SME ECONOMIES: ADJUSTMENTS TO GLOBAL TRENDS

Edited by Zoltán BARA and Beszéde GÁBA

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Small Economies' Adjustment to Global Challenges

Edited by

Zoltán BARA

and

László CSABA

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Introduction

One of the most challenging tasks of transition economics is the need to be integrated into international economics. This is not only due to the fact, (which could be highlighted years ago (Csaba [1995, p. 280–291]), that with the progress of systemic change successful countries are likely to become increasingly akin to already available models of the European market economy. The international financial contagion of 1997–1999 has even more accentuated the circumstance that transition countries – Russia included – are all small open economies, whose progress and well being is to a large extent beyond their control, a function of the ups and downs of their global economic environment. If anything, this has been proven unambiguously by the Russian currency crisis of August 1998, when a domestically per se successful policy line proved unsustainable in the context of

1 Comments by Ms Kamilla Lányi, with the usual caveats, are gratefully acknowledged.

2 Russian imports from ‘far abroad’ – i.e. the effective demand of Russia against the global economy – were 29.8 Bn$ in 1999, (cf. Ekonomika i Zhizn, 2000/6) thus hardly exceeding the respective Hungarian figure of 25.5 Bn$. 
the Asian contagion, and of course, the then collapsing world oil market, was probably the first time since World War II, that the Russian government was exposed in its total defencelessness, of its extreme vulnerability to non-market agents, whose herd behaviour simply overwhelmed international coordination, culminating in the unsuccessful IMF rescue package in 1998. Likewise, concerted policy efforts could do little to help the Sukharto economy, or to sustain the level – if not the regime – of the real exchange rate in Brazil.

What is to be done? Most of the international literature has taken the top-down approach, focusing on possible reforms of the international financial architecture, improving bank supervision, the overhaul of the Basle Core Principles of Bank Supervision (Bonte [1999]) and on devising international institutions for reducing financial instability, (Rogoff [1999]). By contrast, in the present volume we have attempted to make a bottom-up approach. Either by relying upon individual country experience, or by highlighting the corporate experiences and features of microeconomic adjustment, they have been joining the search for answers from the point of view of price takers, not from the point of view of price makers or regulators. This might prove to be a fruitful addition to the previously available literature on the subject.

The political economy of country size

But does country size matter? In standard – introductory – textbooks on economics and on political science this item does not show up in the subject index. However, at times of political earthquakes, when country borders are redrawn from exogenous conditions of economic activity, including the norms and relation game, or the geographical territory on which it may be extended automatically change, such as in times of transformation, a sizeable amount of theorising happens and re-emerges on the subject.

It is not at all trivial why the national issue has resurfaced with the collapse of the Soviet empire with such an extreme and mostly unforeseen force. International relations theory lists at least ten factors having contributed to the resilience of nationalism all across Europe and not only the ruins of the empire (Balogh [2000]). This includes i.e. the negation of the existence of a political force, particularly in the post World War II period, the suppression of any non-universalist idea in the fight against Nazi mental heritage, the over-estimation of European and universal humanistic ideas, lack of earnestly facing one’s own history (Vergangenheitsbewältigung), and last but not least, the loss of previous rules and related stabilatory enforcement mechanisms. In the ideological and power vacuum the west positively lost its legitimating enemy, while the east was still in a vacuum, without relevant points of orientation for many, or even most political forces. And above all, in many areas, especially in south-east Europe and the newly independent states, nation-building and state-building, having dominated western Europe in the 18–19th century, is just belatedly, but unmistakably, taking place in post cold war context.

This is, i.a. an outcome of the collapse of not only the post–Yalta system, but also the post-Versailles system of international relations. Thus, it is hardly surprising that theorising about small countries and their viability has a long history to look back. By the same token, the more one had been impressed by arguments focusing on scale and scope economies, the more tended one to be sceptical about the longer-term viability and welfare potential of the newly formed small political entities. While the Austrian economist Kurt Rotschild [1944] highlighted the importance of international trade for the well being of small nations (in direct defiance of the economic nationalism of the inter war period), the more typical view was formulated by the Hungarian post-war political theorist, István Bibó [1946/1991]. He talked about the misery of small nations. In this approach only a larger community of regionally close and possibly like-minded democratic nations and a chance to meet the challenges of a modern economy. Only they are able to provide welfare and overcome the historic dead alley of the interwar period. This was obviously not a far cry from the Adenauer–Schuman idea of the united states of Europe, making way in reality to the compromise of European Steel and Coal community in 1951, with the obvious idea of making any war, waged against each other, impossible.

It is worth noting that much of the theory of economic integration has been going with the obsolescence of nation state, with the narrowness of national boundaries, with the incongruence between full-scale and sophisticated demand and specialised national production. And in terms of finalité, the idea of a supranational Europe has been re-emerging ever since the 1950s.

Since this finalité has proved unattainable, two types of answer emerged to the question of viability of small nations. One was the already quoted integration theory, which called for political and institutional integration as the precondition for any way-out. The 1974 world congress proceedings of the International Economic Association (Machlup ed.) [1975]) comparing economic integration in east and west. For obvious reasons, integration under the red banner, Comecon, was missing.

The tripling of oil prices and statist measures, producing primarily stockpiling rather than marketable output, lie behind the Russian 'success story' of 1999. (DW 11/00a)
some of the earnest idealism of its west European counterparts. Therefore adherents of eastern integration were not at all so ready to sacrifice sovereignty in order to attain more (planned) efficiency. But if we subtract the political component, the integrationist stance was fundamentally sceptical about the viability of small national economies on the longer run. Thus the real reason is basically not about sustaining it. To paraphrase them, being small is not a virginity: a virtue where the basic question is how to lose it properly and civilised fashion, with mutual benefits to the partners.

There has also been an alternative, a softer view, especially in Britain and the US (Robinson (ed.) [1960]). This called only for more specialisation and less offset the inherent weaknesses and vulnerabilities of price-taking small economies. The conceptualisation of smallness is an economy below 10-15 million inhabitants, characterised by inherent diseconomies of scale and scope, a reduced enhanced vulnerability to external shocks, and limitations to conduct independent policies, and last but not least, by shallow local linkages.

From today’s perspective, the ‘Golden Age’ of the 50s and 60s did not get empirical support to either of these approaches. Some small societies exhibited quite exceptional resilience that could not be attributed to either EC or Comecon, and these were not the United States either. Austria, Switzerland, Sweden, Finland, Spain all exhibited robust economic development without being a member of any regional political integration group. They all had varying dissimilar developmental path heritage, and a dissimilar policy mix, the dissimilar social model.

Hungarian economics highlighted the possibility of small country breaking vis-à-vis mainstream of the day. Béla Kádár [1971] presented a forceful plea of the continued viability of national economic success stories, provided we followed the political of outward orientation, against the then dominant view substituting view of development economics. Later, Kádár [1984] this point re-stated against the background of two oil shocks, when the idea of self-reliance enjoyed new popularity. In the ‘second world’ as attempts at regional Comecon autarky, in the third world as attempts to create a new international economics and the adoption of the basic needs approach by various UN fora. This insight is quite in line with contemporary international economics highlighting outward orientation as the clue to sustaining economic progress against external disturbances, especially for small open economies (Balassa [1981]). The secret of newly industrialising nations was precisely in their ability to get lose of the predetermined of natural endowments, and follow policies not constrained by regional or historic considerations. This required a de-emphasis of overpoliticised national integration projects and the braveness to choose partners overseas, should these be more forthcoming and solid for the products, manufactured in the with the changing comparative advantage of the exporting nation.

In a way, this insight was not in line with the liberal mainstream of economics, since outward orientation did require strong states, sometimes even picking winner strategies, and extensive régimes of export promotion. Some of the European success stories were not based on resorting to such interventionist policies. Meanwhile global and regional trade liberalisation in the framework of GATT and the EFTA, but also the opening up of much of the non-farming markets of the US and the EC have contributed to the success of ‘outsiders’, consisting not only of Japan, but also several small nations, like South Korea, Taiwan, Hong Kong, in this period.

While the EC stagnated and Comecon decayed during the seventies and the eighties, small economies exhibited extraordinary resilience, and not even primarily as resource based economies. By 1998 among the ten leading economies of the world in per capita terms we find Norway, Switzerland, Denmark, Iceland, Belgium, Austria and the Netherlands, but according to the traditional definition, cited above, Canada would also count as small in terms of inhabitants, leaving only the US and Japan among the top ten as large economies (Wall Street Journal Europe, 4 January, 2000). Size and wealth creation does not seem to be intertwined.

Disintegration of the bipolar world during the nineties led to quasi-automatic dissolution of a large number of old and to the creation of new states. To cut a long story short, some of these were regaining their independence, while others, like Ukraine, Bosnia-Herzegovina, Moldova, Macedonia, Slovakia or Slovenia were entirely new state-constructs for contemporary history. Given the predominance of the integrationist school as well as the traditions of international relations theory, these developments were mostly ascribed ruinous, destructive features.

While the political science argumentation cautioned against the power vacuum and the generalised erosion process – sometimes termed Africanisation – economic arguments focussed on the conceived need to preserve intraregional trade, and advocated currency and payments unions. The view was predominant that disintegration may though be a nationally or politically virtuous deed, its economic consequences must be per definition deleterious. International agencies have invested considerable amount of time and energy in trying to forestall the process.
and discourage all actors from 'going astray'. IMF support for the pressure on the ruble zone was probably the most extreme example.

These approaches usually abstracted away from the most salient feature of 'pre-crisis' systems, i.e. the blatant lack of efficiency in levels and the lack of freedoms, both individual and collective, otherwise enshrined in the UN charter, as well as in all pan-European (OSCE) documents. A proper prices was of course not the single most evil of the ancien régime. However, this factor made, by definition, impossible to make proper price terms of allocative efficiency. Therefore abolition of such systems, irrespective of the liberties, was bound to have some efficiency related elements. The more important we see the role of money as a coordinating instrument in a modern economy (Dietz [1991] and Riese [1990]), the greater dangers of a demonetised and overcentralised system for efficiency and welfare. Thus abolishing deficiencies and the mere introduction of decentralisation of relevant money was bound to improve both co-ordination and welfare.

This puts the problem of viability of smaller units of a former giant interdependent structure in a completely different perspective. We could expect at least some of the potential efficiency and welfare gains to materialise by way of spontaneous adjustment. Should conscious policies of institution building promote the transformation process had to be dynamically efficient and self-sustaining.

The experience of the respective countries is mixed. Bert van Selm [1996] was among the first to highlight the inherent duality in the process. While some, like the former Soviet Union managed to capitalise on the newly acquired freedoms, Ukraine missed this opportunity. The analysis referred above underscored the need of policies and institutions supporting spontaneous adjustment and limiting expropriation, otherwise potentials and outcomes were bound to differ substantially.

This finding has been retroactively supported by the analysis of transitions in the Baltic states, (Haavisto (ed.) [1997]). These small countries would have seemed to be the most ill-suited for independence in the globalising world economy. In fact, the contrary proved to be the case, if and when appropriate policies aiming at and actually delivering stabilisation, liberalisation and privatisation have been put in place. Estonia has secured the country's edge case, Latvia and Lithuania, where similar policies were put in place with considerable delay. All in all, the segregation from the previously unified Soviet economy could be mastered, and the institutions of the market economy could be put in place with reasonable success. The sustainability (or failure) of the respective policies were contingent upon success (or the lack of it) in terms of institutions.

very large degree of regionalisation, without however, breaking up existing states.\(^7\)

By contrast, both the Yugoslav and the Soviet disintegration is attributable to the lack of both democratic forms of interest representation, and reconciliation, and to the lack of truly market driven forms of economic integration. The integrating role of foreign capital and supranational arrangements, so long up traditional borders, were equally missing.

In the course of disintegration most new independent states resorted to traditional statist policies to foster nation building, and reflecting these protectionist policies to fund state building. An earnest belief, built on the socialist and nationalist doctrines, in the ‘inevitability’ of crisis management, and bureaucratic means has also had a role to play. This drive has been supported by the advice of international agencies, i.e. clearing arrangements, licensing, and strategies in opening up. Michalopoulos and Tarr [1994] have already underscored the success of free market Estonian policies, and contrasted this to the hesitant Polish and Ukrainian reform practices (not promulgations).

The causes of the failure of the Commonwealth of Independent States could be summarised as the lack of market-based institutions, the lack of market-promoting policies and the lack of democratic interest harmonisation among the major forces of failures (Olcott et al. (eds.) [1999]). It is not the pure diversity, but rather similarity among the CIS states, in terms of lacking reforms, restructuring and a resultant lack of (foreign and domestic) capital for restructuring and a reconstruciton, that hinder their recovery and prosperity, (ibid 238–243) is not the size of the respective states, rather their policies and institutions which at the root of a lengthy and self-reproducing series of crises. (Olcott et al. [1999]) advocate the introduction of WTO rules, convertibility and SLIP strategies to remedy the problems, rather than any form of enchanted regional co-operation based on geographical closeness or re-establishing historic ties.\(^8\)

To sum up the contrast, while western Europe managed disintegration parallel with integration to global flows of information, capital and technology, lacking these external conditions rendered disintegration in eastern Europe more destructive, ruinous process. In fact, as the examples of Slovenia, Estonia, the Czech Republic and Slovakia indicate, disintegration may be parallely freedom and welfare enhancing. Echoing the western experience, also in central and eastern Europe small, rather than large, countries have proved to be the true success stories. This is explained, to a great extent, by changes in technology, capital and information flows, making scale economies less important, while rendering both corporate and country boundaries relative, i.e. issues taken up by several contributors to this volume.

These findings do not, however, invalidate the relevance of country size for economic analysis. Country size does effect trade patterns (Tornstensson [1998]). Small countries, relatively better endowed with skilled labour, are more often exporters of R+D intensive products. Meanwhile the presences of large internal markets do not necessarily favour specialisation in industries or activities with scale economies. Small economies’ health is often crucially dependent on their constituent region’s (Amstrong and Read [1998, p. 578]). This is demonstrated by the modest success of Kyrgyz economic reforms, where remoteness of the country seems to overarch any other consideration for international investors. By contrast, neither Slovenia nor Slovakia are particularly highly regarded for their reformist fervour, still, their embeddedness in flourishing regional economies – Triul-Veneto and Bavaria–Austria, respectively – seems to have had a highly beneficial impact on both their actual performance and on their perception abroad.\(^9\)

Small countries obviously benefit from multilateralism, both in the trade and defence areas. In the former, generalisation of any concession waged by stronger partners allow small countries to free ride, while multilateral arbitration procedures limit the unilateral use of force, figuring high e.g. in traditional US trade policy practices. Individual defence is though possible, however it is definitely more costly, in terms of both armament and mobilisation, than collective defence, where small countries may specialise on certain activities, while benefitting from the umbrella provided by an alliance.

Small countries also face a problem in defining the optimal degree of their freedom in terms of monetary and exchange rate policies. While the official creed of the 80s and 90s were pegged rates, combining stability with flexibility, the lessons of the Asian crisis prompted both theorists (Schuler [1999]) and policy advisors (Goldstein (ed.) [1999, 178]) to reject this option, as a panacea for runs or currencies, due to asymmetric risks and decentral information. However, free floating may be practically unacceptable to small countries with large – sometime:

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\(^7\) Later produced monographic analyses (Barkus [1999]) continued to have difficulties establishing how far secession can go; similarly these approaches – as all purely economic theories – have difficulties in delineating what a nation is, or what is the optimal/minimum unit for which cost benefit calculations in the spirit of Gary Becker can meaningfully be made. Likewise, it has generalise in quantitative terms when devolution pre-empts, and when it fosters, secession.

\(^8\) SLIP = stabilisation + liberalisation + privatisation

\(^9\) If we take incremental growth as the sole success indicator, the EU has not been much of a success either. As Vanehoudt [1999] demonstrates, impacts of a large market were negligible against traditional items in the Solow model.

\(^10\) Cf. the econometric exercise in the chapter by Attila Soda.
over 100 per cent – shares of foreign turnover against their GDP may offset all the fundamentals. Since exchange rate movements are related, if at all, to fundamentals (Rogoff [1996]), there is no good reason for this to happen. Therefore, Armstrong and Read [1998, p. 571] consider the evil to give up sovereign monetary policy in exchange for an automatic what membership in a hard currency zone entails. The more one is aware of the uselessness of discretionary interventions and of the authorities' fine-tune economic processes, the weightier this argument may count in policy-making. The current rush of candidate countries for taking over Greece’s recent victorious announcement of its joining the euro from a clear sign how widespread this conviction has been among policy-makers. It has been a clear indication of the same, notwithstanding the severe economic costs the preparation for this step implied.

Experiences of transition economies as well as other European countries support the insight drawn from developing country experience (Csáki [1986]) that being small is not necessarily a recipe for failure, even in a monodrome, going for niches, and generally being imitative and innovative in the international economy.

The challenge of international economic disturbances of 1997–1999

1997–1999 saw a series of events that may qualify as international disturbance for small open economies. Let us reflect only upon four of them. The first disturbance was the chain reaction of stock market crises, setting off attack on the Thai baht in June, 1997 and ending with the halfway-way attack on the Brazilian real (where the currency had to be devalued, but the dollar could be maintained) in January–March 1999. It has questions on the shape and future of international financial system and put the viability of arrangements of small countries to the limelight. The truly new and innovative feature in this series of events was, at least, twofold. First, fundamentals seem to be in particularly bad shape, especially in east Asia, where current deficits were small, or often the balance was in surplus. Thus traditional, ex ante measures to flawed fundamentals neither precautioned, nor ex post warranted the event.

11 Though this finding is well established both through theory and empirical evidence, it is provocative to many departmental views, that it is still contested. Most recently in The Quarterly Journal, no. 459, (Nov, 1999), pp. 652–691.

...the second feature was that the chain reaction has not originated in any of the G 7 economies, still the waves of disturbances have not left the major OECD economies untouched. The ‘one world’ symptom was felt more than ever.

As a second economic disturbance shock oil prices skyrocketed. In 1998 oil prices fluctuated between 9–11 $ per barrel, they climbed to 32 $ per barrel by March, 2000. Recall that in 1973 the quadrupling of oil prices induced recession and the balance of payments crises. New terms, as ‘stagflation’ and ‘epic changes to the world economy’ were introduced in the economic vocabulary. When in 1979 oil price hike restored the 1973 price relatives, economists talked of a ‘new price revolution’. Many analyses were produced to elaborate on the limits to growth and expand ways to change technologies to make production less energy-intensive. The second adjustment recession could also not be saved. In 1998–2000 similar happened. While oil prices tripled, EU growth accelerated to 2.5% per cent, with inflation in the euro zone remaining at 1.3 per cent, well below the ECB target of 2 per cent. Also in the United States growth reached 4 per cent, inflation remained barely above 1 per cent, and unemployment fell to 4 per cent to a historic low. Also a series of small countries managed to survive these shocks in good shape, as the contribution of Magas on Hungary and Gottlieb on Israel demonstrates in this volume.

As a third economic shock to small countries a series of mergers and mega-mergers have been going on in the period under scrutiny. While the first wave of mergers may have been attributed to forward-looking strategies making use of the euro, cementing and deepening the single market of the EU, the US wave of mega-mergers is hard to attribute to this factor. The concentration in the banking and financial sector exemplified most recently by the (unsuccessful) merger of two archivials in the German landscape, Deutsche Bank and Dresdner Bank, or the mega-mergers of Japanese banks may be indicative of the increasing importance of scale economies. Other contested mergers, as the failed Volvo–Scania project, or the Vodafone–Mannesmann deal seem to be indicative of this feature.

However, it is important to avoid the conventional post hoc, ergo propter hoc argumentum, Frölischer... [1998]. This is surely not the first merger wave, experiences with former such actions often have shown mere fashion, rather than good business ecologies, behind this trend. Following the acquisition of Bankers Trust Deutsche Bank concluded its financial year with a loss, for the first time in many years. Also in many other examples, it seems managerial megalomania, rather than enhancing shareholder value that lies behind the merger craze. The new trends in industrial organisation, highlighted by Kocsis, Szabó, Dallago and Galvez as well as the limits to transferability in the area of management and industrial organisation, as exemplified by the contribution of Lukács to this volume, all are indicative of strong counteracting tendencies.
In a way, these countervailing forces represent nothing else than the **elaboration of the boundaries of the firm**. **Ceteris paribus** the enhanced competition of multinationals, having contributed significantly to adjustment processes in countries and other small economies, as elaborated by S̆ereghyová in this book, imply the same for the macrolevel. The parallel rendering both macro- and micro-boundaries fluid, may have hold of explanation, why small countries have not suffered more from all the shocks.

Last but not least, as the fourth shock, the **fragmentation of security** on the ruins of cold war era should be mentioned. Analysing the facets of issue goes beyond the scope of the present chapter. Still, mentioning that the migration wave is often triggered by bloody ethnic strifes, from Kurdistan to Ethiopia and Kosovo. Besides, the economic and in many ways unprofessional, armament race of large developing states may pose an immediate threat to their smaller neighbours and the (Mangeide, [1999]). The clash in Kashmir, that has been close to nuclear conflict between India and Pakistan, is just one of the many examples of the grave conflict potential. Obviously, these trends of integrity and stability of small nations, in a manner that seem to have overcome the by second world war, or by the post-cold-war era, still instability prompts larger defence and peace-keeping expenditures also for small states. In more extreme cases, it may call into question their mere or economic viability, as the case of Macedonia, Albania, Sri Lanka in recent years Congo/Zaire could be observed.

Coming back to economics, how do we conceptualise instability? The growth and other activity indicators show extreme volatility, if the function of prices get blurred, that leads to depressive signs, moral hazard adverse selection in financial intermediation (Mishkin [1999]). If these features remain uncorrected, the distortions cumulate, devaluation of, that depreciate assets of banks. Thus even good macroeconomic watch warranty against financial collapse. This has been compounded by, financing, making book-keeping largely irrelevant, owing a large extent record activities, that may have gone up to 40 per cent of turnover. In contribution of Benczes elaborates, how these practices have lead to the contagion in east Asian small countries.

How does contagion spread? Fratzsch [1998, 640–645] names three channels: unsustainable fundamentals, contagion due to herd behaviour of investors, finally contagion due to close trade and financial interlinkages. Investigating the importance of each factor he finds the third to be more important than anything else, (ibid p. 688). This means the limited ability of countries and small countries to do much more than conduct sound policies that enhance credibility in the respective countries, like avoidance of much too heavy dependence on short-term finance, and enhancing transparency across the board. However, this may not be entirely sufficient to prevent the spillover effect. This is exactly what Keren’s model and discussion implies in this volume.

These all sound like serious warnings for small countries, where open door policies have played a major role in catching up and modernisation, as the previously quoted literature in general and the contributions of Benczes in particular in this volume highlight. **Should they continue open door policies?** Or should they be more restrained, heeding the suggestions for growing and among the wheels of capital markets, a call originating with James, B. There is no simple answer. On the one hand, countries, having conducted outward-oriented policies and having integrated themselves to international flows, could reasonably withstand attacks. This holds for Greece, Portugal (cf. Braga de Macedo in this volume), Poland and Hungary, but also for Singapore, Switzerland and Austria. On the other hand, closer scrutiny of the Hungarian success story is indicative of the high intervention costs (Darvas and Szapáry [2000]), as well as of the crucial role of the still existing limitations on short-term portfolio operations in the efficacy of crisis management.

Does it imply that capital controls, at least on short-term flows, are to be seen as the principal answer to the problem of contagion? The answer is clearly no. Countries where contagion has triggered lasting troubles, like in Indonesia or Brazil or Ukraine, had been facing more or less covered structural and policy ills for quite some time before the crisis erupted. Controls alone, lacking sound fundamentals and solid financial structures, have not been particularly helpful in any of the problem cases. Controls alone are no substitute to sound policies and credible policies, since they have a tendency to cement themselves as lasting policy elements, further they do allow for postponing overdue reforms (Edwards [1999]). This danger is imminent not only in Latin America, where Sebastian Edwards draws his policy examples from, but has clearly been observable in Malaysia, Russia, Ukraine, Rumania, and Croatia, just to list some other recent cases.

Recent semi-official and quite radical proposals (Fischer [1999]) to overhaul international lending and reporting practices conspicuously miss any old-fashioned quota measures, controls and prohibitions. Instead they aim at bailing out the private sector in, at making transparency, both at the level of corporate finances and general government finances, enforceable and uniform in standards, so as to make the signals comparable and cross-checking practicable. Furthermore they aim at more information sharing among creditors and more publicity vis-à-vis governmental and corporate malpractices. Requiring non-banks to publish reports on their
activities, public information notes on the performance on government flexibility in reserve-building practices tailored to debtor specificity, and a Code of Good Practices on Fiscal Transparency, elaborated by the Committee, all go in the right direction, without instituting new controls.

This is all the more important, since capital controls are constraining access of foreign savings, one of the preconditions for accelerated growth in economies. They further act as efficiency constraints, limiting the intertemporal and international combination of factors. Furthermore, they substitute sound financial institutions and transparency, which may, by their risk in due time, act as pre-emptive before crises, and so is the rearrangement of portfolios and asset values therein, as a consequence and/or exchange rate risk.

This finding is quite in tune with a broad analysis of the contagion for transition economies, see (Fries et al. [1999]). Having country experiences, they conclude that deep reforms make financial systems crisis-resistant. Sound financial systems retain, or quickly regain, international capital markets, thus the suffering associated with the drop in indicators was likely to be much shorter and recovery more. Notwithstanding these general conclusions the small country vulnerability to cyclical effects is unlikely to disappear.

This is quite important an insight for transition countries. On the one hand, the oft-voiced criticism, levelled against their overzealous realism in the reserve building, especially in the early transition years, seems retroactively even misguided than it sounded in contemporary times. Output and job losses in the 1990–1993 period, have to be measured against cumulative output employment losses in the control groups of CIS and southeast Europe. Furthermore, one-time losses must be weighted against cumulative and dynamic losses incurred those from contagion in the 1997–1999 period. On the other hand, the advancement of transformation and broadening the scope of capital markets, the reliance on portfolio investment is gaining importance as a means to hedge risks. Also enhancing the liquidity of capital markets and better access to a pool of foreign saving is becoming important, as well as the opportunity for created private pension funds to find safe and lucrative investments, probably also abroad (Buch et al., 1999, 212–213]). The more a country transits to the first and even the third (pre-EU) maturity stage of systemic change, the less it can afford a regression to capital controls and other statist policies.

These are all important theoretical and also policy relevant insights, for countries with no alternatives but striving for EU-accession, as Hungary is portrayed in the contribution of Prager to this volume, have to face the limitations known also from the Mundell–Flemming model, i.e. that full (capital account

Verifiability, exchange rate stability and endogenous monetary policy can not be attained at the same time. If open capital markets weigh so heavily in terms of development strategies, as seems to be the case on the base of above cited theoretical insights and country evidence, it is not that surprising to find that making specialists caution from premature pegging of candidate countries' currency to the euro, from premature joining the ERM, due to the overdose of rigidity this option would entail (Backé [1999], p. 60).

This finding is in line with other insights gained from transition-specific research. While the rate of exchange serves, by and large, inevitably as a nominal anchor in the first stage of stabilisation, this is but a short-term, temporary option (Czaba [1997, 105]) and (Desai [1998, 640]). Fixing the exchange rate is a poor substitute for disciplining fiscal policies or for reforming the system of financial intermediation and regulating it properly in terms of soundness and transparency. Therefore too early and too long a fixing may actually backfire, as the Czech and Russian cases evidenced. The resulting enforced devaluation undermine the entire hard-won credibility of economic policies of the previous periods. This implies not more and not less than the candidate countries can simply not meet the EMU accession criteria as defined in Maastricht i.e. including two years of membership in ERM before joining EMU. They have to be waived either from the inflation criterion, which seems politically next to impossible or from two years of membership in ERM before joining EMU, which has already two precedents with Italy and Finland. In fact, this waiver would not equal to softening up the Copenhagen criteria, but adapting them to the needs of catching up small open economies, though not in their capacity of postcommunist transition régimes.

Perspectives of small economies

Small economies have positively been refuting the 'big is beautiful' ideology of the industrial period, and the related integrationist school all across the last half of a century. Eight out of the ten richest economies are small. Many of the lasting success stories, from Finland to Singapore, have been written by small nations. From the ruins of the Soviet and Yugoslav empires only small, previously subordinate, nations have been emerging victoriously in economic terms: Estonia and Slovenia, respectively. The great east Asian contagion has not shaken small economies, as such, and success or failure has not been related to country size. Switzerland has not suffered more than Germany, and Greece or Israel proved positively more successful than Russia or Japan.
The underlying causes for this apparent paradox have been the political economy level by Brada and Boltho, and at the corporate level, Sereghyová, Dallago, Szabó and Szlavetz. Country experiences might be, all point to the same direction: towards the viability of small. We have found some new insights:

1. The new economy does not seem to be confined to the United States. Countries' resistance to new oil shocks seems to have proven.

2. Good institutions and good policies seem to work irrespective of history and country size. The relatively quick contagion in Israel (cf. Gottlieb in this volume), Hungary, Estonia and Greece, the resilience of the Singaporean and an Austrian economy, are taken as empirical evidence for this thesis.

3. Earlier and more global insights seem to have gained new support by highlighting: being small calls for even more going global, not only in industry, but also in finance. Small economies should not be conceptualised similar to large economies, as small business is not the mirror copy of the latter. Quite analogously, small economies are pushed to specialise and niches, to be more innovative and flexible than larger ones.

4. But does not globalisation, i.e. the rendering the borders of both territorial and nation-states permeable and fluid lead to the abolition of economies, their full absorption by a larger group or integration? Does the merger wave itself prove this tendency? As we tried to show, as our findings, the institutions ensuring the maximisation of shareholder value are already at work. Similarly to the industrial era, but this time supported by the decentralised trends in modern technology and organisation, it is naive to hold that they will get better. Mega- and related networks are inefficient, or are internally decentralised and crisis-resistant in the 1990s.

5. Our finding is in line with a broader review of literature and related economic testing of popular assumptions, (Schulze and Ursprung 1999, esp. 347). They claim that countries and activities are integrated in a rather different manner, thus there is no empirically testable sign of homogenisation. Policies seem to have remained fairly independent, moreover if those societies require more welfare spending, it could mostly be accommo-

Another interesting and reassuring finding is our sixth one, i.e. how much transition economies and their problems are becoming truly akin to non-transition economies of similar size and similar level of complexity. The latter have been sufficiently explained why picking winners strategies and statist export promotion policies do not work any longer in east Asian small economies either. Likewise, what transition economics has delivered in terms of the importance of financial institutions and the focal role of transparent and well regulated capital markets can no longer be contested with a share reference to east Asian successes (Park 1991) where high growth rates sustain without such devices. On the contrary, with their maturing economies, east Asians had to similarly reform their corporate, disclosure and public finance practices, much in the same way as transition countries have done, or else choose to stagnate, as Japan has been doing all across the 1990s.

Having said that, we do not subscribe to the bureaucratic view seeing primarily the EU or WTO as a forum for cross-border standardisation, and measure success purely in terms of meeting their respective criteria. On the contrary, the strength of the EU lays in the balance it strikes between common rules of the game and regulatory competition, which ensures freedom and efficiency. The existence of such small safe heavens as Luxembourg and Liechtenstein, that are not subject to populist pressures of the politicians of large and heavily taxing countries, contribute to the sustained competitiveness of west European countries. They do so as they counteract the otherwise hardly constrained 'heavy hand of the taxman', as the Finnish minister of finances called it recently. Such complex structures as the Swiss wouch warranty against what is traditionally called the dictatorship by the majority. This may count as our seventh finding on the future role of small economies.

We tried to underscore the ongoing devolution and decentralisation process, which is observable from Belgium to Russia. This process is made possible by the very same technological, organisational and motivational changes as we discussed primarily in the context of postcommunist transition. The finding, in both cases, points towards the limitations of purely economic generalisation.
We too have fallen short of establishing how exactly a community is being constituted, and how far secession may be needed. Obviously, basic issues like the competence of the economics discipline to take certain factors as exogenous, the same way we do not study research to the psychology of the Schumpeterian entrepreneur, afford assuming his presence, and distill his qualities through abstraction.

8. Having reached the external limits of our approach we may now stop assuming that the viable size of a nation or an economy is culturally and technologically constituted. As such it may be different in time. It must certainly be different by the historic era, since the possible exchanges and the scope of the extended order varies. Thus, our eighth thesis goes as follows: globalisation enhances making a relatively small nation viable, with the chances having better than they used to be, say, in Antiquity or even in the Middle Ages. Small nations are economically all the move viable, the more they engage in various exchanges, the more they find their niches. Reggio Emilia, a region specialising exclusively on traditional handicrafts and earning a very good living, is probably the best example how options may be, the further examples going from Silicon Valley to

This finding is in line with all what we know about the nature of the market economy, based on diversity, competition and the selection processes. Therefore, being small is not a predestination. Nor is it, however, a recipe for prosperity, as the fate of Sub-Saharan Africa may more than sufficiently demonstrate.


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