

Spontaneous Entrepreneurship Versus the Insider “Privatization” of State-Owned Enterprises

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1/ The Entrepreneurship under Communism

The failures of the communists’ economic management throughout Central and Eastern Europe resulted in a domino of political collapses unparalleled in human history. These coups, achieved so easily, were named “velvet revolutions”. Some political speculators even question whether the dismantling of communism was a genuine demise and rather an attempt at retrenchment by the communist masterminds. A massive apparatchik involvement in the privatisation in practically all transition countries suggests that more scrutiny of the process of new entrepreneurship in these countries deserves attention. Where could entrepreneurship in transition countries come from?

Before going into more detail let us start with an old joke as an outline – a joke that circulated in various national forums from Eastern Berlin to Vladivostok throughout 1970s and 1980s.

Six miracles of communism:

1/ All are employed – but no one works.

2/ No one works – but the output target is always fulfilled.

3/ Output target is always fulfilled – but there is nothing in the shops.

4/ There is nothing in the shops – but the people have everything.

5/ People have everything – but they all swear at the regime.

6/ All swear at the regime – but in elections they all vote for the communists.

There may be a lot of exaggeration in this joke but its anecdotal wisdom also reveals that practicing the communism required a great deal of entrepreneurship for each “miracle”. But what kind of entrepreneurship could it be? Baumol, 1990, provides the best clue when he stressed that human entrepreneurial activities were omnipresent and could never be destroyed. The problem is in which alternative economic fields – productive, redistributive or destructive – and under what conditions the entrepreneurship is allocated in the given period. Baumol’s classification also allows distinguishing between the Marshallian-Schumpeterian productive entrepreneurship and its other orientations. The crucial role is then played by economic incentives and market institutions, which should be fine-tuned in order to enhance productive entrepreneurship and to divert it from redistributive, predatory or destructive ventures. Therefore, however bizarre the organisation of communist economies, some entrepreneurship even found its way there. We can distinguish its two roots: the capitalist and the socialist (communist) one.

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The Central European and the Baltic countries, but to a lesser extent the other countries of the Soviet Empire, could still rely on the cultural principles that characterised their societies two or three generations ago. The legacy of capitalism and the memory of self-reliance were most useful in situations when the workers had to forage moonlight and barter things for livelihood. At the same time the mechanism of career building under communism was such that only a fraction of the productive human capital, such as the technical skill, was necessary for a job at the nomenklatura level. So the entrepreneurial outsiders could satisfy their natural urge either in retail trafficking or in do-it-yourself household or fraternity tie-ups, such as house or car repairs, sports, arts, holidays, underground political dissent, etc. Their entrepreneurial skills were to a large extent frittered away by high transaction costs on the exchange side. Nevertheless, it was a valuable entrepreneurial training that could be most useful whenever small business practices would be liberalised. The legacy of capitalist entrepreneurship in communist countries was therefore spread asymmetrically throughout the social structure.

The legacy of socialist entrepreneurship was of different stock. It concerned the party bureaucrats who had to invent the most bizarre tricks in order to push through the unviable system of blind central command to achieve at least some sort of performance. If it were not for the common good, they would do it at least for their own “residual **claimancy**” to be **satisfied**. The Brezhnev style of corporate management introduced in early 1970s could not avoid innovation or flexibility, whatever absurd were both in their processes and outcomes. As an option, the management of enterprises could either take an inward orientation towards innovation and efficiency ² or an outward orientation towards negotiations with the vertically superior bureaucracies. In the latter case the objective was to bargain for a softer plan for output or a higher quota on inputs.

With the widening possibilities for the official (and unofficial) accumulation of wealth, the socialist millionaires cropped up everywhere since the 1970s. If an apparatchik fulfilled the plan target and showed sufficient loyalty to the superiors, he/she received a free hand to exercise power over resources, staff policy and bonus remuneration in the economic unit belonging to his/her respective rank in the hierarchy. On the equal horizontal level of bureaucratic subordination the apparatchik manager had powers to collude with other "partners" in order to form cartels, information asymmetries and political coalitions, which liquidated potential interference in the production, distribution or planning processes. In their relation to various superiors (on the level of state planning, district council supervision or party subordination) bureaucrats had a wide range of alternatives for negotiations and vertical collusions in order to strengthen their strategic standing.

The resulting socio-political antagonism caused by the different relationship to entrepreneurship can be identified with three social groups. Based on the study of Benacek, 1994, we will call them "marketeers", "nomenklatura" and “outsiders”. The following approximate list of activities can be made in order to distinguish between them:

(i) Marketeers: private farmers, repair workers, artisans, tradesmen; catering and hotel staff, cab drivers, foreign exchange touts, greengrocers, used car dealers; shop managers, shop assistants, stock keepers; popular entertainers, artists, top sportsmen; administrators of queues, bureaucrats issuing licences, certificates and permits; ringleaders of organized crime.

² Given the known lack of microeconomic fundamentals, as it came clear from the Hayek versus Lange-Lerner controversy, the management of efficiency could rely on some rudimentary principles only, such as the minimisation of queues, inputs of material and energy or imitation of products and processes used in market economies (Kornai, 1980).

(ii) Nomenklatura: directors of companies, their deputies, heads of divisions or financially independent units, paid party apparatchiks, high-ranking bureaucrats at ministries, district and municipal councils.

(iii) Outsiders: people with low entrepreneurial aspirations active in the do-it-yourself activities; but also there were people with high morals and/or human capital, such as doctors, engineers, computer whiz kids or scientists whose entrepreneurial skills could not be used under the communist system.

As an illustration of the size of such groups, we can use the data from the Czech survey of 1992. The pre-transition society in Czechoslovakia could be intuitively structured as 10-15% belonging to group (i), 4-8% to group (ii) and 77-86% remaining in group (iii). This had an impact on how the economy was split into the state, the private and the shadow sectors. Their sizes differed by countries. According to Janacek, 2000, the share of private sector on GDP in 1989 was 1.5% in Czechoslovakia, 8.5% in Eastern Germany, 14% in Hungary and 26% in Poland (mainly due to private farming). However, what mattered for the potential of entrepreneurship were the extents of the shadow economy and autonomous managerial activities of nomenklatura. Although they can be hardly quantified, their presence and the crucial importance for the communist economies are undeniable. When the window-dressing of central planning and hierarchical subordination finally lost the institutional support in 1990, the enterprises and the economy hardly recognised any change at the beginning: the "shadow management systems" were already in control and ready for transition (Benacek, 1994 and 1995). However, the transition was tougher and different in its contents than anyone of them presumed.

2/ Entrepreneurship in the Early Stages of Transition

It follows that it was the apparatchik management of the state monopolies and not the central planners who were in control of the official parts of the economy and who even gained more when Gorbachev's "glasnost" undermined the instruments of totalitarian coercion. Such national systems were ready for transition, once a strong external shock cracked the institutional braces in merely one country. There was a risk and uncertainty in individual cases but under the premise of a "velvet revolution" the nomenklatura could not expect to lose much as a group. A similar situation rested with the marketeers: they expected a better deal once their activity were liberalised. The Outsiders group seemed to gain the least in immediate entrepreneurial advantages and their gains from the transition were originally associated with higher consumer choice and the introduction of democracy.

As the 15 years of transition later revealed, the small-scale entrepreneurial gains were favourable for the outsiders. In the long run they used their human capital, organisational skills and endurance for the majority of gains in the small businesses and self-employment. For example, in the Czech case 18% of all employees were registered as self-employed businesses by 1994. In 2003 that number increased to 28%³. These figures show a very high degree of entrepreneurial organisation in an international comparison. Also in other Central European and Baltic countries the rise of self-employed among the former outsiders was very high (Selowsky and Mitra et al., 2002) and comparable with the situation in traditional market societies.

³ According to the Czech Statistical Office, Annual Yearbook, 1996 and 2004.

The transition hit harshly the private sector that was already established under socialism. As pointed out by Winiecki, 2000, and Winiecki et al., 2004, the emergence of new business opportunities after 1989 caused bankruptcies not only among the state firms but also among the old private businesses. The reliance on the shortage economy, the lack of discipline and entrepreneurial vision and the failure in restructuring caused shrinkage of the old private sector by 40-75%, while at the same time the new the start-ups coming from the group of “outsiders” contested the markets. We can therefore come with a general hypothesis that the group of socialist “marketers” did not prove to have sufficient skills for an easy transition to the ranks of new entrepreneurs. The reason was a dramatic change in incentives and in the environment of businesses after the fall of the iron curtain. The incentives under communism induced the marketers to profit from the excess demand, black market prices and corrupt state bureaucracy; not a useful experience for functioning markets.

The most surprising was the transition of the nomenklatura to the ranks of entrepreneurs in enterprises with hired employees. In the Czech case, as in practically all post-communist countries of Europe and Asia, their betting on an easy deflection after the velvet revolutions proved correct. So it was at least in the early stages of transition. Benacek, 1994, p.20-22, estimated the social structure of successful entrepreneurial transition in 1992. Nearly 16% of all nomenklatura succeeded in becoming owners of firms with employees. In the top ranks the transition rate was 29%. It implied that practically all the departures (forced or voluntary) of top nomenklatura from the state employment must have been directed to some sort of private businesses! The importance of insider domination in former state-owned firms was present in all transition countries (Djankov, 1999).

The Czech data also suggests that 73% of new entrepreneurs who were not self-employed were not associated with the nomenklatura because 44% came from the lower ranks of the communist bureaucracy and 29% came from the ranks of “outsiders”. This latter figure is highly disappointing. It demonstrates that only 0.8% of the outsiders managed to overcome the border of self-employment. This phenomenon can be explained only by presuming that there must have been other barriers (except managerial incompetence) precluding the outsiders from entrepreneurial entry after 1989: lack of wealth, lack of appropriate access to public property and lack of pull from the bureaucracy or the crony network. For the nomenklatura the situation was the opposite.

3/ The Explanation of the Selection Bias

The notion of “order” is one of the pivotal concepts in explaining the social development and organisation. According to Hayek, 1973, it was in the tradition of German philosophy to distinguish between the natural fundamentals, i.e. the intrinsic real contents of human aims and development that he called “Cosmos”, and the man-contrived infrastructure of the spontaneous order called “Taxis”, which reflects the aims (i.e. the interests) of specific social groups. Hayek claims that it is impossible to introduce a new viable order by force – by simply manipulating Taxis, irrespective of the state of Cosmos.

We can use Hayek’s reasoning and argue that the collapse of communism was a natural process of correction at the level of Cosmos because the communist organisation was an attempt at social engineering that brought the centrally planned societies to a universal economic breakdown. But that required an introduction of economic liberties, including the enforcement of property rights (as legal norms) and an opening-up of speedy privatisation (as an open auction), that both belonged to Taxis. However, the body of Taxis, as the pivotal

instrument of the communist social organisation, could not be changed as quickly as the speed of privatisation would require.

Thus privatisation could not avoid being caught in the vicious circle of the impossible: introducing new Taxis before having new Cosmos and developing new Cosmos before having new Taxis. Based on the mentioned typology of Hayek, the clashes between these two intertwined conditions for a balanced development, as seen at various angles of observation, are indicated in Table 1.

Table 1: The typology of the notion of „social order“ and their contradicting duality

COSMOS	TAXIS
Exogenously given as spontaneous	Endogenously given as man-contrived
Personal liberty	Economic freedom
Economy	Politics
Technological progress	Organisation of enterprises
Free markets	Hierarchies of governance
Allocation of production factors	Institutions of power and bureaucracy
Informal rules, ethics, behavioural patterns, social capital and personal networks	Formal rules, formal networks, laws and judiciary

The right-hand side of the table is man-contrived and, except for rare revolutionary breakthroughs, dependent on social negotiations and administrative clearing that are subject to a strong influence of inertia. Some observers speak in this context about path-dependency, embeddedness or hysteresis. We cannot say after 16 years of transition, even in the most successful transition countries of Central Europe that all features of the command economy have been eliminated. Their institutions are only gradually catching up with the advances in the development of their markets. In the early stages of transition, let us say in the first five years, the taxis could not but move within the communist legislation, judiciary and formal networks. Privatisation was carried out in this opaque period.

Such a situation offered an environment that facilitated the past elite transiting to new entrenchments of economic power. Privatisation became the main channel for a trade-off between the former political and the new economic powers. In order to find workable analytical concepts, we will use two typologies of the evolution of the private sector: “privatisation from **above**” and “privatisation from **below**”⁴. The former is based on turning existing state-owned enterprises into private hands, which crucially depends on the activism of the government and its hierarchical institutions. The alternative approach to the rise of the private sector leads through the establishment of the authentic (“generic”) private sector by the creation and expansion of “*de novo*” private firms. In the strategy “from below” the mainstream of activism comes from the grass roots of the economy, i.e. at the autonomous level of firms, where it is the entrepreneurial activism of their owners what matters. The difference between the two concepts rests in the difference between the *de iure* and the *de facto* meaning of “privatisation”. The parallels with the Hayekian notions of Cosmos and Taxis are crucial too their distinctiveness.

⁴ This typology was first applied by Gruszecki and Winiecki, 1991, and later used by Benacek, 2001 and Winiecki et al., 2004.

In contrast to the development of private ownership by evolution in the traditional market economies, private ownership in the initial transition period had to be created by a “privatisation shock”- the privatisation from above. There, the initial selection of both the owners and the property privatised was subject to an “acquisition bias” that depended on how selection techniques departed from the criteria of perfect market bidding that included free competition and access to information. For example, the administrative methods of privatization had the following structure in the case of Czechia (computed from the value of all productive assets held by the State in 1989):

- a/ retail auctions (0.7%), public tenders (1.3%), voucher privatisation by individuals (12%), restitution (11%), transfers to cooperatives (8%);
- b/ voucher privatisation by investment funds (27%), transfer to municipalities (18%), direct sales to pre-determined buyers (4%), liquidation (2%), retained state ownership (16%).

The bias to non-competitive transfers or to methods where insider position was strengthened, such as to privatization techniques concentrated in the group b/, was evident in other countries too, not only in Czechia (Benacek, 2001). On the other hand, privatisation from above is a one shot game subject to information asymmetry and no one could expect that its outcome would result in a sharp improvement of efficiency. For example, the objective of new owners could be acquiring debts and practising asset stripping for mere private consumption.

In addition, it could even be affirmed that the intransparent methods of bureaucratic privatisation strengthened the negative properties as “markets with lemons” (Akerloff, 1970) and the outcome could not escape adverse selection. As argued by Pejovich, 1994, or Loužek, 2005, the main objective of privatisation should be seen in creating the free market for institutions and incentives supporting property rights. Unfortunately, the privatisation in Central and Eastern Europe often failed in succeeding even in that goal because the new entrepreneurial elite found itself in a situation where it was more advantageous to postpone enforcement of property rights and to continue rent-seeking strategies.

As a result, the problems with governance and management at the state enterprise level contaminated also the privatised enterprises. The governments, instead of standing by the policies defending market discipline (e.g. hard budget constraint and debt reimbursement) and market sustainability (e.g. pro-investment climate, transparency of information and competition), over-protected old enterprises, levied high taxes on successful firms, built investment barriers and engaged in anti-competitive practices. We can therefore show in Table 2 how the contradictions inherited from the communist order, as described in Table 1, transformed into a bias in policy-making in the early stages of transition.

Table 2: The bias in policy-making when politics dominate over economics in the privatization stage of transition

ECONOMICS	POLITICS
Independent firms	State authority
Private property	Public property
Incentives /”carrots”/	Fiats /”sticks”/
Wealth creation	Wealth redistribution
Capital accumulation	Capital consumption
Market competition	Regulation

Profits and asset returns	High taxation and subsidies
Free trade	Restrained trade
Hard budget	Soft budget
Creditor-dominance	Debtor-dominance
Low transaction costs	High transaction costs

As administration-driven privatisation “from above” could not succeed in creating effective final owners, a new round (or even several additional rounds) of re-privatisations had to follow. The structure of new “capitalists”, many of who were former apparatchiks, was bound to be only transitory. There were too many agents who lacked incentives or capacities to help their principals in the accumulation of wealth. There were some principals who also lacked both and failed, but there were many others who were not backed by institutions for the defence of their property rights. Granted the conditions that caused adverse selection of the new elite and the external shocks to their stability, the vested interests forced the new entrepreneurial elite to collude with the state bureaucracy in order to retain their position and defend their objectives. Free markets and competition became the most effective instruments for revealing the non-tenability of their status. Thus the policies as a spin-off of privatisation “from above” and its non-authentic entrepreneurs acquired a strong bias towards regulation, restrained trade and soft budget legislation.

Once the early stages of transition were associated with the state-administered privatisation, bureaucratic policy-making, information asymmetry, moral hazard and institutions not in harmony with free markets, the most important capital for becoming an entrepreneur was the social network capital (Sik, 1993, Mateju, 1993). As further analysed by Bezemer, Dulleck, Frijters, 2003, the economic behaviour of entrepreneurs in transition cannot be explained without recourse to the concept of relational capital. Thus we should distinguish between the human capital, as the skill directly associated with market-related efficiency in decision-making, organisation and innovation, and the relational capital, as the skill associated with redistributive coalitions, bureaucracy and state capture that are negatively associated with the efficient functioning of markets.

The relational capital in the time of the fall of communism was highly concentrated in the communist nomenklatura network because hierarchies formed the core of both formal and informal channels of communist governance. The velvet revolutions, which relied on the power of free markets to administer the post-communist “governance clearing”, have not succeeded in dismantling the old relational capital and replacing it by a new network of outsiders. Therefore, it was obvious that the apparatchiks and nomenklatura could retain or even strengthen their initial insider advantage and use it in their favour in the first round of privatisation.

4/ Entrepreneurship in the Later Stages of Transition

We have mentioned in the previous chapters that the transition from socialism to capitalism was impeded by the inability⁵ to dismantle the previous institutional order in a sufficient speed, so that the spontaneous changes in the economy could not be supported by an equally progressing institutional setup. The clash of spontaneous development with its lagging institutional barriers was imminent. Such situation strengthened the comparative advantages of nomenklatura for getting an easier access to the assets privatized by insider bureaucratic methods that deviated from the standards of competitive bidding under perfect information. As argued by Loužek, 2005, installing an ideal environment for transition was practically unachievable and both the governments and the economic agents must have accepted the solution of the second best. There were hardly any tractable alternatives that would guarantee a Pareto-optimal improvement, as there were no alternatives without trade-offs and social clashes. The resulting information uncertainties and asymmetries also limited their ex-ante cost-benefit analyses.

The distribution of new ownership after the first wave of mass privatisation did not satisfy the condition of finding the final and most efficient owners. The obsession with privatisation resulted from the illusion of “windfall gains” led to a social myopia, which overlooked more productive alternatives of *de novo* enterprises, often representing a more creative entrepreneurial achievement. The crucial question of transition then remains: how the society is capable of launching processes after the initial “privatization shock”, which would bring gradually a convergence to an optimal equilibrium in the ownership structure (Pejovich, 2004).

It should be stressed that this is a problem of installing institutions and incentives supporting entrepreneurship and wealth creation. It is not a task of direct government intervention with such processes but an inducement of the behaviour to rely more on markets and competition. What kind of conditions and processes were available that would bring about the task of convergence to a viable alternative? We will speak about five of such critical factors:

- Liberalisation of markets
- Rise of the de-novo sector
- Spontaneous enhancement of competition
- Lowering of transaction costs for contracts
- Rising hard budget constraints.

Liberalisation of markets advanced by introducing new laws that were market-friendly. The process of legislative changes was one of the most resistant to progress practically all transition countries. In this respect the EU accession process played a highly positive role because it forced the accession countries to introduce some of the highly liberal parts of *acquis communautaire*, for example the competition, contestability and free trade policies and the Copenhagen criteria of competitiveness. The judiciary and law enforcement were the

⁵ We should even speak about the impossibility to attain a speedy institutional transition in a democratic environment because the imposition of democracy was generally a process with a higher priority than the introduction of property rights and privatization. It was simply politically unacceptable to postpone democracy and commence with the revamping of the institutions supporting the private property build-up and with the elimination of relational capital that former nomenklatura used for their low-cost transition from the apparatchik “entrepreneurship” to the capitalist one.

critical bottlenecks, which are recovering only very gradually. After 16 years of transition there is still much to be improved.

The rise of the *de novo* sector had two main channels: foreign and domestic. The penetration of foreign direct investors was not uniform in all countries. However, as the countries lagging behind recognised the advantages of FDI, their willingness to adjust laws and institutions to become more market-compatible was increasing. The development of indigenous entrepreneurship concentrated mainly in the small and medium-sized enterprises was as important as the former. In many transition countries the efficiency of this sector was even higher than the efficiency of the former large state-owned enterprises privatised by vouchers or employee or managerial buy-outs. Small and medium-sized enterprises and the FDI firms are also the creators of new jobs, which raised their moral standing in society.

The spontaneous enhancement of competition resulted from the two previous trends. Markets cannot be suppressed by government interference once the flow of information concerning opportunities is available, and the enterprise sector is subject to free entry. It was of high importance that the competition from domestic *de novo* firms and enterprises from abroad were not be eliminated by laws from entering the non-tradable sectors that were originally state monopolies (e.g. telecommunications, energy, transport, banking).

The lowering of transaction costs for contracts and for the transfer of ownership is best explained by the Coase theorem. Once the transaction costs of negotiations about property rights are decreasing, what was achieved by improved laws, judiciary and information flows, the role of negotiations about the compensation for negative externalities and the opportunity costs of the asset ownership gain on importance. The lowering of risks, uncertainties and the higher transparency of accounting and debt disbursement allowed an easier cost-benefit analysis, which speeded up the transfer of property to more efficient owners.

The rising hard budget constraints, caused mainly by improved banking, capital markets and the enforcement of property rights, replaced many negative externals of dysfunctional institutions by new positive externals, especially by changing the incentives and objectives. The availability of stocks of assets that could be stripped of their value was also sharply decreasing because such assets depreciated to even negative net worth, once the markets revealed the price of opportunities. The wave of bankruptcies, especially in the banking sector and former state-owned enterprises, diminished the strength of vested interests lobbying previously for incentives and institutions that were not market-compatible. Time was gradually moving the pendulum towards reforms favouring the economics column of Table 2.

Given the development of the environment that followed the market requirements, the Central European and the Baltic countries (CEBCs) have turned gradually from laggards in growth to Europe's dynamic economies. Their catching-up with the level of less wealthy countries of the EU-15 is undisputable. Countries like Estonia or Slovakia became leaders in reforms in the EU-25 and the liberalisation of their economies brings a pressure for reforms to be implemented in other CEBCs or even in the leading countries of the EU-15. Even though there are still many impediments to free markets pending the dismantling or institutional changes to be introduced for liberalisation of markets in CEBCs, the indices of economic freedom have been improving recently. A marked progress can be observed in the efficiency of capital markets. Thus their previously hidden extra-market transactions lost the feature of information asymmetry, which raised the efficiency of capital assets substantially.

The role of the nomenklatura among entrepreneurs has been steadily declining since the end of the first wave of privatisation in CEBCs. The subsequent waves of secondary re-privatisations and bankruptcies favoured the young elite without any links to former communist networks. The importance of relational capital in entrepreneurship has been losing ground by being crowded out by the human capital.

Inefficiency dropped almost completely from the privatised enterprise sector. At present the main burden of dead-weight losses is concentrated in the expenditure side of the state budgets. Their inefficient allocation to insufficiently restructured public services (defence, police, education, health care and public administration), whose functioning is in conflict with the market behaviour, is a burden that constraints directly the growth in approximately one quarter of the economy⁶. It is in the expenditure side of state finance where introducing entrepreneurial techniques of management could bring radical gains in efficiency. On the other hand, the indirect inefficiency in public finance is due to excessive taxation and excessive social and health insurance premiums. The potential gains in competitiveness of enterprises, from the revenue side of the budget, are also substantial and the recent radical fiscal reforms in some CEBCs will have to be followed by others.

Regulation, as the legacy of communist management, is a problem that impedes the spontaneous entrepreneurship throughout CEBCs. What matters in the formal rules is the relative regulation vis-à-vis the trading partners. Here the level of official explicit regulation became compatible with the EU-15 countries because of the acquisition of *acquis communautaire*. The implicit (hidden, informal) regulation represents a more serious impediment to entrepreneurship. Corruption, rent-seeking of bureaucrats and the residuals of ethics originating from the communist past (e.g. the resignation of individuals on self-reliance and initiative) could drive the entrepreneurs to behavioural patterns, which hit the long-run competitiveness of the country. Its speed of development may thus get constrained as the entrepreneurs respond to such negative incentives.

We can conclude by pointing to the recent empirical evidence about growth. According to growth statistics, the advances in the healthy market-based sectors of the economies in CEBCs more than compensated for the under-performing sectors in the domain of public finance, whose entrepreneurs have not followed the incentives for restructuring. Such a tendency for hiding behind the second best (or even third best) strategies is spread in all bureaucracies. What matters is the trend. Here the recent reforms and the rising institutional competition among the CEBCs suggests that they are aware which track favours accelerated development. This is due to a growing importance markets have in decision-making, whose dominant agents are the authentic entrepreneurs. Much less can be ascribed to the government, the entrepreneurship of which has been unable to adjust to open market competition requirements.

⁶ There should be considered an even more sophisticated explanation of the inefficiency in the public sector: as the accounting for the value of government expenditure is based on the cost mark-up and on the quantity of „services“ rendered, the official contribution of this sector to growth can be quite high. The problem is in the dissociation of expenditures from its utility. While the government can allocate a rising amount of funds to the public sector (e.g. due to rising indebtedness or proceeds from privatization), there is no guarantee that also the utility to consumers will rise accordingly. High level of corruption in the government sector in the CEBCs and populist expenditures aimed at bribing the voters backfire and undermine the competitiveness in the private sector. They can even decrease the social utility of the total aggregate demand by means of opting for policies with high opportunity costs. Unfortunately the GDP accounting is not the best instrument for estimating such adverse spillovers of the public finance.

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