sectors including mining, an important part of footwear, iron and steel, motor vehicles (mainly buses) and agricultural machinery industries. Most of their capacities disappeared and this is why it would be misleading to think that the very slow recovery of domestic sales after 1995-1996 re-created former structures of production. In fact, under the titles of old industries completely new ones were born, mainly under the control of foreign investors:

An overview of the development of diverse Hungarian manufacturing sectors, 1992-1997

Section	Output growth (1992-1997, per cent, constant prices)	Former players	New players
Textile, shoes, leather	-6,9	Budaprint, Panyova, Tisza Cipő, Mino, BBV	Graboplast, export-oriented subcontracting firms
Iron and steel	46,4	Dunaferr, Csepel, LKM, Ózd, MAT	Dunaferr, Alcoa
Engineering	213,0	IKARUS, Rába, Videoton, Ganz, MGM	Opel, Suzuki, Ford, IBM, Siemens, Daewoo

Table 1

Source. A gazdasági fejlődés és a foglalkoztatottság a 90-es években ECOSTAT, Budapest, 1999. 74

The above table shows the divergence in sectoral developments on the example of just three sectors. Even an incomplete sample shows the extent to which almost all major players in the three sectors were replaced by new ones, most of them multinational firms. Most of the latter have been real newcomers in the engineering sector, entering the market through greenfield investments. Their appearance in Hungary has greatly contributed to the fact that the relative share of engineering in the gross output of Hungarian industry increased from 14,6% in 1990 to 35,2% in 1998 [ECOSTAT, 1999b. 46.].

A special case has been that of the pharmaceutical industry, too little to be included in the table above. This industry has kept all of its major players and plants, but the companies were renamed after their privatisation. Six out of the seven leading domestic firms in this industry were acquired by multinationals from France, the US and Israel, and one (Richter) went public on the Budapest stock exchange. This one got back its old, pre-war name, while all the others now bear the names of their foreign mother firms.

Privatisation: many state-owned firms were privatised in a multiplicative way. Specialised units of former industrial complexes became independent firms even if their only market remained their mother firm. But many of these spinoffs were later forced to enter open competition and survived under such circumstances.

Hungarian privatisation seems in 2000, that is in retrospect, a process important first of all for its political and social implications, but not so much for its direct structural impacts on the economy. Only a few strong and competitive Hungarian-owned firms emerged from privatisation, and even when this occurred (cf. the Dunaferr case), the way privatisation had been carried out raised very loud and politically motivated questions. The really competitive part of the Hungarian private sector was created mainly through foreign direct investment, and the main channel of the latter was not privatisation.

Restrictive fiscal policies: high levels of personal income tax and social security payments have kept the cost of labour outrageously high as compared to incomes from employment. Even after a recent series of reductions in tax and social security burdens of employees and employers only about one third of the cost of the employee to the employer can be pocketed by the employee. The implications of this situation for fiscal policy cannot be discussed here, but it has had quite special consequences for entrepreneurship development.

The result has been called "forced entrepreneurship" by several Hungarian authors. It means the transformation of employment into subcontracting at a number of firms or even government authorities¹. The employee hoping for a higher net income gives up his job but keeps his desk in his former office. He creates a small firm (preferably a limited partnership with modest accounting and auditing obligations) and this firm bills his former employee for the same services now rendered in a form disguised in subcontracting.

Such practices are widespread and not illegal as such even if not always tolerated by the taxman or the labour authorities. If more fiscal transparency is envisaged, employment and subcontracting is combined for the same service: the employee keeps his job for a minimum wage and bills the employer on a subcontracting basis for the rest.

The game described above is one of the reasons why entrepreneurship has so spectacularly flourished in Hungary. The fact that the number of limited partnerships increased from 5 789 in 1990 to 170 762 in 1999 (MNB, 1999. 192.) can partly be explained by the massive transformation of employment into subcontracting.

Such developments also offer a partial explanation of the fact established in several analyses of the Hungarian labor market². Namely, that the employment level of the active population has declined in Hungary to a critically low level in an international comparison. Many family firms are not even self-employers: their owners get only dividends and try to have part of their living costs covered by the family firm. Such small firms have no employees at all and this is why it has been possible that the loss of jobs at larger firms and in the government sector was not offset by job creation in the SME world.

So far we have mainly assessed some such critical or not completely transparent areas of the Hungarian economy in which sometimes spectacular development did not always yield really important results in terms of macroeconomic growth and competitiveness performance. However, neither structural changes in the nationally-owned part of the economy nor privatisation as such could prove to be massive and long-term engines of growth. Nearly all analyses coincide that mainly the spectacular development of foreign direct investment (FDI) helped transform both the outward appearance and the real performance of the Hungarian economy.

¹ There have been government offices in recent years where about 10% of *de facto* employees were *de iure* subcontractors. This situation was, however, less attributable to a concerted attempt at tax avoidance than to the repeated obligation of reducing employment in the public sector.

² Cf. [ECOSTAT, 1999a. 107.].

3. Foreign direct investment and economic perspectives

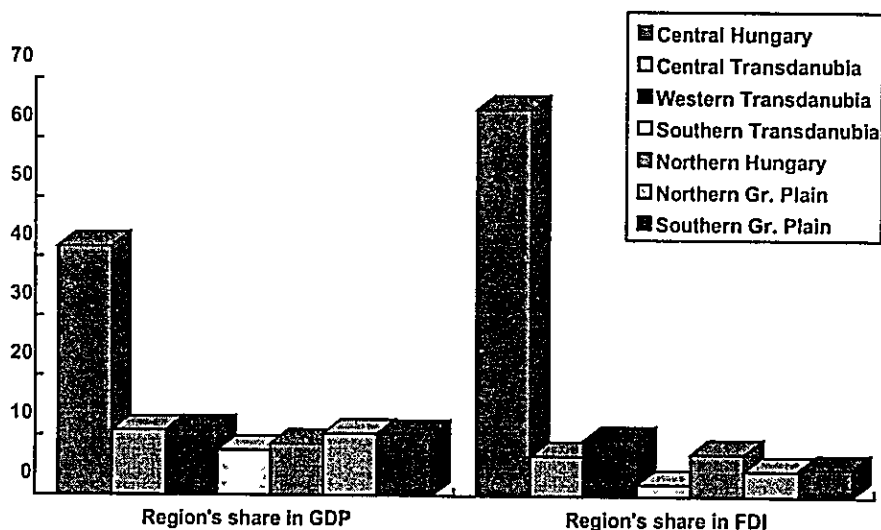
The massive inflow of FDI into the Hungarian economy during the nineties has completely transformed the economic landscape of the country. Suffice to mention that about two thirds of Hungarian exports are generated by multinational firms (MNCs) present in the country and about 40 of the 50 largest corporations in the world have subsidiaries in Hungary. Two preliminary conclusions seem appropriate before more in-depth analysis:

- 1) Massive structural changes and considerable improvements in competitiveness took place in the Hungarian economy owing to the inflow of FDI. Many MNCs present in the country have tied their Hungarian subsidiaries into their worldwide, and especially European supply networks. This has meant rapid micro-integration between Hungary and the European Union in several industries such as engineering, chemistry, light industry, electronics and food. Micro-integration has been going well ahead Hungary's official process of accession to the EU. Technologies, labor relations, employee skills and corporate cultures have undergone great improvements in all the sectors doing business within or with the MNCs.
- 2) Dynamic developments in the Hungarian economy were, to a great extent, limited to both the structural and the geographical segments of the economy where MNCs have been strongly present. This has led to a certain "*dualisation*" of the economy which, in a regional approach, can also be called "*italianisation*". Smoothing out the structural and the regional tensions of the economy is not an easy task at all since it should take place in a very cautious way, with the highest possible degree of freedom from short-sighted political influences, and without endangering the already existing growth base of the economy.

Our subsequent analysis will focus on the development of FDI in Hungary in an international comparison, while a section on its own will be devoted to regional economic developments due to the increasing importance of the problem. Graph 3 shows Hungary as one of the most important FDI receiver countries of the region, second only to Poland with almost fourfold GDP and population sizes and in a close competition with the higher developed Czech economy.

The considerable size differences between the economies shown on Graph 3 could make it worthwhile to show FDI stock on a per capita basis. In such a comparison, Hungary would also fare much better than when absolute indicators of FDI stock are used. Such an approach would be, however, questionable from a methodological point of view. Global competition including regional competition for FDI takes place irrespective of per capita indicators. What matters is in the first place economic performance by country regardless of how a given country has been able to overcome its competitive disadvantages linked to its smaller size.

The stock of FDI in selected CEEs, billion US dollars, 1998-1999



Graph 3

Source: Business Central Europe September 2000. 69.

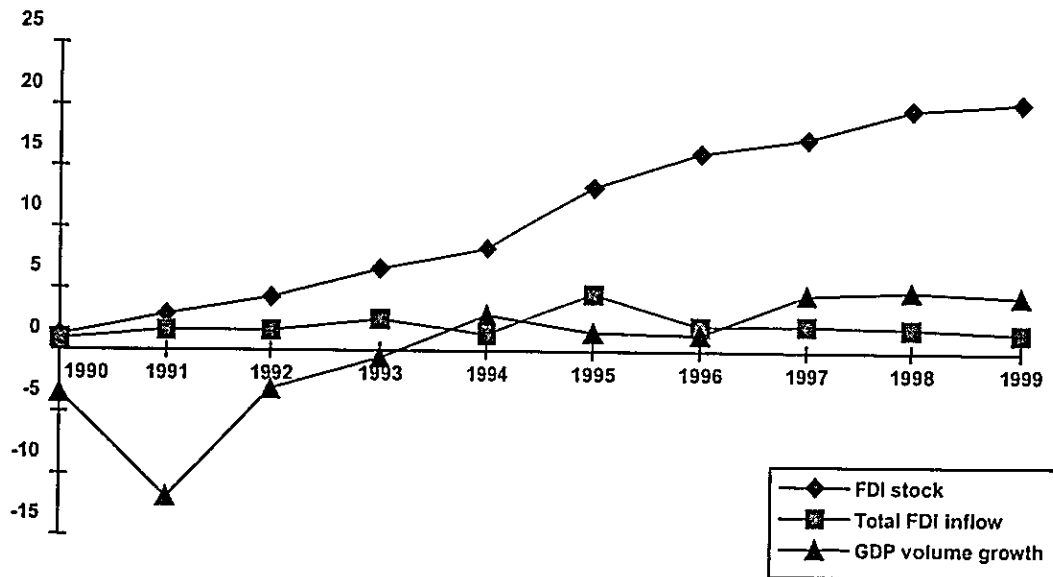
The inflow of FDI in the Hungarian economy took a head start in the early nineties. Up till 1994, the stock of FDI in Hungary made out more than 50% of all FDI stock in the 12 comparable countries of the region³. The corresponding figure for 1999 is significantly lower, about 18%. The reason for this substantial decrease is twofold: on the one hand, FDI inflow in Hungary has slowed down as it will be documented below. On the other hand, the "reform lags" in the other CEECs have started to disappear as the possibility of EU accession came within reach and transition gained speed almost everywhere in the region. Economic stabilisation policies and reform packages were positively received by MNCs and they started to set foot in most other CEECs.

The time series based analysis of FDI inflow in Hungary makes it possible to link these trends to overall economic performance as well as changes in different locational advantages making Hungary a more or less attractive investment target during the nineties. We will use GDP volume growth as background data visualising investment climate⁴.

³ Countries listed in Graph 3 plus Latvia and Lithuania.

⁴ We are aware of the fact, of course, that GDP growth as such is largely insufficient to depict changes in investment climate. Still, at least in the Hungarian case, it has been a quite good indicator of cyclical developments during the nineties given the fact that the economy had suffered from a lasting growth crisis between 1979 and the late eighties.

FDI stock and FDI inflow (both in billion USD) and GDP volume growth (in percentage) in Hungary 1990-1999



Graph 4

Source: for GDP data MNB 1999., 188.; for FDI data the homepage of the Ministry of the Economy (<http://www.gm.hu/economy/capital/capi-01.htm>)

The cyclical picture shown by Graph 4 seems to be somewhat confusing. FDI inflow has been more or less constant during the nineties. It peaked in 1995 due to the massive privatisation of utilities in December of that year. If trends of FDI inflow and GDP growth are compared striking divergences arise: the lasting slump of the early nineties did not prevent foreign investors from appearing massively in Hungary. In the same time, accelerated GDP growth in the late nineties did not increase the attractiveness of the economy for foreign investors.

These apparent contradictions might have to do with a somewhat narrow perception of the relationship between FDI inflow and macroeconomic performance. Not only FDI might prefer to flow into high-growth economies but growth also accelerates in economies where FDI stock is strong enough to support competitiveness increase.

If any parallel should be sought in Graph 4 between FDI developments and GDP growth then trends of FDI stock and GDP growth have shown a certain convergence. In fact, the nineties have been the decade of massive revival of the Hungarian economy's export base due to the fast increase in FDI stock: Hungary's exports measured in US dollars and sold on competitive markets increased from 10 billion to 25 billion in less than ten years. Interestingly, non-FDI based exports have more or less stagnated between 1990 and 1999 and basically all the incremental part of Hungarian exports was generated by inflowing FDI.

The slowdown of FDI inflow to Hungary in the late nineties can also be tracked to two further factors:

1. *Structural exposure.* International comparisons speak of a quite tight relationship between levels of economic development and the capacity of FDI absorption. In fact, Hungary is one of the few countries of the world where a medium level of development is accompanied by a well above average weight of FDI in the economy. According to the UNCTAD, four countries of CEE had very high ratios of inward FDI stock by international standards in 1997: Hungary (35 %), Estonia (25 %) and both Latvia and the Czech Republic with 23 per cent each [UNCTAD, 1999. 71.]. The world average for the same year was 11,7 %, the average of the developed countries 10,5 %, and the EU average 15,2 % [UNCTAD, 1999. 513.]. Only very highly developed and traditionally very open developed economies had ratios higher than Hungary: Belgium/Luxembourg 55,1 %, New Zealand 48,1 % and the Netherlands 35,3 %. From the less developed world and besides about twenty city-states and tiny Third World economies including a number of Pacific and Caribbean islands only Chile had a ratio comparable to that of Hungary in 1997 (33,1 %).

Both Chile and Hungary are countries in the second tier of world economic development which have followed liberal and export-oriented economic policies during the nineties. It may well be possible that they both become Dutch- or Belgian-type financial and trading hubs later in their history. Still, a significant difference between them and the two Benelux economies is that the two latter have been traditionally very important exporters of FDI which cannot be said of Chile and Hungary.

Another important sign of Hungary possibly approaching kind of an upper limit of its FDI absorption capacity is provided by the international comparison of *FDI inflows measured in terms of gross fixed capital formation*. In this respect Hungary almost tops the CEEC field: only Latvia came ahead of Hungary in 1997 with 40 per cent. Hungary was second with 30 % and Poland, Bulgaria and Estonia were tied with 15 % each [UNCTAD, 1999. 71.].

If worldwide data are used Hungary's high structural exposure to FDI becomes even more striking. World, OECD and EU averages are all between 7 and 9 per cent. Within the developed world only Sweden stood out with 35 % in 1997 (but all the same its outward FDI flow came to 40 % as compared to gross fixed capital formation in 1997) and, besides Latvia, still Colombia and Venezuela had indicators higher than Hungary [UNCTAD, 1999. 501-512.]. Any other country with higher indicators had so small economies that basically one or two major investment projects could send the ratio easily above 30 %.

The very high relative data of inward FDI flows in Hungary do not necessarily speak of a major risk to the country's economic development since most foreign-owned capacities have become organically integrated with the domestic economy. The problem is rather that the government does not seem to understand that a turning point *vis-a-vis* FDI is approaching: if nothing is done FDI inflow might very well go down in an asymptotical manner since an absorption capacity problem could appear in a macroeconomic and structural approach.

It has to be decided rather sooner than later whether Hungary would like to become a small and very open trading nation such as Belgium or the Netherlands, very probably in a pioneer role among the CEECs. If this is not decided and declared fast enough, the economy's *current* FDI absorption capacity would determine further inflows in which case further falls in FDI inflow could be predicted.

2. *Regional saturation.* The regions of the country receptive to FDI and acceptable for foreign investors might have become saturated which is shown by labour shortages in industrial locations (Győr, Székesfehérvár, Komárom, Tatabánya) with high FDI stock concentration. Any further acceleration of FDI inflow would suppose an intense development of both physical infrastructure and human resources in less developed Eastern and Northeastern regions.

Whatever has been said in the previous paragraphs on the country's overall FDI absorption capacity now it turns out that *everything* regarding Hungary's high exposure to FDI is valid for only a few regions of the country. FDI is rather scarce in a couple of regions. Regional imbalances therefore play a major role in how Hungary could benefit from eventually continuing FDI inflow during later stages of its economic development.

4. The regional picture of growth, development and FDI

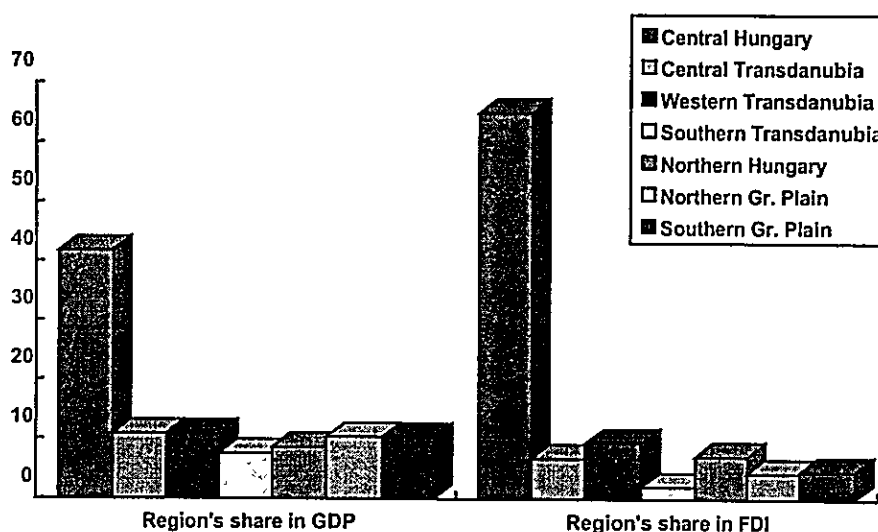
Hungary consists of seven so-called planning-statistical regions according to the EU methodology used for the distribution of regional subsidies. The regions are as follows:

- Central Hungary (around Budapest);
- Central Transdanubia (including Székesfehérvár and Veszprém);
- Western Transdanubia (including Győr and Szombathely);
- Southern Transdanubia (including Pécs);
- Northern Hungary (including Miskolc);
- Northern Great Plain (including Debrecen and Nyíregyháza);
- Southern Great Plain (including Szeged).

These regions have about equal geographical sizes but greatly different population numbers and they also show a great diversity of economic structures and potentials. As a rule valid also in historical retrospect the Western part of the country has been more integrated with the Western part of Europe and has been usually ahead of the Eastern half of the country. The reasons for these lasting development gaps include the much higher exposure of Eastern Hungary to Turkish occupation in the 16th and 17th centuries resulting in a devastated economy and traditionally poor infrastructures in the East of the country.

Graph 5 shows regional differences within the Hungarian economy from two aspects: the regional breakdown of GDP and the regional breakdown of FDI.

Relative shares of Hungarian regions from the country's GDP and inward FDI stock (in percentage, 1998)



Graph 5

Source. A magyar régiók zsebkönyve'99 KSH, Budapest, 2000. 15, 22.

The dominance of Central Hungary, and within it Budapest is astonishingly strong in both respects, especially in FDI. It seems from the graph that the presence of FDI in the central region is even stronger than it could be expected from its share in GDP. The unexpectedly great regional disparities make it clear that the absorption problem can be valid only for one region or two, but certainly not for the Eastern half of the country.

The unemployment situation seems to confirm this assessment. Regional rates of unemployment measured in late 1999 ranged from 4,0 per cent in the central region to 17,1 per cent in Northern Hungary [KSH, 2000. 11.], with a national average of 9,6 per cent. Meanwhile, the three central and Western regions had rates of unemployment below 9 per cent each, whereas the remaining four regions had indicators above 10 per cent.

There seems to be a positive loop in the "winning" and a negative one in the "losing" regions. The positive loop is self-asserting in the sense that higher economic development attracts more FDI which, in turn, creates jobs, generates additional exports and growth which, again, make the region even more interesting for investors from abroad. This loop seems to be, though, approaching its end in those regions where very low rates of unemployment seem to indicate a certain depletion of factors for growth.

The negative loop is still well and alive. This loop is also self-asserting because FDI avoids low-growth regions where the availability and the quality of resources for growth are much below optimal levels. Therefore growth in those regions can be supported only by local resources which are unable to generate significant additional exports. As it has been seen in the previous section, the carrier of Hungarian industrial growth has been export to an ever increasing extent during the 1990s. The transformation of Hungary into an export economy has taken place, however, mainly in the "winner" regions only.

The location of the "winner" regions also has some explanatory power. If business contacts of smaller local firms are surveyed it becomes clear that natural contacts for Western Hungarian firms are German, Austrian or Italian businesses ⁵, while Eastern Hungary's smaller businesses tend to cooperate with their Yugoslav, Romanian or Ukrainian counterparts. These differences in trading patterns are very likely to be reflected in diverging developments of business cultures in the different regions of Hungary as well.

This regional approach to the recent development of the Hungarian economy makes it clear that the average indicators of macroeconomic performance and structural change give a somewhat misleading picture. It was explained earlier in this paper that the engineering industry has been the engine of growth of industrial output and exports. It turns out from regional data that 24,5% of the employees of the engineering industry were based in Central Hungary in 1999 [KSH, 2000. 32.]. If this region and Central Transdanubia (including the town of Székesfehérvár with IBM, Philips, Siemens and the Videoton Holding ranking, respectively, 2nd, 3rd, 8th and 15th on the list of top Hungarian engineering firms in 1999 ⁶) are considered together, their joint percentage share in Hungarian engineering employment is above 46%. Western Transdanubia is added and it can be shown that about two thirds of engineering employment are in the three "winning regions".

In any event, the industrial strip Budapest-Székesfehérvár-Győr has been the main stakeholder of recent Hungarian industrial expansion, and most of the benefits including growth in investment and employment went also to this part of the country. The success story is there, but it is still an open question whether this success story would really cover the entire Hungarian economic space or not.

5. Different performance by a different economy

A brief summary of Hungarian economic development in the 1990s should very likely contain the statement "redefinition of the economic space" and its explanation. This redefinition has meant much more than just a structural shift from or a growing regional imbalance between the East and the West of the country. The content of the Hungarian economic space has undergone very significant changes, players and capacities representing completely new levels of quality have appeared in the economy. This transformation has had, of course, a strong regional component but also extremely important other ones.

The main reason why we now see the Hungarian economy different from what it was about ten years ago is the massive appearance of new, competitive players in the economy. It is very telling to see the list of the leading Hungarian firms in 1999 broken down in three groups:

- 1) *pre-1990 market players, unchanged.* This lack of change does not refer to ownership since ownership change has been general in the Hungarian economy. It rather reflects the changing "boundaries of the firm", i.e. those companies are considered here which offered basically the same product/services mix in 1999 as back in 1989. In other words, they remained players on the same markets;

⁵ Large multinational corporations including most U.S. and Japanese firms present in Hungary have a tendency towards preferring the central region but their choices of partners depend much more on global than on regional considerations.

⁶ Figyelő, 2000. 73.

- 2) *pre-1990 market players, transformed*. Transformation does not mean legal transformation (the creation of corporate legal structures) here, because it was again the rule among Hungarian firms in the 1990s. These firms either substantially enlarged or narrowed down their product/services mix in recent years but their core activities remained the same. They continued to compete on the same markets as before but they entered some new ones and/or exited some of their former ones;
- 3) *new players*. Before 1990, these company names were present in Hungary only linked to imports, if any, but not at all related to domestic production.

Old, transformed and new players in Hungary (1999), based on the Top-200 list (first 50 firms, company name plus ranking)

Players unchanged from before 1990	Players transformed since 1989	New players
1. MVM (Hungarian Electricity), 6.	1. MOL, 1.	1. Audi Hungaria, 2.
2. Dunaferr Group, 7.	2. MATAV - Hungarian Telecom, 5.	2. IBM Storage Products, 3.
3. Hungarian Railways, 10.	3. Shell Hungary, 17.	3. Philips Group, 4.
4. Budapest Electricity Works, 12.	4. Hungaropharma Ltd., 34.	4. Opel Manufacturing Hungary, 8.
5. GE Lighting Tungfram, 13.	5. Siemens Hungary, 35.	5. Metro Holding, 9.
6. TVK Ltd., 19.	6. Electrolux-Lehel, 44.	6. Panrusgaz, 11.
7. MALEV Hung.Airlines, 20.	7. Hungarian Tobacco Trading Ltd., 46.	7. Flextronics Int'l., 14.,
8. Hungarian Mail, 21.	8. Szerencsejatek (Gambling) Ltd., 50.	8. Westel 900 GSM, 15.
9. Northern Transdanubia Electricity Co., 22.		9. Hungarotabak, 16.
10. Paks Nuclear Power Station, 24.		10. Suzuki Hungary, 18.
11. Alcoa Kofem, 28.		11. Opel Southeast Europe, 23.
12. Borsodchem, 31.		12. Philip Morris Hungary, 25.
13. Tigaz Ltd., 32.		13. OMV Hungaria, 26.
14. Dunamenti Power Station, 38.		14. Pannon GSM, 27.
15. Budapest Gas Works, 45.		15. Porsche Hungary, 33.
16. Northern Hungary Electricity Works, 48.		16. Tesco-Global, 36.
17. Gedeon Richter Chemicals (Pharma) Ltd., 49.		17. Fintage Ltd., 37.
		18. Visteon Ltd., 40.
		19. Spar Hungary, 41.

Table 2

Note: 6 company names are missing from the source, but their positions were left blank on the original list.
Source: Figyelő Top-200, 2000. 20

The company structure shown by the table is remarkably symmetrical: both about 40% of the companies listed are either unchanged or new, and only 20% of them belong to the "transformed" ones. This first observation seems to suggest that the company picture of the Hungarian economy (judged from the largest firms) has a dualistic character in the sense that old firms coexist with new ones, but relatively few companies have undergone a really deep and adaptative transformation.

This argument is, however, somewhat misleading from a market structure based point of view: out of the 17 firms "unchanged", no less than 11 are utilities, other natural monopolies or national "flagship" firms (cf. the national airlines). As opposed to this, 16 out of the 19 "new" firms are players in really open and competitive markets. The exceptions are Panrusgaz, an exclusive importer of natural gas from Russia, and the two GSM firms competing with each other but sheltered from new entries by a concessions-based regulatory system. Regarding the smallest group, that of the "transformed" firms, 3 out of the 8 are at least partly concessions-based or natural monopolies (oil, telecom, gambling).

All this means that about *two-thirds of the largest Hungarian firms under steady short-term competitive pressure are new entrants to the domestic market*. The competitive sphere of the Hungarian economy was much more different in 1999 from its 1989 edition than it was the case for the whole economy.

The findings of this paper can be summarized based on the above observation. While macroeconomic data speak of an impressive performance improvement in the Hungarian economy, we feel the really important changes took place in the Hungarian corporate world. The new economic landscape also means increased regional differences but, in the first place, an overwhelming majority of large new players as compared to large incumbents in the competitive field.

If there is any real possibility for the country of a catching up with the West, it is based on the strikingly great number of new competitive firms that have appeared in Hungary since 1989. This is only partly due to privatization, but its role in launching the deep transformation process of the Hungarian "microeconomy" can hardly be exaggerated.

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Privatization in the Czech Republic: Results, Problems and Open Issues

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1. The Extent of the Problem

In none of the other smaller European communist countries was the elimination of private property as complete as in the former Czechoslovakia. Poland had private farming; in Hungary there was always some private sector, and its role increased in the Eighties. Even East Germany retained some forms of private business. This was not the case in Czechoslovakia.

Here, though only the largest companies and banks were nationalized in October 1945, all the remaining industrial firms were seized by the new communist regime after 1948 and turned into state-owned enterprises. In the Fifties, 99 % of private farms were massed together into co-operatives in which private property rights were disregarded; the same happened to small businesses in retail trade and services. Since then, for 30 years, no private enterprise practically existed in Czechoslovakia.

Elimination of private entrepreneurial activity was one of the reasons why the country was lagging more and more behind in its economic performance. Complete „socialist“ ownership formed a firm base for a full-fledged command economy, with highly monopolized production structures. The absence of private activities enabled complete central price fixing, with the result that prices, in the end, lost any role for efficient allocation of resources.

In state-owned enterprises or formal cooperatives, individual initiative and responsibility was largely lost, as was entrepreneurial know-how. Collective irresponsibility arose. In the social sphere, people became accustomed to relying on a paternalistic state in every respect.

Centralization of enterprise profits in the state budget led to huge redistributions - profits were taken away from efficient producers, and used to subsidize loss-making ones.

Productivity growth within the economy had been slowing down since the Sixties, and by the end of the Eighties, productivity actually began to fall. Czechoslovakia was lagging behind in the technical level and quality of its products, losing ground in international competition, and becoming more and more dependent on the „soft“ Soviet and other COMECON markets.

In 1989 in the Czech Republic, 98.5 % of GDP was produced in the state-owned sector, private sector having only a tiny 1.5 % share. For comparison, the share of private sector on GDP in the former East Germany was 8.5 %, it was 14 % in Hungary, and 26 % in Poland. This shows the huge extent of the privatization task in the Czech economy at the start of transition, even compared to the above mentioned neighbour countries.

2. The Strife for Fast Privatization

Rapid privatization of state-owned enterprises was seen as one of the main pillars of transformation. Other pillars were the freeing of prices after 40 years of central price control, and the opening of the economy - i.e. freeing of exports and imports, and introducing convertibility of the currency for external trade. All the transformation steps however were preceded by a year of preparation and macroeconomic stabilization in 1990 - so that the transformation program really started as of January 1991.

The privatization program went along three, or better to say four, lines: restitution, small-scale, and large-scale privatization of existing enterprises (compare the Annex for statistical data) - and the emergence of new private businesses as soon as private business activities were legalized.

- Restitution, to natural persons, of property nationalized after February 1948 started in 1991 and concerned mainly real estate and retail businesses. It was the first step to create a new basis for small private enterprise, and till 1995, roughly a hundred thousand persons got their former property back. Restitution to natural persons was accompanied by partial restitution of church property - mainly to the Catholic Church - while another part of church property restitution remains unresolved owing to lack of political consensus up to now.
- Small-scale (or „small“) privatization concerned small state-owned businesses, mainly in retail trade and services, which were sold by auction. Small privatization started in 1991 and was completed in 1993. More than 22 thousand of small businesses were auctioned, in a total book value of about CZK 30 billion.
- Large-scale („large“) privatization was the key, and most difficult, part of the privatization program. It involved almost all large industrial enterprises that were in state hands - with the exception of some public utilities.

The combined book value of enterprises going into the program of large privatization greatly exceeded the financial possibilities of the Czechoslovak citizens; consequently, public tender or direct sale to domestic and foreign buyers were combined with a give-away transfer of part of the property to Czech and Slovak citizens - the so-called voucher privatization.

Privatization projects were prepared by the management, while any natural or legal person could submit a competing privatization project: on the average, four competing projects were submitted for each enterprise (including projects submitted by potential foreign buyers). The winning project was chosen by the respective (Czech or Slovak) Ministry for Privatization. This means that the ministry (or, in conflicting cases, the Government) decided on the actual breakdown of the different privatization methods to be used.

The process actually began in 1991 with the direct sale of some large enterprises to foreign investors, the liquidation of some non-viable units and by turning state-owned enterprises into the legal form of joint-stock companies. But mass-scale large privatization started with the first round of voucher privatization opened in May 1992. As of January 1993 however, Czechoslovakia was divided into two states - the Czech Republic and the Slovak Republic - and this paper, from here on, will follow the progress and results of privatization in the Czech Republic only. The Czech government introduced a second round of voucher privatization in 1993.

In big strategic enterprises (and banks), the most usual privatization procedure was to transform the state-owned enterprise into a joint-stock company, and to offer its stock partly for sale, partly for distribution through vouchers - a small part remaining aside for restitution (in a Restitution Investment Fund, RIF), and another part being retained in the hands of the state represented by the Fund of National Property.

3. The Pros and Cons of Fast Privatization

From the very start of the transformation program, it was seen as vital not only to privatize, but to privatize quickly. The motto was to „privatize as much as possible, as fast as possible“.

Ministerial officials were unable to play the role of effective owners for thousands of enterprises. After the collapse of central planning, they also had very few effective instruments to control the behaviour of firms. The economy could no more subsidize the increasing numbers of state-owned enterprises that actually were value subtractors - the value of their output was lower than the cost of the inputs which they absorbed. So-called „production for production“ was increasing, with little effect for the final consumer. External conditions also changed for the small and highly open Czechoslovak economy as the traditional „soft“ markets were breaking down and trade had to be re-oriented.

Former Czechoslovakia had ample experience with reform attempts that failed to increase the efficiency of the economy based fully on state ownership. Fast privatization was seen as the only viable solution - but it faced a fundamental problem: there was no domestic capital capable to buy such a vast volume of property.

Selling it all to foreign investors was politically unfeasible. It was also practically impossible, as it would have required to attract, within two to three years, USD 40 bill. of foreign investment. Moreover, foreign capital would not have been interested in the whole range of privatized firms. If confronted with actual figures on the cumulative foreign direct investment inflow during the whole 1990s (approximately USD 16 bill.), the idea of mass privatization by foreign capital is clearly unrealistic.

The political feasibility was no less important at the time when decisions on the form and speed of privatization were taken. In the years 1991 to 1993, the entrepreneurs' interest groups, the trade unions, and most of the general public supported the slogan „Czech firms into Czech hands“. Even some very liberal economists backed the idea that the so-called family silver must remain in the hands of Czech capital. In this prevailing social climate, it was a success that the government pushed through the principle of equal access for everybody - that is, no discrimination of, but no big advantages for, foreign capital.

Only practical experience gained during privatization could change this prevailing attitude. Several years later, with the visible economic success of most foreign-owned firms, it became clear that foreign owners bring not only capital but know-how, managerial experience, access to markets, and employment opportunities. Yet, in spite of that, it would be a heroic and naive abstraction to think that the bulk of privatization could have been based on foreign capital.

The solution that was found, as shown above, was a combination of voucher privatization of almost half of the property, direct sale (financed predominantly by privatization credits granted by Czech banks) for another part, and with a third part being privatized by foreign investors. This solution had the benefit of being fast. It prevented huge potential losses of trying to run a state-owned economy for another decade, or, rather, decades.

Of course, there are seldom benefits without some costs. The main problems are presently seen, first, in the lack of effective corporate governance, and second, in the two-sided position of banks as creditors and owners. Let us discuss both problems briefly.

Corporate Governance. Voucher privatization was not best suited to bring effective owners immediately into the privatized firms. It formed only a basis on which effective corporate governance could evolve gradually. A major role in voucher privatization was played by the so-called investment privatization funds (IPFs). The IPFs were originally proposed by the government with the idea of assisting voucher holders, and limiting the dispersion of ownership. Actually, the funds succeeded in concentrating in their hands the bulk of the property privatized by vouchers, and became very important owners. That opened the way for a large role of investment funds in the ownership structure.

Nevertheless, the concept of IPFs had some serious weaknesses from the very origin. Legally, they were inspired by European Union and U.S. legislation, suitable for funds as a tool of collective investment. For this reason, the IPFs' maximum stake in one company was limited by law to 20 % of the shares, and simultaneously, the fund was not allowed to invest more than 10 % of its assets in the equity of one issuer. After the IPFs became the main owners emerging from large privatization (according to some estimates, in 1996 they owned more than two-thirds of assets privatized by vouchers), economists realized that there is no one but the IPFs who could act as agent of corporate governance. In fact however, only the largest IPFs formed by banks were capable of playing this role, as the banks delegated experts to the supervisory boards of companies in which their IPFs had large stakes. But due to legally limited stakes, their influence was undercut, leaving the real control in the hands of managers.

The still underdeveloped capital markets with low liquidity, on the one hand, and the ambiguous position of investment funds toward playing the role of effective owners on the other, opened the problem of effective corporate governance in the Czech economy. The country thus was positioned somewhere between the American model of corporate governance, and the German, or European, model.

The usefulness of the 20 % ownership limit was widely discussed, with OECD even proposing to decrease the limit. But for effective corporate governance, IPFs needed larger stakes. A radical solution found at the start of 1996 was the transformation of IPFs into joint stock companies, in the form of holdings, to which no ownership restrictions are applied. Thus, the holdings escaped the change in law which came into effect in 1998, when, following the recommendation of the OECD, the limit for IPFs was decreased to 11 %. A concentration of ownership followed the transformation into holdings, and opened the potential for a better corporate governance. Subsequently, it could be observed that the restructuring of companies, especially the large „mastodonts“ inherited from the past, speeded up substantially.

On the other hand, the transformation of IPFs into holdings opened another serious problem - that of inadequate legal protection of minority shareholders, whose interests the holdings often neglected. This problem was alleviated only in 1999 by the amendment of law, forcing the majority shareholders (with more than 50 % on equity) to buy out the shares of minority shareholders, at a price representing a six-month average of the Prague Stock Exchange price.

Double role of banks. Some of the largest investment privatization funds (now called investment funds) are owned by big Czech banks which, in turn, were till the end of the 1990s partly state-owned. That opened the way for criticism that privatization was only formal. In fact however, the state had little possibility to control businesses via the banks directly. More important was the line of control of companies by bank credits, where the state had only limited possibilities of involvement. Nevertheless, both public opinion and the government often indirectly pushed banks to continue the financing of ailing companies, to avoid mass unemployment and social unrest. This pressure however proved short-sighted and counter-productive, enhancing the bad loan problem in the portfolios of banks, which the government is presently forced to resolve. That is why the government is now pushing for finalizing the privatization of the state stakes in the banking sector.

Banks that indirectly, via the investment funds, own large amounts of industrial property are in a double position as owners and creditors. In the last two years, additional legal measures to strengthen the „Chinese wall“ between banks and their investment funds were taken, to alleviate possible problems of conflict of interest and to bring the respective Czech law fully in accordance with European Union legislation.

The present position of the Czech banking sector is still largely defined by the role which the banks played during privatization, as creditors. The part of small and large privatization that went by sale into domestic hands was almost fully financed by credits by Czech banks. In addition, Czech banks also financed the newly emerged private firms that mushroomed in the first years of transformation: between 1990 and 1993, the total number of firms in the Czech Republic increased 50 times (from 18 800 to 1 119 000). The result was an enormous increase of demand for bank credit, and bank services generally. Credit activities in this period, of course, involved an unusually high degree of risk. By taking the burden of this risk, the Czech banking system made privatization and economic transformation possible.

The privatized firms also carried a high burden - that of large past debts from the communist era, debts which reflected the decreasing efficiency of the „command economy“. Enterprise debts in the Czech Republic were not written off by the government, so that the firms were privatized with all their liabilities. Unlike in Poland in Hungary where double- or triple-digit inflation effectively wrote-off the old debts of companies, in the Czech Republic inflation was successfully kept at low levels. That was a remarkable success on the one hand. It preserved, for households, most of the purchasing power of their savings. But, on the other hand, it meant that Czech firms entered the phase of microeconomic restructuring with a substantial burden of past debts. Via the ownership relations, as well as via bad loans (due to enterprise insolvency), this burden has to a large part been transferred to Czech banks. This is a problem with which the Czech economy is struggling till today, and it will preoccupy us for several years to come.

The Government and the Czech National Bank later helped to relieve part of this burden by programs of recapitalization and consolidation of small banks. Despite all the efforts, 15 small banks collapsed and were either closed down or taken over by large banks, in 1995-2000. As to large banks, the government has in 1999 and 2000 transferred a part of their bad loans to a special institution, the Konsolidační banka (basically, a bad-asset management agency). The aim is that with cleaned portfolios, the large banks can function normally, and be privatized in a standard way by strategic foreign partners.

4. Was Privatization too hasty ?

Both among Czech economists and in international circles, a dispute exists on privatization. Privatization was one of the main pillars of transformation. Was it correct to privatize fast, and to start privatization before a standard institutional framework of the market economy was established? Lately, it was Joseph Stiglitz, Chief Economist of the World Bank, who cast doubt on one of the pillars of the so-called Washington Consensus (the basic IMF and World Bank recommendations to the post-communist transition economies, stating that transition toward a market economy must include macroeconomic stabilization, liberalization of prices, trade, and capital movements, as well as mass privatization). The critics - with the benefit of hindsight - now argue that the transforming economies should have concentrated their effort, first, on building and strengthening the basic institutions of the market economy and the legal system. Only afterwards, mass (and fast) privatization was to be started. The slogan is „Regulation and institutions prior to privatization“.

Let us leave aside the problem whether it is at all possible (except in the virtual reality of a theoretical concept) to start building a market economy without its main constituting element, i.e. private property, or privately-owned firms. In the light of this problem, the only realistic view is to discuss the adequate speed of privatization in the transition from a centrally-planned system toward a market economy.

However, even here, the critics of the adopted way of privatization can find no strong evidence. Two recently published studies⁷ have come to two fundamental conclusions:

- in spite of all problems, privatization in transition economies can be seen as a success. Countries that did a fast and massive privatization (e.g. Poland, Hungary, Czech Republic, Slovenia, Estonia) have substantially better macroeconomic figures than those who hesitate to privatize, hoping that the state-owned firms can survive (e.g. Ukraine, Belarus, Russia).
- any privatization is better than none, because in general, private firms are much more efficient, more profitable, they export more, and restructure faster.

It is of course true that there has been a weak point - the problem of efficient management, and effective corporate governance in general. Discussing the Czech way of fast privatization, the voucher method which helped to solve the problem of lack of capital at the start of privatization (and helped to gain support of most citizens for radical economic transformation), suffers from this weak point. Insufficient or wrong enforcement of ownership rights then can, in some cases, lead to inefficient functioning of firms, and to non-ethical or illegal behaviour of the owners. However, the social and economic costs of waiting for a well-established institutional market framework would have been much higher than the costs of fast privatization - as experience of some other countries in the last decade shows.

5. Privatization and Economic Efficiency

Opinions on the effect of privatization on efficiency of the Czech economy differ significantly among Czech economists. One stream argues that at least one part - the voucher privatization - led to substantial loss of efficiency. In their view, only in companies privatized by standard methods, and mainly by foreign capital, can one observe productivity growth and visible gains in efficiency.

This view however is not substantiated by facts, as both Czech and foreign analyses show (see, i.a., Pohl et al., 1997). Empirical evidence, rather, indicates that companies which had sound management, good prospects on domestic and foreign markets, and started early with restructuring, show significant increases of productivity and profitability, without respect to their ownership structure. Of course, there is a high share of foreign-owned companies among them, as these had easier access to foreign financing, know-how, and could restructure earlier and faster.

Indirectly, one can prove that the micro-efficiency has improved during the last decade, by some macro-data. At the end of the Eighties, the (then) Czechoslovak foreign trade was primarily oriented on soft Comecon markets, their share reaching 70 %. Within the last ten years, we succeeded not only to shift trade to advanced, mainly European Union markets (EU now represents 71 % of Czech exports), but also to increase the share of higher-value-added goods in exports. In 1993, the share of SITC groups 7 and 8 (machinery, technological equipment and industrial consumer goods) represented 38 % of Czech exports. The respective figure for September 2000 is 64 %.

⁷ Nellis, John: Time to Rethink Privatization in Transition Economies? IFC Discussion Paper No. 38, 1999. Hawrylyshyn, Oleg - McGettigan, Donal: Privatization in Transition Countries: A Sampling of the Literature. IMF Working Paper WP/99/6.

This inevitably reflects a substantial increase of efficiency, not only in a few large companies. Almost 50 % of exports in these commodity groups are exports by small and medium-sized companies, largely owned by Czech capital. The importance of these figures is underlined by the high degree of openness of the Czech economy (combined share of exports and imports on GDP exceeding 135 %) which means that exporting companies form the bulk of the economy and their results are thus highly representative.

6. What to do next ?

Evaluating ten years of economic transformation in the Czech Republic, we can conclude that the privatization program has created a private corporate structure, separating the state from most of the property which was formerly state-owned. It has also been an important step toward a functioning capital market. At the same time, some weaknesses, as analyzed above, still prevail. The weaknesses are mainly rooted in the institutional and legal framework.

Creating and improving the institutional framework of market economy is a permanent, unending task. Implementing the laws takes time and requires numbers of competent experts. This process can be speeded up in some aspects, but it cannot be „solved“ in a short horizon (and once for ever). Yet it has to be said that in this sphere, more could have been done to the benefit of private enterprise - by making the activities of some government institutions more efficient and transparent, and providing more support to small and medium-sized firms. I do not mean financial support - which exists since several years - but consultancy on legal procedures, on accounting, on preparing entrepreneurial projects, etc. In this respect, experience from some EU countries remained untapped. In general, convergence to the European Union and the necessity to adopt the „acquis communautaire“ is a factor speeding up the process of institutional change toward a full-fledged market economy in the Czech Republic.

The main problem of effective corporate governance lies in the former IPFs, which, as holdings, often still have a fuzzy and non-transparent, or weak-defined incentive structure. As a result, they lack a strong long-term strategy and a strife for long-lasting success. More important than sanctions for improper behaviour, in the longer perspective, is a pressure for acquiring the standards of proper corporate governance, good corporate citizenship, vision, awareness of the need to live in a globalized economy. Here, education and exchange of experience with the help of entrepreneurs' organizations (chambers of commerce and other interest groups as the Business Leaders Forum in the case of the Czech Republic) is as important as the improvement of the legal framework.

7. Annex

7.1. Restitutions

7.1.1. Legal Framework:

- Law No. 403/1990 (On Relieving the Consequences of Some Property Injustice), October 1990
- Law No. 87/1991 (On Extra-court Rehabilitations), March 1991

7.1.2. Property Concerned:

- only property nationalized after February 25, 1948
- originally only Czech citizens eligible (later changed by the Constitutional Court)
- concerned mostly real estate and retail businesses
- until 1995 over 100,000 cases; the majority was real estate
- retail: 17,000 - 20,000 cases

7.1.3. Restitution of Church Property:

- first round based on the Law No. 298/1990 (On Regulation of Property Relations of Religious Orders and Congregations and the Olomouc Archdiocese; amended by Law No. 338/1991)
- around 250 properties returned to the Catholic Church (out of 800; the remaining roughly 550 properties were not demanded by the Church)
- restitution of the remaining property (land, forests etc.) is still unresolved and currently represents a major political problem

7.2. Small Privatization

7.2.1. Legal Framework:

- Law No. 427/1990 (On the Transfer of State Ownership of Certain Properties to Other Legal or Physical Bodies), October 1990
- no preferences to employees

7.2.2. Property Concerned:

- The small privatization went on between January 1991 and December 1993; the number and value of items sold was the following:

Small Privatization in the Czech Republic

	Number of Units Sold	Value (in CZK bil.)
1991	15,291	18.3
1992	6,411	11.1
1993	640	0.8
Total	22,342	30.2

Table 1

Source: Fund of National Property

- The sectoral composition of privatized property was as follows (the group "others" refers to cars, trucks, garages, warehouses, production plants, factories, houses, offices and cultural centers):

Sectoral Structure of Units in Small Privatization

	Number of Units	Average Final Price
Shops	13,042	1,194,000
Restaurants	1,861	1,790,000
Services	4,007	1,491,000
Others	3,435	2,185,000
Total	22,345	1,665,000

Table 2:

Source: Fund of National Property

7.3. Large Privatization

7.3.1. Legal Framework:

- Law No. 92/1991 ("The Transition Law"), February 1991 (+ several amendments, the most important one is Law No. 222/1993, July 1993)

7.3.2. Privatization Process:

- there were competing privatization projects (the basic project was prepared by the management of companies); the winning project was selected by the government
- the privatization projects have been implemented by the Fund of National Property (FNP)
- 3 % of each company went into the Restitution Investment Fund (RIF)

7.3.3. Time Schedule:

- 2 privatization waves (1st wave: 1991 - mid 1993, 2nd wave: mid 1993 - 1994)
- since 1995 privatization has taken standard forms (sales on secondary market, direct sales etc.)

Time Schedule of Large Privatization

	Projects submitted to the FNP	Property (in CZK bil.)	Completed projects	Property (in CZK bil.)
1991-94	4227	869.2	2329	840.1
1995	1050	23.5	1212	20.3
1996	714	11.7	1211	21.9
Total*	5991	904.4	4752	882.3

Table 3:

*) as of December 31, 1996
Source: Fund of National Property

7.3.4. Privatization Methods

- a variety of privatization methods was used in the Czech large privatization. The property of former state companies was either sold directly, or a joint-stock company was formed and its shares were then privatized.

Completed Property Sales and Restitutions (as of July 31, 1997)

	Projects submitted	Property (in CZK bil.)
Public auction	1016	7.6
Public tender	1077	28.6
Direct sale	5686	61.7
Free transfer, restitution etc.	4600	48.5
Total	12379	146.3

Table 4:

Source: Fund of National Property

- voucher privatization was the main, but not the only, method of joint-stock company privatization (see Table 5)

Joint-Stock Companies Privatization (as of December 31, 1996)

	Property (in CZK bil.)	In % of the Total
Public offer	12.6	1.8 %
Direct sale	35.3	5.0 %
Employee shares	2.2	0.3 %
Public tenders	17.8	2.5 %
Voucher method	341.4	48.0 %
Free transfers	52.3	7.3 %
Restitution or shares for RIF	21.4	3.0 %
RIF shares	6.1	0.9 %
Others	13.0	1.8 %
Strategic holdings by the FNP	170.1	23.9 %
Other holdings by the FNP	38.8	5.5 %
Total	711.7	100.0 %

Table 5:

Source: Fund of National Property

7.3.5. Voucher Privatization:

- all shares had the nominal value of CZK 1000 and were dematerialized
- every Czech citizen over 18 living in the Czech Republic was eligible to buy a "voucher book" for CZK 1000 in each wave
- the shares were allocated for vouchers in several rounds of auctions

Voucher Privatization - basic facts

	1st Wave	2nd Wave	Total
Number of companies	988	861	1664
Number of shares offered (mil.)	212.5	155.0	359.5
Number of shares sold (mil.)	198.0	149.3	347.3
Eligible citizens (mil.)	7.2	7.2	-
Number of participants (mil.)	5.95	6.16	-
Number of shares per one participant	35.1	25.2	60.3
Number of IPFs	265	194	326
% of vouchers invested by individuals	73.3	63.5	-
% of vouchers invested through IPFs	26.7	36.5	-

Table 6

Source: Fund of National Property

Inflow of foreign direct investment , 1991 - 30.06.2000

Country of origin	mill. USD	% of total
Germany	4253,2	24,3
Netherlands	2958,0	16,9
Belgium	2528,1	14,4
U.S.A.	1924,8	11,0
Austria	1562,2	8,9
Switzerland	1359,5	7,8
France	877,1	5,0
Others	2062,3	11,7
Total	17525,0	100,0

Table 7

Source: Czech National Bank

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Session 2

Business Infrastructure from the Viewpoint of the Private Sector

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The Operation in Czech Republic

Mr. Fumio Inoue, Japan
Managing Director
Matsushita Television Central Europe, s.r.o.

International Conference

**The Operation in
Czech Republic**

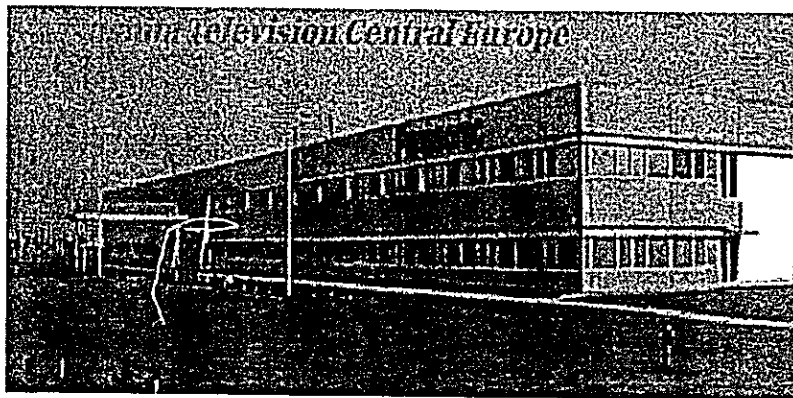
Nov 30 & Dec 1, 2000, Vienna, Austria

Matsushita Television Central Europe
Mr. Fumio Inoue, Managing Director

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2. Reasons of Investment in Czech R.
3. Guidelines for Global Management, Business Principles
4. Start Up Operation
5. Problems and Actions of Setting Up
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PREMISES



1. COMPANY PROFILE

Name:	MatsushitaTelevision CE
Capital:	CZK 2.7 bn (77 mil. EUR)
Product:	Colour TV
Place:	Pilsen, Czech Republic
Established:	March 13, 1996
Product. Start:	April 1, 1997
Employees:	1 500 / October 2000
Land:	166 000 m²
Building:	47 000 m²

2. REASONS OF INVESTMENT

- 1. Cancellation of import duty to EU (if EUR)**
- 2. Political and economical stability was better than in Poland and Hungary**
- 3. Localisation of Logistics**
- 4. Forward looking of the CR government concerning search for foreign investor**
- 5. Forward looking of City of Pilsen by the Mayor**
- 6. Human resources**

3. GUIDELINES FOR MANAGEMENT

- 1. Good Corporate Citizenship**
- 2. Mutual Respect & Understanding with the Host Country**
- 3. Product Competitiveness in Quality, Cost & Performance**
- 4. Transfer of Technology under a Worldwide R&D System**
- 5. Autonomous & Responsible Management**
- 6. Management Localisation & Employee Skills Development**

3. MTE BUSINESS PRINCIPLES

- 1. Through the Most Competitive Products Contribute to Prestige and Progress of the Czech Republic**
- 2. Maximum Customer Satisfaction**
- 3. Development of Individuals & Groups with Strong Belief in High Productivity & Positive Involvement**
- 4. Business Expansion & Market Share Increase**

4. START UP OPERATION

a) PRODUCTION & SALES

Cumulative: 1 mil.: Oct '99
2 mil.: Oct 2000
Destinations 30 Countries

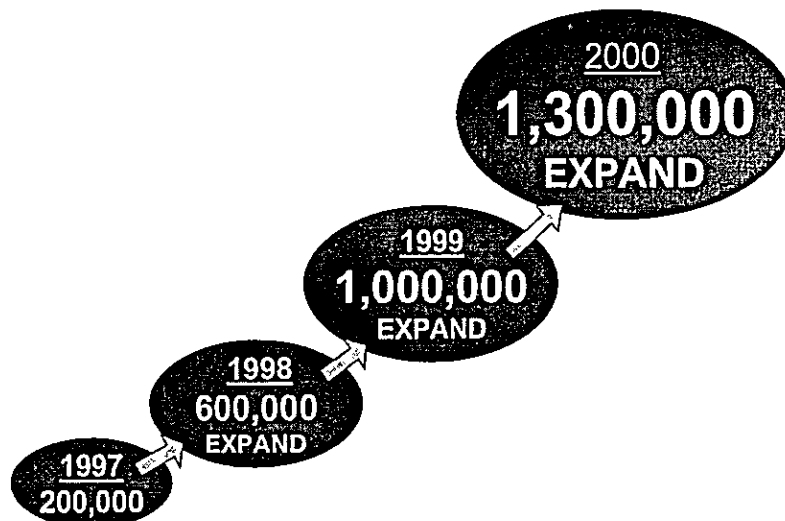
b) QUALITY

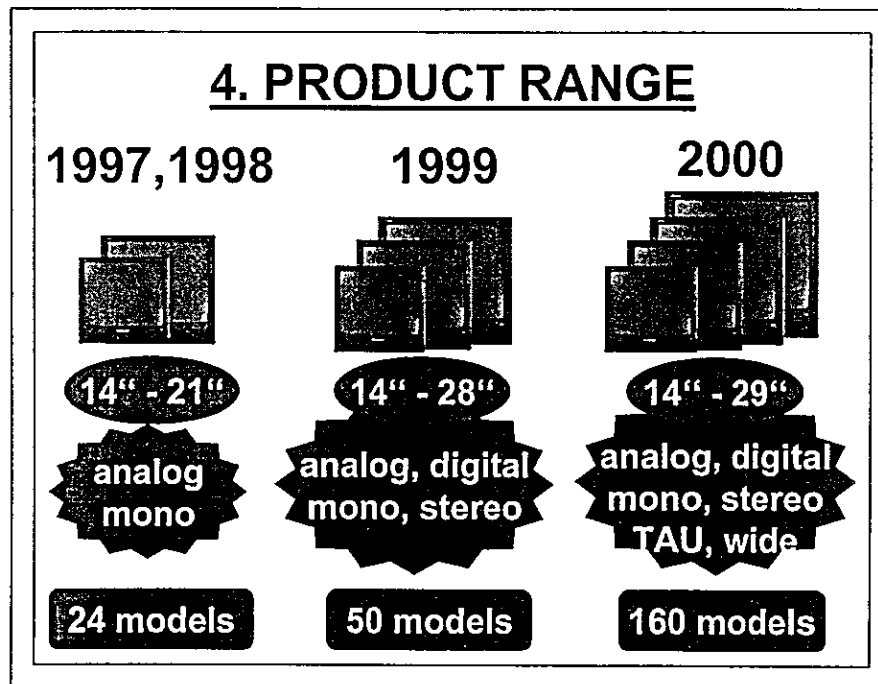
Market Approval 30 Countries
The target was achieved

c) CERTIFICATIONS

BEAB July 1997
ISO 9002 March 1998
ISO 14001 December 1998

4. PRODUCTION & SALES



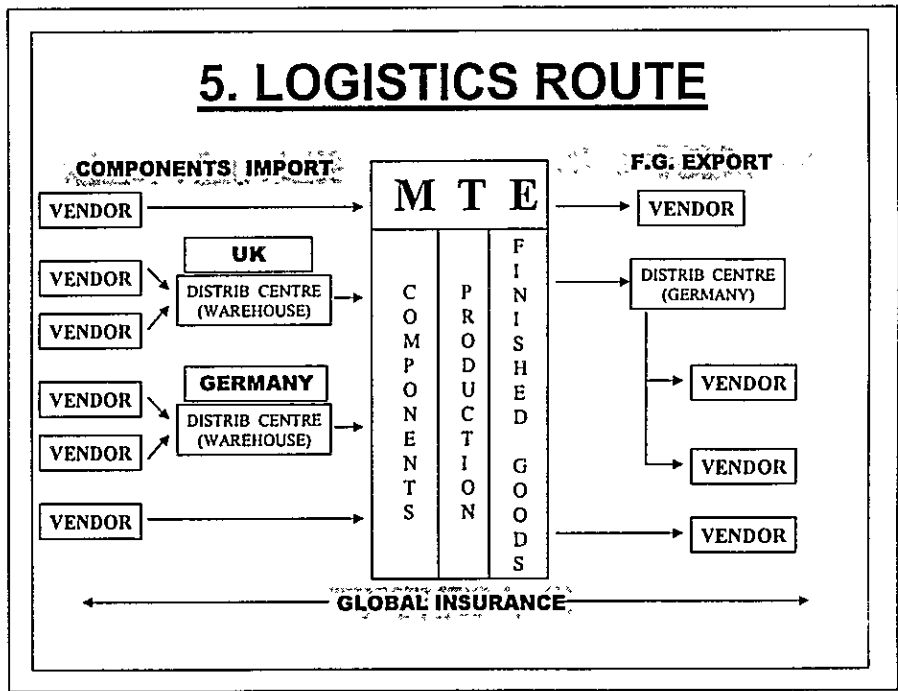


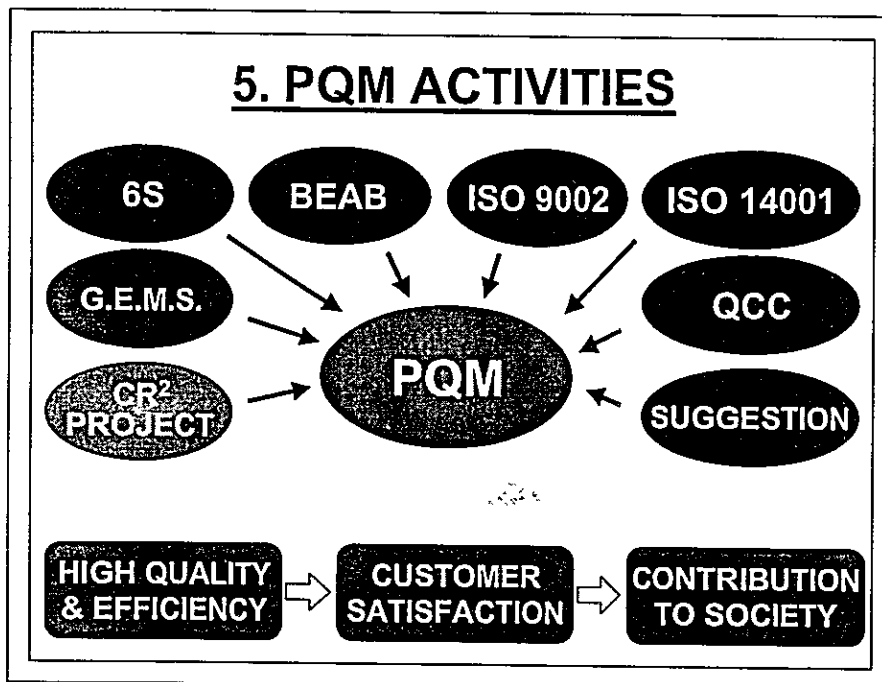
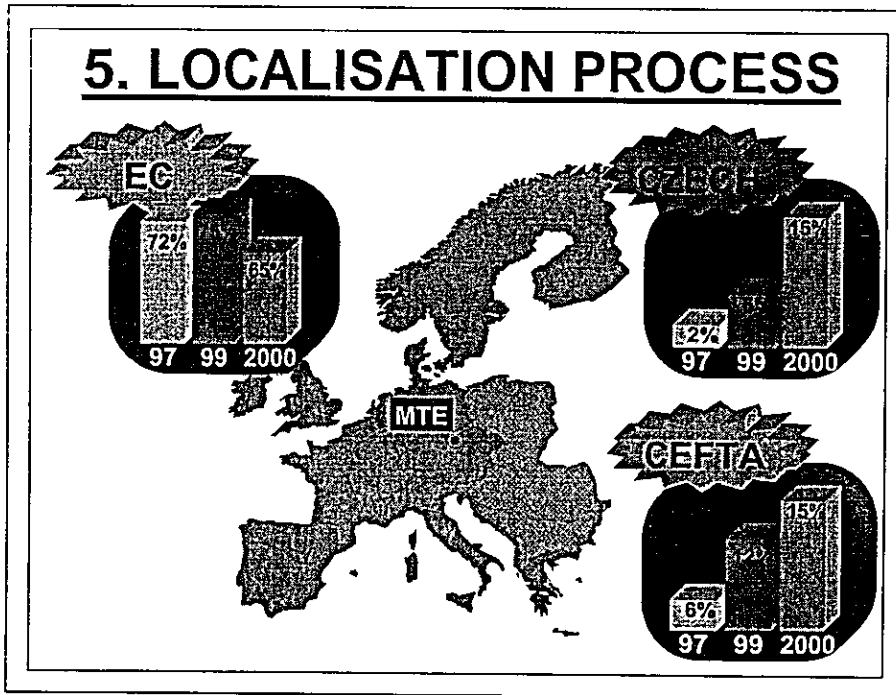
5. Problems and Actions of Setting Up

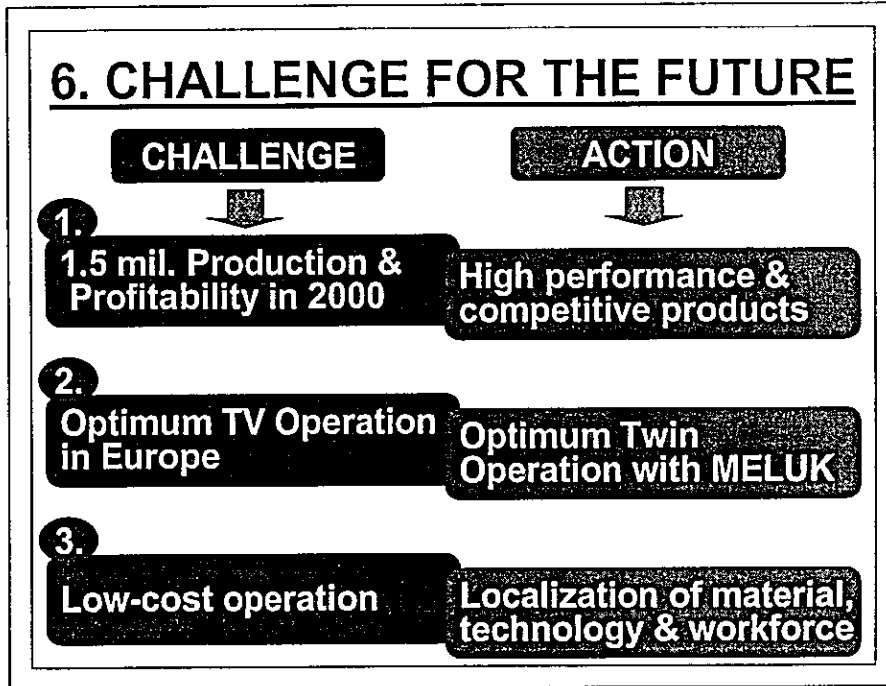
- Problems in Logistics
- Logistics Route
- Material Localisation Process
- PQM Activities

5. PROBLEM IN LOGISTICS

- 1. Customs conditions**
 - Customs clearance depends heavily on human factors
 - Outdated customs clearance controls & procedures
- 2. Transport conditions**
 - Over-exploitation of road transport after 1990
 - Bottleneck at borders
 - Not balanced ratio of incoming / outgoing shipments
- 3. Infrastructure**
 - Lack of state transport policy
 - Low quality of roads and rails







**Please, continue to support
PANASONIC in Czech republic.**

Thank you.

VAE in Central Europe

Mr. Mohammed Kaddoura, Austria
Director
VAE Aktiengesellschaft

1. Key Facts of VAE

VAE is a niche engineering company, operating worldwide. VAE competence is based on nearly 150 years of tradition. Our core business is the design and the manufacture of high 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.

2. Market Position

We are truly international players with 70 % of our business generated outside Austria. We have 2 Austrian and 15 foreign production operations, as well as a massive export business. And most important, we are market leaders worldwide.

We are the largest company specialising in the world on turnout sector, achieving a turnover of about 4 b shillings. Our success in this market is the result of our world leading technology.

3. Products

The range of our products comprises 3 main categories:

- 1) High quality turnouts
- 2) Special electronic and hydraulic equipment devices and
- 3) Rail Movement Joints

4. Turnouts

The core business is the production of turnouts for railway, tramway and underground and related turnout components, for new track, refurbishment and railway maintenance. These products are fundamental to railway development.

5. VAE Roadmaster 2000

This system contains special developed transducers and microelectronics in the turnouts to monitor operating conditions and wear on a continuous basis on a central control unit.

Trend calculations allow preventive maintenance, help saving maintenance costs and time and all these lead to a better performance of turnouts and increased operational availability.

6. Hot and Blocked Brake Detectors

Hot box and blocked brake detectors are situated on both sides of the track as fixed installations. They control boxes and brakes about overheating.

The fixed detectors controls the moving trains comparing the temperature of the boxes and brakes under recognising the temperature in the air. These systems give an alarm in case of overheating or higher temperatures to stop the train immediately.

Hot boxes and blocked brakes if undetected, will cause the derailment of the train.

These systems are working on an infrared basis. The detectors are sending so many scans to the axles or breaks that also by speeds at 400 km/h a lot of scans allow exact measurements.

7. Rail Movement Joints

These products overcome the special problems which arise from the strain on rail track on bridges which arises from substantial movement in the bridge; the rail movement joints allow the rail to move as a result of traffic, load, speed, temperature and the severe weather conditions.

In other words, the rail movement joints are an extension compensation system ensures that the train always remains in contact with the rails. We supplied with this product the bridges for the new Hong Kong airport and before that the Great Belt bridge in Denmark.

8. VAE Shareholders

Major shareholders are VOEST-ALPINE Schienen, the world market leader in rail business and VOSSLOH, the world market leader in rail fastening systems. They hold both together 90% of the share. The rest of about 10% is still owned by private and institutional investors in Austria and abroad.

9. Group Turnover

The group turnover will be this year around 4 b Shilling or 290 m Euro.

10. Major Markets

Europe is our major market, accounting for 67 % 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 % of group sales and is one of our most exciting opportunities
The Pacific Rim accounted for 4 % of sales. The rest of 4 % of sales is done mainly in project business in the Near East, in Africa and South America.

11. The Way of Internationalisation


Think globally and act locally.


12. VAE in Central Europe


- 1992 starting a Joint-Venture with the Hungarian State Railways
- 1995 / 1996 starting Joint Ventures with the State Railways of Latvia and Lithuania
- 1998 acquisition of the majority of the now private turnout plant in Romania and also
- 1998 we started with our joint-venture with the Bulgarian Railways in Bulgaria


Business Infrastructure from the Viewpoint of the Private Sector


Mr. Christian Dorner, Germany
International Relations
Siemens


SIEMENS	
BUSINESS INFRASTRUCTURE FROM THE VIEWPOINT OF THE PRIVATE SECTOR	
30 November 2000, Vienna International Conference on the 10-year Review of Transitional Economies and Challenges in the Next Decade	
Pres/JCA 30112000	© Siemens AG, Int. Relations Christian Dörner


SIEMENS	
Situation	
<ul style="list-style-type: none"><input type="radio"/> high qualified technical staff in companies and agencies<input type="radio"/> legal background and enforcement<input type="radio"/> goal of FDI could be more precise<input type="radio"/> sensitive issue: FDI and/or privatisation	
Prax/JICA 30.11.2000	© Siemens AG, Int. Relations Christoph Dörner 2


SIEMENS	
Motivation	
<ul style="list-style-type: none"><input type="radio"/> common past in building up infrastructure<input type="radio"/> obvious need<input type="radio"/> historic cooperations<input type="radio"/> service/solution orientation	
Prax/JICA 30.11.2000	© Siemens AG, Int. Relations Christoph Dörner 3


SIEMENS	
Performance	
Cash Flow 1999 (examples):	
○ Bosnia:	33 Mio.€
○ Slovakia:	363,4 Mio. €
○ Slovenia:	63,2 Mio.€
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FDI vs. FDI - and the lack of mutual understanding	
○ Prejudices	
⇒ Investor is not interested in local added value	
⇒ Government considers FDI (if in case of privatisation) as tool for budget regulation - or as foreign influence	
○ Different understanding of protection	
⇒ employees	
⇒ capital	
○ Goal of FDI	
⇒ new - profitable - market	
⇒ release of budget	
○ FDI vs. Privatisation	
⇒ role of free trade areas	
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Statement	
FDI is NOT possible on a large scale if these points are - not discussed and - similar understood by both (all) parties!	
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Clarification	
Government and investor: Who is the client? - Who serves whom?	
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<p>SIEMENS </p> <p>Investment is a process</p>
<ul style="list-style-type: none">○ economic activities rely on trust○ clear understanding of influence of FDI on the national economy○ same/comparable systems of business economics in companies
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<p>SIEMENS </p> <p>Political/institutional background</p>
<ul style="list-style-type: none">○ The intention of the government(s) and investor(s) must be<ul style="list-style-type: none">⇒ clear⇒ communicated○ Clear rules and regulations!○ Transparent procedures/implementation (distrust due to failure discourages further investors)
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Employment	
<ul style="list-style-type: none">○ Increase of efficiency does not mean increase of jobless○ Adaptation to market requirements: training and political courage○ Training supports FDI and privatisation	
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Development of strategies	
<p>The market contradiction:</p> <ul style="list-style-type: none">○ Market in C/SEE needs a unified FDI strategy○ Market needs a country by country strategy	
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What is needed?

- design phase: participation of industry (Economic Fora etc.)
- political commitment
- adapted model treaty = "de facto" law (pragmatic solution accepted by major IFIs)
- toolkit for Investment Promotion Agencies/Privatisation Agencies
- free trade areas - but just one possibility
- support for local banks

