

# Annual Economic Freedom of the World Conference



- The EU and its Neighbours: Challenges to Economic Freedom
- **Centro Luigi Einaudi, Torino, October 5-7, 2011**



# Session 3: EU, Challenges for Economic Freedom:

October 6, 2011

**Prosperity and economic freedom.**

**What can we learn from the post-communist countries' experience?**

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# The purpose

- The title of the session starts with "the EU & its Neighbours" – so my presentation is about BEING NEIGHBOURS
- How to knock on the door of a prosperous neighbour, be let in, and stay inside for longer (for good?) Once inside, you see others cramming at the door outside – the new neighbours ... Will the story repeat? How?
- But this is not only, and even not predominantly, about becoming an EU member in the formal sense

## The purpose, cont'd

- Instead, the purpose **is** to shed some light on the mechanisms of transition
  - from being a communist outsider
  - to a non-communist insider.
- Insider in the sense of belonging:
  - to the free [polity]
  - to the prosperous [economy], and, last not least,
  - to the EU [?]
- **We do it, because**
  - (a) "it is good to know" (how we & others fare)
  - (b) it may possibly serve as a lesson for others(although history is a non-ergodic process, re: D.North)

# The data

- A short presentation of basic EFI figures on Poland and the ECE countries
- more in the Fraser Report 2011 & in the Guggiola/Viroglio paper
- Note 1:  
to what extent is the ECE group homogenous?
- Note 2:  
is it still worth talking about a distinct ECE group?

## Doubts: WHY talk about ECE?

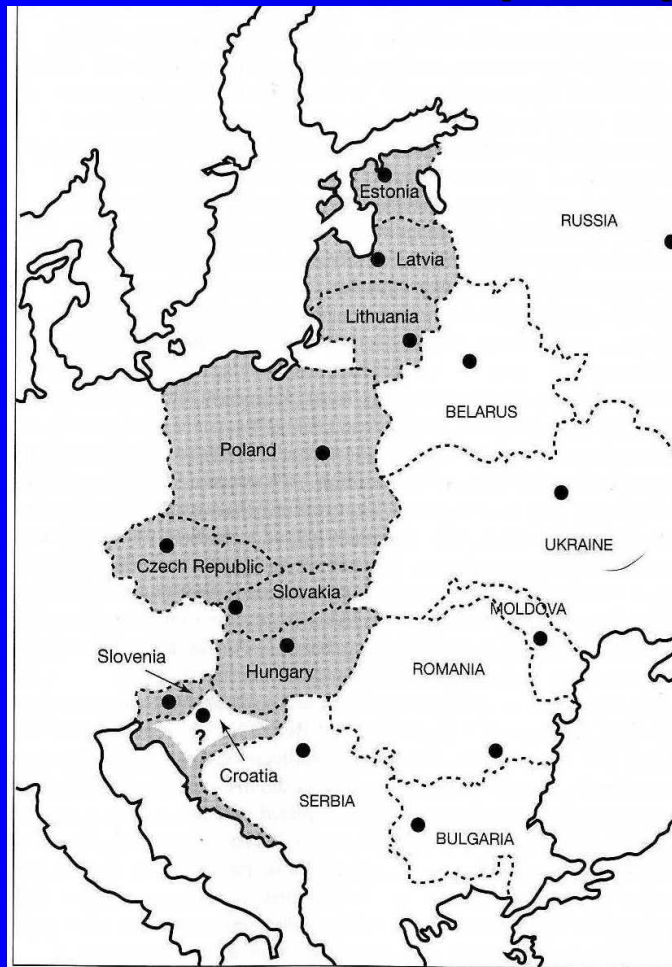
regardless the fact that today most of the ECE belong to the EU (1/3 of EU countries are ECE)

Answer 1: historical past

- "recent past": several decades under communism (but then "*post-communist*" would be better)
- "distant past": being a periphery of Europe ("*of Europe*" more important than "*a periphery*"! - ***institutions do matter***)

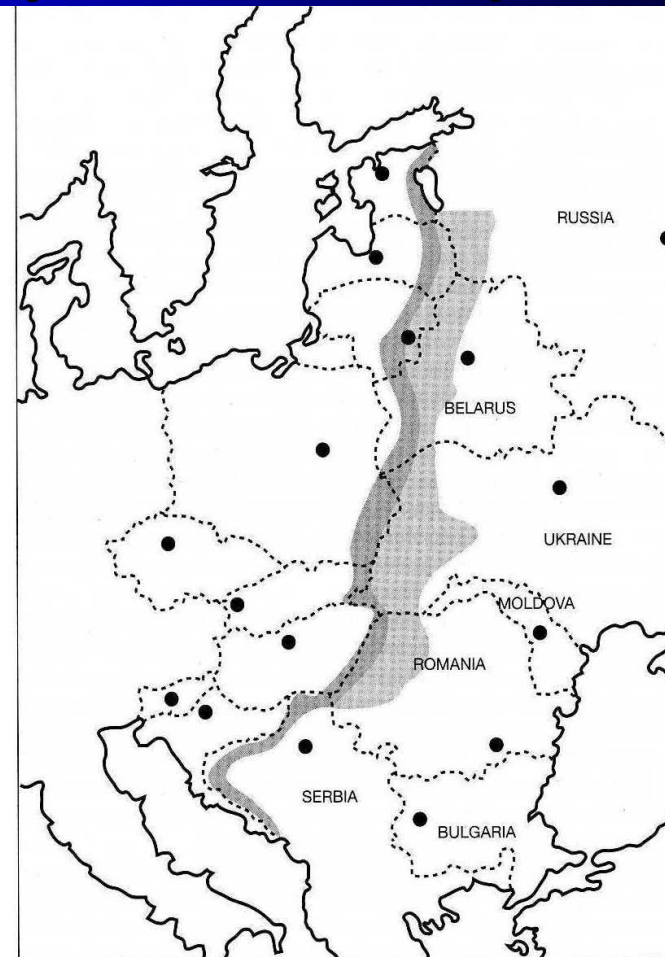
Answer 2: remaining differences *vis-à-vis* WE

# Eastern – periphery of – Europe



Transformation "hopefuls"

Figure 2.5A East-Central European and East European transforming economies.



Eastern borders of Western Christendom (XVI century)  
Territories with mixed population (Western and Eastern rites)

Figure 2.5B The East–West split in Christendom.



# Terminology: ECE, postcommunist or emerging economies?

- Nowadays, economists frequently use the term "emerging economies" – and many of the ECE are among those. But there are others as well – eg. Turkey.
- So, perhaps, we should not exaggerate with those **geography-, history-, culture-, or religion-oriented, backward-looking descriptions** like ECE and start using **future-oriented** groupings? Poland may have more common features with Turkey than with some fellow post-communist, ECE economies. EFI an alternative?
- Then what about the AW countries as a group?!



Table 1.  
EFI ranks and values, 2009 – Poland and its "neighbours"

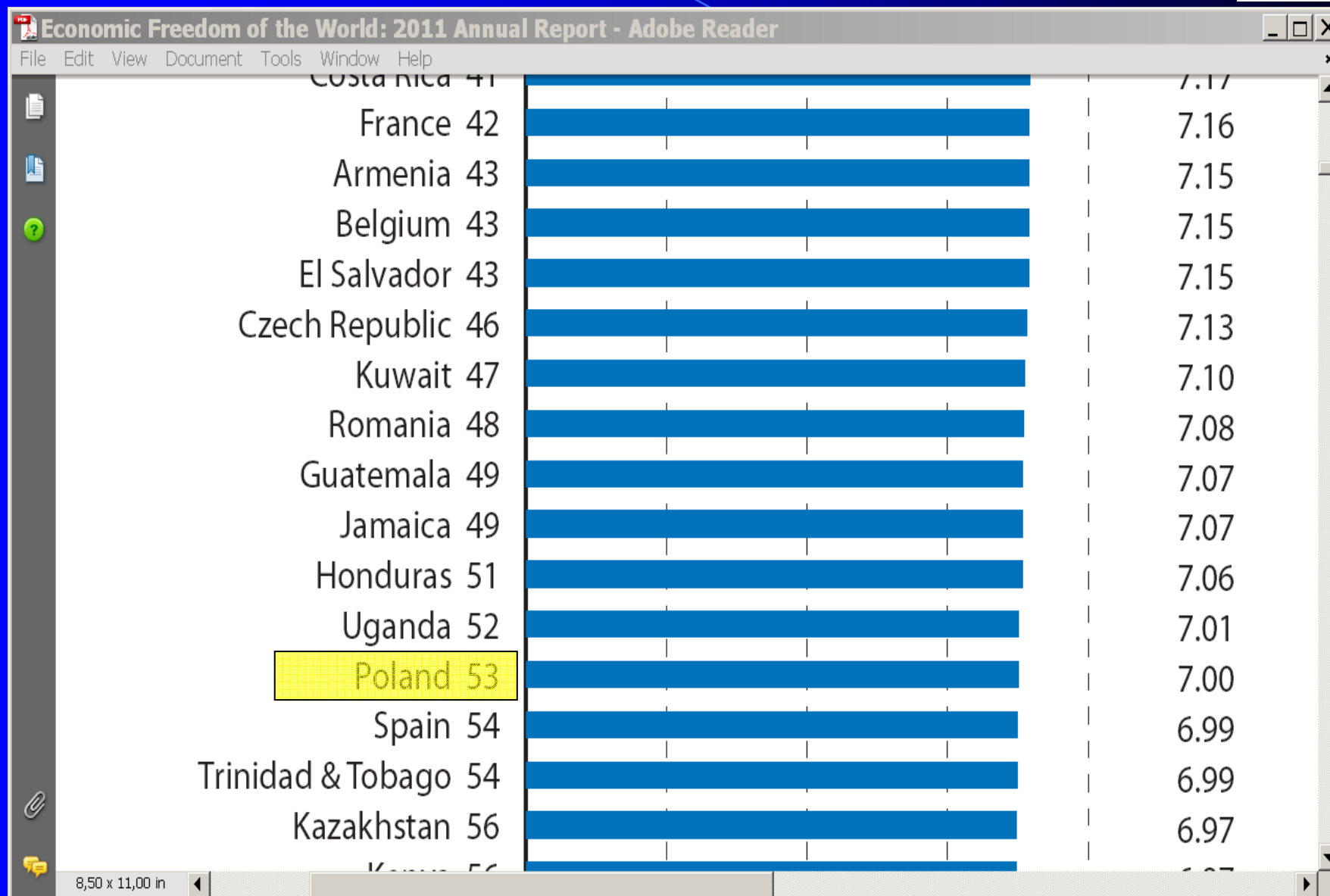




TABLE 2

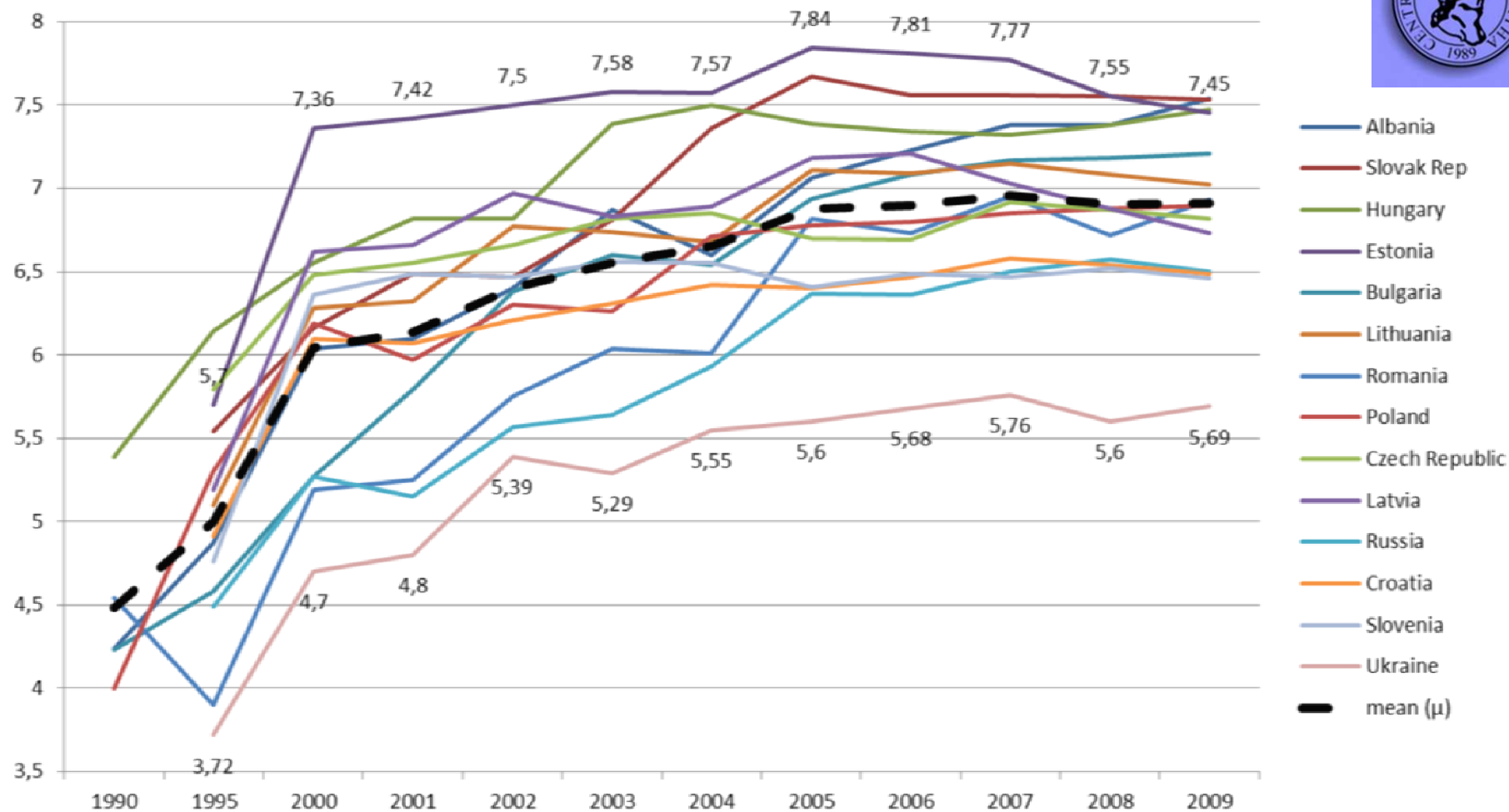
EFI values and ranks for EE14 1990-2009, chained ;

Part I: values for EE14

	1990	1995	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
1 Albania	4,24	4,87	6,04	6,1	6,4	6,87	6,6	7,06	7,23	7,38	7,38	7,54
2 Slovak Rep		5,54	6,16	6,49	6,47	6,81	7,36	7,67	7,56	7,56	7,55	7,53
3 Hungary	5,39	6,14	6,55	6,82	6,82	7,39	7,5	7,39	7,34	7,32	7,38	7,47
4 Estonia		5,7	7,36	7,42	7,5	7,58	7,57	7,84	7,81	7,77	7,55	7,45
5 Bulgaria	4,23	4,58	5,27	5,79	6,38	6,6	6,54	6,94	7,08	7,17	7,18	7,21
6 Lithuania		5,1	6,28	6,32	6,77	6,74	6,68	7,11	7,09	7,15	7,08	7,02
7 Romania	4,54	3,9	5,19	5,25	5,75	6,04	6,01	6,82	6,73	6,95	6,72	6,93
8 Poland	4	5,3	6,19	5,97	6,3	6,26	6,71	6,78	6,8	6,85	6,88	6,9
9 Czech Republic		5,79	6,48	6,55	6,66	6,82	6,85	6,7	6,69	6,92	6,87	6,82
10 Latvia		5,19	6,62	6,66	6,97	6,83	6,89	7,18	7,21	7,03	6,88	6,73
11 Russia		4,49	5,27	5,15	5,57	5,64	5,93	6,37	6,36	6,5	6,57	6,5
12 Croatia		4,91	6,1	6,07	6,21	6,31	6,42	6,4	6,47	6,58	6,54	6,49
13 Slovenia		4,76	6,36	6,49	6,47	6,56	6,55	6,41	6,49	6,47	6,52	6,46
14 Ukraine		3,72	4,7	4,8	5,39	5,29	5,55	5,6	5,68	5,76	5,6	5,69
mean ( $\mu$ )	4,48	5,00	6,04	6,13	6,40	6,55	6,65	6,88	6,90	6,96	6,91	6,91

## GRAPH 2

EFI values and ranks for EE14 1990-2009, chained ; part I: values for EE14

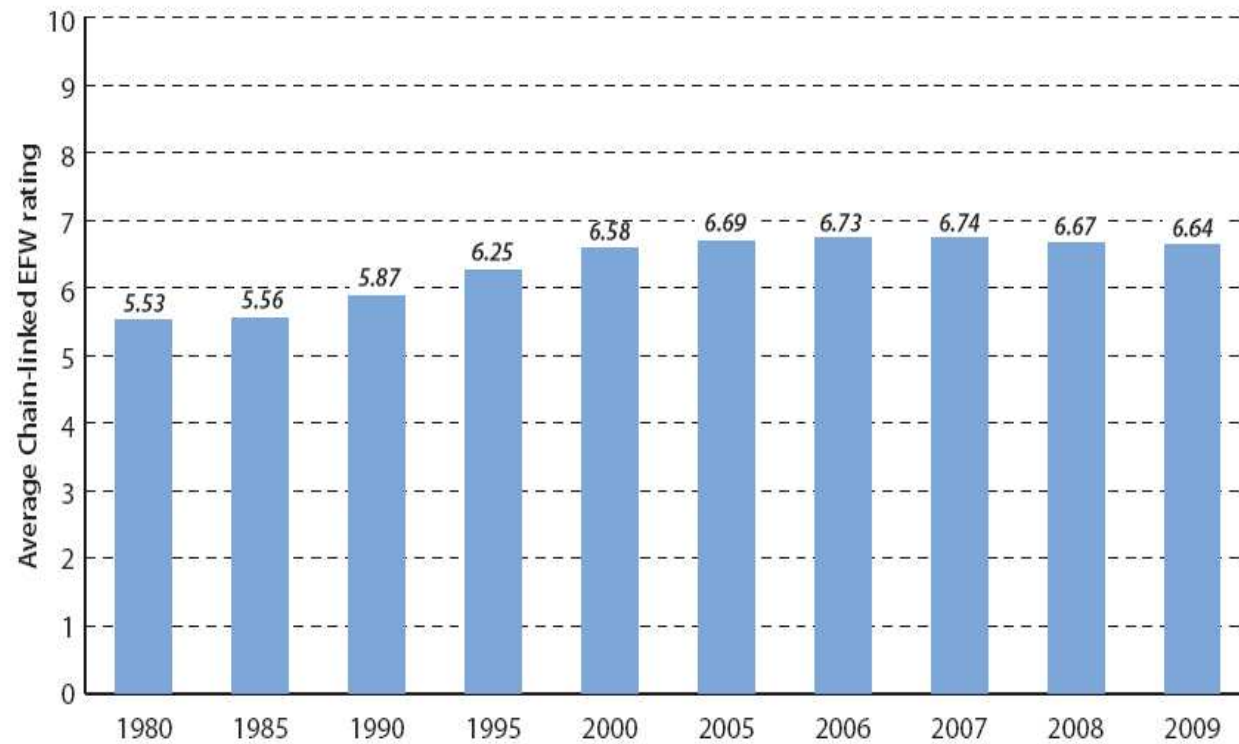


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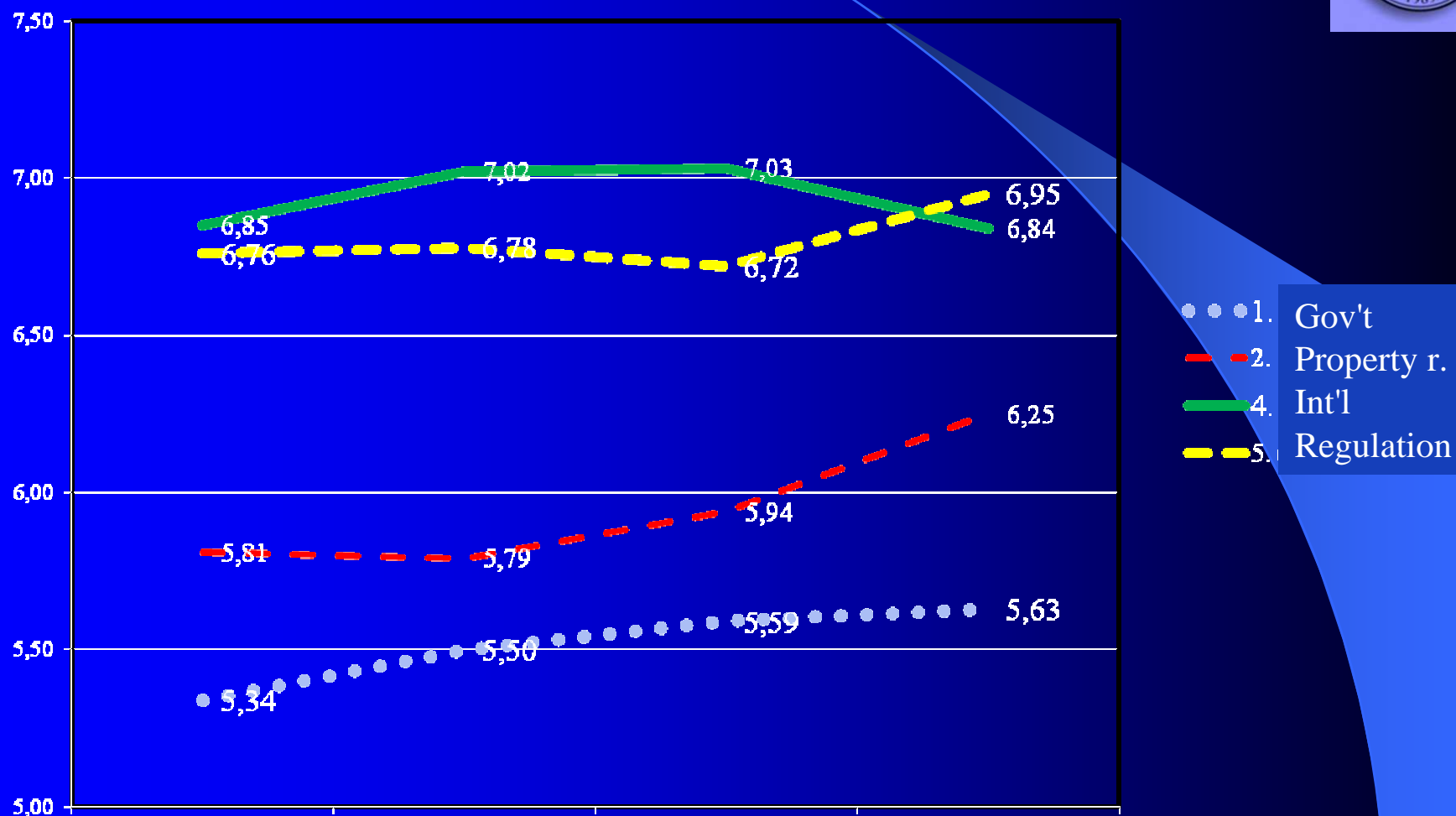
Exhibit 1.5: Average Chain-linked EFW Rating for the 102 countries with ratings since 1980



# EFI and its 5 areas for Poland, values (and ranks), 2006 - 2009

	1. (gov't)		2. (property r.)		3. (money)		4. (int'l)		5. (regulation)		Overall EFI	
year:	value	(rank)	value	(rank)	value	(rank)	value	(rank)	value	(rank)	value	(rank)
2006	5.34	(110)	5.81	(63)	9.31	(33)	6.85	(69)	6.76	(73)	6.81	(74)
2007	5.50	(112)	5.79	(69)	9.22	(38)	7.02	(64)	6.78	(74)	6.86	(74)
2008	5.59	(104)	5.94	(60)	9.21	(34)	7.03	(62)	6.72	(80)	6.90	(65)
2009	5.63	(95)	6.25	(48)	9.32	(33)	6.84	(60)	6.95	(64)	7.00	(53)

## EFI values and its 4 areas, Poland. 2006 – 2009 (without area 4 = access to sound money)



# Emerging economies of ECE: economic freedom vs economic performance:

- Economic freedom has increased, but what about economic performance?
- In most of ECE there has been a dramatic change in economic prosperity: 25 years ago average monthly salary in Poland was below \$20 now is above \$1000
- Those post communist countries that are considered transformational failure have also failed in improving EFI



## Some examples

- Ukraine is a notable negative exception.
- Russia another one, although with some improvement in 2008.
- China's EFI is improving >Russia!
- non-EU Balkan economies (5) are doing worse than EE14 (except for Montenegro & Macedonia)
- ex-Soviet republics from Asia are doing well (~7.0) except non-measured Turkmenistan, Tadjikistan, Uzbekistan which are considered transformational fiascos (as is Belarus)

## Examples, 2

- Oleh Havrylyshyn in *Divergent Paths in Post-Communist Transformations* (2006) classified the above as countries of either limited / reversed reforms or as gradual but delayed reforms.
- In both groups the likelihood of rent-seeking activities of new oligarchs was very high; in some cases it ended up in what he called "the state capture" by those oligarchs colluding with one another.

# 1. The starting point of the ECE transition:

there was no blueprint "*which way to go*",  
no previous experience.

This was "*sailing onto uncharted waters*"

- A. There was no transformation theory
- B. There was no macroeconomic stability  
(equilibrium) internally
- C. There was a broadly understood stability  
externally (i.e. on the global scale)

- The  $A + B + C$  above were construed in economic terms
- But they are also valid from a political perspective
- All in all, the starting point AD 1989 was:  
     $A+B+C$  economically  
     $A+B+C$  politically

## 2. Actions that changed the reality

- I. Ownership structure & the allocation mechanism changed = privatization of the economy & market-driven allocation
- II. Economic policies changed
- III. Formal economic institutions changed
- IV. Informal economic institutions changed ???

**I+II+III by-and-large captured by EFI**  
**IV to a large extent NOT captured by EFI**

### **3. Situation AD 2011 (post-transformational):**

Several ECE have been doing relatively well in terms of economic performance (both LR & SR)

Q: How are they doing in terms of "performance" of their informal institutions?

A: Not so good! And this is a less-known story.

## 4. So called "*civilizational deficits*" characterizing social and political life [as identified for Poland by Jerzy Kleer (2011)]

1. Low degree of social / mutual trust
  - a. (The) people do not trust the state
  - b. The state does not trust (the) people
2. No social coherence in the sense of "common values" or "common mentality" (re Fernand Braudel)
  - a. The past & its meaning highly debated / no settled view of nat'l history
  - b. Limited ability to reach compromise(s)
  - c. Low level of "social" tolerance (of various kinds)
  - d. Hostile perception of "the others"
3. Low participation in active democracy (low turnout at elections, deficient *universal suffrage*)
4. Large fluctuations in the set of political parties (meteors)
5. ....



## **5. A sweet topping on the transformational cake: the EU role**

- a) I will not talk about money (i.e. income redistribution within the EU that benefits the poorer member states – eg. inefficient use of easy money, etc.)**
- b) I do want to mention the EU's importance as a "role model" for ECE countries (before and after accession)**
  - i. In terms of hard/formal institutions (the law!)**
  - ii. In terms of soft/informal ones (re: IV= social values accepted)**

## Additional remarks on the EU's role:

- The positive scenarios present in the EE14 were to a large extent (and may still continue to be) made possible and amplified by beneficial institutional changes caused by accession to the EU.
- What counts is not only "goodness" of some EU institutions but also their spread over a sufficiently large economic area. As Douglass North was stressing (1986) not only **good**, but **common** institutions decrease transactions costs, thus positively influencing economic growth of a given region.
- Those beneficial institutional changes have been reflected by increasing levels of EFI.

## 6. Now, the cherry on top:

What about the Arab Spring?

How do the Arab economies and societies of today compare with those of ECE?

○ The starting point:  $A+B+C =$  better knowledge of "transformation theory" + unstable + unstable

○ The actions to be taken (to be discussed later)

- i. Ownership structure & the allocation mechanism (?)
- ii. Economic policies (?)
- iii. Formal economic institutions (?)
- iv. Informal economic institutions – this is the biggest question mark! What could be a "role model" for the Arab World? What values will be accepted / adopted in the SR & LR?

# **Replicability**

## **of the ECE/post-communist experience: full, limited, none,?**

- **Can the East European experience be helpful to Arab countries today?**
- **The ‘captured state’ story [in some post Soviet Union Republics: *cf* Oleh Havrylyschyn’s concepts and the Arab World today**
- **Will we see convergence or divergence of economic freedom levels and institutions in general within the group of the Arab countries?**

**Can the “Arab experience” (as it evolves) tell us anything about relationship between democracy and economic freedom?**

(on top of what we know from Hayek/Friedman Hypothesis verified statically by Lawson and Clark and dynamically by Coyne and Sobel)

## Additional remarks/questions

- In EE14 we have witnessed quite dramatic economic changes over the past 20+ years. They resulted in enormous increase in the standards of living within just one generation.
- The forces at work may be characterized as a push-pull process: an initial push toward a liberal free market-based economy and a subsequent pull toward the institutions of EU (read: WE) that generally mean higher levels of EFI (except for Area I).
- **Can the Arab countries find and implement some similar ways to boost their EFI and economic prosperity?**
- This remains to be seen, but examples of some Arab economies – like Oman, its economic policies and institutional changes – are encouraging.

# THE END



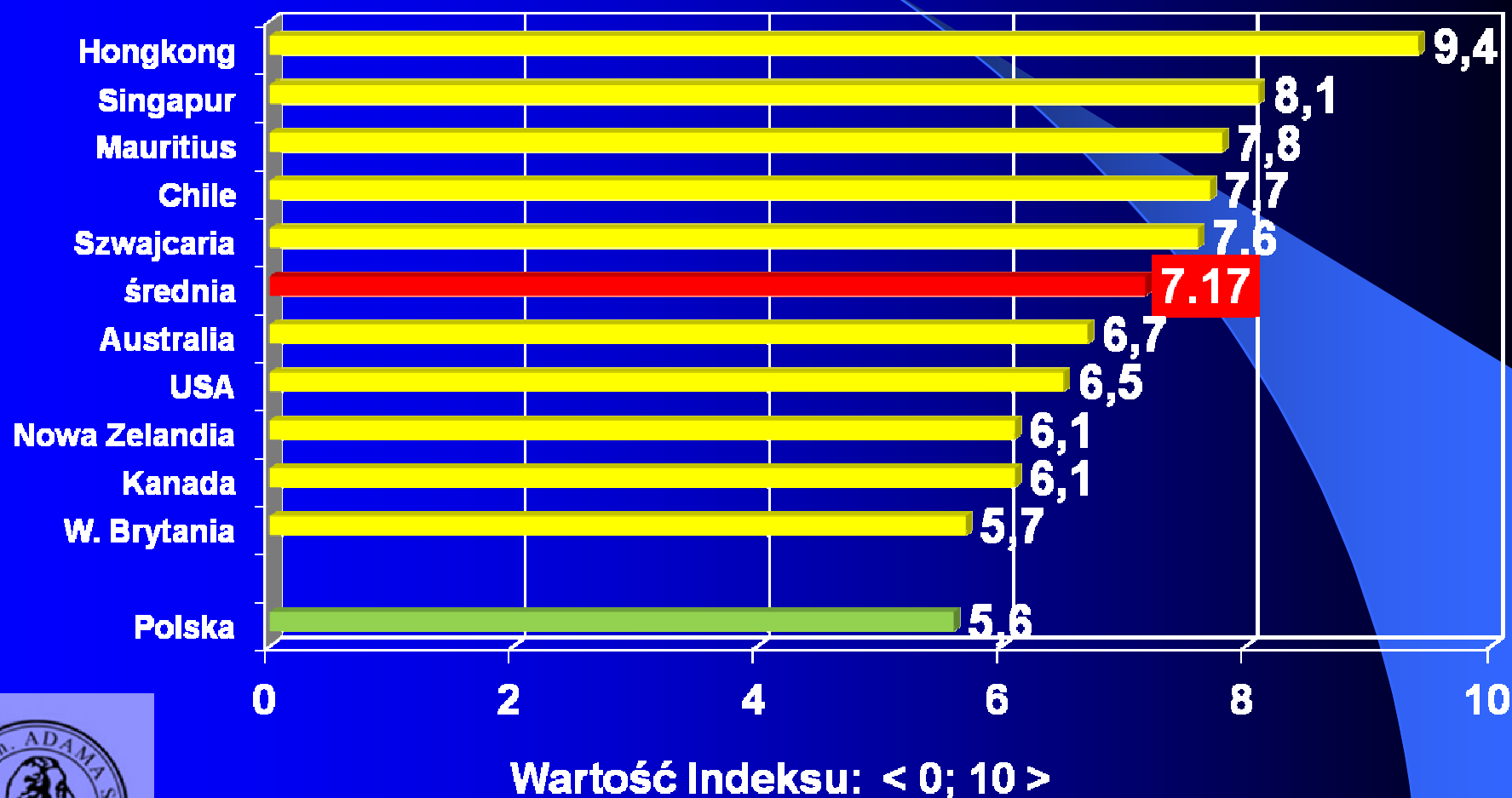




# EXTRAS

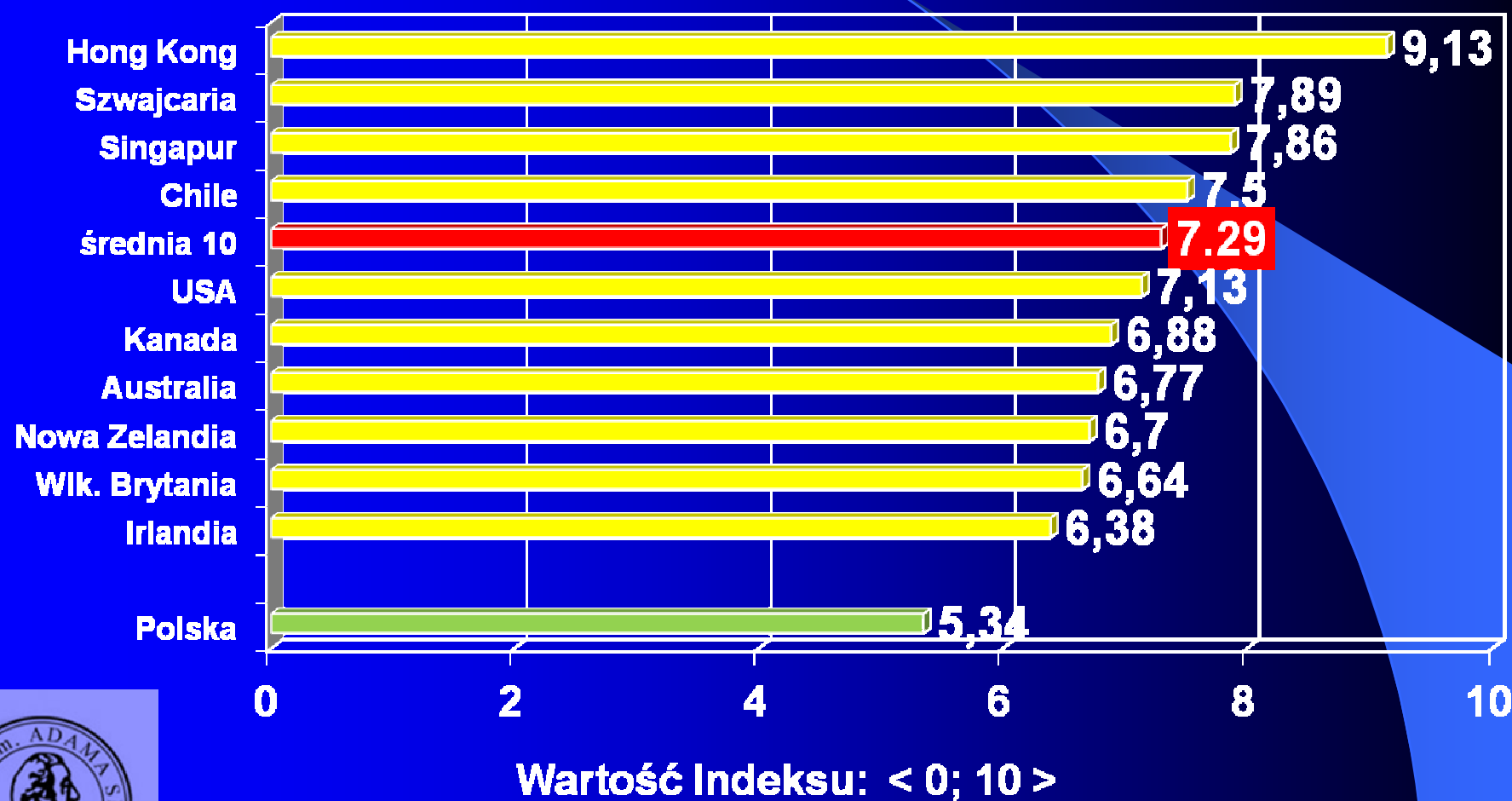
Values of EF in five areas:  
ten top countries & Poland  
(2006 and 2009)

# I. Rozmiary rządu (górna 10. 2009)



źródło: The Fraser

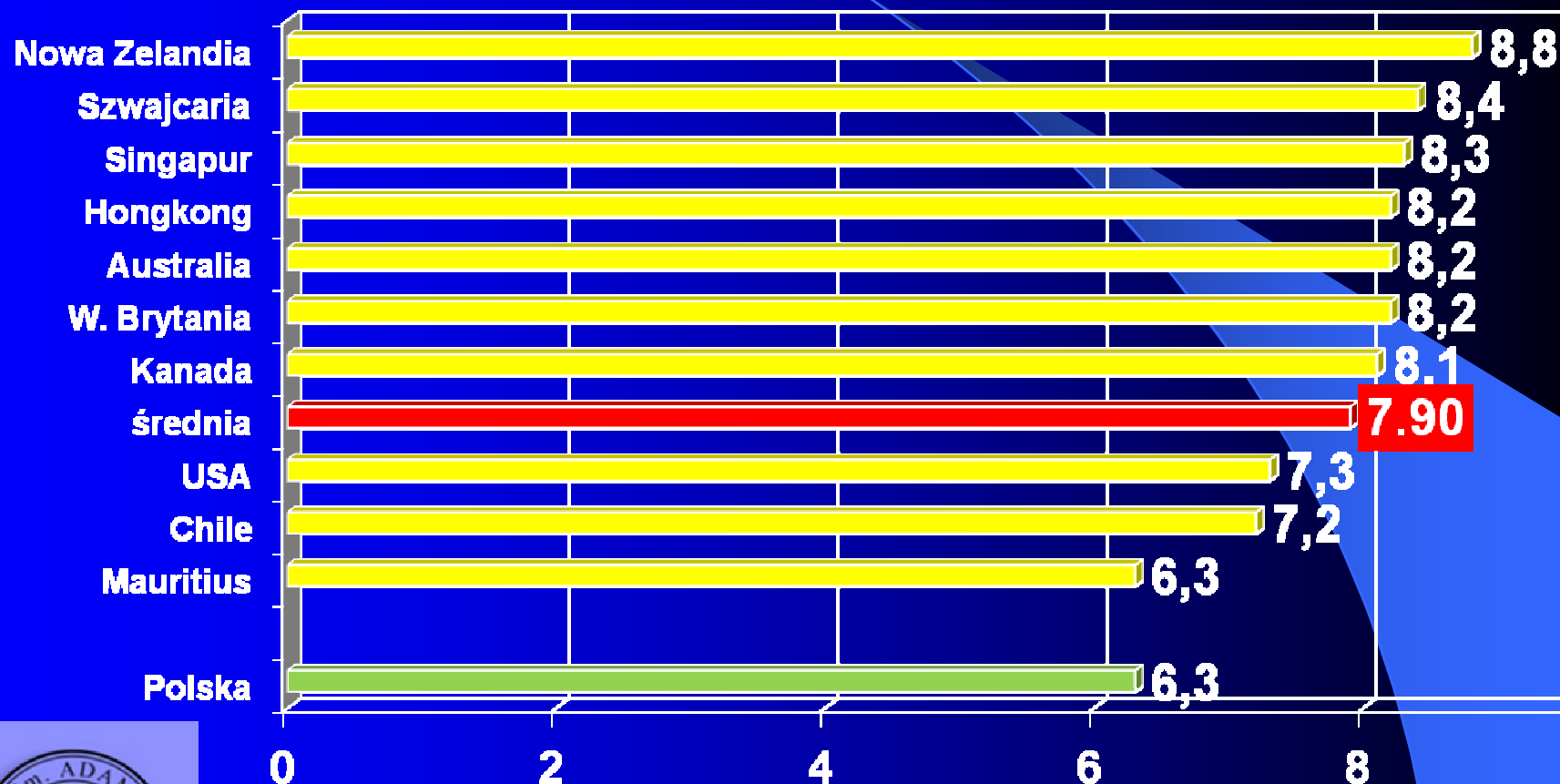
# I. Rozmiary rządu (górna 10. 2006)



źródło: The Fraser

## II. System prawny i prawa własności dla górnej 10 (2009 r.)

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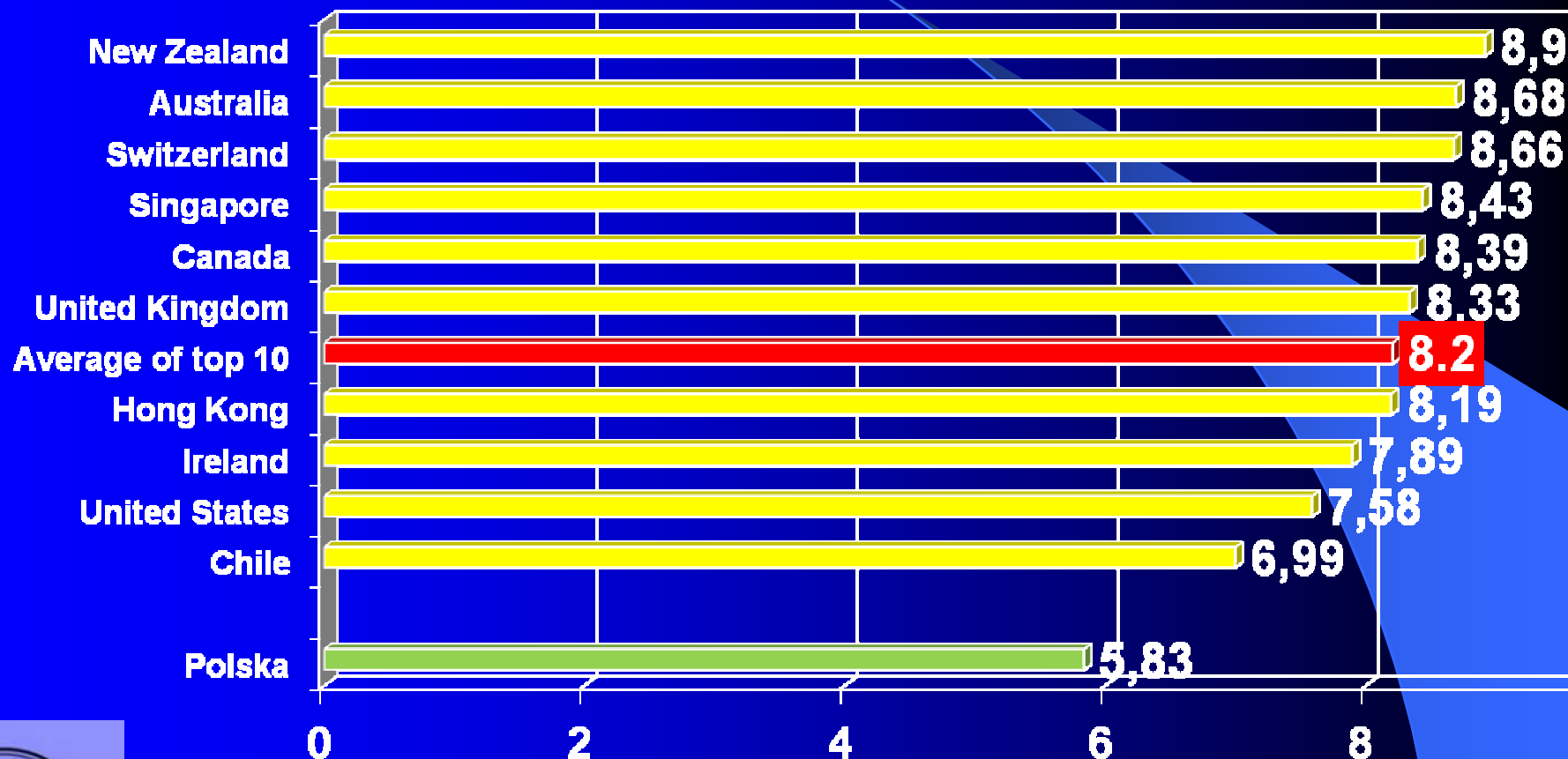


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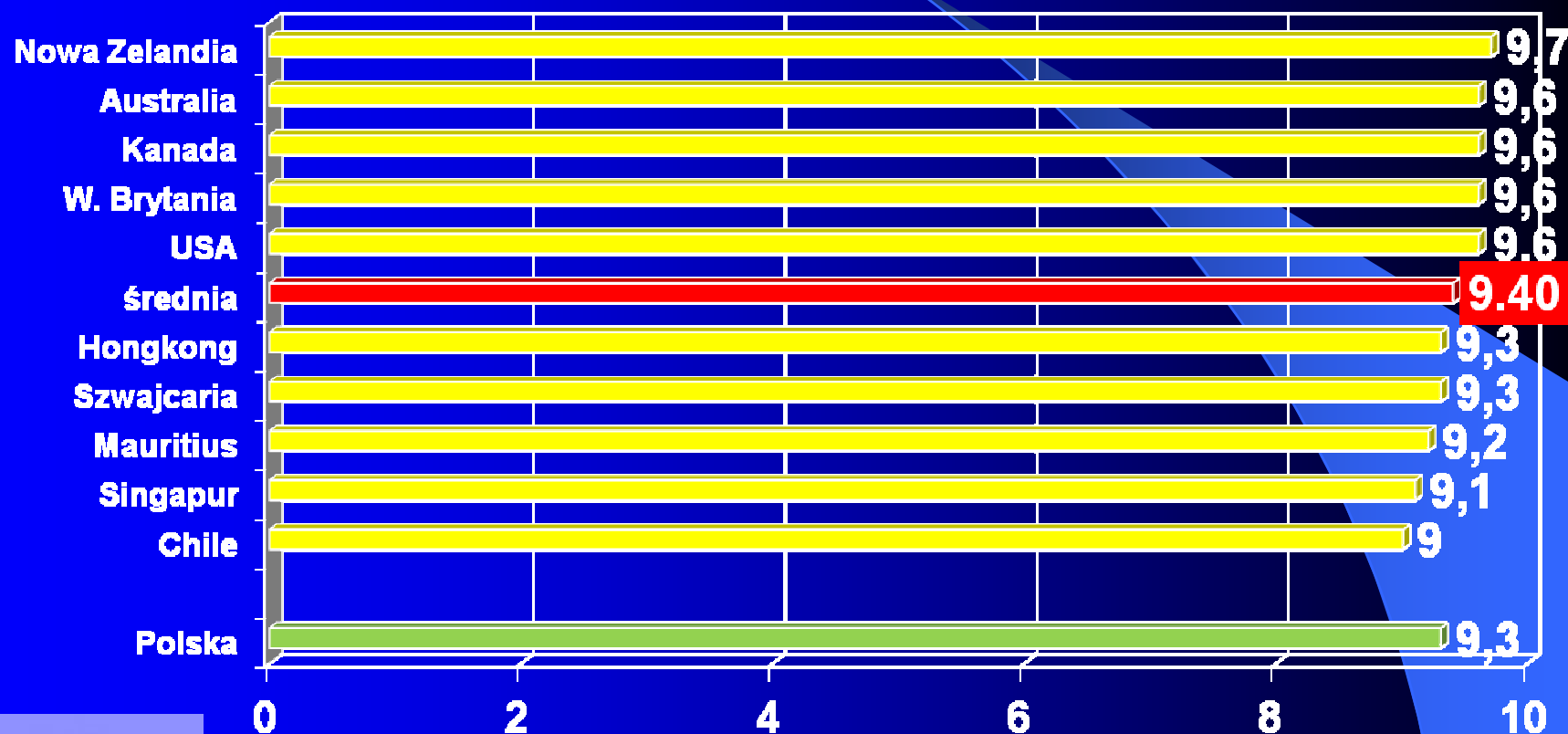


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### III. Dobry pieniądz i jego instytucje dla górnej 10 (2009 r.)

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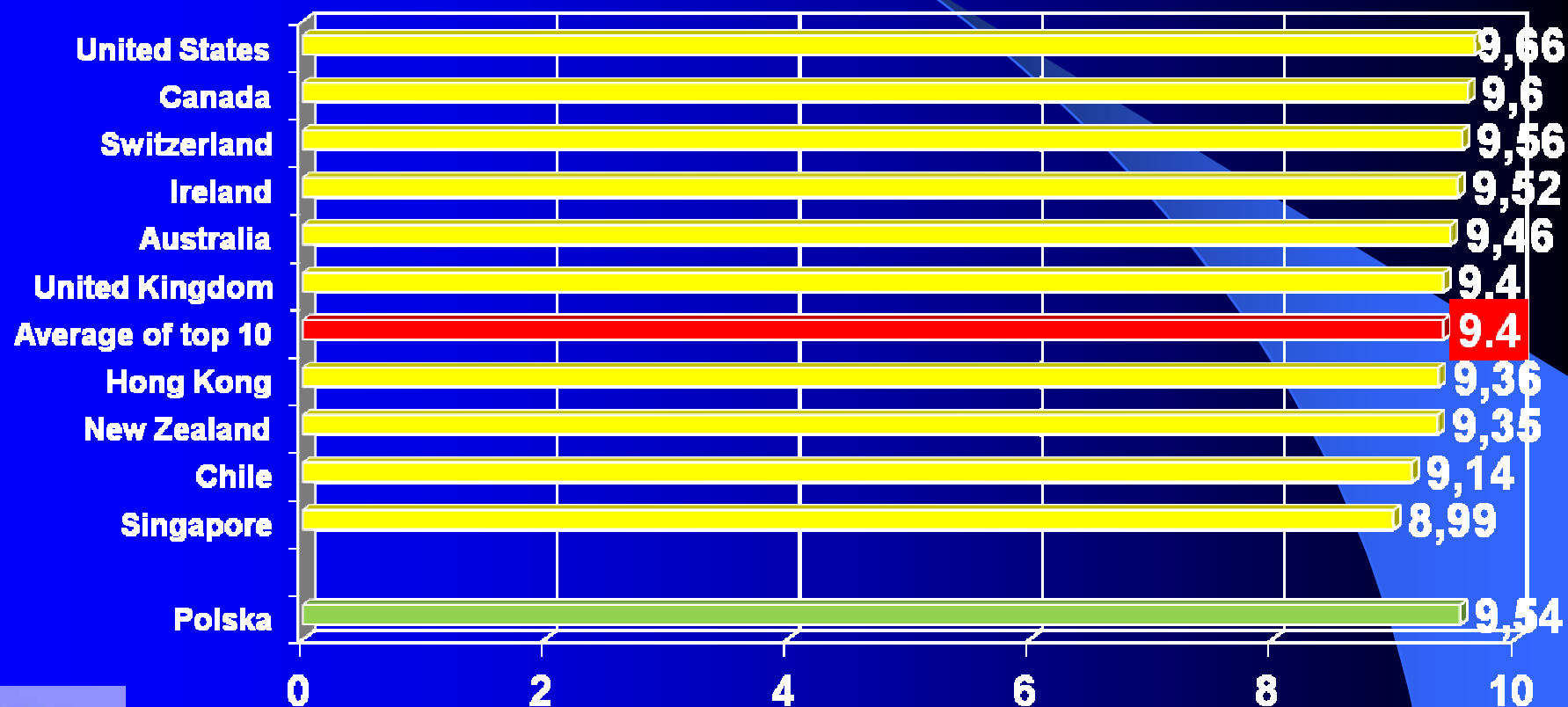


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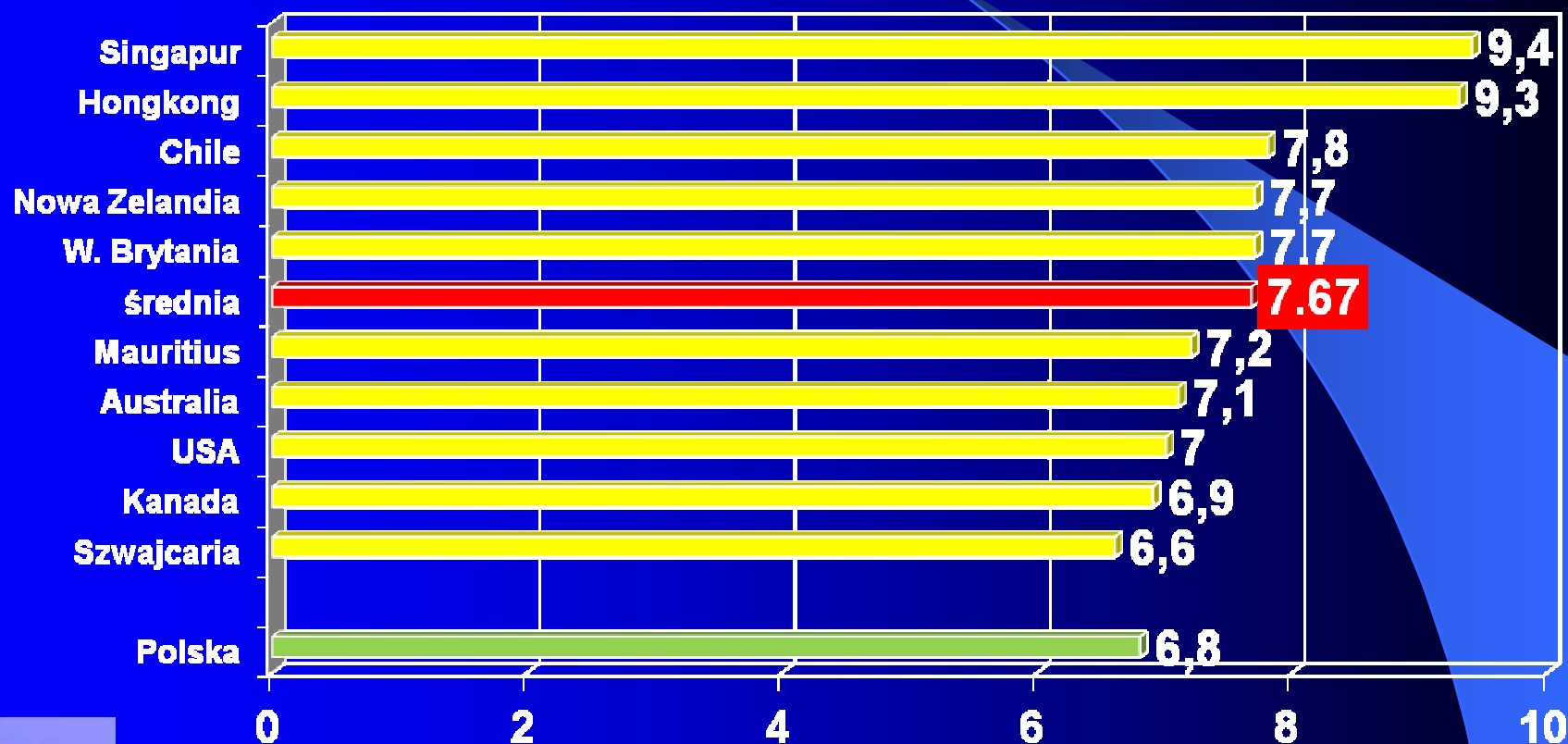
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# IV. Swoboda wymiany międzynarodowej dla górnej 10 (2009 r.)

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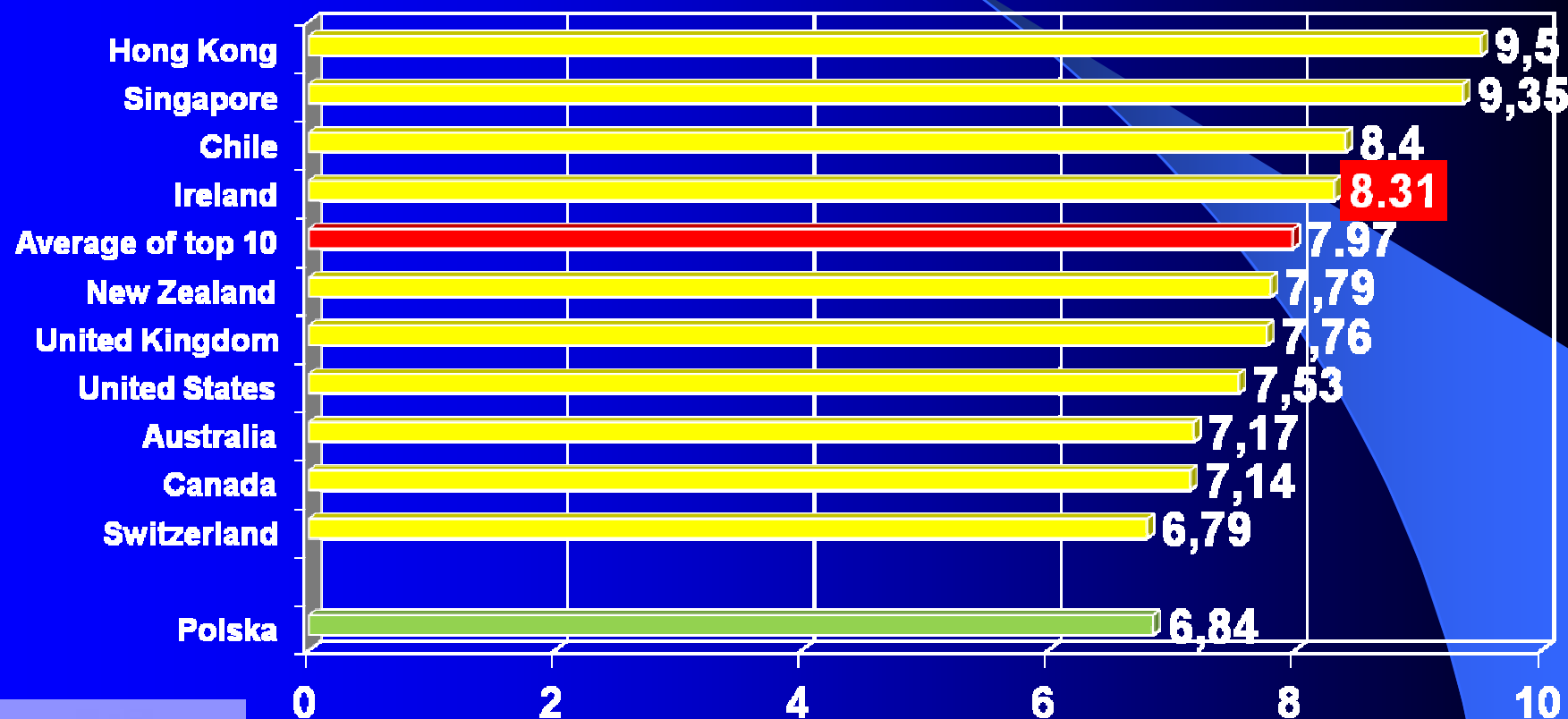


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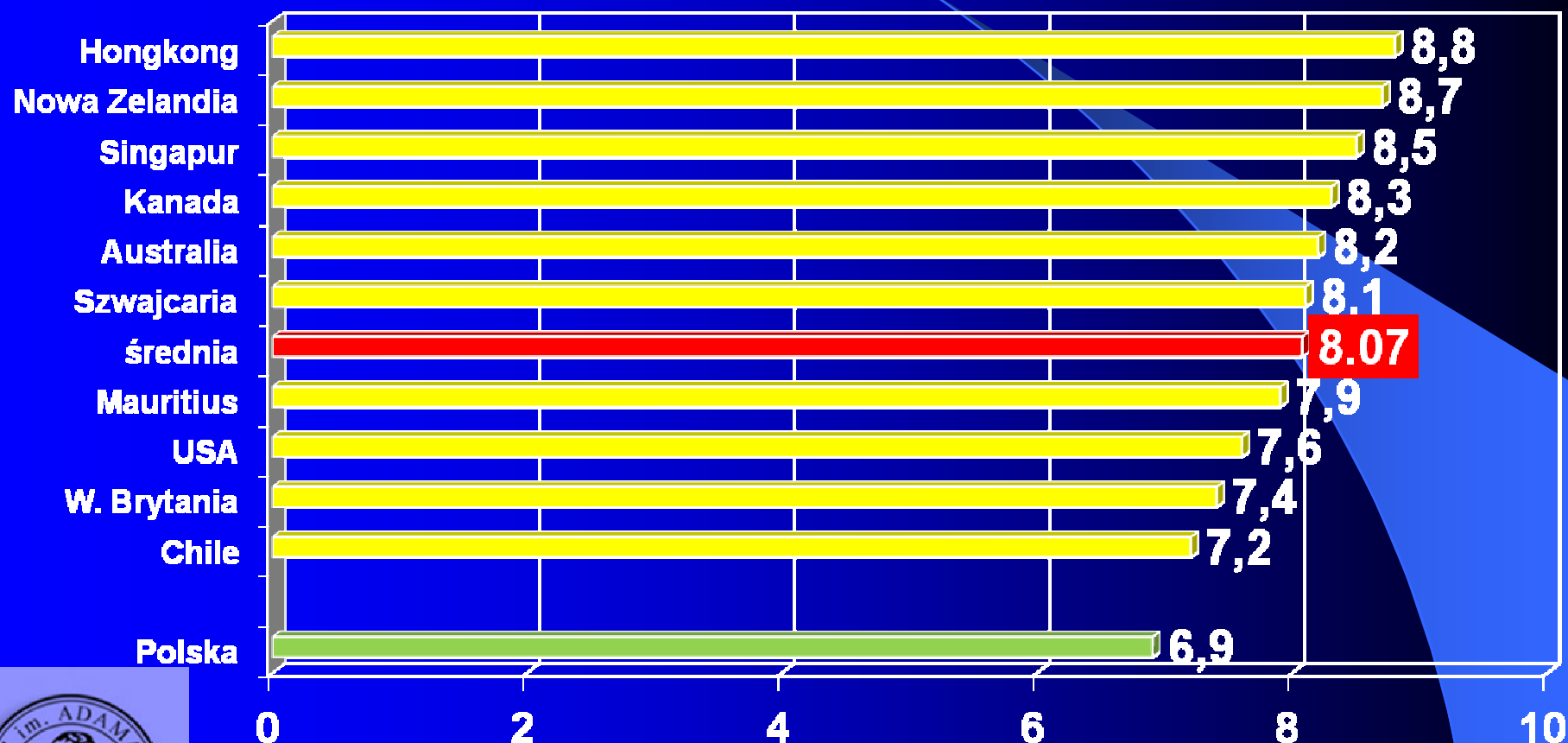


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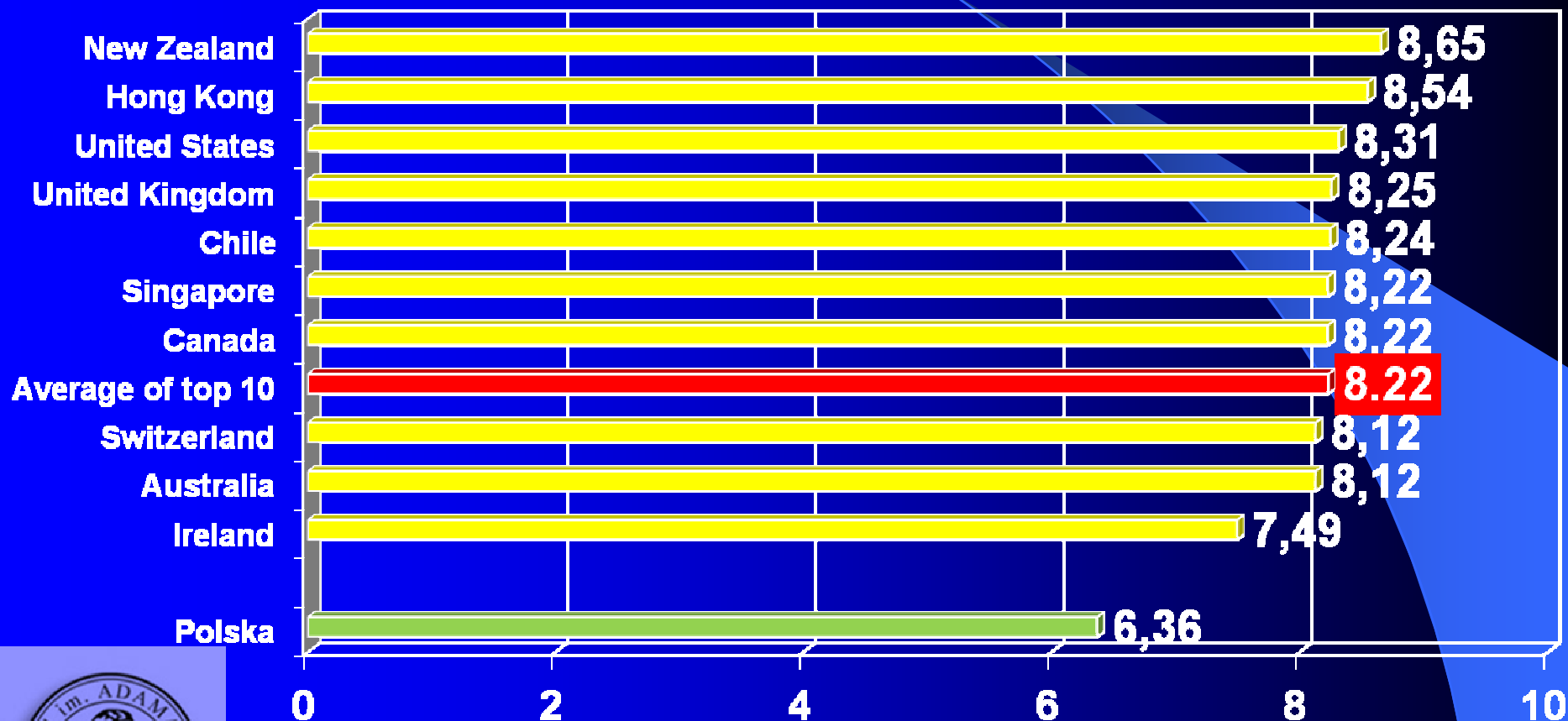


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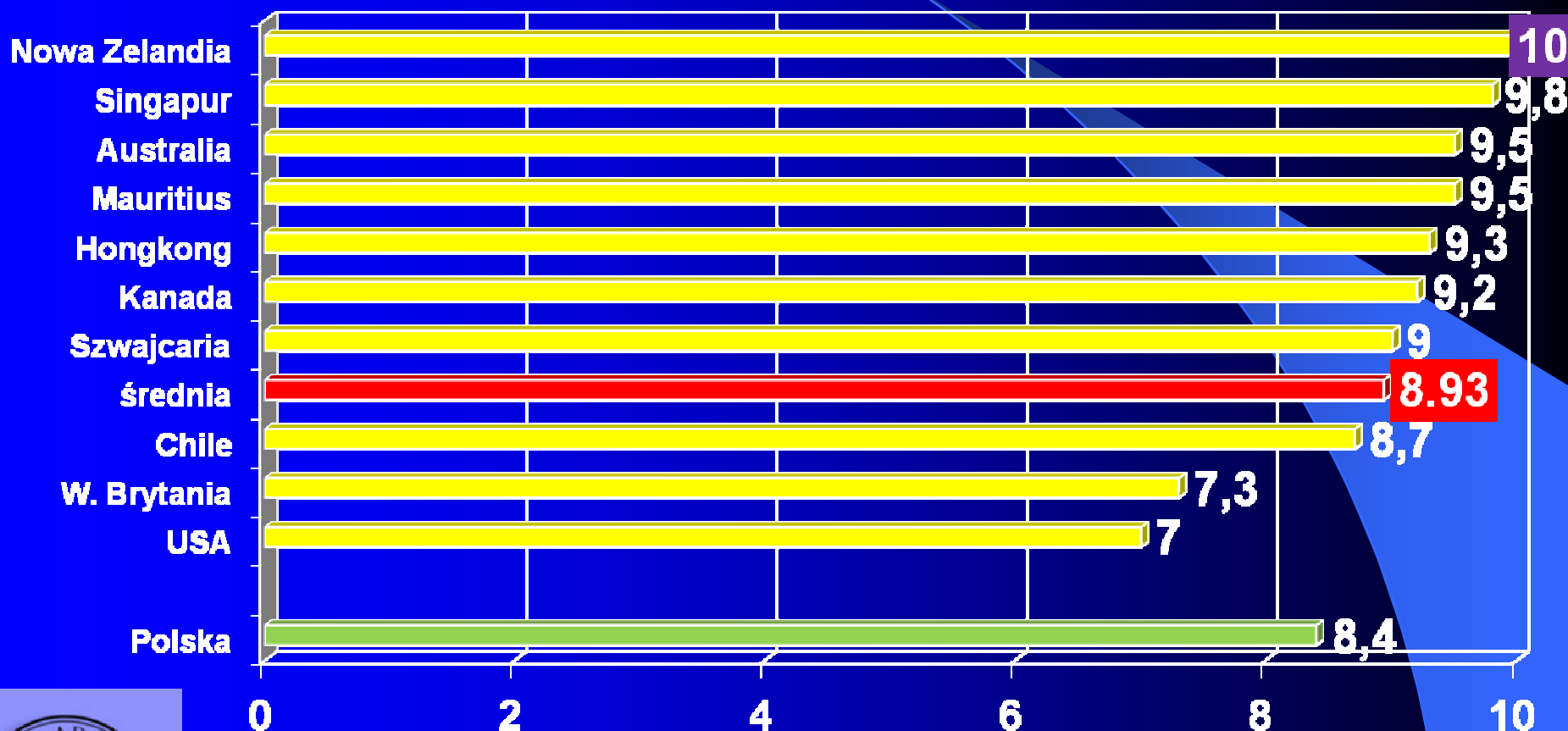
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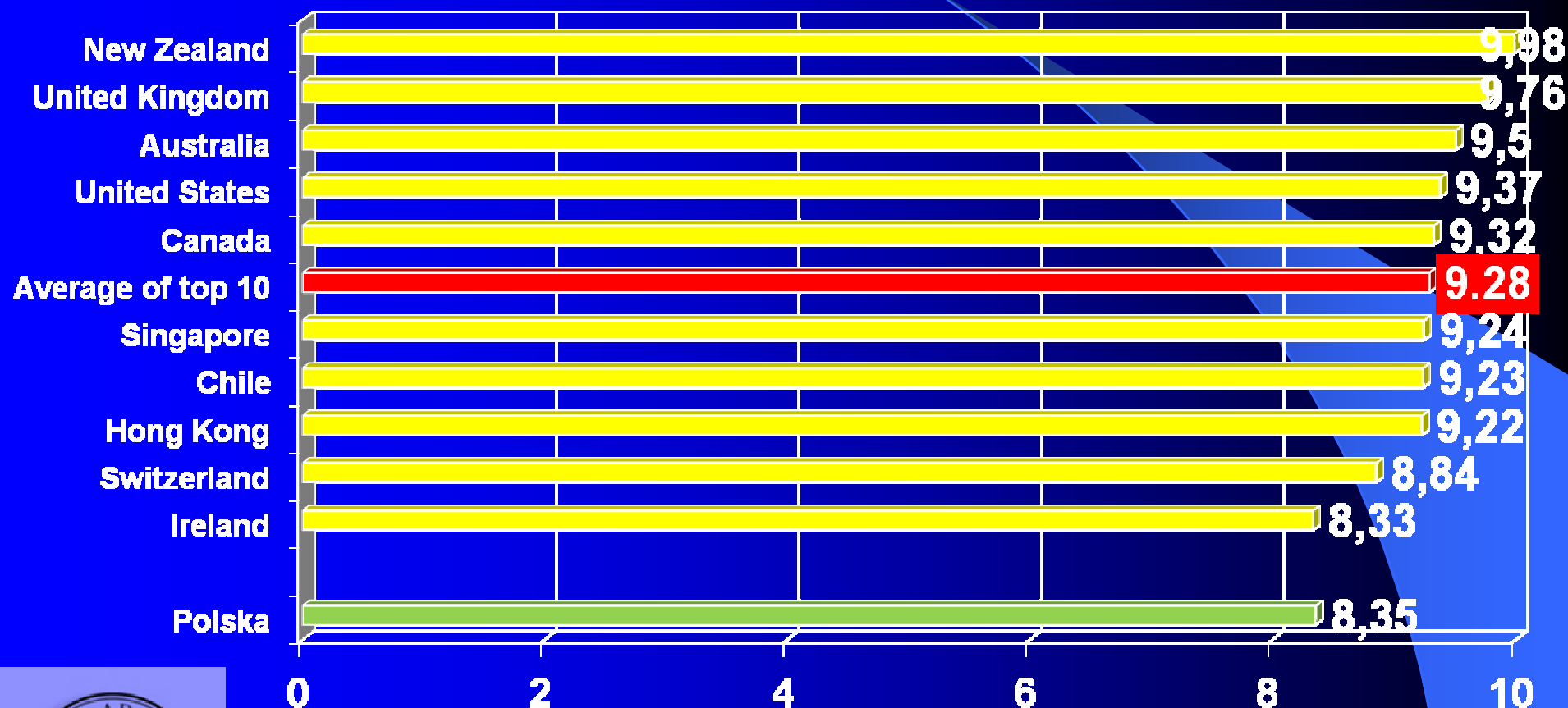
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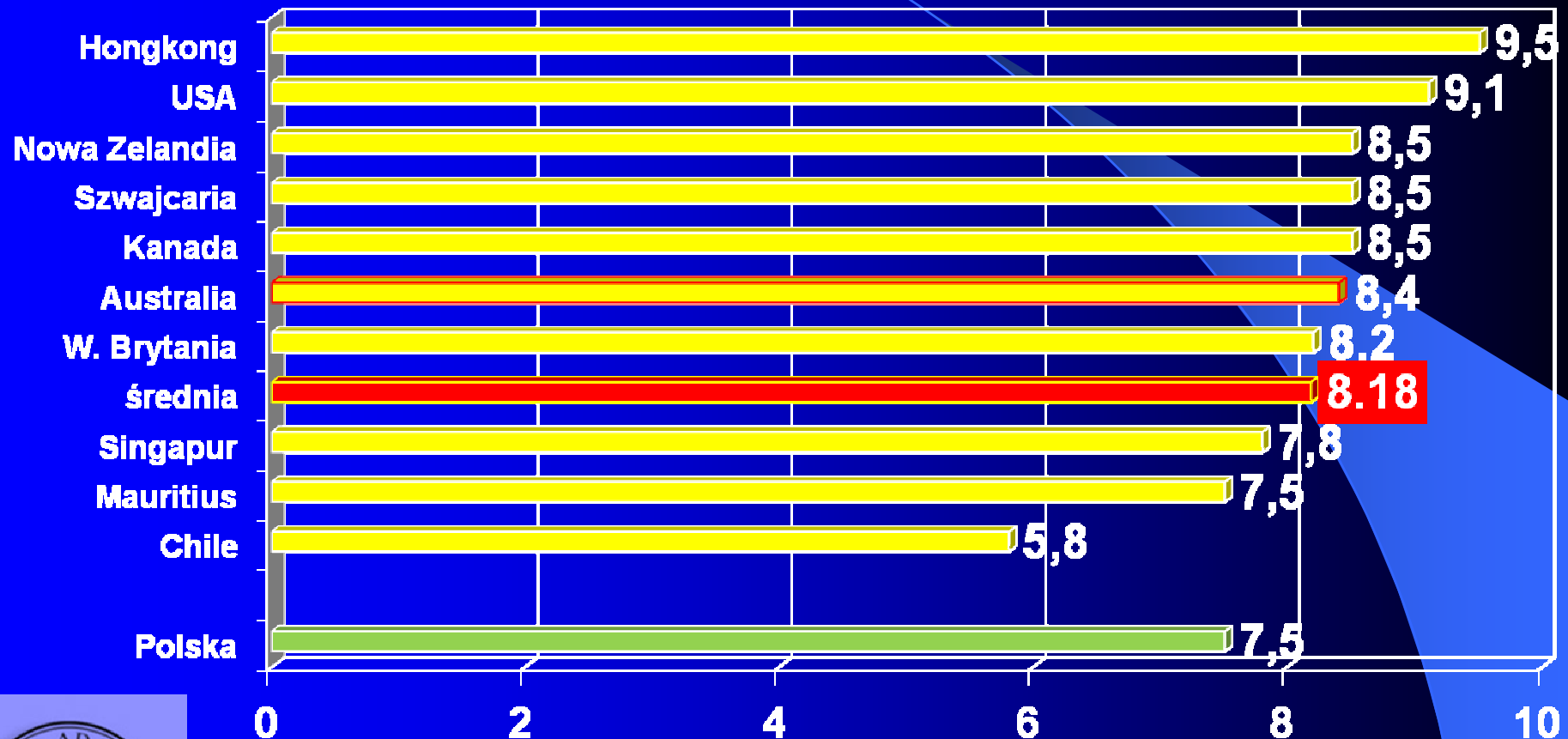


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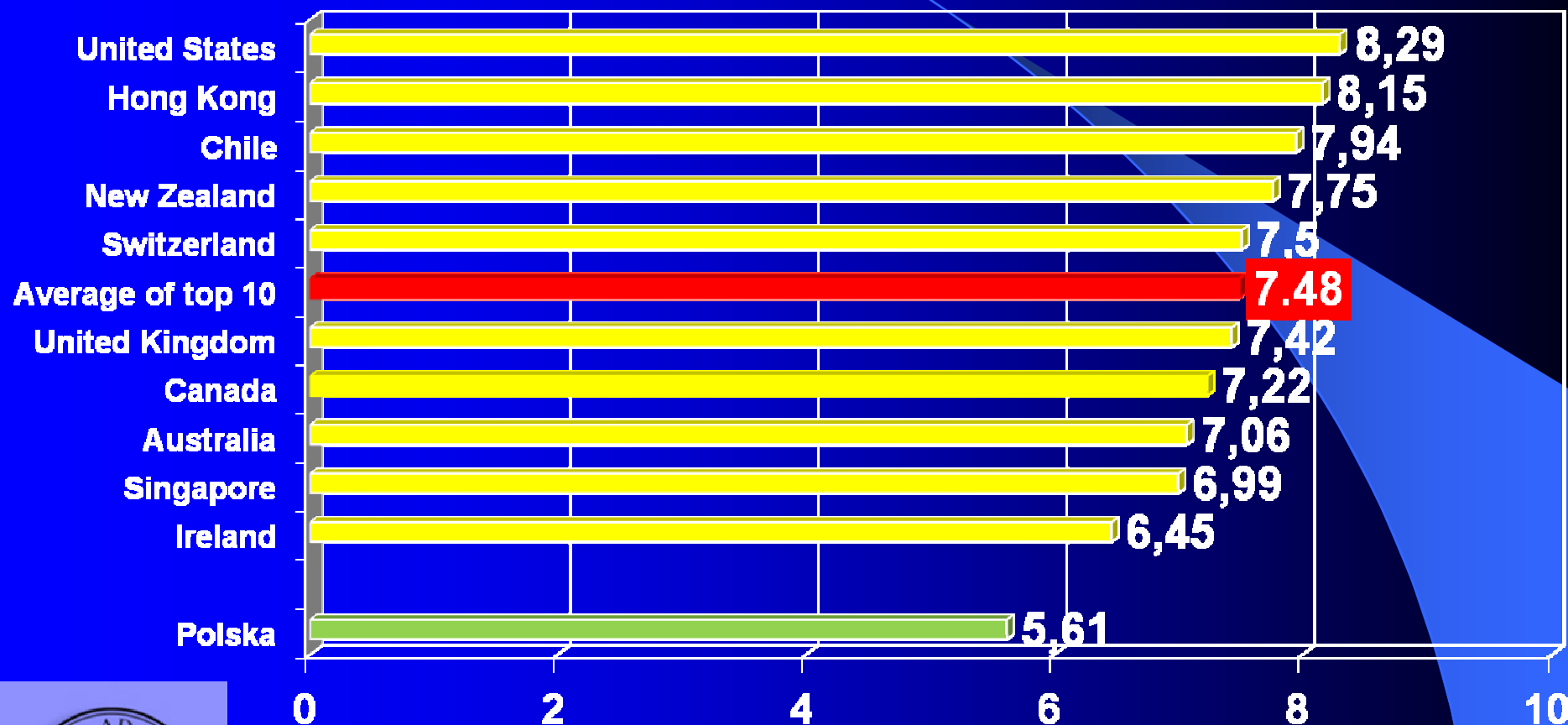


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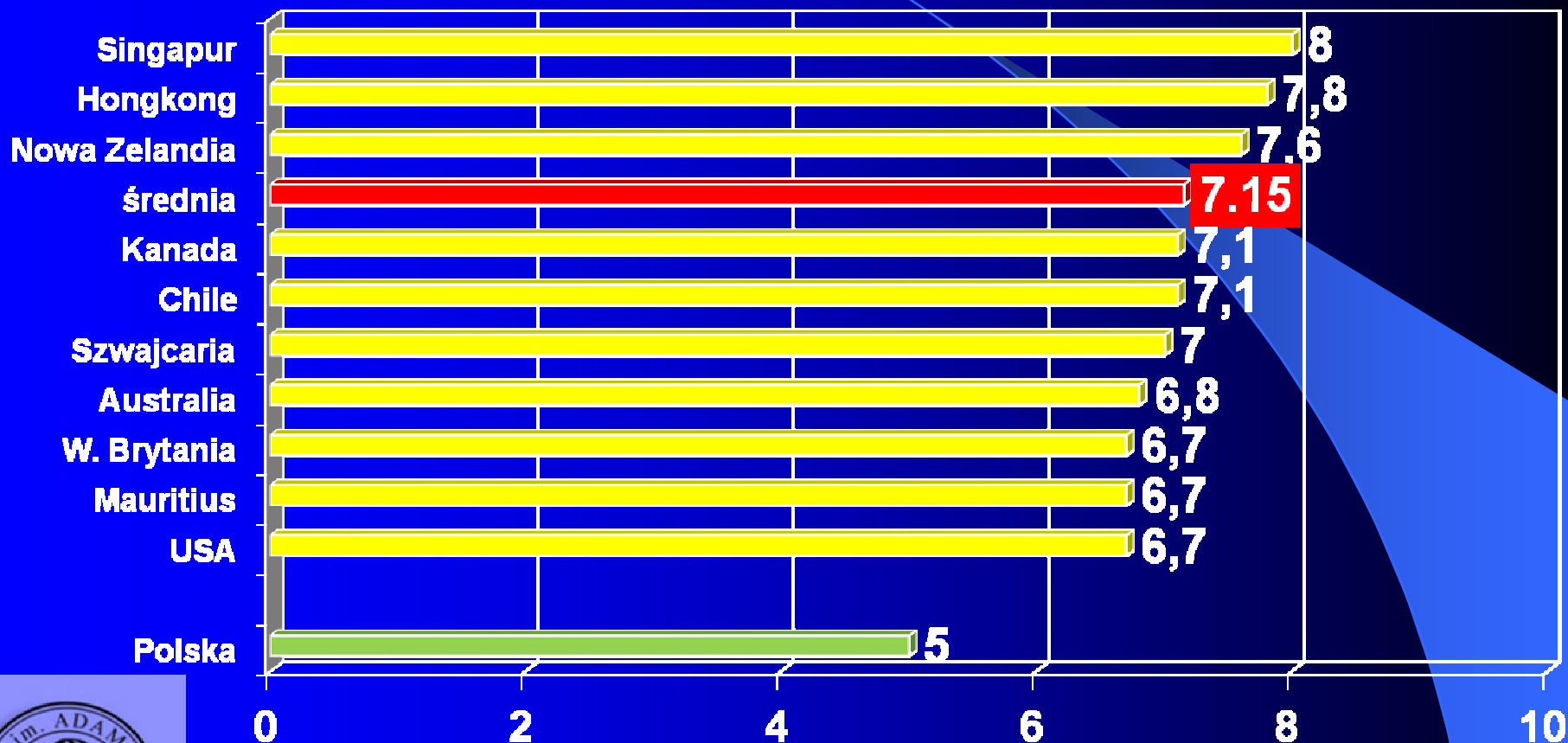


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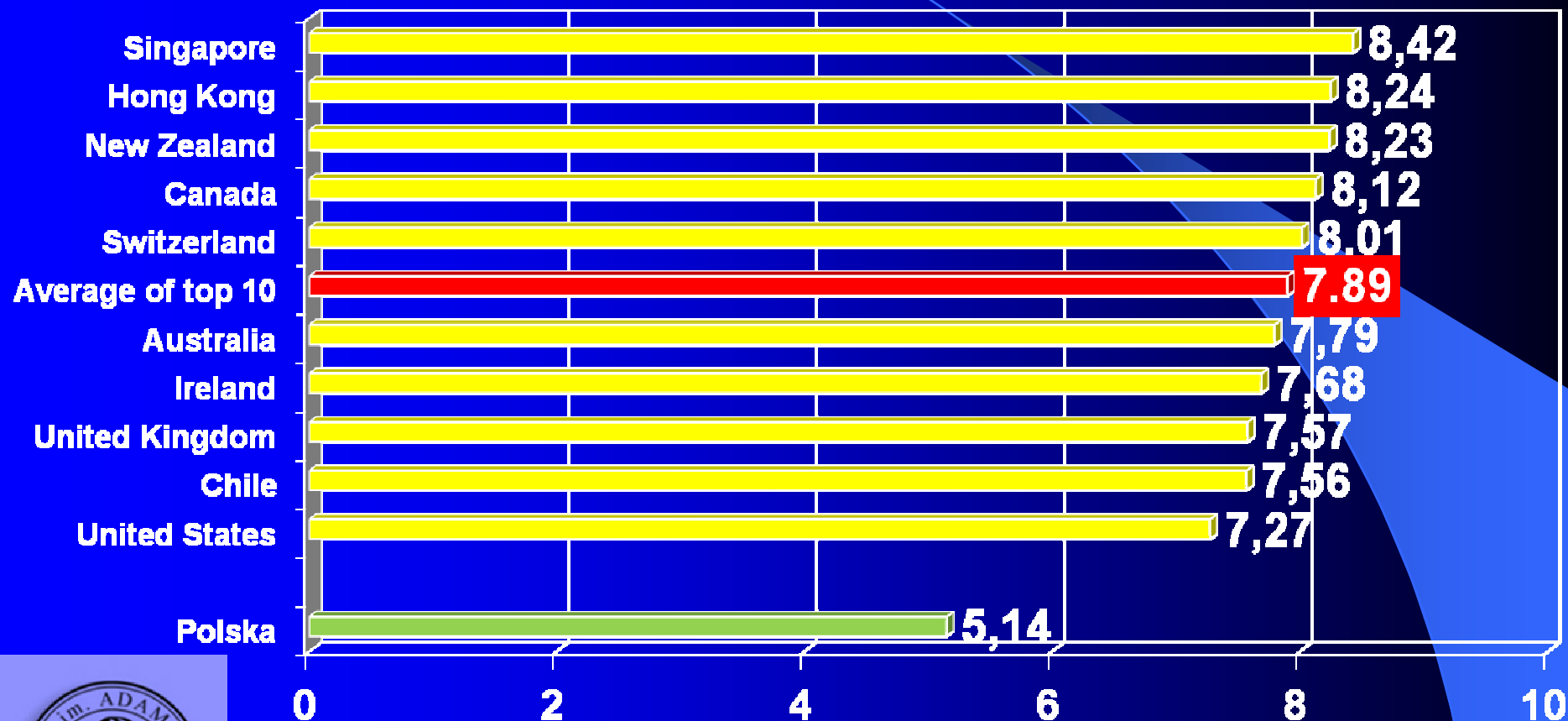
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