

An uphill battle

THE FUTURE BUSINESS LANDSCAPE

Hungary went from a leading position in the region in the '90s to a disappointing performance during the present decade. In the future, Hungary will have to rely relatively more on internally generated sources of productivity and competitiveness. A key to the country's future business landscape is whether elected officials will have the political will – and the country the social cohesion – to fix or improve, at sufficient speed, those areas where it lags behind its competitors.

B. PAUL MARER

ECONOMIC HISTORIANS are likely to evaluate the 1990s as a decade of impressive achievements in Hungary's transformation to a market economy. Hungary had the lead position in the region. Among the reasons was the decision to privatize state-owned enterprises largely by selling them (instead of voucher privatization or management buyout); another was that Hungary welcomed and supported foreign direct investment (FDI). A large number of foreign firms came to Hungary. AmCham was established and quickly became the most influential organization representing foreign investors in the country.

Hungary's comparative economic performance during the current decade has been somewhat disappointing. AmCham members know well the facts and the reasons behind them. To be sure, regional growth comparisons are often biased against Hungary, whose population has been stagnating – versus the rapid population growth in neighbors like Poland. Therefore, per capita growth comparisons put Hungary in a better light, not far from the region's average.

EXTERNAL ENVIRONMENT

A COUNTRY'S ECONOMIC performance – past and future – depends in part on the external environment and in part on the effectiveness of its domestic policies and institutions (including government bodies, companies, and NGOs). During this decade, prior to the global crisis, the external environment for Hungary and the rest of Eastern Europe was favorable.

The region's impressive growth rates through 2007 rested on three pillars, which I call the Eastern European growth model:

1. Extraordinary rapid trade and financial integration into the global economy, especially the EU, as shown by the fast increases in these countries' foreign trade and foreign financial participation ratios in GDP.
2. Large capital inflows, including FDI, making rapid growth of productivity and improved living standards possible. Continuous capital inflows helped to finance large current-account deficits and thus excess consumption.
3. Appreciating real exchange rates, contributing to improved living standards and to keeping inflation in check.

Let us note that all three pillars rest on sources of growth that are partly or largely externally generated or supported. I am in agreement with those who forecast that Western Europe's recovery and growth during the next five years will be sluggish. If correct, this does not bode well for Hungary and Eastern Europe, because it means that the region's past rapid trade and financial integration into the EU (pillar one) is also likely to slow. Net capital inflows, including FDI (pillar two), are likely to be smaller also, in part owing to the growing relative attractiveness of China and Asia's other developing countries. And the sustained large appreciation of real exchange rates (pillar three) is unlikely to continue, especially not vis-à-vis the strong euro.

Improve the effectiveness of government at all levels.

INTERNAL SOURCES

IF THESE ASSUMPTIONS are correct, it means that in the future, Hungary (as the rest of Eastern Europe) will have to rely relatively more on internally generated sources of productivity and competitiveness, that is, factors largely within the control of the nation's authorities, industries, firms, and workforce. These include improvements in the physical and social infrastructure, in the health and education of the workforce, in the efficiency of the markets for goods, services, and labor, as well as better technological readiness and innovation.

At the top of Hungary's agenda on internally generated improvements in productivity should be to streamline and improve the effectiveness of government at all levels. Let me highlight a few facts from the two best-known international comparisons of national competitiveness – the Global Competitiveness Report (GCR) of the World Economic Forum and the Ease of Doing Business (EDB) index of the World Bank.

In the GCR, Hungary's global competitiveness, expressed in a single composite number, ranks this nation 58th among the 133 countries surveyed. The most problematic factors of doing business in Hungary are the tax regulation and rates and the inefficiency of government bureaucracy. On the "burden of government regulation" indicator, Hungary ranks 130th among the 133 countries surveyed; 127th on the "wastefulness of government spending"; 114th on the "favoritism in decisions of government officials"; 113th on the "transparency of government policy making"; and 110th on the "public trust in politicians". Since there are some questions about methodology, these rankings should not be taken as absolutely accurate. But, it is unquestionable that the neighborhood Hungary finds itself in, with respect to the efficiency of its government, is not a desirable one. The EDB ranks Hungary 47th among the 183 countries surveyed. The major problems identified are taxes – where Hungary ranks 122nd – and, surprisingly, the "protection of investors" where Hungary ranks 119th. It would not be fair to deliver only the bad news. Hungary ranks quite well on public health, its educated workforce, and the relatively low incidence of crime.

WHAT WILL SHAPE THE FUTURE?

THE KEY FACTORS that will determine Hungary's future business landscape – which is the microeconomic foundation of productivity growth, competitiveness, and thus, the standard of living – is whether the country will have the political will and social cohesion to fix or improve, at sufficient speed, those areas where it lags behind its competitors, while at least maintaining its comparative advantages in other areas. Generating the political will and a social consensus will be an uphill battle for years to come. I am confident



that AmCham will remain in the forefront of these critically important efforts, given its declared mission to work to improve Hungary's global competitiveness. Let me conclude by suggesting – exhorting, if I may – each and every member of this influential body to redouble his or her active support for such AmCham initiatives as the transparency of decision making and anti-corruption efforts. Progress in these areas will make the local business landscape more inviting for each and every foreign company and improve Hungary's global competitiveness.

This is a slightly abridged version of the speech given at the celebration of AmCham's 20th anniversary by Paul Marer, professor at the CEU Business School. Marer emigrated from Hungary to the US in 1956, where he became a professor of business at Indiana University Bloomington. He wrote books and articles about Hungary's economic and political reforms and spent sabbaticals at the IMF and the World Bank. In 1989, he was a co-founder of the "blue ribbon commission" (BRC), which set out to chart the unexplored route of transforming Hungary from a centrally directed economy, which had proven to be a dead end, to a market economy – the only possible destination after systemic collapse. In 2000, Marer returned to Hungary to teach and help administer the CEU Business School. ★

