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response 7 | week 8 |
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transition: local government

discussion Q

- what are some important characteristics of the interaction between firms and local government that are productive for economic development?

As FSU and CEE countries strive to align their governing structures and institutions in arrangements that are conducive to economic development, research reveals increasing evidence that the nature of the interaction between private firms and local government bears important consequences for overall economic growth potential. To date, much of the research on emerging firms in transitioning economies attributes the prevalence of "unofficial activity" (i.e., officially registered firms who avoid accurately reporting their output and profits to the state) to four main disincentives for firms to operate in the formal sector: high profit tax rates; lack of faith in the legal system to enforce formal contracts; corruption within the government; and harassment by mafia-type groups (Johnson, et al).

The Johnson and Torgler articles both examined these attributions in more detail, but their approaches reflect different premises. Johnson's firm-level study attempted to measure the correlation between unofficial activity and all the aforementioned disincentives. They found the strongest correlation to be with the firms' desire to avoid bribe payments demanded by corrupt government officials (though direction of causality was undetermined). Torgler's study, however, focused in on examining the link between taxes and unofficial activities through probing the concept of citizen's "tax morale". He concluded that (dis)trust in the government was the main determinant in firms' (un)willingness to accurately report their profits and pay the according taxes. Although these two studies investigated different questions, both point to government corruption as a major disincentive for firms to operate transparently -- and therefore as an overall barrier to economic development through less investment, less tax revenue, and greater market distortions that further aggravate inefficiencies.

Gel'man's article shed light on the government side of the firm-state paradigm through his analysis of local governance in Russia. His case studies highlighted the impact of contentious versus collaborative, intra-elite, political arrangements on the level of local governmental autonomy within the context of political (vertical vs. horizontal integration) and economic (localism vs. departmentalism) preconditions. The legacy of socialist planning was also referenced by Hsing's seminar talk in order to identify key problems in adopting capitalist planning models (ie, fragmented political environments in which government officials have more incentive to capitalize on newly valued land through speculative/transaction-heavy market tactics than to invest in sustainable economic and institutional development).

In light of the discussion on growth-inducing, firm-state interactions, a couple of extra points came to mind while reading these articles. First, the ability of local governments to assume market-oriented roles and responsibilities depends heavily on the kind of institutional and administrative capacity that is under-developed in these transitioning contexts. This capacity-building process should be closely linked with the needs of firms -- not only to boost short-term growth but also, as Torgler argued, to boost morale and trust through private sector participation in a democratic system. Another point pertains to culture and norms and the importance of considering the contextual norms of a particular country in the design of the institutional restructuring. The Russian cases borrowed a western model that stemmed from practices that were not embedded in Russian society.