Building Competitive Advantage in Nations: Increasing Transparency, Combating Corruption and Improving Corporate Governance

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I. Welcome

Welcome to Budapest and this conference on building competitive advantage in nations, combating corruption and improving corporate governance. The overwhelming response to our announcement of the conference and the large turnout here today clearly indicates the timeliness and importance of the three related topics we will be covering between now and when we adjourn on Thursday.

Let me thank our implementing partners, the Center for International Private Enterprise and J. E. Austin Associates for their successful efforts in assembling an outstanding panel of experienced development practitioners. USAID's special thanks are extended to our distinguished speakers and honored guests. We thank each of you for participating and contributing to the success of our conference sessions over these three days. For everyone in USAID / Washington and Budapest who has worked so diligently to make this event happen, "thank you."

II. Introduction to the Themes of the Conference

From Poland and Slovenia in the west, to Kazakhstan and Russian Siberia in the east, the economic changes in Central and Eastern Europe and Eurasia during the 1990s were profound and, in some cases, astonishing. In 1989, the state controlled almost every aspect of economic activity. For decades, people lived without basic democratic or economic freedoms. Bureaucrats set prices, established production quotas for factories and farms, decided which companies got credit and how much, and determined wages and working conditions. Governments not only owned land, natural resources, utilities, public transportation, and banks, but nearly all productive assets as well. Private businesses were banned or severely limited. The region was filled with factories employing thousands of workers they didn't need, to produce shoddy goods that few wanted. The whole centrally planned system was propped up by subsidies and noncommercial trading relationships and sustained by wasteful use of human, financial and natural resources.

The old system crumbled when the Berlin Wall fell and the Soviet Union imploded, but the task of constructing something new was just about to begin. Before the dust had time to settle, new governments were facing economic and social problems that would have challenged well-established democracies. The economies of the region were reeling under the effects of decades of centralized control and mismanagement. Bloated bureaucracies and huge subsidies – used to keep the command economies afloat – had driven most of the region to the edge of bankruptcy. Health, education and social protection systems were strapped for resources and bankrupt or nearly so. Unemployment and poverty had increased in much of the region, with social services and benefits unable to keep pace. In many countries, infant and child mortality and the spread of infectious disease were rising with life expectancy falling.

Central and Eastern Europe and the countries of the former Soviet Union were a new development frontier in 1989. As the people of the region struggled to overcome the legacy of the past, it quickly became clear that the United States had compelling interests in promoting economic stability and peaceful democratic change. The region's 27 countries, which cover one-sixth of the globe and are home to 400 million people, could play a critical role in the global economy. The region's weapons of mass destruction were a major concern. Additionally, the United States wanted to respond to the humanitarian needs of the millions of people who became victims of civil conflicts and natural disasters.

A strategy for U.S. assistance crystallized. The United States recognized that encouraging the development of stable democracies would underline the historic U.S. commitment to democracy and human rights, and promote U.S. and regional security interests. Helping countries develop private enterprises and enter global markets would expand opportunities for trade and investment. Developing economic and political alliances with the new governments and their people would make it easier to address global challenges.

Drawing on years of experience, but ready to innovate, USAID moved quickly to assist the region with its historic transformation. USAID initiatives in the economic, democracy, and social sectors complemented one another and promoted national policy change while strengthening local grassroots organizations and businesses. The overarching goal was to create lasting change so that the countries of the region could move beyond donor assistance, stand on their own, and become full partners in the international arena.

In the 1990s, USAID supported and accelerated dramatic changes in the region. In so doing, USAID helped the courageous and hard working women and men who took the risks and confronted the challenges needed to start the transformation from old command to new market economies. Today, the countries of the region are moving – some quickly, and some far too slowly – toward more open, market-driven economies. Statistics for the region are impressive. Though the pace of progress has been uneven, we find –

- ♦ Prices set by markets, not bureaucrats.
- ♦ Farms and homes owned by individuals rather than the state.
- ♦ Ordinary citizens now shareholders of once state-owned companies.
- ♦ Strategic investors bringing new capital, technology and market experience.
- ♦ Reformed institutions supporting improved macroeconomic policies and fiscal discipline.
- ♦ Sound bank regulatory systems and increased bank deposits and savings due to citizens gaining confidence in financial institutions.
- ♦ Reformed commercial and company law frameworks.
- ♦ Productive private enterprises and individuals benefiting from commercial lending, mortgage finance and equipment leasing.
- ♦ Governments encouraging the growth of small and medium enterprises by reducing red tape and improving tax policies.
- ♦ Private enterprises beginning to use international accounting standards to produce audited financial statements which shareholders, banks and investors can rely upon.
- ♦ Fiscal reform improving tax collection and reducing budget deficits.
- ♦ Governments moving from opaque public procurement regimes to ones based on transparency, accountability, competition, fairness, non-discrimination and value for money.
- ♦ Pension systems reformed from the edge of bankruptcy to fiscal sustainability and security while accumulating huge pools of funds for productive investments.

The historic transformation that has occurred during more than a decade of change is indeed remarkable. Although most countries moved forward in at least some key areas during the 1990s, we know that the journey is far from over. A great deal remains to be done. For some countries – especially those in our Northern Tier – the transition has resulted in great progress; for others the results are mixed, uneven at best; and for still others, the benefits are still more in the future than in the present. Because countries in the region have come so far, yet have so far to go, the three themes of this conference are today – more than ever – of critical importance. However one measures the successes and failures of the last decade, enhancing country competitiveness, combating corruption, and improving corporate governance should rank high on the development agenda of each country represented here. That's why we are here together in Budapest.

III. Twin Enemies of Competitiveness: Corruption and Weak Corporate Governance

In a few minutes, my colleague, Ken Lanza, will set the stage for the presentation of Dr. Garrett FitzGerald, the former Prime Minister of Ireland. Ken will introduce the framework for understanding what competitiveness is and what it is not. Permit me to set the stage for Ken by linking competitiveness to USAID's mission in the region. Our assistance programs are based on the premise that broad-based economic growth is the most effective means of bringing poor, disadvantaged and marginalized groups into the mainstream of an economy. Country competitiveness is a key to economic growth and reduced poverty.

The way to building competitive advantage in nations begins with a determination to get two things right: the macroeconomic enabling environment and the microeconomic foundations for growth. The former calls for credible public sector institutions, ethical and effective public officials, and institutionalization of the rule of law while the latter calls for robust industries and businesses that think and act in competitive and ethical ways. Key building blocks for a enabling environment that promotes country competitiveness include peace, security, personal and economic freedom, good governance, the rule of law, public and private probity, sound macroeconomic and fiscal policies, access to financial services, realizable property and contract rights, and effective market augmenting institutions.

A decade ago, corruption and corporate governance would not have shared the same agenda with building competitive advantage in nations. Now we see corruption and weak corporate governance as twin enemies of country competitiveness. Not only are they threats to future growth; left unchecked, they hold the potential for reversing gains already made over the last decade.

Today, more than a decade after the fall of the Wall, we know that endemic corruption in the region is not just a cost of doing business or a benign supplement to the wages of low paid public servants. In the new language of corruption, we know that "state capture" and "administrative corruption" stymie foreign and domestic investment, misallocate public resources, benefit a privileged few, tax the poor disproportionately, undermine public institutions, thwart the rule of law, and increase public cynicism and mistrust of government. Corruption is not petty!

Corruption and poor corporate governance are two sides of the same coin of no accountability. Each suffers from the same structural problem: misalignment of the interests of agents in positions of authority with those of their principals. In each case, due to perverse incentives and institutional imperfections, public officials and managers of private business act in their own short-term interests – abusing their positions of authority – rather than acting in the long term interests of their stakeholder principals.

Global capital flows towards businesses, regardless of location, that are directed by responsible boards and managed by professional and accountable agents; businesses that practice transparency, protect shareholders' rights, and maximize long-term shareholder value. In a highly competitive global marketplace, sophisticated global investors examine the countries and business in which they invest to assess if they suffer from weak governance or benefit from strong. Increasingly, global investors look to how well countries and corporations combat corruption and operationalize the OECD Principles of Corporate Governance or their equivalent.

The antidotes for corruption and weak governance start with the same formula: Identify, attack and replace the perverse incentives and institutional imperfections that breed and sustain these twin evils. Increase Transparency; increase Accountability; devote more resources to Prevention; and broaden our views of Enforcement to one that moves us beyond a narrowly focused criminal law mindset. Create public-private dialogue and partnerships that develop indigenous approaches and solutions. Begin by doing a better job of decreasing the public's tolerance for corruption and weak governance – by personalizing their real costs, by marketing the tangible benefits of reform, and by showing the pathways to probity.

Now, let me turn over this morning's program to Ken Lanza.