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Market Quality and Government Quality

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When the Soviet Empire collapsed, there was a wide-spread belief that the study of comparative economic systems will become a matter of the past. Command economies and textbooks describing them will be rendered obsolete by the sea change in politics. These economies would be replaced by high quality market economies akin to their western counterparts, and the textbooks by cutting edge American ones describing these economies in a methodologically demanding fashion. I vividly recall discussing with colleagues from Europe and the Americas if our tribe will become extinct soon, or just be gradually relegated to one of the many subsections of the history department. As a matter of fact, in several places, perhaps most notably in Germany, this is exactly what happened. I recall my recurring visiting professorship at the Free University of Berlin in the late 1990s. It was the time when the formerly prestigious and high-flying Institute for East European Studies, with four full professorships on the study of the economy of the region and many others for other areas of academic study, was scaled back. It had become, for all practical purposes, in part a subsection of the Faculty of Economics and in part of the Otto Suhr Institute for Political Studies. The surviving colleagues spent most of their time teaching introductory courses at the bachelor's level for large cohorts of student in general university training rather than transmitting their region-specific tacit knowledge accumulated over the decades.

I could not believe my eyes. 'Do you really believe,' I asked in an astounded manner, 'that anybody trained in the Samuelson-Nordhaus textbook will indeed be able to trade and manage investments in Ukraine, or Russia for that matter, your traditional partner?' The German colleagues at the time were smiling scornfully at the 'ignorant and backward' looking Easterners.

Nowadays, we are living in a fundamentally different world. Illiberalism and outright statism is back in vogue and that too in forms and degrees nobody could have envisaged, let alone conceived, in the *annus mirabilis* of 1989. The new Zeitgeist is marching on victoriously in developing countries, gaining features of respectability and even admiration, much to the dismay of top policy analysts and research centres in the USA (Kurlantzick, 2016). China is being portrayed as the vanguard of making a successful transition from a planned economy to a market economy, without any unnecessary and painful destruction that was observed all across Central and Eastern Europe (Naughton, 2017).

Populist policies are back on the agenda in the advanced economies as well. The Trump presidency has already changed the face of the United States to the point of being described as an

'illiberal democracy' by the very person who coined the term long time ago (Zakharia, 2016). Brexit also implied a jump into the darkness with the Prime Minister and members of his cabinet denying their lack of strategy, without, however being able to provide evidence to support their claim.[1]

To use a worn-down term, if there is a 'benefit of crisis', it is that the rise of illiberalism has drawn attention to the major differences among distinct modes of operation of real world market economies. If one thinks of the more recently awarded Nobel memorial prizes in Economic Sciences, a clear reflection of the relevance of this insight in the eyes of the top peers of the profession can be found. If one thinks of the decoration received by Diamond, Mortensen, and Pissarides in 2010 for their work on imperfect labour markets, Jean Tirole in 2014 for regulated and network industries, Olivier E. Williamson in 2009 for corporate governance, or Robert Shiller and Eugene Fama in 2013 for financial markets and asset pricing, they all point to a common understanding. It is not that the market is 'the' solution, as was thought in 1989. It is about 'the kind of market' that best coordinates firms. How do we integrate financial markets in economic theory which tended to exclude this field? How to interpret and improve outcomes of regulated markets, from banking to network industries? How does regulation impact the outcome of market interplay as conceptualized in microeconomic theory? How does corporate governance relate to cultural underpinnings of different societies? Is it not possible that the road to success must differ under dissimilar institutional settings, contrary to what we teach in business administration on the merits of benchmarking?

By invoking the fields of analyses of some of the more recent Nobel winners we come straight back to the traditional field of inquiry in the research on comparative economic systems. It has been typical for this avenue of thought, despite its distinguishing feature of having ended, to consciously avoid the trap of over-generalizations, inherent in the formalized-mathematical description of any real world issue. The focus of study has always been what political scientists described in a different conceptualization as the 'varieties of capitalism'. In comparative economics the focus has remained largely on nation-states, highlighting the distinctness of their modes of operation (Rosser and Rosser, 2004). In a certain way, financial globalization and the recent financial crises have triggered parallel rethinking in both fields, each underscoring the limitations of any grand theory and 'one-size-fits-all' policy prescription (van Zon, 2016).

Thus, we arrive at a new juncture. From the point of view of empirical, policy relevant analysis, the issue of quality of markets and the intimately related quality of governance transforms from one of the several issues to be studied into 'the single most important' issue, both from theoretical as well as empirical perspectives. If we take the most obvious case, that of the European Union, the current policy debate in its bulk has rightly been revolving around the questions of how, to what degree, and through what methods, are the systems of such different qualities, as those in the North and the South, can in theory and in practice be jointly managed under a single system of governance, called the

Banking and Fiscal Union? Over and above the issues of technical, procedural, and legal nature, this debate goes into the heart of economic philosophy, economic traditions, and modes of governance conditioned by the preceding factors.[2]

However, differences also matter in terms of political and social outcomes. If democracy and civic freedom are, by no means, the pre-conditions for innovation and improved economic performance, the illiberal model is likely to see its revival, not least by the influence of populist policies which seem to positively invite such practices of governance. In contrast, as argued most forcefully by the last monograph of the recently deceased Jan Winiecki in 2016, if we accept the insight which is supported by both economic theory and recent economic history, than exactly the opposite is the case.

Accepting the latter approach implies that it is not merely our personal commitment to a free society that drives our preference towards liberal and participatory solutions in governance both at the corporate and country levels. Theoretically speaking, it is becoming a side condition necessary for innovative behaviour. It is uncertain if human beings should be compartmentalized into a submissive political being on the one hand, or a vigorous, innovative business professional, in eternal search of new ways, on the other.

In a broad summary of contemporary trends in global economic thinking I try to present arguments (Csaba, 2016) in support of some of the traditional traits of the comparative systems' paradigm being an indispensable component of any relevant economic theory, with the hope of interpreting an occasion, or even influencing real world phenomena. These include contextuality, historic and social conditioning, limits to human comprehension, and the ensuing limits of human action in designing policies and institutions.

With the rising challenge of illiberalism 'the comparative approach stands to gain in relevance'. Analysing the roots and limited economic improvements brought about by one of the greatest political earthquakes of the contemporary decade, the Arab Spring, (Ghanem, 2016) yields the conclusion that at the end of the day 'outcomes depend crucially on the quality of governance'. As long as the institutions in the Arab world do not become more inclusive, the representation in both business and polity is not improved for the lower as well as the middle classes, any economic progress is likely to be timid and temporary. In this analysis it is the incremental steps, including supporting small business and labour intensive activities and limiting entry barriers in a synergic fashion may deliver the much expected stabilization of the restive region of Middle-east and North Africa (MENA). At this general level, this is a replica of what we may think of as the lessons of post-communist change.

A bird's eye view on contemporary challenges may lend support to our original claim. That is, market quality, and in turn the outcomes of market interplay, depend crucially on the quality of governance. Governance is known to be a concept broader than government or administration. By the same token, the socio-political conditions of any open society allowing for trials and errors,

that are the conditions for incremental improvement, may become fundamental 'under any cultural setting'. The quality of governance may and should be brought about by human action and interaction, social learning, and co-operation. Retaining the comparative perspective may be just one element, but it is an important element in providing for continuous improvements both in academic comprehension and practical management of economic affairs across the globe.

Notes

[1] EU 'well prepared' as May prepares to press Brexit trigger, *Euractiv*, 13 March, 2017.

[2] This intriguing issue is analysed in an unconventional fashion with a lot of insider information by three Princeton professors of three disciplines, finance, public administration, and economic history, in the recent volume of Brunnermeier, James and Landau, 2016.

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