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CONFERENCE REPORT

A Survey of The EBRD's Transition Report 2002*

Since 1994, the European Bank for Reconstruction and Development (EBRD) has been assessing, evaluating and monitoring the transition processes – from a socialist model to a market economy one – in each of the 27 countries of Central/Eastern Europe and in the Commonwealth of Independent States (CIS). In Hungary, its 9th report was presented to a fairly large international audience organised by the Central European University (CEU), in Budapest, on 27 November 2002. Presentation of the report was hosted by Stefan Messmann, Academic Pro-Rector of the CEU, with the moderation of László Csaba, Professor at the Department of International Relations and European Studies. Martin Raiser, Senior Economist at EBRD, highlighted the main findings of the report and Hubert Warsman, Head of the EBRD Budapest Office, discussed the investment climate and the Bank's activities in Hungary.

The first chapter of the latest Transition Report is an inquiry into the interrelationship between transition on the one hand, and welfare and sustainable development on the other. According to the concept used in the report, sustainable development means that *at least* the current level of welfare or well-being of the population needs to be maintained. Apart from traditional economic indicators (like per capita GDP, etc.) a measuring of well-being can be extended to non-market factors that can then be evaluated by current or future generations (e.g. the environment, the depletion of non-renewable or slowly renewable natural resources, etc.). Sustainable development has other implications too, including the development and distribution of benefits to current and future generations. The key issue here is, firstly, how to meet the essential needs of the have-nots of current and future generations; and, secondly, the needs of existing (or future) generations should be met without compromising the interests of the future (or existing) generations.

* EBRD (2002): Transition Report, 2002. Agriculture and Rural Transition. London, 220 pp.

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The report came to the conclusion that a strong overlap exists as regards the objectives of sustainable development and the transition to an open market economy, to democracy and to pluralism in the countries under scrutiny. Transition to a market economy is an essential means of achieving sustainable development. However, transition has been associated with increasing poverty, diminishing life expectancy and educational standards as well as a depletion of natural resources (particularly in the CIS countries). To reverse these trends, an appropriate political, legal and regulatory setting has to be established, one that provides incentives for sustainable development. Such incentives include the elimination of market distortions, particularly with the energy market, the promotion of private investment/ entrepreneurship, etc. Social protection must be an important element of sustainable development.

As with previous volumes, the rest of the Transition Report is divided into two large parts; the first devotes itself to a discussion of the relationship between a transition process and the business environment, as well as to the macroeconomic performances and prospects of the countries being surveyed.

The report gave an account of the second round of the Business Environment and Enterprise Performance Survey, which covers close to 6,000 enterprises in 26 of the region's countries. The business environment as shaped by government regulation was defined in terms of macroeconomic management, taxation, business regulation, corruption, crime, the judiciary, finance and infrastructure. The firms surveyed assessed how these factors – related directly or indirectly to the functioning of the state and public administration – had influenced their operations and growth. The survey gives an insight into the quality of the business environment in the region together with differences among countries and various types of enterprise. A comparison of the present results with those obtained by the first survey in 1999 is instructive.

In fact, the overall business environment improved significantly from 1999 to 2002. These improvements were much more pronounced in Southern and Eastern Europe (comprising the countries of the Balkans, including former Yugoslav republics) and the CIS than in the more advanced East Central Europe and the Baltic states – which reflected the logic of the catching–up process unfolding in the more "backward" regions. From among the countries of East Central Europe and the Baltic region, the business environments of the Czech Republic, Hungary and Slovenia had improved most sharply.

As far as the various size categories and ownership types are concerned, the survey of 1999 came to the conclusion that the general business environment was more averse to newly-established private companies as well as to small firms

than it was to state-owned enterprises and large companies. By 2002, however, the position of these formerly handicapped firms had improved, thereby indicating that the playing field for the various types of business organisations had become more balanced.

From among determiners of the business environment, corruption deserves special attention, since this could well put a severe cost burden on the corporate sector. According to the survey, the so-called bribe tax (the proportion of sales paid in the form of unofficial payments to public officials) went down from 1999 to 2002. At present, corruption is most widespread in Southern Eastern Europe and in the CIS – with Albania, Azerbaijan, Georgia and Romania ranking high here. Remarkably, although the level of corruption is still low by international standards, it increased slightly in Hungary and Slovakia between 1999 and 2002.

Apart from corruption, institution building should be the focal point of economic policy in transition countries. Nevertheless, depending where economic development levels have arrived at, institutional weaknesses to be overcome are different for the new EU member states compared to other transition countries.

Transition countries have proved to be quite resilient in the preceding period of global slowdown and economic and political uncertainty, with GDP growth rates exceeding the average of the developed industrial countries, barring the case of Poland. The inflow of foreign, direct investments was up in 2002 – in spite of the drop in global volumes. Regarding the main medium-term macroeconomic challenges, the ability to attract foreign capital in general, and FDI in particular, remain crucial for sustained growth. The coherence of monetary and fiscal policies could be improved as well. High fiscal and current account deficits have not been constraints as regards economic growth. Nonetheless, reserves connected with existing external and internal indebtedness might become exhausted quite easily.

The second large part of the Transition Report has traditionally consisted of special issues occurring with the shift from a socialist model to that of a market economy: the present report focuses on the agricultural sector and rural development in the transition countries. The relevant chapters analyse the differences in performances across countries and examine political factors influencing such variations. The analysis of rural development has focussed on the business environment in rural economies and the links in the rural economy between farms and other enterprises.

Although variations are broad, agriculture under-performed when compared to the other segments of the economy in every transition country. The lack of basic reforms regarding land, ownership and control rights was an impediment

to a sustained increase in production and productivity. The countries that started the transition to market economy earlier are better off. General market reforms – like the liberalisation of the economy and the privatisation of state-owned enterprises – has had a positive impact overall on agriculture as well; yet with the under-performance of this sector, the trade *deficit* of agricultural produce grew in these transition countries. Thus, in this regard the incomplete and rather controversial reforms in agriculture are tending to hamper the involvement of transition countries within the international division of labour.

In line with past practice, this time, too, a valuable assessment of the progress of economic reforms in the 27 transition countries in the survey is attached to the report. The verbal or qualitative assessment covers liberalisation, stabilisation, privatisation, economic reform, infrastructure, financial institutions and social reforms, these being followed by some quantitative indicators pertaining to transition as well as statistical figures on macroeconomic development. The statistics here (in particular) should be considered a gold mine for those involved in one way or another in Central and Eastern European issues and business.

The *discussion* following provision of the report focused (not too surprisingly) on Hungary. Relevant contributions gave participants the opportunity to comment on the general economic environment that Hungary is offering domestic/foreign businesses. One commentator said that a successful transition to a market economy is reflected in the fact that EBRD has shifted the focus of its activity from Hungary to less developed, transition countries. The emergence of a legal and institutional structure associated with a market economy, which has been reinforced by strong GDP growth since the late 1990s, has resulted in a significant reduction of Hungary's international competitive edge *vis-à-vis* her latecomer competitors in terms of attracting foreign direct investments. Recent sharp wage increases combined with appreciation of the Hungarian Forint against the Euro and other major currencies has affected rather adversely Hungary's international competitiveness, though these were bolstered not only by government efforts aimed at fulfilling the requirements of sustainable development but also by populist promises and commitments made by the main political parties in the election campaign of 2002 as well.

The other major topic of the discussion was corruption in Hungary. Participants thought that corruption frequently "oils the wheels" of the powers-that-be, i.e. substituting for transparent, more efficient incentives. Yet given the nature of this phenomenon and a type of domestic "tradition", it will be difficult to combat corruption – even if the necessary tools are available in the public sector. In addition, at the level of local administration the representatives of governing and

opposition parties tend to put aside their political differences when allocating funds to clients in public procurement procedures. Since the interests of the parties involved are the same (everybody's clients are also beneficiaries), it will be very difficult to see revealed these subtle "practices". What is certain is that corruption is causing a steady inflationary pressure emanating from this segment of the economy. There were concerns in the audience about the positive effects of a deep reform in the financing of political parties, as corruption has become quite deep-rooted here, too. Hungary's accession to the EU will, nevertheless, perhaps help when it comes to fighting corruption, thus lessen the number of occurrences.

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