Summing Up

THE ROLE OF THE STATE WITH PARTICULAR FOCUS ON SECURITY AND DEFENCE ISSUES

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The Function of the State in a Transition Economy

Adam Smith enjoined on the state "first, the duty of protecting the society from the violence and invasions of other independent societies; secondly, the duty of protecting, as far as possible, every member of the society from the injustice or oppression of every other member of it...; and thirdly the duty of erecting and maintaining certain public works, and certain public institutions, which it can never be for the interest of any individual or small number of individuals to erect and maintain" (*Wealth of Nations*, Book IV, ch. ix). They figured among the "five key pillars on which Slovenia is building its future" in the Address opening the Colloquium by its Minister of Economic Relations and Development, **Marjan Senjur**. Adequate defence expenditure and prospective membership of NATO is aligned with Smith's first duty. Consolidating in parallel the institutions of democracy and of a market economy, with EU candidature in view, is an expression of Smith's second and third duties. But two of the Minister's "pillars" (objectives shared by all transition states) are staked outside the Smithian boundary - macro-economic stabilisation as expressed by price and budget stability and by a sustainable balance of payments, and dynamic economic development to catch up with the advanced countries of Europe. The second Ministerial Address, by the Romanian Minister of Finance, **Daniel Daianu**, immediately queried the causality of stabilisation to growth and cited three instances where stabilisation measures may prove counterproductive - permitting wage arrears in order to slow monetary circulation; incurring uncovered expenditure outside the budget to create a smaller, but notional, fiscal deficit; and accumulating government debt at high real interest rates so as to claim that financing is non-inflationary. Because post-communist governments are averse to the Chinese model of economic transformation "from above", he was chiefly concerned with the paradigms for combining spontaneous change with state-led institutional design, such that public intervention manages change in the (non-exclusive) light of market-generated information.

When the excessively statist regimes fell in 1989-91, the western democracies were generally pursuing a policy encapsulated in Lady Thatcher's phrase "to roll back the state". In the United States the parallel was the movement against "big government" and in the European Union it was for "subsidiarity". The Czech government was in the forefront of a "Thatcherist" transition path, and its ministers declared that "the best industrial policy is no industrial policy" (Vladimir Dlouhy) and "the object of privatisation is privatisation" (Vaclav Klaus). Few transition governments would today affect to "leave it all to the market", and papers at the Colloquium analysed the role of the state either for the content and inter-relationships of such public economic management or for the provision to the state of inputs which could not mainly be chosen according to market-generated parameters. The economics of the transition state for its "output" and for its "input" forms the structure of this overview.

The Transition State as Needed for its Output

The papers and ensuing debates focused on five areas in which state mechanisms and policies effect, or foster, transformation from a command to a market economy - one was the Smithian supply of public goods; three supplement the market (through industrial and technological policy, and assuring social security); and another supports the market (though in ways in which transition governments profoundly differ).

Joel Turkewitz discussed the one function of the state of which Adam Smith would have approved, a task sometimes described as that of the "night watchman", to keep in check the informal economy and criminal activities. Widespread as the former had become in the post-communist states, they had been largely responsible for the dynamics of the newly-legitimised private sector. The most patent example was Poland, where some two million operators in the shadow economy formed a ready-made basis for small and medium enterprise; the emergence was less abrupt in Hungary, where the pre-1989 government had legitimised most of such activity during the preceding decade. Their impact changed from benign to malign after legitimation: tax avoidance reduces budget revenue and hinders monetary stabilisation; criminality exploits shortcomings in the transition process and undermines the authorities; the informal economy is often an inefficient use of resources; money is not channelled through the banking system, which hence has fewer resources to mediate into investment and other productive uses; and, usually together with political instability, encourages capital flight. It was pointed out in the discussion that the non-settlement of clear property rights was another factor contributing to the informal economy, and that - to put the issue into perspective - most citizens participated in the informal economy, whereas crime was restricted to a few.

Three further considerations of state functions can be interpreted as offsetting market failure, that is, when the market economy cannot attain a state of efficiency on its own. The first is the state's guidance and support for what is broadly termed "industrial policy". **Wally Struys**, taking as twin objectives the defence of the nation and an efficient economy, perceived such a state function as including regulation against imperfect competition in the procurement of military goods. Unlike most goods and services, the producers of which evaluate and can even create a market demand, the need for a weapons system originates with the client, that is, the host state (or another state whose choice has to be ratified by the host state's issue of an export licence). Defence industry trades with national monopsonies and even, where there is but a single producer, instances arise of bilateral monopoly; in many cases relationships become exclusive and personalised. In the transition economies the adaptation of defence-industry capacity to civilian uses has been taking place in the difficult environment of dismantling the planned economy while still needing the state's Visible Hand to guide conversion. Discussants contested the empirical accuracy of bilateral monopolies, because the international arms trade furnished competition: 60% of Russian arms production was exported and governments usually made some opening for imports in their defence procurement. **Elena Leontjeva** was still more critical, asserting that because defence industry leaves no room for the final consumer - the citizen whom the armed forces protect - and the buyer remains the state, at home or abroad, an inefficient use of resources is inevitable. Once the state is involved, as Struys proposed, in enterprise restructuring as defence demand diminishes, experience has shown, she claimed, that further intervention persists. **Yuri Khromov** situated the Russian defence industry among a "high-tech" group of industry, of which the competitive enterprises were selectively supported under the government's industrial policy; another group, of energy and minerals with ready export markets, was a principal tax base; and the final group comprised a miscellany of uncompetitive branches for which the government instruments were import protection (within WTO rules), weeding out and technological enhancement. **Marko Simoneti** showed that on a much smaller scale a similar industrial policy was being pursued in Slovenia, where, due to the collapse of former Yugoslavia and its programme of import substitution, manufacturing output had declined from 38% of GDP in 1988 to 24% of a slightly smaller GDP in 1996. Enterprise restructuring was, however, inhibited by "insider" ownership and restitution claims as well as by insufficient viability for privatisation. Finally, **Thomas Nowotny** observed that transition was an accelerated experiment for variant roles of the state and related GDP growth experience to variables such as welfare changes, investment ratios, political continuity, democratisation, banking reform, prevalence of corruption and even distance from Brussels (for which a participant substituted a negative correlation with nearness to Russia).

The two other dimensions of market supplementation analysed in the Colloquium related to Soviet-type establishments which could be judged too large for countries at their level of economic activity, scientific-technological research and social expenditure. The state's output of such "public" and "merit" goods and services could be described as sub-optimal because a transfer of resources from them to alternative uses (such as investment or productivity incentives for the workforce) would have yielded not only growth itself, but a product-mix of higher welfare content. In the historical dynamics of economic growth, the Soviet magnitude of resources devoted to R&D had been "premature", and had, moreover, been constructed, as **Julian Cooper** observed, on an interpretation of technical progress which was linear within a set of state organizations - from pure science through to "introduction" into practical application. That conceptual approach haunted some transition governments today, especially in Russia where a programme for science reform to the year 2000, adopted by the government in May 1998, conceived the state as "all-embracing and hyper-active, with only passing reference to the existence of the market". Although economists analysing innovation in developed market economies had as yet formed no common view on causalities, government policy in this field should concentrate upon selective support for the scientific establishment (notably incorporating peer-group review) and for investment in human capital within a competitive open economy. Cooper warned against over-reliance on the technologically-educated personnel of the Soviet period because their training had in many cases been narrow and was proving inadequate for the flexibility and management which market conditions demanded. Realistically, as a participant added, scientific establishments in both transition and market economies were facing a reduction in their share of public funding. In that context, a paper by **Todor Dimitrov** delineated the high shares of the business sector in R&D expenditure in OECD countries, which was as high as 75% in Japan and Switzerland, and of foreign funding therein - in industry more R&D was financed from abroad than by the government in Canada, Greece and the UK. To the pro-market conclusions of Cooper and Dimitrov, the description of French practice by **Jean-Paul Panié** came as a surprise, for the Délégation générale pour l'armement (DGA), which he serves, replicated Soviet planning from the prospective horizon (30 years in the French usage, against 15-20 in the former Soviet *Genplan*), through the five-year plan to the annual plan, "corrected" (here to employ the Soviet term) in the light of previous-year fulfillment and the longer-term targets. The past practice of the USSR Gosplan seemed to have been still more fully emulated in 1997, when, as Panié recounted, an operational concept officer from the relevant armed service was linked with an "architect" of the DGA for sectoral planning - the Soviet term for such practice was *kurierovat*'.

The legacy to transition governments of a "premature establishment" was evident also in the relative magnitude of social security commitments. **Lajos Héthy** posed governments' dilemma on diminution of their disposible resources when continuing welfare-protection was evoked by growing poverty (attributable to general recession and widening disparities in income and wealth), bolstered by a long historical record of social policy and by citizens' (as voters') expectations.

For candidates in EU enlargement, the application of the EU Social Chapter (as agreed in the Maastricht and Amsterdam Treaties) would influence resource allocation; although the welfare objective was paramount, the restraint of emigration to richer member states by a high social safety net was a consideration noted by one participant. The paper by **Hans-Hermann Höhmann** complemented that of Héthy particularly by reference to an "antagonistic potential" which can be released when expectations run far ahead of actuality: although recently expressed constitutionally in Central-East Europe by switches of electoral support, such antagonism could destabilise society, especially in the poorer countries, and foster support for reactionary communist or nationalist reversals in transition policies. Three case studies - Albania by **Genc Ruli**, Russia by **Rostislav Kapeliouchnikov** and Slovenia by **Tine Stanovnik** - revealed, for example, trends which hindered the widely-advocated change of unemployment and retirement pensions from state "pay-as-you-go" to actuarially-sound contributory schemes. In Albania long-term unemployment was 76% of total unemployment and one in five private-sector workers were unregistered and paid no premia. In Russia surveys had shown that a significant proportion of unemployment claimants were in full-time work and that benefits such as child allowances were being paid to both parents for the same child. In Slovenia the ratio of contributors to pensioners had fallen from 2.3 in 1990 to 1.6 in 1996. Kapeliouchnikov adapted Kornai's phrase of "premature welfare states" to "wild welfare states" to characterise a chaotic social expenditure pattern, the reform of which was held up by parliamentary resistance. A comment from a participant was that in some countries it might take three decades for social insurance schemes to become actuarially-viable.

The fifth policy constituent examined was the government's role in supporting market activities - but which, as **Franz-Lothar Altmann** warned, was being undertaken or essayed at a time when the governmental system as a whole was itself under reconstruction. Authors had been asked to focus on external economic relations, and Altmann detailed the framework and duties incumbent on a national administration as trade and payments were liberalised. Given the incompleteness of privatisation in many transition states, the state could conflictingly be both protector of competition and advocate of its own enterprises. His contention that the state should primarily stand aside from the development of the private sector and concentrate on the removal of obstacles to its development was tacitly contradicted by an additional paper submitted by **Abduvali Isadjanov** which cited the practice of the government of Uzbekistan as being itself the initiator and actor in market reforms. The other invited papers on this topic examined aspects of international collaboration and of capital transfer. In conformity with the Colloquium sub-specification on defence issues, the two papers on collaboration addressed trade in military goods. **Michel Crochet** went through an impressive range of weapons systems developed since the 1960s through Western European collaboration, which expressed both a political will and a desire for cost-efficiency. He incidentally countered the strong planning framework outlined by Panié by emphasising transnational corporate participation and the increasing share of dual purpose outputs, the civilian segment of which had to respond to market demand. **Roman Czerwiński** cited offset agreements benefitting Polish suppliers in the purchase of aircraft abroad: the watchword was “to the Polish military market through, or together with, the Polish defence and aviation industry”. A contributed paper by **Oleg Duko** noted the necessity for relatively small-capacity Belarus to collaborate with the Russian defence industry not only for its own military procurement but to retain the linkages which had come from a unified Soviet military-industrial complex. Widening the arena to international capital flows generally, **Gerhard Burian’s** paper (presented by Thomas Nowotny) surveyed the stock of foreign direct investment (FDI) which the seven Central-East European states had accumulated - a range in percentages of GDP which by end-1997 was as much as 34 in Hungary but as little as 6 in Romania - and cited the “Danube Recommendations 1998” just formulated by a business conference in Vienna on promoting such cooperation. To these a participant added the international protection of intellectual property, and **Vojka Ravbar’s** paper the value of regional free-trade areas, among which EU Association Agreements were salient (two-thirds of Slovenian trade was now with the EU). **Leon Podkaminer** warned that trade, FDI and national foreign currency reserves had been dwarfed by foreign-exchange flows, even excluding those in financial derivatives. The world’s aggregate reserves were equal to little more than a single day’s forex transactions (against 15 days two decades ago). “The economic El Nino can strike any time, any place” he concluded.

Optimising Inputs to the State

The Colloquium considered the opportunity costs arising from public-sector resource use, particularly defence expenditure, starting from a paper by **Keith Hartley**. There could be a superficial explanation through a public choice model compacting electoral mandates, parliamentary debate, interest-group expression and information, but it was insufficient when applied to the provision of defence security. Security provision both as to its composition and its objectives (such as confrontation and deterrence during the Cold War, and crisis management and peacekeeping now) was not open to public discussion and costs were initially understated. More sophisticated and publicly-accessible indicators of security objectives should be presented in a context of alternative and realistically-costed supply-mixes. Feasible as such practice might be in NATO countries and its enlargement partners, **Silvana Malle** questioned its applicability to transition states, notably those of the CIS. In Russia, for example, political parties - and hence the formulation of electoral mandates - were ill-developed; ministerial policy was affected by frequent cabinet reshuffles and government macroeconomic policy was poorly coordinated with central bank decisions;

interest groups within the armed forces skewed budget allocations; and there was at least one free rider, Tajikistan. **Ivo Paparela**, arguing within a broad context of eight Central-East European states, also saw defects in the public choice model, partly because the civil service was still inclined to statism and because capital formation was inadequate to implement both public and commercial decisions in new directions. Polish experience, as stated by **Katarzyna Żukrowska**, did not however bear out that view, because the budgetary mechanism had been integrated into the variables related to macroeconomic choice, which was formulated by ministries for parliamentary (and ultimately electoral) approval. The debate launched by Hartley's paper was the liveliest of the Colloquium. On the one hand some participants defended the *rationale* of allocations to military requirements and of intra-NATO burden-sharing, or found historical examples where ministries competing for resources were surrogates in a public choice model. On the other hand the difficulty was demonstrated of measuring a defence outcome to set against those of other public-sector and market activities.

For participants drawn from the military and civilian branches of government, parliaments, the international agencies, economic and commercial research and business, interchanges from the floor and between sessions were valuable complements to the presentation of invited papers.