CREDIBILITY OF THE ECONOMIC POLICY: EMPIRICAL RESULTS FROM THE BALTIC SEA REGION COUNTRIES

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Abstract

The purpose of the article is to analyze how the credibility of the economic policy influences on the business environment. How is the development of the legal and institutional infrastructure connected with changes in the society and the economy? Corruption, in the authors' opinion, might be one of the reasons for the institutional uncertainty. It is rather difficult to eliminate and detect. In the public sphere corruption is a particularly interesting and revealing area to study at the initial stage. Data for the empirical part of the article will be taken from the results of a special interview study of Estonian entrepreneurs and managers. The similar interview study was taking in Russia, Finland and Sweden. In order to compare and analyze the results of the questionnaires the following statistical methods have been used: standard deviation and correlation analyses. Empirical results of studies have been shown a strong impact of improved policies on economic growth and on the desire to invest in the country. Recent studies have shown that public sector corruption is the most severe impediment to development and growth processes in these countries. Credibility of purpose is indeed the crucial problem to be confronted in the process of policy innovation; any policy that aimed at being believed should be based on clear and relatively simple announcements against which to evaluate subsequent policy actions; some form of delegation is likely to strengthen the credibility of the announced policy path.

Keywords: credibility, institutional framework, corruption, government agencies behavior, law enforcement mechanism.

Introduction

Economists deal with the meaning of corruption as a public economic policy issue. In this sense, statements that link corruption to economic performance are essentially statements about the link between economic performance and structural/policy distortions. Widespread corruption remains one of the leading problems for governments, business and individuals nowadays. The process of globalization has brought together individuals from different countries. They represent countries where corruption is widespread and countries with little corruption. The rise of international attention to corruption can be seen as an outcome of this process. Corruption can be considered an institutional problem. It is recognized, that it’s thriving in countries with weak legal systems, poor enforcement mechanisms and slight transparency at various levels of government. It is an activity that introduces additional costs on governments, businesses, and individuals in the long run. There for the author tries to find out how bureaucracy (government agencies; their behavior) is influencing and ruling the law-making procedures. How is the law enforcement mechanism operating in the changing business environment? Operating the enforcement mechanism is very important, and if this mechanism is not working well, the self-enforcement mechanism will carry out this void space. The practical part of the article is based on the results of the interview study that was undertaken in 2004, 2006, and 2008 in Estonia, Sweden, Finland, and Russia. In order to compare and analyze the results of the questionnaires the following statistical methods have been used: standard deviation analyses and correlation analyses. It was interesting to see the position of Estonia, how the businesspeople evaluate the changes in the institutional framework during the last years.

General ideas of related literature

All In the literature the main explanations of what causes corruption can be divided into three categories: a) moral, b) functional and c) political-economic. The last one of these traditional explanations can be subdivided into two categories. One deals more with macro-level explanations and the other one is more oriented towards micro- and rational-choice-oriented explanations.

Corruption has been used in various spheres and can also be defined in many different ways. The most common definition of corruption is, as the following – taking advantage of public office for personal or other political interests. However, economists deal with the meaning of corruption as a public economic policy issue. In this context corruption undermines the state’s capacity to carry out its nominated functions in the economy (regulation, rule setting and enforcement; redistribution of income; stabilization of economy). Using this context, it can be easily seen, that economic policy distortions and weak state institutions provide
such environment that is conductive, leads to corruption. In the same way, regulations invite economic agents to find ways, including bribing public officials, to secure favourable interpretations. Also exchange and trade restrictions tend to breed informal, frequently corrupt channels for a market-induced transaction. In this sense, statements that link corruption to economic performance are essentially statements about the link between structural/policy distortions and economic performance. There are various methods for combating corruption. On one hand they are similar, but on the other they have some national differences, due to cultural traditions. “Combating corruption is like judo. Instead of bluntly resisting the criminal forces, one must redirect the enemy’s energy to his own decay” (Lambsdorff & Nell 2006). Recent studies have shown that the size of government remains high and the scope of government activities has not necessarily become appropriate. (Gupta et al. 2003).

Poor governance has hampered economic growth, development of private sector economic activity, and the reduction of social equity and poverty. Why so much attention is being focused on corruption? Is it because of the fact that nowadays there are more corruption cases than it was in past? Is it therefore that of the fact that previously this phenomenon was somehow ignored? Thus, sustainable solutions are required for an institutional approach to combating corruption. It means not only blaming on individuals but also reforming government agencies and reducing opportunities for illegal behavior.

**Research of the International Organizations combating corruption**

The struggle against corruption is very actually in all countries and at the same on the international level. The U.S. Agency for International Development (USAID) is one of the most important and prime government agents in the efforts to combat with corruption in the international business (Atwood, 1998). Various international institutions (World Trade Organization (WTO), the World Bank, the International Monetary Fund (IMF) and others) are also playing very important role in the struggle process against corruption. Some of the most significant studies on corruption are collected in the IMF various publications. As it was mentioned already corruption is an outcome – a reflection of a country’s legal, economic, cultural and political institutions. Corruption can be a response to either beneficial or harmful rules.

There are several of the major international organizations in economic and political sphere, which work in order to fight corruption. The United Nations’ General Assembly took steps already in 1996 to combat corruption. Member states dedicated themselves to carry out measures to combat various forms of corruption in international business transactions. It encourages international business communities to fight actively corruption. Among the most distinction organizations, that work against corruption is Transparency International (TI). It has influenced public perception and its corruption perception index, rating countries has received much publicity. Transparency International (TI) has ranked 163 countries by Corruption Perceptions Index (CPI) in 2006 and 180 countries in 2008. CPI is a composite index. Because the index is based on polls, the final results are subjective and at some extend are less reliable for countries with fewer sources. Also there are differences between countries: for example a matter viewed as acceptable tipping in one country may be considered as bribery in another. Therefore the poll results are supposed to be understood very specifically, measuring mostly public perception, rather than presenting an objective measure of corruption. The scores range from 10 (squeaky clean) to 0 (highly corrupt). A score 5.0 is the number TI that considers the borderline figure distinguishing countries, which other have or do not have serious corruption problems. Illustration of this can be seen in the Table 1.

In 2005, Estonia stood at the 27th place among ranked 159 countries by the Transparency International’s CPI (6.4 points) and in 2008 the situation has been improved, the same 27th position, but among 180 countries (6.6 points). Our neighbor country Finland (9.6 points) was ranked as a least corrupt country, the second position in 2005, and in 2008 the position with (9.0 points) has given chance to be at the 5th position. It has worsened position. Russia was on the 126th position in the ranking list by CPI (2.4 points) in 2005 and with last year has dropt this position and became 147th with (2.0 points). The other Baltic countries Lithuania took 44th place (4.8 points) and Latvia 51st place (4.2 points) in 2005 and with last year has dropt this position and became 147th with (2.0 points). The other Baltic countries Lithuania took 44th place (4.8 points) and Latvia 51st place (4.2 points) in 2005 and with last year has dropt this position and became 147th with (2.0 points). The other Baltic countries Lithuania took 44th place (4.8 points) and Latvia 51st place (4.2 points) in 2005 and with last year has dropt this position and became 147th with (2.0 points).
Empirical Results of Surveys, 2004-2008

In the next section, are presented some results of special interview studies, which questionnaire was similar to Borner (Borner et al. 1995). The main areas of the questionnaire were: Government Agencies’ Behavior; Law Making Procedures; Law Enforcement Mechanism and Uncertainties in Government Agencies’ Behavior, Law Making Procedures, and Law Enforcement. Entrepreneurs and managers from Estonia and other neighbor countries, Finland, Sweden, and Russia were respondents. Interviews were undertaken in 2004, 2006, and 2008. This study was a logical continuation of the sample surveys undertaken in 1994-1999 in order to study the development of the economic environment in Estonia more widely (Vensel & Wihlborg, 2001). The sample general characteristics, variables characterizing the behavior of the government agencies, of law making procedures, and of law enforcement mechanism are presented and discussed.

Respondents were occupied in various industries: manufacturing industries; trade, communication, transport and other productive industries. Their firms were located mostly in big towns (65%). Respondents represent different business professions (mainly top-managers in all countries about 52 %). Respondents in all countries were mostly participants of training courses for managers. In Russia the respondents were from Moscow, St. Petersburg and Kaliningrad.

There were three main blocks in the questionnaire: Government Agencies Behavior; Law Making Procedure Enforcement Mechanism and in each block there were several questions (See Appendix 1).

Five questions were given to evaluate government agencies’ or civil servants’ behavior, and five variables were formulated on the basis of these questions. Questions were similar to (Borner et al. 1995). Respondents evaluated questions in six-point scale. Some comments to all variables characterizing government agencies behavior are as the follows. Common remark to the answers of the respondents: not many changes were happening between 2004 and 2006. Almost all the results are the same stable. But the comparison with the 2008 gives some differences with 2004.

Civil Servants’ Willfulness: This variable is a result of the question: “Please evaluate the following quotation for your country: “Laws and regulations are so complicated, unclear and sometimes even contradictory that it is impossible to adhere to them on a regular basis. Therefore, civil servants can always find ways and means to give you a hard time (long delays, arbitrary decisions etc.).” This happens: never (1), rarely (2), sometimes (3), frequently (4), mostly (5), or always (6).” The similar answers were used for the other blocks of the questions.

Respondents evaluated civil servants willfulness as quite frequent phenomenon in Estonia and in Russia, but as rarely happening both in Finland and Sweden. It can be mentioned a little decline (improvement of the business environment) in Russia (average grade 3.90, given by Russian respondents in 2004, and 4.07 in 2008), and about the same level of civil servants’ willfulness in Estonia in 2004 and in 2008, average grade 3.88 and 3.58. Some improvements in this area have taken place. Finnish and Swedish respondents evaluations were quite similar in the observed years, 2004, 2006, and 2008. It can be concluded that civil servants’ willfulness is still a serious problem in Estonian society. Due to the results of the interviews it is indeed, also in Russian society.
Will to Resist and Fight Back: This variable was formulated on the basis of the question: “Assume that you are confronted with clearly unfair procedures or outright demands for bribes by a civil servant. Would you try to resist and fight back either by appealing to his superior, or to an administrative court?” There are the same possible answers as for the previous question.

The resistance and fighting back and possibilities were evaluated by respondents quite highly in Finland and in Sweden, less in Russia and in Estonia (in general, as frequent phenomenon). We may conclude that the will to resist and fight back in the case of civil servants’ willfulness is not very high in Estonia. Nevertheless in both countries (Estonia and Russia) the attitude of the businesspeople towards this phenomenon is changing. It seems that respondents have started to understand, that resistance makes sense.

Civil Servants’ Power: This variable was formulated from the question: “As an entrepreneur you are always afraid of committing a small “error” here and there in the eyes of regulatory bodies because these “errors” can be (ab)used by civil servants to gain a position of power and construct a case to blackmail you.”

The possibility of the answers was the same as for the previous question. Possibilities to gain a position of power by civil servants are evaluated by respondents as frequently happening event in Russia and in Estonia (average grades respectively 3.53 and 3.48 points in 2008), and as sometimes happening in Finland and Sweden (average grades 1.75 and 1.58 points in 2008). It is interesting that respondents evaluated civil servants willfulness as more relevant problem in comparison with possibilities to gain a position of power. In any case, civil servants power problems (for example “blackmailing” cases) are relevant both in Estonian and Russian society.

Knowing the Civil Servants - Influencing his Decision: This variable was based on the question: “If you know the civil servant you have to deal with personally, can this influence his decision (for example, amount of taxes, issuing a business license etc.)?” There are the same answers as for the previous question.

It is interesting to mention that this phenomenon is even more relevant in Estonia (due to the small society, where about all players are knowing each other). Russian and Estonian respondents evaluated that knowing the civil servant personally will speed up the procedure very frequently - average estimates respectively 4.57 and 4.31 in 2004 and very close results can be seen in 2008. This is just sometimes happening in Finland and in Sweden. Fact, that knowing the civil servant personally will speed up different procedures of economic agents, is very dangerous especially in a small society and this generate basis for widespread corruption cases.

Knowing the Civil Servants - Speeding Up the Procedure: The next two variables are connected with the cases when economic agent knows the civil servant personally. Variable “Speeding up the Procedure” is formulated on the basis of the question: “If you know the civil servant you have to deal with personally, can these speed up the procedure? Knowing the civil servant personally will speed up the procedure” There are the same answers as for the previous question.

It is also quite interesting that knowing the civil servant will speed up the concrete procedure very frequently, but this will influence the decision of the civil servant not so frequently – especially in Estonia. This phenomenon was evaluated by respondents as happening also frequently in Russia and in Estonia (average estimates respectively 4.19 and 3.57 in 2004), but not in Finland and in Sweden. Remarkable to mention, that the results from the 2008 have shown that in both countries, especially in Estonia this phenomenon is reducing. In any case we may argue that knowing civil servants personally will distort their decisions, will speed up needed procedures and sometimes also influencing civil servants’ decision.

It can be concluded, that Estonia is situated (by evaluated civil servants’ behavior characteristics) quite clearly between Russia and its Western neighbors, but at the same time nearer to Russian estimates. The same quite clear differences are between other characteristics of government agencies behavior.

Law Making Procedures. There were four variables characterizing law-making procedures. Unexpected Changes in Law: This variable is a result of the question: “As an entrepreneur, do you regularly have to cope with unexpected changes in laws and/or policies which could seriously affect your business?” Changes in laws and/or economic policies were evaluated by respondents in all countries as sometimes unpredictable - average estimates 2.69 points in Russia, 3.00 points in Estonia, 2.33 points in Finland, and 2.57 points in Sweden in 2004). In general, entrepreneurs have to cope with unexpected changes in laws and policies in countries, which could affect their business. Although the results of 2008 show that in all countries there is a positive tendency. In Estonia the result is 3.65 and for the other countries: Russia - 3.0 points, Finland and Sweden 4.5 and 4.65 points respectively.

Information Availability: This variable is formulated on the basis of the question: “As an entrepreneur, are you officially or unofficially informed (through mass media, business associations etc.) about new laws and/or plans to change existing laws or policies?” Information availability problem was evaluated by
respondents as sometimes happening phenomenon in Russia and in Estonia (average estimates respectively 3.24 and 3.45 in Estonia in 2004), but as mostly happening phenomenon in Finland and in Sweden. The answers of managers and entrepreneurs in Estonia and in Russia have shown that the situation is being improved about new laws or plans to change existing laws and policies, especially in the case of Russia.

Possibilities to Consult: This variable is a result of the question: “In case of important legal changes affecting your business, can you voice your concerns indirectly and/or are you directly consulted?” There are the same answers as for the previous question.

Estonian and Russian respondents were on the opinion that the possibilities to voice their concerns indirectly or directly are quite small. And so, in general there is nothing to do in the case of important legal changes affecting the business. Finnish and Swedish respondents evaluated their possibilities to consult much more higher – average estimates respectively 4.2 and 4.85 points in 2008.

Government’s Announcements Credibility: The basis for this variable was the question: “Do you expect the government to stick to announced major policies (e.g. new tax law, infrastructure projects, budget goals and priorities, protection of domestic producers etc.)?” There are the same answers as for the previous question.

The government announcements’ credibility was evaluated by Estonian and Russian respondents as sometimes (or even rarely) happening phenomenon. We may argue that government announcements’ credibility is quite low, but some improvements can be seen also in this area. Finnish and Swedish respondents traditionally evaluated government announcements’ credibility very highly, as mostly happening phenomenon – average estimates respectively 5.17 and 5.48 points in 2008.

Law Enforcement Mechanism. All variables are connected with the court objectivity and credibility problems.

Objectivity of Courts: This variable is formulated on the basis of the question: “Imagine a private conflict is brought into court with the evidence being very clearly in your favor. Do you have confidence that the assigned judge will enforce the law objectively? Courts can be trusted to enforce the law objectively according to transparent rules”. On the bases of the results, it can be conclude that in most cases courts are trusted, mostly in Finland and Sweden, and also in Estonia. But in Russian case still economic agents have to use self-enforcement mechanisms in the case of disputes.

Power of Money on the Decisions: This variable is formulated on the basis of the question: “Please consider the following quotation for Estonia: “The party who pays more (e.g. bribes or better lawyers) will win the case. Even if the evidence is clear, money can change the result.” There are the same answers as for the previous question.

Respondents evaluated this case as sometimes happening in Estonia and in Russia. Finnish and Swedish respondents evaluated that this will happen very rarely. It can be argued that money plays quite important role in court cases both in Estonia and in Russia. It must be added that this is also widespread public opinion.

Knowing the Judge Personally: The basis for formulation this variable was the question: “Is it irrelevant which individual judge decides on a case? Is it advantageous to know the assigned judge? If you know the assigned judge personally, this will influence the procedure and result.” There are the same answers as for the previous question.

Estonian and Russian respondents were on the opinion that knowing the assigned judge personally will in general sometimes influence the court procedure and result. We may conclude that personal relationships may play an important role in court cases, both in Russia and in Estonia. It must be added that this is also widespread public opinion.

Turning to the Higher Court: This variable was formulated on the basis of the question: “If you were treated unfairly in court (i.e. because of bribery demands or a decision you do not deem “correct”), would you fight this by going to a higher court?” Respondents in all observed countries evaluated the will to fight with unfair court decisions as frequently happening in Estonia and in Russia or as mostly happening in Finland and in Sweden. The respondents are rather optimistic and will appeal in the case of unfair court decisions to a higher court. There are a notable number of cases appealing to a higher court in Estonia, and sometimes these were successful. The general conclusion on the basis of a comparative analysis is exactly the same: There are still some significant differences between Russia and Nordic countries, and Estonia lies between them.
Conclusions

Nowadays the world’s economies become more globalize and domestic economies become more integrated, rising business crime rates in various regions are no longer a local problem. Thus, crime needs to be combated simultaneously on both the national and international level.

Continuous economic reform aimed at reducing policy distortions and strengthening economic institutions are bound to reduce the opportunities for corruption, while progress in establishing an effective administrative and legal system and in creating a more open society is likely to facilitate detection of corruption behavior and raise the cost to those who may be engaged in it. Thus, anticorruption strategies are related to the reform process-taking place in government institutions.

It can be pointed out that fight against corruption is often connected with the process of reforms. Therefore corruption will decrease only in those countries where governments are willing to substantially reduce some of their functions. Corruption still remains one of the main obstacles to sustainable development. And it leads to loss of public funds needed for improvement of social sphere (education, healthcare and etc.) in developing countries and less extends in developed countries. In many countries lack of transparency of laws, and rules creates a fruitful ground for corruption.

The problem is how to find an optimal trade off between the costs of disorder and those of dictatorship via institutions building. At the same time policymakers face a dilemma: privatization by sale to ineffective owners versus continue state ownership.

Empirical results of studies have been shown a strong impact of improved policies on economic growth and on the desire to invest in the country. On the basis of the empirical study, the main conclusions are: civil servants can frequently find ways and means to give entrepreneurs and managers a hard time, and sometimes they are able to gain a position of power and to construct a case to blackmail entrepreneurs and managers; knowing the civil servant personally will mostly speed up needed procedures, and sometimes this will influence the decisions of civil servants - this phenomenon is dangerous especially in a small society and this generate basis for corruption; entrepreneurs and managers have to cope quite frequently with unexpected changes in laws and government economic policies, which could seriously affect their business decisions; the situation with information about new laws and plans to change existing laws and policies has been improved, but still quite small for entrepreneurs and managers remain possibilities to voice their concerns indirectly or directly, especially in Russian case; money power on the court decisions still plays an important role in the court cases, knowing the judge personally could influence the court procedures and outcomes also quite frequently; Estonian and Russian entrepreneurs and managers are quite optimistic and they will to fight with unfair court decisions, and in most cases they will to turn to a higher level court; uncertainties in dealing with government agencies, uncertainties in law making rules, and uncertainties in law enforcement mechanisms are not improved during the last five years and mostly these uncertainties remained about the same level.

Concerning the Russian case recent studies have shown that public sector corruption is the most severe impediment to development and growth processes. Also studies demonstrated empirically that courts are often unreliable and inefficient. Basic corporate governance principles were violated in privatized firms with attempts to expropriate minority or even majority shareholders, but courts were not able to penalize such efforts. An institutional environment that encourages creativity and experimentation is the ultimate determinant of economic growth and renewal.

References

### Appendix 1.

#### Table 2. Estimates of Government Agencies Behaviour, Law Making Procedures, and Law Enforcement Mechanism in Different Countries

<table>
<thead>
<tr>
<th>Questions</th>
<th>Estonia</th>
<th>Russia-total</th>
<th>Finland</th>
<th>Sweden</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Government Agencies Behaviour</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. Civil servants’ wilfulness</td>
<td>3.88 3.65 3.58</td>
<td>3.90 3.97 4.07</td>
<td>2.07 2.05 2.06</td>
<td>2.31 2.28 2.30</td>
</tr>
<tr>
<td>2. Will to resist, fight back</td>
<td>3.19 3.50 3.60</td>
<td>3.23 3.35 3.46</td>
<td>4.12 4.25 4.30</td>
<td>4.69 4.78 4.82</td>
</tr>
<tr>
<td>3. Civil servants’ power</td>
<td>3.12 3.14 3.48</td>
<td>3.16 3.27 3.53</td>
<td>1.92 1.92 1.75</td>
<td>1.98 1.99 1.58</td>
</tr>
<tr>
<td>4. Knowing the civil servants – speeding up the procedure</td>
<td>4.31 4.50 4.48</td>
<td>4.57 4.38 4.50</td>
<td>2.72 2.70 2.69</td>
<td>2.37 2.32 2.30</td>
</tr>
<tr>
<td>5. Knowing the civil servants – influencing his decision</td>
<td>3.57 3.65 3.48</td>
<td>4.19 3.97 3.85</td>
<td>2.12 2.05 2.00</td>
<td>1.97 2.28 1.99</td>
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<tr>
<td><strong>Law Making Procedure</strong></td>
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<td></td>
</tr>
<tr>
<td>1. Unexpected changes in law</td>
<td>3.00 3.40 3.65</td>
<td>2.69 2.90 3.00</td>
<td>2.33 3.01 4.50</td>
<td>2.57 3.33 4.65</td>
</tr>
<tr>
<td>2. Information availability</td>
<td>3.45 4.50 4.85</td>
<td>3.24 4.00 4.50</td>
<td>4.88 4.88 4.90</td>
<td>5.02 5.02 5.25</td>
</tr>
<tr>
<td>3. Possibilities to consult</td>
<td>2.24 2.24 2.30</td>
<td>1.95 2.03 2.00</td>
<td>4.09 4.12 4.20</td>
<td>4.29 4.35 4.85</td>
</tr>
<tr>
<td>4. Government’s announcements credibility</td>
<td>2.60 2.65 2.67</td>
<td>2.06 2.08 2.1</td>
<td>5.15 5.17 5.17</td>
<td>4.91 4.98 5.48</td>
</tr>
<tr>
<td><strong>Enforcement Mechanism</strong></td>
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<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. Objectivity of courts</td>
<td>3.26 3.85 4.00</td>
<td>4.10 4.15 3.85</td>
<td>5.44 5.40 5.50</td>
<td>5.25 5.28 5.45</td>
</tr>
<tr>
<td>2. Power of money on the decisions</td>
<td>3.41 3.41 3.25</td>
<td>3.48 3.48 3.55</td>
<td>1.76 1.70 1.50</td>
<td>1.63 1.65 1.45</td>
</tr>
<tr>
<td>3. Knowing the judge personally</td>
<td>2.76 2.70 2.99</td>
<td>3.08 3.10 3.45</td>
<td>2.01 2.01 1.85</td>
<td>1.78 1.78 1.60</td>
</tr>
<tr>
<td>4. Turning to a higher court</td>
<td>4.31 4.35 4.50</td>
<td>4.26 4.35 4.45</td>
<td>4.95 5.05 5.54</td>
<td>5.28 5.42 5.68</td>
</tr>
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*Source: On the bases of the results of special interview studies*