

Veselin Vukotic

## *Institutional Reforms - from political to entrepreneurial capitalism*

### **Starting point:**

Final goal of institutional restructuring in the field of economy is to motivate people who have money (investors) and people who have idea (entrepreneurship). We need institutions, which encourage people to invest money and people who want to realize their business ideas!

What is or what should be the result of institutional restructuring? Should that be nominal adjustment or real?

### **What should be the goal of institutional restructuring?**

The goal of institutional restructuring should be motivation of investors and entrepreneurs! The human capital must be motivated!

### **Why are investors and entrepreneurs important?**

Both of them are like flock of birds: at the slightest noise, they leave the place or the territory they are located. And without those people, there is no new energy in the economic system. I will repeat, without those people! I believe neither in the development of businesses nor in the profit - if they are not created in people's heads!

The problem of transition countries, especially at the Balkan, is the fact that people earned more money from rent seeking; corruption; war profit; hyperinflation, then from market behavior (lucky, things are changing and people earn more money from market activities every day).

Phenomenon of gaining profit somewhere out of market in Balkan countries is represented as conflict of two categories of capitalism: political capitalism and entrepreneurial capitalism!

Political capitalism is process of acquiring and managing capital through politics! Key characteristic of political capitalism is that it lead down to redistribution of existing GDP in favor of people whose businesses depend on political market! It is completely irrelevant if that is business done by private firm, which cooperate with state company; or that is monopoly created through protection measures, no matter which: customs, tariffs or contingents; or maybe business owner has good relation to court system,... Then, different models of privatization... Donations are not too far from political capitalism. More or less, all ex Yugoslav countries are in state of political capitalism!

Entrepreneurial capitalism is basically oriented on market, acquiring profit on the market; market is there where the customer is, no matter if that is in the domestic country or abroad! Investors and entrepreneurs are bearers of entrepreneurial capitalism!

In my opinion, first institutional reforms in Balkan countries were the path from communism, toward political capitalism! From bureaucratic personnel, to bureaucratic capitalists! That is dominant today!

Politics is big business! Everybody is running into politics! Conflicts on political scene are severe and personal! Is that conflict of ideas about building of new economic system or just pure struggle for political power and control? I am not sure if that is fight between different concepts! It is fight to join political capitalists!

When we are talking about investors and entrepreneurs, are they more motivated in the ambient of political or entrepreneurial capitalism?

My hypothesis is that institutional restructuring must stand at three network connected pillars:

1. Rule of law and introduction of strong court system
2. Strengthen of individualism
3. Respecting culture (tradition)

In other words, nominal institutional reform can't give any results if it does not originate from the essence of society, from the essence of individual, from history! If we want to throw this out, if we want to forget this, to hide it - then we are falling into constructivism and we are endangered from so-called institutional engineering (EU and this danger).

There is no corn cob, without stalk, which grows out of land! (Majority would said - we are living in Montenegro - corn cob without hoe! There is no Europe without hoe! Just be unselfish out of our biological limits!) Nema klasa kukuruza ako nije na stabljici koja izrasta iz zemlje! (To će većina reći: Mi se hranimo u Crnoj Gori - klasovi bez motike! Nema ni Evrope bez motike! Budimo nesebični izvan svojih bioloških granica)

### **Danger from institutional engineering:**

Everybody emphasize need of institutional reforms. I just want to warn that institutional reforms can be dangerous; institutional reforms can drive away investors and entrepreneurs, and can attract the others!

It is not enough just to say: we are conducting institutional reforms!

It is not enough just to say: we want capitalism!

It is not enough just to say: we want democracy!

It is not enough just to say: we want freedom to choose!

It is not enough just to say: we want.... not to invent the hot water!

Institutional engineering is basically substitute for so-called rational, constructivist approach. There are two reasons for that:

1. Bearers of institutional engineering are people from ex establishment: you can tear down the institutions, but you can not destroy its spirit!

2. Economists from abroad: I admit their importance in this processes, but after all, many of them come from administration and they belong to "transition industry" more then they have new, fresh, live ideas!!

When I speak about EU, it fairly fell into institutional engineering! It is approach that is more nominal! Much more then it is real!

### **How institutional engineering can be avoided?**

My opinion is that we must develop so-called network basis of institutional changes. The capillary approach is needed!

That means that we must respect differences between different phases (stages) of institutions.

The bases of this approach are:

1. Institutions are expression for maturity of a society! That means that institutions express interests of majority of people at one territory. Interest is one form of maturity of an individual! When an individual can define his or her interests and fights for them - it means he or she is mature!
2. Expression of transition spirit! Expression of national culture! As all histories of economic thought at Western countries are specific (East is not included), all institutions, which can be accepted by a tradition are also specific!

English grass:

1. We are wondering: why English grass in Montenegro can not be as same as in England. What is the secret?
2. First You plow, then saw, then fertilize, water it, then mow the grass,... And you must do that again and again for next 300 years! You will get the English grass!

### **Network basis of institutional changes:**

Institutions are related here to rule of law, strengthen of individualism, and respecting the inertia of old system, as well as cultural inheritance..

#### ***1. Rule of law and strengthen of the court system***

Analysis shows that rule of law is one of the indicators which influence economic growth (Barro, 1997.; Chaufen and Gusman, 2000)

Rule of law should disable discretionary power of individuals and provide equal treatment of all citizens in front of law, stabile and credible rules, and independent judiciary. Rule of law solve the time-horizon problem for investors and entrepreneurs, in other words, rule of law solve the problem of making long term decisions. As Buchanenon says, rule of law should limit the state - the power of majority!

In late transition countries, as the West Balkan countries, the real problem occurs: democracy is above the law! It is represented through insufficient independence of judiciary, inefficiency and politicization of courts. It means that from the investors and entrepreneurs' viewpoint rule

of law means limited role of state, meaning, limited role of politics! Professor Barro proves that in countries with low level of democracy, as Germany was in 1995, or East European countries in 1990, improvement in level of democracy is less important for economic growth than rule of law! If the energy for reforms is limited, then it should be used for implementation of the rules and rule of law!

## ***2. Strengthen of individualism and individual behavior***

Collectivism is one of the main characteristics of Balkans' societies. Collectivism is based more on passions than on interests. For example nationalistic ideas, religious ideas, ideas of social justice etc have those characteristics. How to transform passions into interests! How to transform irrational behavior into interest (rational) behavior? How to explain wars and bloody break-down of ex Yugoslavia? Where so much passion is coming from? Collective has own psychology.

The importance of institutions (rules) is in the fact that institutions (rules) individualize human behavior. Institutions influence human behavior! Institutions have impact on behavior of each individual! It is particularly important for investors and entrepreneurs, because institutions are more intelligent than any single person. That is the way to develop society based on interests and not on any kind of passions!

### **2.1) Inheritance of old socialistic system**

No matter how much the old socialistic system is ruined, no matter how much all of its institutions disappeared, the spirit of old system still lives. As example there is tendency to solidarity! Belief in state! Fear from competition! Institutional development should take these remainders into account. The real problem is the fact these reminders are not taken into account – huge jump are made and that creates problems in the law implementation!

### **2.2) Informal rules**

*Informal rules* are tradition, culture, customs, moral belief, religion belief and other behavior standards and norms.

Institutional restructuring in ex socialistic countries brings new formal rules, which are in interaction with informal rules! *A harmonious interaction of new rules and informal rules reduces the transaction costs in the economy and frees some resources for the production of wealth!* When informal and formal rules are in conflict, it increases transaction costs, but it also increase uncertainty for investors and entrepreneurs.

### Warning results of institutional engineering:

Results of institutional restructuring are given in table below.

**Table I: The Rule of Law, Corruption, and Black Markets and Regulation**

Country	Rule of Law	CPI	BM&Reg
Czech Republic	2	4,3	2,5
Estonia	2	5,7	2
Hungary	2	5,2	2,5
Latvia	2,5	3,4	3,5
Poland	2,5	4,1	3
Slovenia	2,5	5,5	3
Bulgaria	3	3,5	3,5
Lithuania	3	4,1	3,5
Romania	3	2,9	3,5
Moldova	3	2,6	3,5
Russia	3	2,1	4
Slovak Republic	3	3,5	3
Albania	3,5	Not rated	4
Ukraine	3,5	1,5	4
Belarus	4	4,1	4,5
Croatia	4	3,7	3,5
Yugoslavia	Not rated	1,3	Not rated
Bosnia	4,5	Not rated	5

Sources: 2000 *Index of Economic Freedom*, and 2000 *Corruption Perception Index*.

### **3. Where do the differences between East European countries come from - importance of culture?**

It is topic for special discussion! Maybe the answer of Douglas North on similar question asked for Latin American countries can be useful in seeking answer on the question asked here!

*"Many Latin American countries adopted the U.S. Constitution (with smaller modifications) in 19<sup>th</sup> century, and many laws originating from different countries has been implemented in the Third world countries. But, the results were different. Although rules were the same enforcement mechanisms, way of implementation, norms of behavior and subjective models of actors were different!"*

In other words, capitalistic culture is not developed in the same level in each country. The essence of capitalistic culture is culture of individualism: culture based on personal interest, self-determination, self-responsibility.

These behavior principles encourage society to develop *competitive performance, promote risk taking, and view income inequalities and desirable results of entrepreneurship!*

The link between culture, in other words influence of different cultures and religions can be expressed through index of economic freedoms:

**TABLE II: *Economic Freedom in Central & East European Countries***

Country	Heritage	Fraser	Country	Heritage	Fraser
Estonia	1.80	7.5			
Lithuania	2.35	6.2	Macedonia	3.25	N.R.
Latvia	2.45	6.6	Bulgaria	3.35	5.3
Czech Rep.	2.50	6.9	Albania	3.35	5.6
Hungary	2.65	7.0	Ukraine	3.65	4.6
Slovenia	2.85	6.1	Russia	3.70	5.0
Slovakia	2.90	6.0	Romania	3.75	4.7
Poland	2.90	6.0	Bosnia	3.80	N.R.
Croatia	3.15	6.0	Yugosl.	4.25	N.R.
Moldova	3.20	N.R.	Belarus	4.30	N.R.

Sources: *Economic Freedom of the World:2003 Annual Report*, the Fraser Institute; *2003 Index of Economic Freedom*, the Heritage Foundation

It is obvious those countries, which were under Austere –Hungary empire: especially catholic countries, as well Baltic countries, which were connected to Protestants church, have higher index of economic freedoms. Countries, which were under impact of Ottoman and Russian Empire, have lower level of economic freedoms!

### **What steps of institutional restructuring are undertaken in Montenegro?**

Reforms in Montenegro have started in 1998, when political situation was very tough. Montenegro has passed and still is passing through diseases of all transition countries. Besides many measures of liberalization and increasing of economic freedoms, the restrictions and limits are still high! For example, a company in Montenegro can be registered for 1 EURO; now a company can be established and registered in electronic way; law on registering and licensing all at one place is prepared; around 65% of Montenegrin economy is privatized; around 6000 new private enterprises operates; more then 75% of capital in banking sector is privatized (there is only one state bank, with around 54% of state capital); EURO is legal mean of payment... Investors from several European countries come to Montenegro, investors from USA, Japan... Montenegro has pretty developed capital market, (average yearly volume of transactions in last two years was around € 130 millions, or around 10% GDP of Montenegro).

