State Intervention and Economic Development

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"...in social evolution nothing is inevitable but thinking makes it so."
Friedrich A. Hayek, 1944

"In recent years macro-economists have made great strides in learning more about the limits to our ability to make predictions about and to control national economies."
Thomas D. Willet, 1992

The problem of the role of the state in economic life, better than any other social problem, confirms Hayek's idea that in the evolution of society nothing is inevitable — inevitability is the product of thinking it. This is one of those subjects the social sciences deal with that give perception the slip by their very capriciousness: as soon as it seems that logical, consistent and empirically convincing answers have been found, in new social circumstances they prove incomplete or even persuasively erroneous. For this reason the economics profession in the last twenty years has been in the phase of sobering up from the idea that depersonalized, well-nigh natural laws have been discovered that allow for the possibility of the successful supervision and control of national economies.

The exponentially growing complexity of 20th century social systems has contributed to the diffusion of this perception. Questions and problems multiplied much faster than answers, the disproportion between problems and the understanding of how to solve them culminating at the end of the 80s. Then the problem of transition, as it is called, showed how many practical questions there are to which economists have no answers in which they can have at least some confidence.

Because of the nature of the topic, this paper does not have any rigorously scientific ambitions. It would be best to describe it as an essay or an unfinished train of thoughts which I have endeavoured to imbue with a little logical firmness and theoretical and empirical grounding. The degree of logical consistency and empirical conviction attained is much lower than that required by a serious scientific paper, and consequently I harbour no illusions that my ideological beliefs have not had some influence on it. To this extent the views put forward are very largely subject to criticism, further work and major alterations.

Finally, the subject of this work is kept deliberately narrow. I am not dealing with the problem of defining growth and development, preferring to assume that growth and development are in proportion to the growth in measurable added value. I am not dealing, then, with the problem of immeasurable social costs and gains (negative and positive externals) that arise in the production of real added value, although this part of the economic process is very important with respect to defining the role of the state. However, addressing this problem would require a great deal more space.

In the first part of the paper the problem is viewed from a historical perspective so that it might be possible to define it with some precision. The aim is to distinguish two different views of intervention: short and medium term intervention, the aim of which is to bring into equilibrium an economic system that has unexpectedly become unbalanced under the influence of some temporary macro-economic shock; and general forms of state intervention that determine long term growth and development. In the second part of the work indications of some answers at a general level are offered. In the third part of the work, the answers are made concrete through examples of countries in transition, as they are sometimes called.

THE DEFINITION OF THE PROBLEM IN A HISTORICAL PERSPECTIVE

Can growth and development in the West in this century be explained by growth in state consumption, or the strengthening, that is, of the role of the state and intervention in the economy? It would seem that the answer is "no": Germany and Japan have achieved high average rates of growth with a below average percentage of state consumption in added value. Great Britain, with a below average percentage, has achieved a rate of growth that is convincingly the slowest among the developed countries, while Sweden, with the highest share, had achieved the highest growth after Japan by the end of the seventies. It is also clear that the relative slow-down of growth in Great Britain started round about 1870-1880, at a time when the share of public expenditure in GDP was still relatively small (Brittan, 1979, according to Olson, 1982). And Sweden, as well as having the greatest state share in added value, went through a period of very rapid growth until the end of the 70s and a period of very slow growth from the beginning of the 80s until the present day. It seems that the experiences of individual countries are so specific and that their socio-economic systems are so different that any kind of country average (statistically and logically) would be insufficiently reliable to be able to have any kind of firm theory built upon it.

It is enough to look at statistical data. Whatever big enough group of countries we might take, we would soon see that it is difficult to set up any kind of determinist link between economic growth and the share taken by the state in the economy. If the ratio of public indebtedness to GNP should be chosen as a yardstick of deficits accumulated in the past, and if we assume that this gauge correlates with the role of the state in the economy, we shall see that countries with sound developmental successes have almost incredibly different ratios. At the beginning of the nineties Spain had a 35% share, Austria over 50%, Holland about 60% (this last figure being the Maastricht criterion), while Greece was close on 90%, and Italy, Ireland and Belgium exceeded 100% (Barro and Grilli, 1994 according to Alesina and Perotti, 1994). Alesina and Perotti analyzed the possible causes of these levels and the differences in the ratios of national debt and GNP, and found two very important ones: political conflicts of interest groups or political parties from the same coalition government, and differences in the institutions and procedures involved in making up the budget. All these, of course, are political causes. There is no trace of a connection with development or growth.

And yet, most economists today believe that economic growth cannot be achieved without the state having a large role. This belief is not troubled by the fact that in the real-life political process, in which the ideas of economists are turned into the concrete measures and instruments of economic policy, the argument for state intervention undergoes systematic changes and is sometimes transformed into protectionist or populist pamphlets. Nor is this belief disturbed by older historical experience, for example the fact that Great Britain, during the course of the previous century (more precisely, from 1812 to 1896) was the fastest growing national economy with a very small role being played by the state, with a deflation of about 50%.

When an averagely trained economist in Croatia today thinks of deflation, he will recall the link between deflation and recession, with the small role being played by the state, in developed countries at the beginning of the 1930s. Because of a superficial interpretation of events and the neglect of economic history at the universities, the collective professional memory of Croatian economists about the coexistence of deflation and growth without there being any very great role for the state during many previous periods has been completely erased. What are the reasons for this, and are they at all connected with the belief that there is a narrow positive link between state intervention and economic growth?

I believe that two causes might explain the amnesia of the average economist when it is a question of historical facts going back further than 70 or so years. The first cause is political. At the turn of the 19th and 20th centuries, in the period

that Schumpeter called the defeat of laissez-faire, there were very deep political changes in the West. Ever wider social classes became involved in the political process, the franchise was given to more and more people, and the political initiative was taken by the conservative and the socialist parties. Only those liberal parties that were prepared to change their political programmes and renounce their originally liberal ideologies of the 19th century remained on the political scene (Schumpeter, 1954). The constantly more pronounced political ambitions of various classes and groups were carried over into political life: the unions grew stronger, cartels and monopolies got stronger on the supply side. For this reason prices got less and less responsive to the relations of supply and demand in the marketplace and some of them could be altered more readily via the use of political power. From today's perspective it seems that it is just this fact that has marked the 20th century, and that the influence of these political events on economists arose because of the belief that only the relations between the variables in the kind of political framework that is similar to that existing today can help in the solution of current economic problems.

The second cause of the collective amnesia of some economists derives from the fact that Keynesianism, or Keynesian politics and ideology, vulgarly interpreted as a recommendation that the budgetary deficit be increased so as to encourage growth, has always found more supporters than different ideas that came from the other side of the ocean. Messages that grew out of British ideas and the state of the British economy in the thirties have been transferred to us.

The ideas, and particularly the different interpretations of the ideas of John Maynard Keynes, cut economists off from economic history before the 20s of this century and implanted a belief in the economic profession that the collective mind with sufficiently powerful macro-economic instruments at its disposal was capable of palliating cyclical recessions through reactions. In this it was too often forgotten that Keynes himself very clearly distinguished between the scope of macro-economic policies in the short and the long term. Keynes pointed to the possibility that the expansion of aggregate demand/consumption stimulated by the action of the state (monetary expansion and/or a budgetary deficit) might ease a recession that occurred as a result of price rigidity, that is, because of the inability of prices to be adequately downward adjustable in the short term, in conditions of exogenous contractions of aggregate demand. Keynes was but little concerned with the longer term. Thus the central message of Keynes's *General Theory* was really accepted as being general however much it arose in and was good for the specific circumstances of a small number of developed countries.

Keynes did not bother much with an analysis of the causes of price rigidity. For him rigidity was a fact of life, for the world in which he grew up and worked (Great Britain in the first part of the 20th century) was marked by a growth in the cartelization of the supply of goods (and a cartelization of the demand for labour), as also by the growth in the unionization of the supply of labour. Later empirical research showed the justifiability of Keynes's point of departure for a group of developed countries. Philip Cagan (1974) for example showed that prices in the USA have been less and less adjustable downwards during the cyclically repeated recessions of this century.

Keynes, and the Keynesians, believed that the "market error" had been discovered, the cause of involuntary unemployment, and the cure for it. But this conclusion meets with problems at several different levels of perception. Here we shall mention two:

1. Is price rigidity really a market error or is it a matter of a political error, that is the influence of political on economic processes?

2. Did the results achieved by Keynesian policy in the 30s unambiguously prove the credibility of the Keynesian message?

In Table 1 the main macro-economic indicators for Great Britain are displayed, for the homeland of Lord Keynes, that is, where the influence of his ideas and policy was the greatest.

Table 1: Great Britain between two world wars.

Year	Unemployment rate	GNP*	Base index of ind. production	Base price index
1913	2.1%	4.8	61	36
1918	0.8%	4.3	50	85
1923	11.3%	4.4**	60	60
1928	11.2%	4.9	73	53
1933	21.3%	4.7	73	39
1934	17.7%	/	80	40
1935	16.4%	/	87	40
1936	14.3%	/	94	43
1937	11.3%	/	100	50
1938	13.3%	5.8	97	46

* constant prices ; ** datum for 1924
Source: Cipolla, Carlo M.(ed) 1976, *The Fontana Economic History of Europe, Contemporary Economies*, 2 -statistical supplement

The period between 1918 and 1923 was marked by deflation and a constant rise in the un-

employment rate with a very small rise in real GNP and a somewhat more sensible rise in industrial production. In the period from 1923 to 1928 there was still both deflation and growth, but the unemployment rate was by now very high. In the period from 1928 to 1933, the time of the Great Depression, unemployment peaked, and real output stagnated, although deflation came cumulatively to as much as 26.4%. After this there were obvious policy changes. From 1933 to 1938 the country entered a phase of mild inflation, a somewhat faster growth and a fall in the unemployment rate. However, the unemployment did stay very high and was at the lowest in 1937 with 11.3.%. That is, the name as in 1923. Accordingly, the policies implemented in the 30s only palliated the problems, and did not go very far towards solving them. Very high unemployment obviously existed immediately after the first and immediately before the second world war. The policy of the exogenous expansion of domestic demand proved to be a stop-gap measure that did in some measure succeed in softening the recessionary effect of the contraction of the international market that went on during the interval between the two wars. The scope of the anti-cyclical Keynesian policy is limited to the short and medium term, and in the long run we are all dead, as Keynes wrote; however, the question that Keynes to some extent neglected in his recommendations does need answering: what determines growth and development in the long run and, especially, how does a state have to behave in order to encourage or at least not hamper long term growth and development?

According to Olson (1982) it was impossible that there should be better results from Keynesian policies because the policy of manipulating aggregate demand was based on a superficial diagnosis of the problem. Price rigidity, which was considered a market error, was in fact a political error that arose as a result of the unionization of the labour market and the cartelization of the market for goods. Various formal and informal interest groups accumulated enough power to be able to effect the suspension of the functioning of the market and the subordination of price trends in their own partial interests. This kind of political sclerosis of the price structure led in the long term to the deceleration of the process of reallocating resources. From Olson's argument it follows that, with a correct diagnosis of the problem, much better effects would be given by a micro-economic policy directed to the increase of price structure sensitivity and the acceleration of the reallocation process than by a macro-economic policy that simply came to terms with the existing micro-economic structure.

The social function of the market and prices can be seen in the coordination of the kind and intensity of various economic activities in accord with the wishes and material capacities of people. When prices are formed freely and in some markets high rates of profit are achieved, entrepreneurs are motivated to enter these markets and increase supply. A greater supply depresses the price (increases real output and standard of living) but the new entrepreneur continues to make a profit. It is true that this is somewhat less than the profit of the entrepreneur who has already been doing business in this market, but it is still big enough to bring in new entrepreneurs until profit becomes equal to zero (which still contains the normal profit, the usual entrepreneurial remuneration) or, that is, until prices come into balance, supply and demand being equal. And as long as markets are not in equilibrium, here is a motivation for the movement of resources to produce for various markets. However, at the same time, there is also the motivation of those who have been operating in this market to stop the movement of resources to keep supply at the existing (too low, from the point of view of social benefit) level, at which they can make very high profits.

Accordingly, even on markets that at first sight seem competitive markets, producers can block the transfer of resources by political means and thus indirectly control prices. The final result is similar to a monopoly, with the difference that market disequilibrium is maintained with instruments of political power, while in the case of the monopoly it is a matter of economic equilibrium.

Keynesians, accordingly, failed to notice that the essence of economic problems lay in the arthritic state of the British institutional system of the 30s, in which various interest groups had been consolidated, with enough power to hold up the process of free competition, which was made considerably easier by the reduced scope of international trade and the reduction of pressure from import competition. And instead of recommending a policy based on the slogan that a good micro-economic policy that encouraged the reallocation of resources was the best macro-economic policy (Olson, 1982), in the search for the best macro-economic policy, Keynes achieved only partial results. We should say at the end that such results, imperfect as they are, are also very

important. But it is necessary to move on.

INDICATIONS FOR A SOLUTION

The achievement of partial solutions is not an unusual outcome if one bears in mind that the expansion of total domestic demand does not necessarily have to be connected with the main economic problem — tardiness in the reallocation of resources. In this light it is useful to consider the experience of two countries in which different macro-economic policies were carried out, in which the state played an important role in the macro-economic processes, but whose micro-economic policies were directed towards stimulating the speed of the reallocation of resources. These are Switzerland and Sweden.

Switzerland is a country that in the period between the wars shared the recessionary fate of other European countries. After the second world war, Switzerland recorded a high rate of growth, and during the whole of the century the Swiss unemployment rate has never exceeded 6.5% (Siegenthaler, 1976): "It is true that the disintegration of international economic links after 1929 had a restrictive effect on the trends of overall demand in Switzerland, as in other countries, so that some capacities remained unused, and the growing quantities of resources for increasing productivity were out of use. However, at that time the foundations for future growth were laid down. The traditions that favoured growth were strengthened, and all kinds of tradition that impeded growth vanished." (Siegenthaler, 1976: 534). According to this author, among the prerequisites for growth the following stand out:

1. cooperativeness among unions and employers and loyalty to peaceful settlements of industrial conflicts and
2. employers' associations refraining from lobbyist pressures to protect individual products or to carry out any other measures that would slow down the reallocation of resources, all between 1945 and 1975.

Mancur Olson (1982) identified the same causes in Sweden, a country with one of the highest and most stable growth rates between 1870 and 1980. He stresses a firm national union organization that in the post-war era had two great advantages over American or British union organization:

1. Unions were centralized, so that the union leaders managed to resist the narrow interests of locals and protect the interests of the working class as a whole, which was not necessarily in opposition to the inter-sector mobility of the labour force.

2. Unions organized in this way often refused a static policy of subsidizing wages above the value of the marginal product of labour in companies without a future, and instead advocated the subsidizing of the costs of the spatial and technical reallocation of labour (subsidizing moving costs and/or retraining 'etc').

And as far as the system of "protecting the domestic product" is concerned, the following table says more than any kind of verbal explanations. The figures show that Sweden and Switzerland in the 70s were the most open national economies:

Table 2: Average weighted rates of protection of industrial products in 1976

Country	Rate (%)
Switzerland	2.4
Sweden	3.3
USA	3.5
Japan	4.1
Norway	4.4
Finland	5.3
Canada	6.1
Austria	8.5
N. Zealand	16.3

Source: Olson (1982): 134

The trustworthiness of these data can of course be suspected, but if we have in mind the previously quoted explanation of Siegenthaler about the development of Switzerland and Olson's reference to Sweden, it would seem that there is some point in the data. An additional confirmation is offered by the example of New Zealand which, from the top of the development list of the OECD countries in the 1950s had by the end of the 70s fallen to the very bottom with, as we can see, an exceptionally high level of protection. The renewed economic boom in the country from the mid 80s started with the carrying out of a whole series of economic reforms directed towards demonopolization, privatization and the opening up of the country's economic system.

Accordingly, it is worth repeating again and again what should have been clear enough after a study of the basis of micro-economics: only competition ensures adequate socio-economic dynamics that can in turn ensure a stable, high and long-term economic prosperity for a nation. The opening up of the domestic market and the removal of barriers to mobility of resources are measures of economic policy whose efficacy does not bear any

comparison with the macro-economic manipulations of the Keynesian type, which only in certain conditions is capable of alleviating problems in the short term, but will not heal the deeper problems of economic ill-health. The share of the state in added value thus comes in as a second order indicator: in an open country in which resources shift quickly from sector to sector, a high state involvement can appear in conjunction with a high growth rate insofar as the structure of state outlays is such as not to hinder and perhaps even stimulate reallocation; in a closed economy with institutions that slow down the allocation of resources, even a very low input of the state in GDP is not an adequate condition for stable and rapid growth.

If this recipe is so simple, why is it not followed in all countries?

The answer was given by Mancur Olson developing the theory of collective action (1982) which he tested by the explanation of the rises and falls of relative economic power of individual nations. The theory starts off from the natural tendency of people to combine in order to defend their short term interests (it seems that only in political life does Keynes's dictum that we are all dead in the long run hold true). Further, some (formal or informal) group organization can increase the prosperity of its members so that:

a. it can appropriate a greater amount of newly created social value for its members or

b. it can contribute to an increase of the total newly created value of society so that its members can profit from a higher absolute value of an unchanged share.

Investing resources in another type of activity is clearly the only effective solution from the standpoint of society as a whole. However, the problem of social coordination arises because an increase in total newly created value requires coordination with other interest groups, which can have prohibitively high costs. If we imagine that some group includes social actors that create 1% of added value, every increase of the overall added value will bring the group an advantage of 1% of the increase. Because of this, the group will support an increase in overall added value only if the costs of this support:

a) are less than the 1% increase of added value (a necessary condition)

b) if the net benefit (1% increase minus the costs of support) is greater than the net benefit resultant upon group action for an increased cut in the existing added value (an enabling condition).

If the formal and informal groups are already strongly organized and if there is a large number of them so that their coordination is expensive, groups will act as "distributive coalitions" whose aim is to increase the share of the group in existing added value. On the other hand, if such groups are not yet consolidated so that they cannot block the process of the reallocation of resources, the mechanism of economic competition will ensure the maximum attainable total added value. Also, if the partial interests of the group have been inserted in the wider organizational framework at the national level (for example, the corporative model of collective bargaining of the German or Austrian type) then the likelihood of the reallocation process being blocked is smaller.

Olson's theory consists of nine hypotheses, of which only the most important are mentioned here.

1. Organizations for the attainment of partial interests and partial cooperation reduce efficacy and aggregate income, and make the political life of the nation more difficult.

2. Great organizations like national unions that include a greater number of creators of added value have a greater chance of recognizing overall interests than small, partial interest groups.

3. The number and power of small distributive coalitions are cumulative in time.

4. Distributive coalitions reduce the capacity of society to accept new technologies and the reallocation of resources and so reduce the potentially achievable rate of economic growth (a formal, mathematical proof of this hypothesis was given by Sir John Hicks in Mueller, 1979, according to Olson, 1982).

5. An accumulation of distributive coalitions in some society increases the complexity of regulation, the role of the state and reduces the ability to understand and change the directions of social evolution.

Olson showed the correctness of these hypotheses through the examples of a number of countries. It is a pity that he wrote his book before it came clear that in the 80s that Sweden's economic rate had begun a relative slow-down. It would have been an interesting example.[1]

AFTER SOCIALISM

The economic causes of the collapse of socialist systems are: closedness, slowing down (or erroneous) reallocation of resources, and the accumulation of power on the part of partial interest groups. From 1990 until the present day

throughout Central and Eastern Europe there has been a laboratory social experiment attempting to create national economic systems to overcome the severe sicknesses of old and outmoded developmental models.

After five years we are witnesses to the enormous differences in approach to this social experiment. Unfortunately the time period is too short, and macro-economic measures are too unreliable, for us to be able to judge with any certainty about the successes of the various countries. However, there are already indications that those countries that the earliest and most deeply started to carry out liberalization measures directed towards the building of a market system, among which is Croatia, are entering the phase of economic recovery.

But there is one particularly important fact: the process never takes place spontaneously, economic recovery never takes place anywhere where there is simply a regulative vacuum. A great role for the state in this process is important and indispensable, and instead of the state being understood as a necessary evil, the state, or better to say, its instruments, should be understood as an opportunity for the shaping of the principles of the life of a community based on individual freedoms limited only by equal freedoms for others. Of course, the instruments of state power in themselves do bear elements of coercion and because of this the state can help to ensure that market competition takes place according to civilized rules, that economic defeats and victories are worn with grace, that the reallocation of resources is speeded up, but it can also be instrumentalized and turned into a sword in the hands of a minority, that is, of formal and informal groups with exclusive (formal or informal) right of recourse to the instruments of coercion, after which economic backwardness and an institutional crisis in the community will ensue. The state, then, is a potential that can be used for good or evil.

In this, what is crucial is the perception of the role of the state that is dominant in the ruling party or coalition or among the creators of economic policy. If changes in the micro-economic structure are pushed into the background because of lobby influences, and the imperative to provide short term growth is pushed into the foreground, then it is clear that this kind of country is going to try to manipulate aggregate demand. This will be manifested in a budgetary deficit, monetary policy will have an accommodating character, and the exchange rate will probably be run with successive devaluations. And in such conditions too it is possible to attain growth, but this will be "bad" growth for it is taking place in a static micro-economic structure that does not have an internal motives for change, because of the poor structure of rights of ownership and relative prices that in great measure differ from prices in other countries. In short, this is a growth that cannot be guaranteed to be sustainable over the long term.

On the other hand, in countries in which micro-economic reforms are foregrounded, we can expect a smaller budgetary deficit and even a balanced and autonomous monetary policy which is not dependent on fiscal policy but on exchange rate policy. The exchange rate can be fluctuating or fixed, but if it is fixed we will not expect frequent devaluations.

If we look at the five most successful countries in transition (according to de Melo et al., these are Poland, Czech Republic, Hungary, Slovenia and Croatia) then Poland and Hungary belong to the first group, and the Czech Republic, Slovenia and Croatia to the second group of countries.

The shape and "behaviour" of a country are obviously related to the political process, and politics is in close connection with the culture of the people who live in this country. (Unless it is a matter of a state form deriving from a different culture imposed by force, as happened to the nations of Central and Eastern Europe after the first and/or second world wars.) For this reason the kind of state intervention in the economic processes will depend on the (lack of) existence of informal norms, habits and the formal micro-economic institutions deriving from them that help in the reallocation of resources. Where such habits and institutions do exist, a state form will probably arise that does not have very large interventionist or protectionist ambitions, but which will build up its institutions or regulatory system with the aim of further development of the market economy of free prices and mobile factors. Where such habits and institutions do not exist, there will be on the one hand a regulatory vacuum which will favour the (further) growth of a crime economy, and on the other hand a state with powerfully expressed protectionist and interventionist ambitions, which will attempt to make up for the shortage of micro-economic stimuli for the allocation of resources. It should be emphasized that these are only abstract and extreme cases; real-life economic systems will only tend towards one or other of these extremes.

For this reason it is difficult to approach the problem of the role of the state in the transi-

tion phase in some standardized way and to opt for some general solutions. The fact is that the opening of the economy and the encouraging of price freedom and production factor mobility does have the ring of a general recommendation, but it is also a fact that this is not a sufficient condition for growth. Diverse norms, habits and institutions in different countries can favour or work against the efficiency of such a policy, and the social sciences have, for the present, unfortunately, little to say about the causes of non-economic differences, about the mechanisms by which they can be changed or made to converge. Thus the final result will depend on the culture and history of the nation, on the political relationships, on the many factors that lie beyond the cognitive range of economic analysis. Therefore economic analysis at this moment cannot, at the level of principle, recommend more than slightly threadbare phrases about the need to open up, to have a stable country and to carry through microeconomic policies directed to a speeding up of the processes of resource reallocation. And therefore on the basis of economic analysis itself we cannot foresee the results of the so-called transition process, and in several years at least on the basis of economic analysis itself we shall be in the state to understand what has actually happened to us.

When we are speaking of Croatia, we believe that we have a culture that as well as accepting will actually provide for the growth of an economy of free prices and, in general, market freedoms. The role of the state, accordingly, I see in the sophisticated regulation and assistance of this system, and in no way in any rigid industrial policies that in the long run can put the entrepreneurial instincts of thousands of people to sleep. For me, in this phase of the development of a young state, the fact that 100,000 companies have been set up (one for every 48 citizens) is much more important than data about the trends in the industrial production index. The first number is mainly a measure of the future, while the second is a measure of the past. The quality of economic policy should be evaluated according to the extent to which it makes possible the accomplishment of the economic potential that is for the moment concealed in these small organizations.

If we evaluate the current economic policies of the Republic of Croatia from this point of view, the following conclusions have to be drawn:

1. The overall macro-economic framework (fiscal, monetary policy and exchange rate policy) that came into being after the beginning of the implementation of the stabilization programme is ideally adapted for the accomplishment of long term and stable growth, which has already shown some first results (the growth for 1994 and 1995).

2. The price system is satisfactorily liberalized so that all the preconditions have been created for domestic relative prices to mirror the relative scarcity of goods and to move in narrow correlation with world prices.

3. However, in the system that protects the domestic market there is still a great degree of arbitrariness and subordination to interest pressures, which can be seen in the great dispersion of protective instruments and the great dispersion of degrees of protection for various groups of products.

4. Privatization is too slow and is going on according to the hyper-normalized model thought up back in 1990/91, when it was slave to the illusion of so called "estimated" values of companies. However, the rapid privatization of property in which the state funds had an intermediary function would not have been a problem *per se* if it had gone side by side with the de-monopolization and privatization of the public companies, which however did not occur.

5. Linked to (4) above, all the chances for reducing the national debt via swaps of shares for old foreign currency savings were not used, because the so called "fire sale" was not allowed on that market. For that reason we have a national debt and a lower level of privatization, and if a "fire sale" had occurred we would have had a smaller national debt and a larger degree of privatization of property.

6. The legal protection of creditors is inadequate, which creates large internal debts and reduces the possibility of controlling the money supply. Protection of creditors is not carried out because of a few large and medium sized companies (public companies and companies largely owned by the state) which, by non-payment of debts, subsidize labour costs above its (very low) marginal productivity. Thus a quasi-fiscal deficit in the wider sense of the word is generated and in fact in this way there is the uncontrolled financing of a static social policy which directly freezes the reallocation of labour.

7. Linked (6) above, there is an absence of a dynamic social, or rather development policy that would set up sophisticated mechanisms to encourage the reallocation of resources. Since the problems of resources frozen in production that has no future is area-specific (for reallocation is much faster in Zagreb than in Osijek, Sisak or

Trogir), it is clear that there is room for a spatial development policy (great fiscal relief for all kinds of employment of the workers in steel-works, shipyards and so on in other economic activities, but only after the establishment of an efficient control mechanism).

8. Inadequate pressure to rehabilitate the banks, which will have to end up with the privatization of bad banks.

At the end it should be said that although in this work there has been no mention of the reconstruction and defence that are the main questions of the day and the chief forms of state intervention, everything that has been previously stated is directly connected with these problems. The success of a wisely designed economic policy which will contribute to the openness and rapid reallocation of resources will directly contribute to defence capabilities and the opportunities for reconstruction. This attitude is not based on sheer religious faith, but on experience from the 1993-1995 period, in which macro-economic stability was the key factor leading to the recovery of economic activities and the state budget (the Oliveira-Tanzi effect, according to Anušić, Rohatinski and Šonje (ed.), 1995). This has directly contributed to the increase of the degree of the organization and equippedness of the Croatian Army in a critical period of our history, and to increased abilities to invest in the reconstruction of the country.

CONCLUSION

There are two different kinds of state intervention. Firstly there are short term and medium term macro-economic (anti-cyclical) policies the aim of which is to palliate the cyclical recessions. However, these are not the policies that determine growth and development in the long run. In the long run, the growth and development are determined by the openness of the country and the speed of the reallocation of resources, which depends on the intensity of the competition. And competition, openness and speed of reallocation of resources depend on the resistance of the instruments of state power to pressures of smaller interest coalitions whose power of influence, if it does exist, mainly brings about a redistribution of existing added value and does not contribute to the growth of the overall real added value. However, the framework of the state is nevertheless necessary for the development of a market economy: wherever there is no regulatory framework a criminal economy will develop, as will a stagnant institutional and economic structure. Therefore the state has to provide a legal framework for the enforceability of contracts and for respect for rules of the game that are clear and known in advance. Insofar, the state is a collective instrument of power that can be used well or badly.

The post-communist recession is not a cyclical phenomenon and its causes cannot be removed only by anti-cyclical macro-economic instruments. This is rather a deep institutional crisis from which the only exit is through the carrying out of micro-economic policies directed towards the opening of the country and the accelerated reallocation of resources. ■

[1] In the 80s, the Swedish economy rose at the low average rate of 2%. In 1991, the social-democrats lost the elections when it became clear that the Swedish model of market socialism had lost its internal stimuli for growth.