

***Two Decades of Post-Communist Change in Europe and the CIS:
What Has Been Achieved? What Is Still To Be Done?***

CRCE Colloquium- September 2011

Central Europe (2) Poland and Bulgaria

Chairman: John Moore

Discussion Leaders: Tomasz Mickiewicz: "Is Poland a nation of entrepreneurs?"

Krassen Stanchev: "Democratization and Nuclear Power in Bulgaria"

For Tomasz Mickiewicz's papers access the links below. What follows is the discussion:

www.sec.gov/info/smallbus/acsec/bradford-doessizematter.pdf

<http://www.sciencedirect.com/science/article/pii/S0883902608000098>

Tomasz Mickiewicz: The important question is, what is the likelihood that the decision you get is the one that you expect? If the question is asked that way; then Poland will score highly. The problem with the World Bank is that they try to avoid politics. The effect is that they overlook the dimensions that may be far more important. The question of predictability of decision is a question of rule of law, and they don't ask this question. A good definition of security of property rights is the effective constraints on the executive branch of the government. The fundamental question that any entrepreneur will ask is 'am I afraid of the administration' 'am I afraid of my governments' arbitrary decisions'. The business indicators do not capture it that well. You may have widespread corruption but it does not tell you the whole story as it may be *institutionalised*. We are talking about Kazakhstan, where you may receive and give bribes but they are only small, a sort of custom. It may not yet be dysfunctional.

Oleg Manaev: Some words about a similar story in Belarus, where three or four years ago the government announced plans to build a nuclear power station. The government in Russian context means Lukashenko. So Lukashenko said that there are three competitors - Russia, China and France. He signed the final 'ykaz' on the location of this station- not far from the Russian-Lithuanian border, and signed a contract with Ross Atom. But the expert assessments that were published, sand that in terms of economics and ecology they were quite dangerous. Of course the government completely ignored everything. Krassen emphasised the special interest of 'insiders'. I was thinking about the Russian strategy- because Russia is providing not just money but technology – reactors, services, etc. It means that the country, which built the power station with Ross Atom, will be dependent on Russia. So it is a very sensitive, very interesting issue.

Duncan Allan: If I could add a thought to what Oleg just said. This is a very big issue in Ukraine at the moment. There was a big deal a struck between Ukrainians and Russians on the supply of nuclear fuel and nuclear technology to Ukraine's nuclear power industry. This is a big factor in the Russian- Kazakh relationship as well.

My question: You touched upon several times in your presentation the considerable importance to various moves to liberalise entry. The other side of the coin is exit. Could you say a bit more about how the authorities have addressed that issue?

Karl-Peter Schwarz: Krassen, could we imagine nuclear energy being developed without state subsidies without governmental programmes, only paid by private insurers? I should also like to ask Tomek what he said about start-up and self-employment.

Silvana Malle: You notice that Poland is not placed well on the entry of business. What struck me are the countries at the top, the more or less crooked countries (Equator, Peru, Venezuela), what business are they doing? It is very important to shorten the entry time of business. If in Italy you start a business in one day, and open a café under a block of flats and the customers make a lot of noise- you need someone to regulate the situation. Someone has to compromise between different interests – the peace and tranquillity of the residents and the business owners. Therefore, I am not in favour of opening a business in one day nor one week, as there is not enough time for various factors to be taken into consideration when granting a license.

Looking at the bigger picture, we have Gaz Prom, now we have Ross Atom; this raises the issue of energy policy in Europe, now we are becoming more dependent on Russia for energy supply.

John Moore: Can you explain the correlation between the size of the state and the rule of law. In that chart, Peru was in the worst spot- big state, weak rule of law. But the very next chart showed that Peru was right at the top: the percentage of self-employed of the working population is high. Therefore can you explain how those charts relate?

Tomasz Mickiewicz: The World Value Survey Indicators is based on factor analysis. The interesting thing here is where it links with entrepreneurship is that it links with informal finance. Finance from family and friends. There seems to be a lot of it going on in china, unlike the soviet bloc. As the Maoist period was a lot shorter thus it did less damage and there is a lot going on in China on a private level – in terms of self-organisation. Now, bankruptcy and exit; Kadar did much better in terms of bankruptcy in Hungary where a much more radical regime was established than in Poland. In Poland they allowed state companies to sell assets. That worked in Poland because there was a social control on enterprise level, as the trade unions were against the managers- that is how Solidarity first developed. But still a lot of assets were sold, a lot of downsizing of the state sector without bankruptcies. Bankruptcies were later used as privatisation methods, which was not very efficient.

East Asia: there is a lot of research these days demonstrating that East Asia has no individualised culture thus there is no entrepreneurship but it seems to be more complicated. Taiwan is an interesting case with an economy based on very small companies. The stereotype of Korea was based on support for large companies. What we simply overlook, there were conditions and people on the ground that were starting new businesses. That was the case in countries that we do not typically associate with this model of development.

Latin America: what would be going on in Venezuela without the vast new business entries? Perhaps the regime will collapse much faster and it is one of the factors. You may have dysfunctional policy on one level and some other positive factors on another level, it is multidimensional. About 50% of Peru's economy is in the informal sector and it is very low in terms of rule of law, nevertheless it has quite a small state.

It is not just about entry, there is another measure – high inspiration entry. This is even more important. Then the picture changes a bit. From the social point of view- you want wide spread private ownership. That creates support for institutions of capitalism. From the purely economic point of view – the key issue is high potential, high growth firms. The question is not only about entry, but also to have the opportunities for companies to grow. It is about the institutional environment as well as finance. What makes the US stronger is the financial

market. Early on, you can be listed on the stock exchange: there is the emergence of venture capitalists. You can take risks and pick up the winner on average.

I tend to disagree on the regulation of entry issue. At the end of the day, you have courts. Thus if a business produces too much noise, the residents can take the dispute to the court. You do not want to create another weakness in the system by putting up barriers to entry.

Philip Hanson: I'd be interested to hear something about how that methodology differs from the rule of law measure used by the World Bank in its governance indicators.

Tomasz Mickiewicz: Should I answer that? They are all related questions. I will start with John's comment, which is actually correct. If you run a regression model, the common law tradition comes effectively with smaller size of government spending, not with all countries, but you see that.

What is most interesting, if you had all the countries of the world it would be the same. What that basically means is that there are practically no countries that are able to collect taxes and to spend a lot, if they do not have a functional, institutional system. If you think about it, it is not surprising, but it is there. For instance, in Latin American countries, such as Venezuela, where you have politicians, or governments there, who would like to spend a lot of money. But because the institutional setup is so chaotic, they are simply not able to achieve this. So this is the interesting paradox. Even if you want to spend a lot, if your institutional system is dysfunctional, you will not achieve that. Because the rule of law typically is strongly correlated with a well-functioning administration. If your administration is taking bribes rather than collecting taxes, you will not collect taxes. That is an interesting empirical observation. Now there are some people who say that typically you have a larger state, and then there are some benefits from that, and the price you pay is more corruption, and then you decide if the price is worth paying or not. Now the interesting thing here is that you do not see it empirically; basically: you don't see it. You would expect that there is a positive correlation, but there isn't. And one of the reasons why there is not a positive correlation is that if you have a larger state you necessarily have a weaker rule of law. I am sorry to say this, because I would like to see that result: but it is not there. And the reason why is precisely because if your institutions are dysfunctional, you will not collect much money. That I think is the reason, it is the reverse causation. It is a kind of paradox.

Philip Hanson: And it does not make any difference if you measure the role of the state by expenditure or tax bills?

Tomasz Mickiewicz: They are so strongly correlated in the longer run that it does not make much difference. This is another mistake people make; that if you try to explain something by the level of taxation, you could equally well explain it by the level of spending: they are so correlated. It does not really matter which one you take. Now, the measurement issue is an interesting one, because our favourite measure does come from polity four, because we think if you want a single measure that is clear to interpret, again it is the polity four which is well-defined; which is basically the measure of the effective constraints on the executive branch of the government. This is the favourite at the moment, because we think this is the key measure that identifies arbitrariness or lack of arbitrariness. And then of course it sprinkles down to regulation and everything else. But you know, if you look at the constitutional dimension this is there. Arbitrary government means weak property rights. Then there is heritage, the Fraser Institute, and the Kauffman World Bank project. But Phil's question

about Kauffman; the particular reason why we do not use them is that there is something they do which is very odd. They normalise for each year, so we cannot compare for different years, and we had several years: so that is a technical answer.

Svetozar Pejovich: We are so close to the end. Can I ask a very silly question: is corruption always inefficient?

Tomasz Mickiewicz: Well, you could see corruption as a dysfunctional – well, you could have sort of second-best considerations. As always an economic question, or any question about efficiency, is about what we take as possible. So we first have to agree about what is the range of feasible outcomes. If we answer this question, only then can we answer a question about corruption. If we have a sort of wide perspective that corruption is never efficient – because there are better outcomes than corruption – if we narrow down the number of alternatives, we can talk about corruption; you know, improving the situation. But it is only when we have a more narrow range of options; we eliminate some outcomes.

Svetozar Pejovich: And the second silly question is: how do you measure the rule of law?

Tomasz Mickiewicz: Well in this particular graph, what is hidden is – well, it is factor analysis effective. So what you have behind that is a dimension which combines mostly lack of corruption and strong property rights, strong/strong from heritage. That particular measure, but I would not over-emphasise because as I said the measurement question is an important one, but empirically you get very similar results, regardless of which one you use.

Silvana Malle: Regarding the national state: is that only the contract or is the public sector applied?

Tomasz Mickiewicz: Public sector? The funny thing is that it is actually the only heritage that has this right, because the World Bank will give you the spending of the central government, which is misleading.

Silvana Malle: Yes, but still only considering the local governments – the case of China is very well known because they will use other institutions, not even the government, to spend; and I was wondering whether your indicator included that as well, somehow. It would be difficult of course.

Tomasz Mickiewicz: Yes, it is a very good point, and another interesting one is that you can increase freedom by turning direct regulation into a tax. A good example for instance is the military draft. Which is better: forcing people to serve in the army, or taxing people to be in the army? So you know you may have a country where there is a lot of state corruption; or some of the socialist countries, wouldn't have that much spending because they were directly deciding what to do. So there is this kind of tricky question as well. That you may have a case where increased spending effectively leads to more freedom, because you place direct coercion with a tax.

John Moore: Thank you Tomek. Thank you Krassen for a very interesting session.

