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Review*

In most countries, the statutory retirement age is usually or soon will be 65. In line with the organic view of things in its relation to the state an institute or a company or an association is a natural organism: it is born, grows, blossoms, ages and dies. If this theory were accurate, then an institution of this age – 65 years old – would not be particularly active and would calmly be waiting for liberation from any very serious tasks. Luckily, then, this theory is inaccurate. The best evidence of this is the recently published *Proceedings of the 65th Anniversary Conference of the Institute of Economics*. This institute is the oldest economic research establishment in SE Europe, and the book is the outcome a conference held on 18-19 November 2004 in Zagreb. Further information about the conference can be found at [http://www.eizg.hr/65.html].

The twenty five papers are divided into seven sessions, while five more papers from eight authors were from the session of young economists. The Conference Organising Committee deserves full credit for having sent all the papers out for double anonymous international peer review, which without any doubt contributed to the high quality of the conference. Because of the various areas of interest and themes it is practically impossible to reduce the great variety of approaches to a single common handling. For this reason, as author of this review, I had the rather unrewarding task of selecting investigators and reviews to cover. This selection has mainly been related to a certain area of interests and knowledge, and is no reflection on the quality of the works not mentioned. At the same time, the selection has mainly taken in articles that call into question existing (mainly erroneous) assumptions about economic development and the role of the state.

In the *Growth and Development* session, Jelena Budak and Rajeev Goel explored the relationship between economic reform and corruption in transitional countries. According to their findings, the level of corruption falls with economic progress. Perhaps the results of these two authors that a larger government does not necessarily have to have a higher

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level of corruption in the transitional countries will occasion surprise. In fact, the effect of a larger government may reduce corruption in such countries.

Bruno Schönfelder considers the deeply rooted difficulty in overcoming the problem of the failure of the justice system to be entirely legal, with particular reference to Croatia. Schönfelder lays stress on the importance of stability of laws. In common law the collection and use of precedents is considered a valid approach for the making of rules. If in the alternative system of statutory law the statutes are constantly changed – as happens in Croatia – the precedents are subject to accelerated obsolescence. It is often possible to hear that because of inconsistency in enforcement of the laws, most of the transitional countries are inevitably heading for a total downfall. Nevertheless, the real experience of these countries shows that the alarms are misplaced. In addition he investigates the role of the private as against the public enforcement of the law and the excessively negative attitude to crony capitalism that, in spite of everything, has achieved remarkable rates of economic growth.

The serious difficulties of the fiscal sustainability of the Croatian system of retirement and health insurance are very familiar, as are the deleterious effects they have on public finances. Hence it was particular important that in the session *Fiscal Policy, Unemployment, and Demographic Trends* Sandra Švaljek addressed the problem of the fiscal consequences of the ageing of the population in Croatia. The writer used the standard methodology of the European Commission and finds that over the long term, Croatian public finances are untenable. In order to preserve sustainability, improvements in balancing of the budget and in the reduction of the public debt are necessary.

The article of Danijel Nestić discusses the setting of wages in Croatia according to data derived from the Labour Force Survey. The most important findings in the determination of the levels of wages take into account the effects of education, work experience, gender, occupation, company size and place. Relatively low-paid workers have greater benefit from work in the public sector than better paid employees have. Wages rise with the level of education, but the education premium is nevertheless decreasing. There is a certain gap between the wages of men and women, and unpleasant hours of work can be one of the reasons for the higher wages of some workers, but not those at the bottom of the distribution. Nestić concludes that the level of education is the key factor in the explanation of wage differentials in Croatia.

Interest Rates on Deposits, Equity Risk and Bank Failure by Evan Kraft and Tomislav Galec is one of the three articles to come from the session *The Financial Sector, Inflation and Monetary Policy.* During the 1980s and the 1990s, financial liberation became a practically generally prescribed policy recommended for the whole of the world. A considerable number of countries made it easier to get licenses, deregulated the setting of interest rates, and did away with the system of direct borrowing. Still, there was often questionable wisdom in the decision to deregulate interest rates on deposits totally, since this can lead to jeopardising resources. The authors point out that the transitional countries of SEE were interesting experimental labs for the testing of such assertions, and explore the experience of Croatia, which at the beginning of the 1990's liberalised its banking regulation. According to their findings, the theoretically predicted connection between high interest rates on deposits and portfolio risk is confirmed, which is a powerful argument for the control of deposit interest rates.

In the *External Equilibrium, Capital Flows, Monetary and Foreign Exchange Policy* session, Dubravko Mihaljek discussed these phenomena in SEE. Mihaljek is exceptionally successful in explaining recent trends on global financial markets and the political changes that the governments of SEE countries have to encounter in conditions of ever-increasing capital flows. The monetary authorities in these countries are exposed to a serious dilemma. If they set a low real rate of interest in an attempt to restrict short-term inward flows, perhaps the long-term inward flows with which they attempt to achieve a relatively high rate of return on capital will never come true. But if the authorities on the other hand endeavour to adjust any possible imbalance by keeping high rates of interest, large and arbitrary influxes of capital will be stimulated.

Bearing in mind the importance of the liberalisation of international commerce flows, Lovrinčević, Marić and Mikulić investigated the consequences of capital flows on investment into the transitional countries. The inflow of capital can have positive effects on the development of the transitional countries, and can directly stimulate economic growth by increasing the level and effectiveness of investment, as well as through the development of the domestic financial sector. By a regression analysis of panel data from a sample of eleven transitional countries, these writers find a positive correlation between capital inflow and level of domestic investment, most of all by the enlargement of domestic investment. Foreign direct investment has a positive and essential impact on domestic investment, while foreign portfolio investment has no very important effect on domestic investment activities.

In session on *Innovation Management*, Jadranka Švarc writes of the first ten years of innovation policy in Croatia. She thinks that the country has not managed to achieve the necessary advance from standard research and industrial policy in the direction of an innovation policy that is necessary for the structural adjustment of a national knowledge-based economy. This is very largely brought about by an inappropriate and fragmentary national innovation system. The most important idea of the system is that economic growth is not a spontaneous process, rather a process that goes on within a certain social and economic environment. Thus the creation of innovations requires a certain political activity, available economic resources and social recognition. It is the result of attempts of individuals or firms to act in response to economic and social incentives.

According to many investigations, FDI – foreign direct investment – can improve the productive and service functioning of regional markets. The research of Malgorzata Runiewicz also bears out the positive impact of FDI on the export competitiveness of firms and sectors in the Baltic countries. The writer nevertheless warns that the effect of FDI on the specialisation of the national economy depends on diverse policies and measures that manage the inflow of foreign investment, technological learning and spillover effects among economic entities. Not only for the Baltic lands, but also for new and future EU members, the inflow of FDI into the high technology sectors of the economy will facilitate the processes of catching up, improve the long-term export competitiveness and contribute to specialisations of national economics in the markets of the EU.

The article of Riccardo Cappellini in the session on *The European Economic Space* is dedicated to governance of the knowledge and production networks in the medium technology sectors. The author recalls some very important and often neglected factors: the tacit knowledge and adjustment of formal and informal research activities and processes. Institutions have a central role in the governance of knowledge and innovations. Well organised institutions can reduce the uncertainty and risk related to the expected payoffs of innovations, they can beef up incentives for investing in various projects and support investment in specialised education and qualification programmes. All this can lead to improvements in various participants' openness to new ideas and their propensity to accept them.

In the young economists session, David Takacs asked an interesting question: Does EU integration make people any happier? It is fairly well known that psychologists have collected numbers of data about what makes people happier, and what not. The conclusion is that poverty will certainly lead to discontent, but not that great wealth will necessarily mean happiness. The author explores Hungarian expectations to do with EU integration, and establishes them to be fairly vague. There are positive tendencies that in his idea can be attributed to the favourable development of objective facts. But there are also negative endeavours that are not just a sign of traditional Hungarian pessimism, but are conditional upon the insecurities attendant upon future trends.

The analytically, empirically and politically oriented papers read at the conference will certainly considerably improve the understanding of development difficulties and challenges of the economic process of joining the EU that are underway, and provide well-grounded recommendations to those in charge of political decisions and the business community.

Some quibbles that might be raised about this book would relate to the omission of the contributions of most of the moderators of the individual sessions, as well as the views of the many invited rapporteurs, which would have been very useful for an enlargement of the knowledge of the reader and a better understanding of the frequently complex topics. Then there is no index of concepts to make it easier to find a given subject in a book of almost 750 pages, and there are no email addresses given for the authors included in the book (which there was on the Conference CD ROM). Still, none of this is very important, for we have here a complex and excellently performed task that was set before the organising committee, the numerous reviewers and editors. Since the book was printed in only 300 copies, the organiser would do well to put it on the Web site of the Institute for the sake of more widespread use. Finally, we can only hope that we shall be able to take part again in such a high quality conference and make use of its proceedings.

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