Paradigm Shift
– Information, Knowledge and Innovation in the New Economy

Conference proceedings

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ISBN 963 472 886 3

Book Series of the Faculty of Economics and Business Administration of University of Debrecen
Kassai street 26, Debrecen, Hungary
Responsible publisher: János Kormos
Tel: 36/52/416-580; Fax: 36/52/419-728;
E-mail: competitio@econ.unideb.hu
Typographic work: Kaméleon Dizájn
Print: Center-Print

University of Debrecen – Faculty of Economics and Business Administration
2005
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Growth Theory and the New Economy in a Neo-Institutionalist Perspective

The study surveys new trends in the international comparative and development literature addressing the issue of growth, the related institutions and the role of new economy therein. It highlights the need to address the basics while the economic paradigm may or may not be shifting under the conditions of ITC evolution and changes triggered by it.

Journal of Economic Literature (JEL) code: O11, P26, P51, P52

Keywords: economic growth, institutional development, new economy

The issue of institutions in generating growth remains a major and controversial topic in the literature on the new political economy of emerging economies. Ever since the publication of the World Bank report, From Plan to Market/1996/ and ever since the Nobel Prize of Douglass North in 1993 and of Joseph E. Stiglitz in 2001, it is no longer trendy to downgrade institutionally informed analyses as ‘poetry’. Likewise policy failures in post-Communist and developing economies over the past two decades, the crises in East Asia and in the ITC sector have triggered new interest in institution-related and policy-relevant academic research. Judging by the output of major publishing houses and of leading journals in the International Economics profession this seems to be a lasting trend. And a fore-fighter of the mainstream, Robert E. Lucas/1988,p5/ established some time ago, that numbers on long run development were hard to interpret in other than institutional terms.

In the first decade of the 2000s the question, it seems, is no longer if institutions matter, rather the question needs to be re-formulated: how do they matter? The preceding analyses have supported the claim by Havrylyshin and van Roden/2003/, namely that institutions do matter, but only in the context of supportive policies. And conversely, policies matter and sustain only if the rules of the games – institutions – are supportive of certain economic insights.

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Useful comments by Bart Nooteboom and Balázs Hámori are appreciated, with the usual caveats.
In addressing this field we enter on a slippery slope: similarly to many other ever-in-the-social-sciences-in-general-and-in-economics-in-particular, there is no clear view on which we could rely upon. The nexus between investment and growth remains largely unanswered, or likewise, the interrelationship between human capital accumulation and growth remains largely unclear. Conditions that trigger innovation and embedded technological progress are also at best approximated in the newer – that is in listing what is not conducive to innovation, rather than being positive about it. Therefore our subject has also more unknowns than equations. However, it makes sense to sum up, without aiming at being exhaustive, of what we may claim to have learned about the role of institutions in promoting growth. In so doing, it is not our intent to replicate the thorough and detailed literature review provided by Aron/2000/ and concludes with a slightly agnostic tone on the ways academic findings may be channeled into policy-making. However, even a rudimentary summary may serve our purpose, in attempting to generalize what our analysis contributed to more general knowledge, which is that insights have been supported and which ones not.

Endowments, Policies and Culture

Our analysis is supportive of previous research by de Melo et al/2001/ highlighting the over-emphasis on geography and path dependency in the policy discourse explaining failures and successes. We may join these researchers in underscoring the role of microeconomic incentives for restructuring, and the resultant emphasis on bringing together and sustaining such rules of the game, that are conducive to high domestic income. – high domestic investments scenario, with due emphasis on the efficiency of resource allocation and prudential regulation of the financial sector/not only only of banking-institutions are often path dependent, and conflict-ridden political situations, but also civil wars, but also milder but lasting forms of conflict, even lack of consensus on the fundamental values and strategies of development among major social and political agents, is conducive to sustaining weak core state, and the lack of anchors for sensible, growth-oriented policies. This is the reason, why all the countries are unable to operationalize those academic insights that could, in principle, lead to improvement.

The agenda of good governance, local ownership of reform and the anti-corruption drive all point toward the need for a strong, technocratic and professional administrative system committed to the public good and thus dis-embedded from vested interest groups. However, this maxim is hard to adhere to. In societies where there is traditionally paid investing into civil service, where rule-abiding always resulted in losses, informal rather than formal institutions and dispute settlement mechanisms acting as dominant, it is hard to see how the fixed point of change, the anchor may emerge. We do have convincing historical examples, from Kemal Atatürk to Lee Kuan Yew in Singapore that charismatic personalities can change the name of the game. Also transitions – the famous Huntingtonian third wave – have lent support to normative claims that changes for the better might be feasible. However, Williams/2003/ have highlighted the role of technocrats, policy advice, and the need to create independent agencies where technocratic considerations are provided a degree of autonomy, if not insulation, from countervailing pressures. In short, a long term or collective rationality is institutionalized against vested interest politics, whereas individual rationality, inevitably dominating daily politics in a democracy. However, this is unlikely to be quick and unlikely to produce results in a single electoral cycle.

This finding might explain why macro-economic policies have proven less effective in the longer run than they looked. Unless macro-policies are anchored in some fashion – be that balanced budget rules, privatization plans, Constitutions supportive of state enterprise, EU accession, international accounting standards etc – these are likely to survive the counter-reaction of vested interest groups. Likewise, unless sound macro-policies are supported by micro-economic foundations, brought about in part through legislation – such as the rules on bankruptcy, solid finances, or regulating market industries and deregulating product and factor markets – these are bound to wither and be rolled back. Experience with the inefficiency of these policies lends support to claims of national uniqueness and to justifications for not even attempting what in academic terms may look the obvious goal.

Foreign assistance, once highlighted by Gunnar Myrdal/1971/, and his followers as a component of development policies, has proven to be inefficient in countries. Many states of sub-Saharan Africa, where the domestic institutional infrastructure is too weak for absorbing these/more on that in van der Walle, 2001/. Similar findng is emerging through the observation of the quasi-states of Bosnia-Herzegovina, Kosovo and the like in the NIS. In these cases a culture of aid dependency has already emerged, without however any prospect of self-sustaining development. Decisive words, lack of progress cannot and should not be blamed on inadequate external financing, the lack of a new Marshall Plan for eastern and central Europe, or for the NIS for that matter. Recent empirical analyses/Ovaska,T. 2003/p.186/ has found in the period of 1975-98 in a sample of 86 developing countries one percentage increase in aid as a percent of GDP decreased per capita growth by 3.65 percent, and has not contributed to better governance, but allowed for postponement of reforms.

The focal role of institutions is also highlighted by the insight/Easterly and Levine, 1997/ that questions whether factor accumulation would be the ultimate and forcing force of development. As we have seen in the case of South-East Europe, Japan and also Russia, more investment, even plenty of new investment may well lead to more waste, provided the mechanisms of efficient resource allocation, control of subsidies, incentives for recoupment are not being created. The existence of capital

1 Dorfman,1993/ assigns the following tasks to the core state in orchestrating policy reform: a/ provide a strong ideology, b/ ensure strong administrative capacity, c/ target instruments according to well defined objectives, d/ decentralization and accountability, that is features that are bound to be built-up in a decade or longer; e/ provide a capital goods, to make attractive to FDI, g/ restore regular access to global financial markets. From this it follows that consensus over fundamentals may render even a strong state inefficient.

2 Williams/2003/ considers as weakening the core state the measures that wish the previous executive overweigh and create checks and balances in Japan and South Korea in the turn of the century through the abolition of "head of family" position in the public administration. In the European perspective integration would run the other way around.

3 Similar to the problem of anchoring in terms of stabilization, though the anchor needs to be broader than an interest rate.
flight in all countries at lower level of development is a plain warning, since it is realistic to expect foreigners to risk their property when better informed locals don't venture the same. As we have shown, in some economies the low absolute level of investment is also a cause for concern. But in the majority of cases it is rather inefficient allocation and lack of trans-nationalization that may be at the root of prolonged economic difficulties.

Finally special mention should be made of the resource curse-as elaborated in inter alia in Ross, 1999, or in Karl, 1997, pp.44-67 on petro-states/ which seems to be particularly relevant for the new independent states but also in South-East Europe. While some analysts/Jones-Luong, 2004/ develop sophisticated theories of why this is not a strong pre-determination, empirical studies are not supportive of the latter claim. Empirical evidence, provided recently, inter alia, by Kim/2003, pp.31-34 and 41-45/ has been indicative of the immediate relevance of the revenues from fuel extraction in sustaining authoritarian methods of control, both politically and in terms of corporate governance. This works by providing windfall revenue to the government, thus relieving it from the burden of painful adjustment. Growth could, indeed be recovered without major privatization and liberalization measures, thus the incentive to change must have been diminishing also during the Putin Presidency. What could be observed in the oil producing monarchy in the three decades following 1973 oil price hike/ Glass/ 2001, pp.24-26 and p.59/ seems to have been replicated in Russia and Kazakhstan since the late 1990s. As simple products do not require sophisticated management techniques, nor do they allow for it. And while neither historical determinism nor economic structuralism is by any means our perspective, it is hard to overlook the strong interrelationship. Thus we may only join more recent analyses/Atkinson and Hamilton/ 2003/ observing two items. First the significant negative correlation between resource abundance and slow growth is a statistical fact hardly to be disputed away. Second, the inability of governments to manage revenues is at least as important an explanatory factor as the availability of quick/cheap money on its own right. The two together culminate in regularly low savings that in turn translate into low investment and low growth in the long run scenario.

The interaction between the sophistication of social structures and efficient and deployable management techniques has been one of the oldest insights in sociology. Likewise in management literature it has been among the established facts to assert that more sophisticated intertwining, better educated workforce, more IT, general what is known as Toyotaism, requires different incentives and different forms of control, including less hierarchy, more collective rather than individual incentives etc. Thus the burden of proof remains on the shoulders of those who advance theories doubting such fundamental insights.

4 True in exceptional cases, such as start-up situations, transnationalities with large bargaining power may well venture areas where locals are suppressed by governments. But this colonial type of intervention hardly produces the forward and backward linkages as its Hirschman/1981/.

5 Aslund/2004/ certainly has a point in underscoring, that it is not so much the resource based development per se as ensuing authoritarianism and the disrespect for property rights which lays at the heart of the 'resource curse' inference and elsewhere. Still it would be wrong to see a unidirectional causation in a complex matter where it is the interaction between the two factors that is the key.

In reality, our empirical and analytical survey of the post-Communist economies clearly pointed towards the traditional lines. The prolonged rule of despotic regimes of central Asia, or the less pronounced forms of authoritarianism in other newly Independent States would be hard to explain, if we abstracted away from the lack of structural change, lack of post-industrialism and lack or weakness of civil society. As long as most of wealth creation requires simple management methods, well suited to the endowments of the fuel and energy sector, the incentives to change may come from the diplomatic arena, owing to the broadening of the focus of international agencies. These adopted, already during the second Clinton Presidency, a vigorous anti-corruption stance, advocacy of universal human rights and the like. Over and above this is the entire approach to poverty alleviation and development has undergone a change. As the volume of the chief economist of the World Bank/Stern, 2002/ illustrates, the international agencies have internalized those insights from newer generation development economics, that had been critical of the earlier view that treated recipients as objects of action. Rather than following the earlier passive approach, the idea of empowerment has come to the fore. Here the major objective is not to remedy certain static shortcomings, but facilitate change and learning, spread knowledge, and foster entrepreneurship. In this approach bringing about the abilities that allow for future value creation and innovation come to the fore.

By contrast, if resource abundance allows for rents to be appropriated, even if these are in part shared with the population, there is no receptive environment for the empowering approach. Rather the traditional culture of dependence and self-renforcing processes of patriarchal approaches and policies are likely to cement themselves. The fact that when the resource boom will have been over, the challenge will be all the greater, will hardly change the overall landscape. The more a country sustains the economic base of a traditional society, the more resource dependence, or control over foreign trade, or over a few revenue generating sources, such as smuggling, public monopolies, control of ports, transit routes, or tourist places, the less sophisticated the economic and the ensuing social structure remains, the better are the chances for enduring authoritarianism. Trivial economic costs of opting for the inferior are unlikely to change the balance of forces on their own, short of external influences.

The light at the end of the tunnel comes with transnationalization and the ITC evolution. While in the short run features of path dependence render the continuation of authoritarianism probable, and when fuel prices are high, this may even work, in the long run it is unlikely to remain so. Rather, those processes that have triggered the implosion of the Soviet Empire and the collapse of authoritarian regimes worldwide will exert influences on the resource dependent authoritarian states of the Middle East and Central Asia alike. In the case of Russia the European orientation of society and of the elite, as well as the ongoing process of integration in the global organizations, such as WTO, the political priority enjoyed by G8 and the IMF, membership of many international agencies, altogether will exert a strong demonstration effect with the time passing.
Formalization and Enforcement

Institutions are known to be rules of repeated games/more on that, also in general theorectic terms in: Aoki /2001/. Both formal and informal institutions, such as norms, habits, value judgments and perceptions are important for shaping outcomes. As we have also seen, copying formal institutions is though easy, still in most cases ineffective in bringing about improvements. Institutions emerge in part as an outcome of human deliberation - system design - and in part spontaneously, in ways that are not yet properly understood by the various social sciences. From the perspective of the North-inspired neo-institutionalists approach formalization and enforcement have been shown to be formative in the Russia, China and Trans-nationalization chapters in Csapo /2005/.

From the point of view of economic development the defining moment is if, and under what conditions, new institutions may contribute to the better combination of the factors of production, better allocation of resources and a generally innovation-friendly environment. It is hard to overemphasize the importance of rule of law considerations and property right regimes. The longer horizon we take, the more convincing is the insight that security of savings, the possibility to transfer property and, and, an environment in which the allocation of financial resources in a flexible and safe financial system constitute a single chain, what German economists term as the economic order. The approach implies that there is a strong interdependence among the elements of the macro-system, and changing one of them, while keeping the rest intact is unlikely to be effective. Privatization in the Czech Republic in the early nineties, severing monetary policy in Russia in the mid-1990s are cases in point.

Neither social sciences in general, nor our empirical analysis in particular have produced anything that can be termed as a cookbook of optimal policies, including sequencing and monitoring, that could serve as a general guide to any country in any period of time. What is particularly remarkable is the wide variety of interplay among formal and informal institutions, as well as among institutions and policies may interact. Indeed it seems that, in some cases, the self-reinforcing logic of virtuous circles, in other cases those of vicious circles are demonstrable. Testing the empirical validity of suggestions by Olson and North, Gradstein/2004, pp516-517/ has found a self-reinforcing tendency between the protection of property rights and growth, with law enforcement being crucial. Likewise in the vicious circle scenarios the lack of these mechanisms can be blamed for the self-propelling processes in the opposite direction. While we share the conclusion about law enforcement being a public good we definitely do not subscribe to his second finding, that would consider formal enforcement to be a luxury of rich countries. On the contrary, as we have indicated in several places, poor countries should actually value more public administration and the independent judiciary as a scarcity good. Therefore they are well advised to spend more lavishly on those/in order to preempt other private agents, such as TNC or mafiosi to do the same to an under-demoralized administration. In triggering the outcomes, as well as in the potential range of trajectory the interaction of transnational markets with local politics has been shown to be the key. Major components of development, such as good governance, rule of law, accountability, trust, social intangibles are all soft categories, that are known to emerge slowly and in ways that are non-trivial for the formal economic analysis. The limitations of the latter must herewith be clearly acknowledged.

Finally mention should be made of a quickly changing institution, that has been playing a pivotal role in shaping the outcomes of the past fifteen years: the European Union. Through its existence and changing policies the EU has been shown to play a pivotal role in shaping institutional change and in orchestrating policy consensus between the frontline countries. Meanwhile among the laggards the lack of this anchor has allowed for the reproduction of inefficient and path dependent structures, that is recombinant property and of inward looking coalitions. As the soul-searching assessment of the reflection group headed by former Dutch premier Wim Kok has rightly stated in November 2004, EU arrangements are far from perfect. Nor do they serve the purpose of maximum competitiveness. Still, EU arrangements have been and still are, superior to locally developed alternatives, if for no other reason because of their superior enforcement and monitoring mechanism. This explains why opting for the sub-optimal may be a shortcut solution in policy-making for many years, even if not for ever. By providing the anchor and monitoring functions the EU has helped to change the rules of the game in the frontrunner group. Here path dependent forms of management could be overcome primarily via FDI, and on the macro-economic level by harmonizing laws to the EU arrangements, the acquis. All this explains why it has not been the monetary component through which the EU assisted the more successful cases of transition. Likewise, it is the EU perspective rather than any other arbitrary criterion that has created a dividing line among transition economies. In one group we find those for whom Communism is no longer a defining feature of their development, in the other group, by contrast, those where this weighty heritage still predominates structural change and policy options alike.

Meanwhile it is equally important to re-iterate that the EU has never been meant to be a growth promoting organization in its main functions. The EU, especially following enlargement and the adoption of the Constitution, remains primarily a political architecture. This implies a stronger emphasis on primarily non-economic matters, such as citizenship, the common foreign and security policy, or environmental protection. While EU has contributed to bringing about sound macroeconomic policies in a number of its incumbents and also in the new member states, the ongoing debate on the modification of SGP is a clear indication that it has been built on voluntary compliance. Other words, independent enforcement mechanisms are and will remain limited, by virtue of its predominantly, though by no means exclusively, intergovernmental nature. Therefore it remains within the competence of each and every member-state, to bring about conditions favorable to innovation and growth. Some of the regulatory frame, including monetary regulation, fiscal codes of conduct, and many detailed regulations is allocated to the Community level and enforcement is secured

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6 This is precisely what is often missing, especially if and when nationalism and the related ideology of catching up, is hostile to a virtute in the eyes of the public → a big change over the pre-18th century period, as explained by Land 1998/.

7 Helgher/2004, pp399-400/ in his posthumus article rightly draws the conclusion from empirical statistical analysis, if properly accounted for indirect impacts, private property counts among the ultimate sources of economic growth. This point often overlooked in the heated debates on globalization, for instance.
by the European Court of Justice and the ECB, two supra-national organizations. This framework may or may not be conducive to growth, as the juxtaposition of Ireland and Germany in the 1990s would clearly illustrate. As the empirical analysis of Hughes, Hallet et al. (2003, p59) show, the disciplinary effects of the SGP might have been eroded by 2004 and the consolidation fatigue of large countries could not be overcome by the international/non-enforceable rules alone.

Policies and Trans-nationalization

It is a clear consensus view in the literature to state that policies clearly matter. While macro-economic theory clearly advocates non-inflationary growth, as the only sustainable solution for the long run, prudence and solid fiscal stance are easier preached than practiced. Macroeconomic stability cannot be taken as given, it needs to be recreated from time to time. Fiscal sustainability, though easily conceptualized, is hard to attain under democratic framework, unless what the Germans call Stabilitätskultur emerges. This term implies that none of the major actors conduct policies and pursue agendas that are in open conflict with the virtue of price stability. On the one hand, wage restraint may be attenuated if monetary targets are credible. On the other hand, the expenditure side of general government can be calculated so that it would not offset the maxim of price stability. Irrespective of the role ascribed to cyclical fine-tuning, fiscal policies can remain solid. Likewise, state administration should not be seen a pork to be handed out to clientele. Rather a technocratic/British style/ approach is required. This lengthens horizons, especially if rule-based rather than discretionary decision-making becomes dominant.

These normative considerations cannot be taken as given, not even within the European Union. While in academic terms the overall policy frame, what Wallbroek (1989) aptly termed the 'one world consensus' is no longer subject to serious professional debate, myopic policies and parochial public debates do allow for recurring popular pressures, from Poland to France. Policies in a democratic environment are inevitably at some level, the independent variable in the growth equation, even if there is no absolute freedom of choice sovereignty in the old sense.

Policies and policy agents may be instrumental in bringing about, or torpedoing change by way of their contribution to institution building, or conversely, by avoiding action even if it is overdue. The Swedish Social Democrats' policies under Goran Persson in the post-1999 period indicate, that even the most entrenched structures, such as the investment funds administered by trade unions, or the previously purely public and overly lavish pension system may be reformed. By contrast the experience of Poland and Hungary in the 1997-2004 period is indicative of the dangers of falling to victim.

When Ecoin decided not to launch a formal excessive deficit procedure on Germany and France, but content with their promise to redress public finances by 2005, the ECB issued a reprimand and restored the public of its hallowed stance. This of course implied that both big countries pledged to return to fiscal prudence, and the public backlash was avoided (Niese Zürcher Zeitung, 26 November, 2003).

This is in part, at least, due to the rather general, non-specific formula and approaches allowing for adjustments in different contexts. In fact, already beginning with the East Asian financial crisis of 1997-99 International Financial Organizations, such as the IMF and the World Bank, have also adopted this differentiated approach, in contrast to their previous rigid standardization attempts.
the reasons explaining this that owing to conflict in interest, especially in the finance sector, but also in terms of micro-economic integration/regulating networks, health care, rural development, environment etc. / the regulatory and monitoring function cannot be outsourced from the domain of public policy. This is so, if for no other reason because of the need for a referee in any games that are often, though zero sum in the short run. Thus while most of the tacit knowledge, capital and learning by doing, is bound to come from the corporate sector, the monitoring and macro-economic steering function can only come from public policies.

Finally it would be hard to disagree with a conclusion by T.N.Srinivasan/2005/ that it is a quality, rather than the sort of institutions which is decisive for long term economic performance. The example of the stock exchange in Moscow and Shanghai clearly illustrate, that simply introducing a formal institution with well known characteristics per se is a long way from bringing about the outcomes normally associated with them. It is the social and overall context that determines the outcomes, though as frontrunner emerging countries and the newly industrialized economies have demonstrated, the 'tyranny of history' is no longer a general all-valid argument for justifying any failure. From this insight it also follows that any external influence, should this come from the EU or transnational agents, is bound to be limited in any non-disintegrating society.13 It precisely the ability to adjust and adopt new forms of organization and the concomitant values and behavioral norms that is the name of the game. In a way, there is no way to eschew organic change, that is 'domestically owned' and supported by societies, good policies are to survive one election cycle.15

The Politics of Economic Reform

Already early analyses, such as those coordinated by Bates and Krueger/1993,pp40-472/ have highlighted how little is known about the precise inter-relationships between the economics and politics of institutional reform. Reforms in a broad sense are understood to be more than administrative tinkering. Thus they involve comprehensive overhauls of how the system and its defining institutions operate, on the base of political initiative from above, and conducted in an organized, rather than spontaneous, manner. Experience with policy reform is varied. It is indicative of the feasibility of such projects under a variety of socio-economic conditions in all emerging economies. However, the authors rightly warn, it would be simplistic to postulate an immediate relationship between poor economic performance and ensuing corrective reforms. As many stagnant developing economies, and more recently Japan/Saxenhouse and Stiglitz/2003; Hoshi and Kashyap, 2004/ and Germany and other core European economies, Siebert,2002/ testify, there is no 'inevitability' to change once intrinsic interests

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13 This explains, alas, why so little can be don even through pre-emptive wars and humanitarian interventions to overcome consequences of dictatorships in a sustaining and humane manner. It also explains, why various international organizations tend to be more silent than they should when encountering problems of appraising obvious mismanagement/corruption among their member states.

15 The contextuality of good policy is an issue highlighted by the summary chapter by Stiglitz/2000,pp55-61/.
governmental activity through education and infrastructure\(^{15}\) is rather positive, investment and growth is rather weak if any. Thus policies can not be assigned with the task of generating growth through immediate action.

This implies, inter alia, that adopting EU regulations in the course of harmonization of legal and regulatory systems may or may not provide additional impetus for improved developmental perspectives in the new member countries. If and when local conditions, at the end of the day, translate these formal rules in the old, established inefficient practices, this 'inculturation' may actually deprive these arrangements from their civilizing and monitoring functions. It is clear, for instance, that no amount of harmonization and external monitoring will substitute for an administratively efficient core state, a less corrupt and non-corrump civil service, high levels of professionalism in financial regulation and non-partisan enforcement of existing laws by an independent, properly paid judiciary.

Likewise, many of the categories re-discovered in recent political economy theorizing, such as regulatory quality, prudence, good governance, transparency, fair trading practices, social intangibles hardly lend themselves to quantification. By contrast, some other features of sound policies, such as fiscal sustainability, or a pension system not carrying over implicit debts, clearly can and should be phrased in quantitative terms only.

These dual insights show up in the corporate governance literature where advocacy of particular, culture-dependent, contextually well functioning models has given way to insights primarily in Aoki /2001/ over the inevitability of lastingly diverse forms that lead to success.

### The Role of Financial Institutions

We may venture to formulate some of the necessary, though by no means the sufficient conditions for an environment that is favorable to sustainable economic growth. Since the earlier surveyed, and generally the more technical, literature on growth is inconclusive over the mechanics of its generation. Thus we can only refer to the policy-relevant insights that definitely count among the necessary components of success, without being able to deliver the sufficient conditions for emerging economies.

One of the emerging new consensus points in the literature is the focal role of savings. This used to be part of the conventional wisdom. However, with the triumph of Keynesianism the per se true insight, that savings always equal to investments at the macroeconomic level, has been too easily translated into a policy where saving did not really matter.\(^{18}\) By contrast, the studies on underdevelopment, surveyed our chapter on the developmental dimension of transition have clearly indicated the enhanced policy relevance of savings. Unless the domestic savings rate is kept sufficiently high there is no way how FDI could replace this, nor could activist state policies compensate for the loss. The East Asian growth miracle/Nelson and Pack, 1993

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\(^{15}\) The latter point is obviously contestable. Physical infrastructure projects are prime examples of 'cathedrals in desert', from the Brazilian highways crossing the Amazon rain forests to the Danube bridge of Szekszárd, serving hundred/sth car a day in its year of construction. In general big prestige projects may be the hatted of competitors at the phase of their planning, implementation, completion/controls and retrospective evaluation alike.

\(^{16}\) Analyzing the role of savings in the Hungarian economy Erdélyi/2000 especially attention to the frequent occurrence of forced savings, primarily in the corporate sector, as well as to limitations to increasing household savings in a transition economy, especially through interest rate policy.
norm in the exchanges among Russian corporations, has lent support to the insight that de-monetization is a fairly successful way of keeping the "grabbing hand" of the state away from private pockets. This in turn reinforces our claim that the inability to tax, lack of incentives to save, the lack of formal institutions of finance, and the low levels of investments constitute a single chain in explaining underdevelopment.

Savings therefore need to be in monetary form, that is as deposits in the bank stocks and government bonds. If this norm is violated, the corporate sector has to rely exclusively on retained profits for its expansion. Particularly if taxes are high—say for concerns of re-distribution—firms will sustain low profitability. They turn to "costing," include various items of consumption among the operating expenses of the establishment. This is not only distorting, that is not allowing for the best use of resources, and massaging the signals of consumption. It also provides an incentive to invest within the confines of the firm only, rather than searching for the best returns across the board/nationally and abroad. In turn, the low level of efficiency, rooted in the misallocation of resources will sustain, therefore we are back to square one of the vicious circle of underdevelopment. Even if in this less pessimistic scenario investments will be higher than in a "pure socialist" solution, like the one experienced recently in Zimbabwe, and previously in Mozambique and Ethiopia, growth is unlikely to be impressive. It may not even be attaining potential trend rates of growth, because of the built-in inefficiencies in the system. This is the situation typical of most sub-Saharan and Latin-American small economies. As we have seen in the various chapters, South-Eastern Europe, the Caucasus and Central Asia is clearly trapped in a situation reflecting the above listed stylized facts.

Even if financial savings are high enough, say, because of the dominant precautionary motive that allow for poor societies like China or Vietnam to sustain high savings rates, that need to be in domestic currency. If that is not the case, the latter will either be dis-intermediated, or the function of mediating between savings and investments will be taken over by foreign financial institutions. The latter might well be inevitable to some degree, say at the early phases of transformation, as discussed before, or in countries where policy reform is initiated in a low trust—low credit environment. However, this should not become a lasting feature of the system, else the chain of savings-investments-taxation-public goods and services—more incentive to produce and generate revenues—even if that is taxed will be broken. Moreover foreign banks obviously cream off the best clients and more profitable businesses, since there are no charity foundations. Therefore much of the profit that should be re-invested, building up the financial sector and its costly physical infrastructure in the emerging poor economy will never be made. The second-best option thus may turn to be not all so lucrative. In this context, reference should be made to the old insight, namely that anybody using other countries' currencies is in the end financing the deficit of the issuing government. This is not a very lucrative perspective for any poor country trapped in stagnation, among others due to its low rate of savings.19

What has been unfolded does not contradict to our previous favorable assessment of the role of foreign banks in the process of bringing about conditions of sustainable growth and its financing in emerging economies in general, and in post-communist entries in particular. Nor should these ideas be interpreted as counter-arguments to the universal currency convertibility. Arguments favoring trans-nationalization allow for the full capacity and the full scope of micro-economic optimization and decisions to unfold. In reality, due to non-negligible transaction costs, it is not unlikely that in a normal economy profits would be immediately turned into currency and re-patriated abroad, unless the threat of a return of the predator state is very real. Short of this policy option it is rather likely that foreign investors will increase the scope of their local sourcing—an experience shared by Hungary, Ireland, the Czech Republic and Portugal. The strengthening of domestic tacit knowledge allows for deepening and broadening of financing. The latter in turn allows for more efficient combination of factors, and better external financing of expansion projects of local businesses, small and large alike. Growth in turn allows for more revenues to be channeled to public coffers. If for no other reason, because big foreign banks and investors in general, according to Hungarian and other experience, are unlikely to undermine their brand name by under the counter dealings, or not paying public dues. This holds, if the host country, following the principles of optimal taxation, levies lower burdens than in the country of origin. The resultant inflow, in turn, allows for the broadening of public services, for improving tax collection, professionalizing the state administration, and replicate the virtuous circle scenario we described in the empirical section and in the chapter on trans-nationalization. It goes without saying that secure property rights, law and order, contract enforcement and generally rule of law considerations matter even more in the financial sector. This finding is in line with those of Calderón and Liu 2003, pp.331-332/ stressing that the causality goes from financial sector development toward growth, however financial liberalization and institution building is helpful only if supplemented by other supply side policies. In other panel of 109 countries the mechanics of change works through the chain of capital accumulation, allocation and technological upgrading, stressing the need for financial development already at lower and intermediate levels of development.

Once we accept the insight that rule of law and a deep financial sector definitely count among the defining conditions that allow for innovation and endogenous growth, we can assign this task to public policy. There is a world of difference between two conceptions. One is the assignment the task of growth generation, particularly of attaining quantitative targets—such as high growth rates, above the average of OECD countries—economic policy, normally also changing it with the task of ensuring full employment. As a different one to hold it responsible for bringing about and sustaining those conditions that are not known to be contributive to growth. An overall business-friendly atmosphere does contain a number of non-quantifiable tasks, but definitely includes priorities on price stability, rule of law, fiscal sustainability, cutting back red tape and like.

It has long been a contentious issue in the literature, not least in the context of financial globalization, if and to what degree countries at a lower level of development that lower level of institutional maturity should liberalize and deepen their financial sector. Also the traditional East Asian developmental state did not rely on deep financial markets. However the latter model has not proven to be sustainable. In a recent study Niraj and Valev 2004/ have shown on a panel of 74 countries, that the finance/development nexus does change with the level of development. At low level of development financial

19 This explains why, despite its recent popularity in the financial literature, so few economies have resorted to dollarization/actually Panama, Ecuador and Grenada being these.
improvements have uncertain effects. At intermediate level of development large positive impacts on growth were demonstrable. Finally at high level of development influence is still positive, but smaller. The conclusion from this analysis may be two.

First: emerging economies eminently need improvements in their financial sector if they are to enhance efficiency of the use of their limited resources. Second, at higher levels of development long term factors of growth are not conducive to equally high rates of further improvements for reasons detailed in growth theory. Therefore it might be unjustified to extrapolate mechanistically the efficiency gains of the intermediate levels to the long run.

Freedom in this context is not just an instrument of attaining the supreme technical objective, growth, as Amartya Sen/1999/ reminds us in his seminal monograph. Yet another Indian economist, T.N.Srinivasan/2001/ calls attention to the fact that dictatorships, in historical and statistical evidence, have not proven to be more efficient in generating higher rates of savings and growth, let alone welfare, than democratic societies. Moreover the more we appreciate the insight of the new developmental paradigm, the less is it physical capital accumulation that is the engine of growth, but a broad set of policies and institutions that together add up to a favorable environment, the less likely we shall see the virtues of authoritarian regimes. The insights on the growing role of ITC, on the changing business paradigm, on the growing importance of decentralized knowledge and endogenous innovation, all point toward the non-replicable role played by various forms of market co-ordination, as well as of state policies and regulations supportive of these. Economic freedoms are therefore positively required for growth to take off, while political freedoms need not be postponed – a finding supported also in the empirical study of Vega-Gordillo and Álvarez-Acevedo/2003/.

Finally special mention should be made of the crux of micro-economic restructuring and the entire system of incentives, which is the set of institutions and rules regulating entry and exit, which together define the type of market economy we are addressing.

As illustrated in preceding sections, one of the major unresolved problems of both socialist, post-socialist and statist developing economies has been the lack of market social control over the arbitrary selection of winners. Furthermore this initial failure tends to be aggravated by the lack of monitoring and retroactive control by the consumer market. Local and international alike. The more we move away from textbook-like tasks of the SLIP agenda, and approach what has become customarily termed second and third generation reforms, such as those in the health and pension systems, in network industries, in former natural monopolies, in many previously publicly provided services such as waste management or water management, the greater is the importance of the quality of regulation, or as the international agencies christened it, of good governance.

It is equally important, on the one hand, to sustain gate-keepers, following the earlier described consideration of public purpose in regulating entry into such sensitive systems as finance, pipelines, air transport or health care. These should follow prevention and pre-emptive principles. On the other hand, it is equally important to provide a regulated exit possibility for those failing, and not only/not even primarily the small business sector. This call for updated and sharpened bankruptcy legislation, anti-trust activities, strict enforcement of accounting and transparency rules, and discretionary intervention when big crises are in the making. Experience in the United States in the 2001-2004 period has provided new evidence of the need to act, even

government adopts a general non-interventionist stance. Whereas expansion is often than not taking care of itself, divestment often requires assistance from public authorities, for considerations of employment and regional development alike.

Self-Correction and Coordination in Complex Systems

The big complex of unknowns revolves around the political-institutional preconditions of sustainable policies for growth promotion. This includes issues pertaining to self-correction and the coordination issues in complex systems.

Sustainability has gained prominence both in the more academic and in the more policy-oriented literature in the 1980s and 1990s for a simple reason. The more the focus of attention turns away from issues of fine tuning and managing the business cycle, that is to figure prominently in Keynes-inspired thinking, the more the longevity of policies, rather than their coherence comes to the fore. Simply put, if one contemplates the vices and virtues of changing the pension system, from pay as you go to fully or partially funded, the horizon of analysis is bound to involve the overlapping generations, their divergent interests, and not least the several decades long period in which the processes take place. Similar – in part identical – issues emerge during the partial privatization of health care and related services.

Likewise the more we include such items in economic analysis as trust and credibility, social norms and the like in the context of informal institutions and considerations of implementation and enforcement the more we have to face the fact that these do not change overnight. For this simple reason, but also with reference to frequent policy reversals, experienced not only in Latin America, the consideration of how to orchestrate policies and arrangements that last long enough to bite, has become endogenized in the economic analysis. While traditional economics considered these outside the scope of its attention, the nature of things has changed so that it can no longer be the case.

The more we consider democratic environment as given, the less we can employ the traditional concept of the benevolent dictator and that of the black box of politics, both extraneous to economic analysis. Balanced budget rules and independent regulatory agencies may though help, but unlikely to save the laborious task of building up and sustaining reform constituencies. The more the deliberations need to be continuous, like in health care, where no obvious solutions are at hand, the more important this component is bound to be. Also the availability of a lean and non-bureaucratic state administration devoted to the public purpose rather than to vested interest representation, is a condition that needs to be continuously recreated. The more complex the areas of regulation grows, the longer it takes and the more costly it will be to find and sustain high professional level in the macro-regulation and in the operation of formal institutions.

We have already seen/ Srinivasan, 2001/ that increased participation may or may not improve the quality of governance. The experience of water management projects in India, where non-representative – local elites pursued their own agenda, or the presence of management in the auditing sector, managing the crisis of airline industries, of insurance and many others...
equally non-representative but vocal NGOs in various international negotiations, is clearly indicative of the limitations of a 'the bigger the better' approach. Meanwhile, a democratic society there surely is - perhaps changing - limit to freeing up regulatory agencies from political accountability, at least in the long run. The more these rules and regulations on transparency, accountability, contestability, and the continuous operation of various checks and balances that constitute the heart of democracy.21 While all this looks straightforward, nothing is more difficult to deliver in practice than adherence to these simple maxims. Transparency of general government accounting may seriously inhibit the discretionary handing out of pork to constituencies, creative accounting and cover-up of practices that deviate from the principle of serving public purpose only. Accountability tends to be an abstract category if turnover in the state administration is high, and by the time of finishing investigations, nobody, that could be held responsible is any longer available. Likewise, decisions taken in collective, like in cabinets and within closed doors, without taking votes, may never be fully turned to controls, as everybody tends to remember in a different way. Last, but not at least, political contestability is an important issue. As long as one group or line of thinking may monopolize the floor, as for instance the Italian and Austrian Christian Democrats and Socialists, or Japanese Liberal Democrats could for over four decades - this is likely to enhance the chances for ossification, cumulative cover-ups, and general inability to correct mistaken decisions.

Finally, with the growing complexity of economic and social system, in part due to trans-nationalization and the ICT revolution, problem of macro-coordination is becoming the crucial issue. This insight, highlighted already in the now classic Bates and Krueger, 1993, p. 470/ volume has several planes. First, it relates to the administrative capacity of public administration. Second, it relates to the analytical capacity of think tanks supportive of the government. Third it relates to the political ability of the governance group to deliver coherence and commitment for sufficiently long periods of time. In order to attain these reliance on such meso-level arrangements, as the international accounting standards, enforced auditing requirements, widespread reliance on public procurement and the like may be of assistance. However these can by no means replace discretion and careful case-by-case assessment of the situation - a consideration of the practicing policy-maker or as John Williamson/1994/ called them technopo22 - stresses in their analytical accounts.

21 In his recent book, based on his famous article, Fareed Zakaria/2003/ developed and reviewed this old insight, calling attention to the dangers of the tyranny of fifty per cent plus one.

22 International political economy literature tends to allocate a focal role to the Ministry of Finance. However, as the account of Geskovits/2001/ explains, in emerging economies the relationship between the Prime Minister, following political or even historical aims, and his Minister of Finance, following a narrow economic logic and fiscal management, more often clashes than coincides.

23 This is a merger of the words technocrat and politician, and the article refers to the need of exceptional professional technocratic knowledge combined with charismatic political abilities to communicate the professional agenda. Public figures as R. Barro, A.Campa, J. Stiglitz, L. Balcerowicz, D. Cavall, O. Jorg, and P. Pado-Schioppa may serve as points of reference.

Rules, Ideas and Policy Discretion

The immediate follow-up question that may arise from the above said is, and to what degree, institutions are able to replace policies and exclude discretion? This is all the more relevant, as rules, by definition, act as constraints on deliberation. Thus, whatever rule introduced limits 'sovereignty', 'democratic deliberation', relying on the popular mandate, or just pragmatism understood as 'common sense'. For instance the rules on voting for parties under five per cent of the popular vote to gain representation regularly excludes 15 plus percent of valid votes from Hungarian legislation. The 3 per cent ceiling of the Maastricht Treaty does not allow for a government to be involved in growth generating - 'counter-cyclical' - policies in bad times irrespective of the performance of this government in good times. Adoption of a regime of inflation targeting does not allow for monetary authorities to accommodate lax fiscal policies without their loss of credibility.

By contrast, the more academic economics is concerned with long run phenomena, such as non-inflationary growth, good governance, credibility and sustainability in number of planes, the more inevitable it seems to be the need to provide certain consensus-based insights to be supported by rules and institutions that are hard to change and by no means to be changed overnight. Rule-based behavior certainly enhances calculability, thereby allowing for a better interaction between market makers, thus enhancing the efficiency of policies.24 In concrete terms these new major changes to be accomplished with minor, soft policy measures, that of course other increases credibility and efficiency of both policies and institutions.25 This is the reason why the idea of rule-based behavior enjoys growing popularity in the analytical literature worldwide.

On the other hand, assessment of each and every situation can not be saved. In the period between 1999-2004 we could observe a number of occasions when the governing board of the OECD, of the central bank of the European Union, and of the Bank of France have all come to quite different conclusions on the measures that were deemed necessary to attain their quite similar goals. The ongoing idiosyncratic behavior is part of the proof of discretion, a fact that has never been denied by any of the major actors, from Aschberg and Tricht to Greenspan.

How can we know that policies are also irreplaceable? Besides the earlier quoted insights, recent analyses of ongoing crises/Collier et al, 2003/ call attention to the danger of reproducing the weak and predatory state, in part because of sheer disintegration, not because of the tradition of not investing in the public administration. The latter may turn into a self-fulfilling prophecy, with revolting power groups misusing the administration as their self-service shop, thereby further diminishing its efficiency. In developing countries, mostly in Africa, kinship and political loyalty matters more than professional knowledge; administration also serves as an employment buffer. This is much less so with transparency. Empirical analysis of Eijffinger/2004/ has indicated: transparency may lead to higher credibility, but the latter does not invariably translate into lower/financing/ interest rates.

24 This is a merger of the words technocrat and politician, and the article refers to the need of exceptional professional technocratic knowledge combined with charismatic political abilities to communicate the professional agenda. Public figures as R. Barro, A. Campa, J. Stiglitz, L. Balcerowicz, D. Cavall, O. Jorg, and P. Pado-Schioppa may serve as points of reference.
is why the above quoted analysis is also calling for the creation of lean and professional civil service as a precondition for further improvements.

One of the recurring themes in the policy reform literature is the unfavourable experience with transplants. Arrangements, both at the level of corporate governance and of public policy, that work well under one set of conditions, often fail to deliver under different settings. Once formal institutions become defunct or watered down, the functions of co-ordination is taken over by informal institutions. This, as seen with the laggard group of emerging economies, is about the opposite of what rule of law and credibility considerations would require. Once institutions borrowed from abroad remain on the surface, or function only superficially, there is a grave danger of them being eroded. South-East Europe is one of the regions, together with the post-Soviet space, where formal rules tend to be dominated by informal ones. As we tried to show /Cabinet /2005// in the case of both China and Russia, this is a sign of inadequate modernization and carries the danger of inefficiency and losing slowdown. In this context, Silvana Malle /2004/p42 and p47/ rightly draws attention to the contrasting experiences in Central Europe. She is indicating that institutions take root better if and where they had a certain legal and political pre-history, as common law in former British colonies. This insight also means, as she explains, that those transplants that are fundamental alien to the cultural context are most likely to be rejected by the social fabric and the democratic political process alike.26

We know fairly little about how institutions may be successfully transplanted, it seems that processes of trans-nationalization in general, and of ITC in particular may at a certain level, contribute to this. Also meso-level institutions were shown to have emerged for settling differences and collisions among various national rules. A way forward in the Millennium Round of trade talks, pertaining to several areas outside commodity trade, like intellectual property, public procurement, export promotion, measures and investments,27 would be to create civilized rather than archaic ways of conflict resolution. WTO membership may well serve as an incentive to streamline and modernize their respective institutional infrastructure.

An equally important, though much less explored area is the mechanism of self-correction. Once an insight gets institutional backing, it will have to be hard to change. It is the plus and the minus about it. On the one hand, this allows to act as a bulwark against policy reversal. On the other hand, priorities and insights may and do change. Public choice, for instance, favoring more egalitarian provision of services may give way to insights favoring more self-help and vica versa. Professional insights, especially the social sciences can rarely be taken as given forever. The 1960s was molded by the belief in technological progress - called in German Technikradikult. By contrast, the current age is formed by post-modernist and post-structuralist approaches, and by uncertainty pertaining to the powers of any administration is up to. It goes without saying that the two approaches translate into different institutions, that much more difficult to change than policies are. For instance the moving wage setting of scala mobile, itself a source of chronic inflation in Italy in the 1970s had been possible to change only at the cost of major social unrest and several years of fights. Likewise...

26 A similar conclusion is formulated in an even more pronounced manner by/Wniecki, 2003/.
27 These are dubbed in WTO parlance the Singapore Tasks.
The study of emerging economies has, perhaps contributes, though to a limited degree, to clarifying and understanding these more general considerations of economic theory. In a recent book /Csaba, 2005/ we attempt to show that in the majority of cases it is not the Communist heritage, but factors common to other countries at similar levels of development that are decisive. For instance the level of trans-nationalization, broadness and deepness of capital markets, sound banking, incentives to save and invest, context-specific methods of corporate governance and the like are the usual suspects. Cultural and local specifics modify rather than redefine the logics of its functioning. Therefore both successes and failures of emerging and other post-Communist economies can be interpreted within a single theoretical framework.

While we have found many cases that go along the standard line of explanation we have not found any single counter-case. In all those cases when empirical findings do not seem to be supportive of the general claims, we could spot specific sets of circumstances that explain derailment. For China, Russia and the Balkans the standard set of explanatory variables do seem to deliver acceptable results, once modifying factors such as path dependency and the weak core state are accounted for. This is the standard way of proving a thesis in the natural sciences, and paradigms need to be re-assessed only if the exception becomes the rule. Although we have seen and cited many cases of describing transformation and re-emerging growth in terms of puzzles, we could find empirical and analytical support to substantiate these claims. The latter looks rather wide spread than soundly substantiated. The predictive power of the finding of such as the interrelationship between FDI and export patterns, or financial soundness and growth, seem to hold in line with the general claims/not invented, merely applied by the present analysis. Thus, as Antoni Kuklinski/2001, pp.130-133/ explained, a mere fact of Hungary and Poland each losing ten places in the Philadelphia Index of Scientific Output between 1981-1998 is unlikely to have left the innovative capacity of the respective economies unaffected. The latter is known to translate directly into the long term/trend rate of economic growth. The less policies counteract the innovative bias of transition societies, that has been manifest anyway, the longer the deeper the period of slowdown is bound to be. Likewise, the low level of revealed technological progress is unlikely to leave the Russian growth potential intact, oil prices consolidate. Decades long neglect of R&D and of quality higher education is far from being a forgivable omission from the perspective of what rates of growth will be sustainable in the coming decades. Claims to the contrary, repeated endlessly by self-justifying public figures, are unlikely to invalidate the basics of growth theory and the neoclassical and endogenous, institutional and evolutionary alike.

The list of conditions for emerging from the ruins of the Soviet Empire, presented here is not meant to be exhaustive. However, it does contain at least some of the necessary, even though not all of the sufficient conditions. One of the reasons for this is the fact that the broader developmental literature also struggles with the normative issues. It may offer on small, land-locked countries located in big distances from the major growth poles an obvious disadvantage, currently stressed again by the new economic geography. Therefore we may fall short of offering trivially available remedies for the multiplication of IIs in Central Asia and South-East Europe alike.

Our findings on the emerging economies, both the descriptive and normative planes, point to the same direction as the broader developmental literature presented by the volume of Todaro and Smith/2003/. They are stressing the importance of institutionalization, democracy. They also urge to create stakeholders. They stress the absence of bottom-up, organic development and participation. The latter applies best in two planes. First: participation of the population in the process of macroeconomic deliberation, through voice and representation, since Amartya Sen/1999/ no longer seen as a mere object of "benevolent dictator's", even at the abstract level of theory of optimal economic policy. Second: participation in the processes of trans-nationalization, rather than rejecting it by way of exclusion, de-linking or searching, in "national ways and models" has been shown to be able to produce superior outcomes in terms of wealth creating and well being alike.

Similarly, the great historical overview of Landes/1998, pp.217-218 highlights: beside institutions committed to 'larger goals' over and above vested interest representation, the provision of personal and proprietary freedom, freedom of contract, fair, honest government, free of any predation/or simply non greedy government/have been the major components of economic success across the centuries. Furthermore, as Lambdorff/2003, pp.468-469/ indicates, corruption in poor counties lowers productivity by 2 percentage points per annum on average. For Tanzania for instance he finds that improving its level to that of the United Kingdom would yield less than 10 per cent of the capital stock. Therefore, at least in part, it is the lack of professionalism and non corrupt government that may explain why non-European institutions fell short of capitalizing on their frequent, but temporary, edges in terms of location or technological innovation.29

As we have seen through the publications of the international agencies, as well as the development literature as exemplified by the representative volume of Meier Stiglitz, eds./2001/ a large number of fundamental issues are being re-assessed. Role of policies, institutions, of policy reform and sustainability have put a number of previously settled questions back on the agenda. It is reassuring to observe, that in political science and international relations a parallel development take place. Empirically based comparative methodology evolves toward a neo-institutionalist thesis, that builds though on rational choice model, without however staying at the level of abstraction/of the broad overview of Saxonberg and Linde,2003, p.14. It presents a new research agenda that is in the making. The good news is that emerging economies fit into this picture. The bad news is that the process seems to be much more advanced than it was thought even a couple of years ago, be that from the angle of growth theory, or from the angle of development studies or new institutional economics that matter. Attempting even to take stock of these is a task of a subsequent paragraph.
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Zoltán Ádám

Autonomy and Capacity
State-Centred Approach to Post-Communist Transition in Central Europe

This paper examines state characteristics and their policy implications in five Central European post-communist countries. It argues that state-society relations throughout the post-communist transition shaped policies on macroeconomic stabilisation, privatisation and FDI. Curiously, though, whereas formal and institutional developments exhibited a great deal of path-dependency in some countries, the insignificant policy shifts took place. The conceptual tools of state capacity and autonomy are used to describe both dynamics, as well as to explain the spectacular variation in the role of FDI across them.

JEL codes: P26, P31, P51
Keywords: transition, privatisation, state autonomy, Central Europe

Introduction

The purpose of this paper is to examine state characteristics and their policy implications in post-communist transition in five Central European countries: the Czech Republic, Hungary, Poland, Slovakia and Slovenia. States are understood here as institutional actors playing a key role in economic development. How they fulfil this function, depends on policies, which are significantly influenced by such state characteristics as their vis-à-vis societal actors and their internal capacities to implement policies. Ever, not only policies are affected by the degree of autonomy and the quality of rules, but policies impact upon state characteristics too. Thereby, a degree of path dependence is involved, usually resulting in policies supporting existing state capacities or privileging social groups. Nevertheless, at times of restructuring, path dependence is challenged by policy shifts that potentially rearrange state-society relations or alter state characteristics. In this sense we have witnessed in post-communist Europe in the past 15 years an intense period of structural change in which characteristics have changed to varying degrees in different countries. Policies on privatisation, privatisation and foreign direct investment (FDI) played a crucial role in some countries. Nevertheless, not everything has changed. Some countries exhibited extraordinary dependence while others conducted more policy shifts.

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