

ECONOMIC FREEDOM AND BUREAUCRACY: ROMANIA VERSUS BULGARIA

In this article, we critically analyze some recent attempts to assess the degree of economic freedom that countries around the world enjoy. The devised indices measure the consistency of a nation's policies and institutions with economic freedom. Although there seems to be a consensus among economists that in those countries where economic freedom is maintained economic growth follows, this hypothesis has yet to be empirically proven. The problem of bureaucratic decision-making, as a mechanism that may interfere with the economic freedom is also discussed. We then study the case of two quasi-similar, neighboring countries embarked on European integration, namely Romania and Bulgaria.

JEL: B25; D73; H83

Economic Freedom as a Device: the Freest Countries in the World are the Most Prosperous

One of the most constant questions in economics is what causes economies to grow. The title of Adam Smith's well-known treatise, 'An Inquiry into the Nature and Causes of the Wealth of Nations', published in 1776, evidently shows that the causes of prosperity were Smith's primary concern. He concluded that free markets, the protection of private property rights, and a minimal government presence in the economy lead to prosperity. In other words, economic freedom leads to economic growth.

In older models of economic growth, physical resources were all. In these formulations, output flowed from combinations of various inputs (land, labor, capital). In principle, then, it seemed logical to conclude that faster growth would result from infusions of additional inputs (chiefly capital) or better use of existing inputs (often thought to require centralized economic planning). In practice, however, such prescriptions often have been disastrous for less developed countries.

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Most recently, a few economists interested in economic growth have returned to ancient principles. They have focused on the nature of institutions and on the structure of rules and norms that constrain economic behavior as a way of understanding the development process. And they have rediscovered Smith's old insight that economic liberty is a crucial precondition for sustained, vigorous economic growth.

The main elements of economic freedom are personal choice, voluntary exchange, freedom to compete, and protection of person and property. Institutions and policies are consistent with economic freedom when they provide a framework for voluntary exchange. Legal and monetary arrangements are particularly important. Economic freedom also requires governments to refrain from actions that interfere with personal choice, voluntary exchange, and the freedom to enter and compete in labor and product markets. Economic freedom is defined as the absence of government coercion or constraint on production, distribution, or consumption of goods and services beyond the extent necessary for citizens to protect and maintain liberty itself. Measuring something as complex as economic freedom is not an easy task.

As modern macroeconomics and institutional analysis use quantitative methods to prove their hypotheses, the relation between economic freedom and prosperity as measured by such indicators as per capita GDP, Legatum Prosperity Index, U.N. Human Development Index has been widely studied and debated using econometric models. The results of a large number of empirical studies suggest a strong correlation between these variables. However, as Dawson (2003) shows, the existing empirical studies of these relationships provide evidence of correlation, but not causation. Using Granger causality tests to address the issue of causality in the relationship between various measures of institutional performance and growth across countries, he points out that the overall level of economic freedom *appears* to cause growth, while changes in freedom are jointly determined with growth. In addition, the level of economic freedom overall, and most of its underlying components, are preceded (Granger-caused) by the level of political and individual liberties.

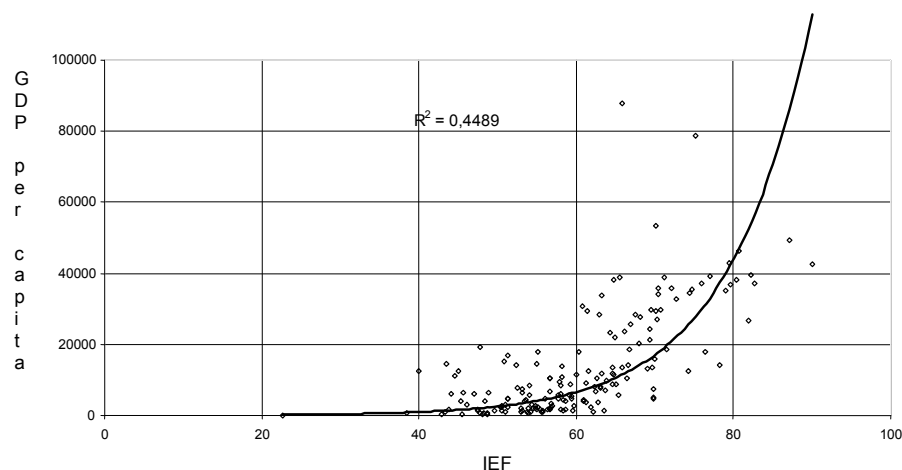
Figure 1 shows the correlation between the economic freedom as measured by the Index of Economic Freedom and the prosperity measured by the per capita for 179 countries in the world. The correlation is a positive one: countries with higher per capita GDP also show a high score in the Index of Economic Freedom. Moreover, the trend line is an exponential curve: constant improvements in a country's economic freedom are related to increasing improvements in its prosperity.

Economic policy prescriptions derived from this field of study are not as straightforward as they seem. There is a complex structure of factors that need to be changed in order to achieve long-term economic growth. An increase in economic freedom will eventually lead to greater economic prosperity. As Vega-Gordillo & Alvarez-Arce (2003 p. 212) indicate '... [N]o single reform by itself is sufficient for fast growth or for sound development. A moderate degree of freedom is necessary in political and economic areas to improve growth perspectives. That is, institutional

reforms have important complementarities, and liberties seem to work as a virtuous circle’.

Figure 1

Economic Freedom and Prosperity, 2010



Note: GDP per capita is in constant 2000 U.S. dollars

Source: Miller, Terry and Kim R. Holmes, '2010 Index of Economic Freedom'

There seems to be a consensus among economists and public policy analysts: the key ingredient for economic growth is economic freedom. The evidence shows that without an environment of economic freedom, growth will not take place. Economic freedom contains a number of components, all of which must be in place for an economy to grow. An economy must have a stable monetary system, secure private property rights, an impartial legal system, low taxes, minimal government, and low barriers to international exchange. If any of these components are missing, an economy will not grow.

After making some general considerations about the bureaucratic behavior mostly from a public choice perspective, in the last section of this article we study the cases of Bulgaria and Romania. Some well-known indicators of economic freedom are of interest; indicators of the degree of bureaucratization of the economy are also considered significant. The statistical correlation between economic freedom and per capita GDP is established for the two countries; however, the determination of causality is beyond the scope of this study. A careful study of the importance of institutional factors in determining the economic performance of the countries is yet to be done. At the actual state of knowledge, the general hypotheses that put institutional factors at the foundation of prosperity are taken for granted.

Economic Freedom and the State: the Power of Bureaucracy

The terminology of state-related activities is a confusing one. Until recently, *public servant* and *civil servant* were the terms used for denominating the personnel working in various state agencies and public organizations. The terms *bureaucrat* and *bureaucracy* had a depreciatory meaning. However, in recent years *bureau* has come to designate any organization that receive the most part of its revenue as grant; its output is not sold on the market at a per-unit rate. The typical form of bureaucracy is *public administration*.

The analysis of the outcome of the collective-decision making process must include a thorough investigation of bureaucratic behavior. Every political verdict has to be implemented through bureaucratic machinery. Hence, the implementation phase is equally important. The bureaucrat does not enjoy a brilliant image in the eyes of the public. He is thought to be lazy, apathetic, lacking initiative and ever ready to take bribes. In the analysis of the bureaucrat's behavior, we will employ the following hypothesis: he is no different then the business people or managers. One does not need special characteristics in order to become a public servant. In fact, there are numerous cases in which, trying to improve its efficiency, politicians employ reputable managers to run a government bureau. The opposite case is also common, but as well more controversial: a bureau chief may become a manager. The bureaucrats are no better or worse than their equivalent working for private corporations. If the analysis of the bureaucrat's behavior leads us to the conclusion that he acts differently than the manager, this fact cannot be the result of different characteristics of the two (Gunning 2003).

The relationship between a bureau chief and the politician whose job is to monitor them is different from the relationship between shareholders and managers of a privately owned firm. The politician has weak incentives to monitor carefully the bureaus and to improve their activity. The instruments that he can use are most of the times inefficient. In addition, civil service laws protect the bureaucrat against being punished unjustly or severely by politicians. They cannot be fired unless they committed a crime.

The very different incentives and constraints that the two categories face are also the explanation for the very different kinds of personality that most probably would be successful. The free markets award managers that proved to be inventive and willing to take risks in introducing new products or technologies. Bureaucrats tend to be conservative: they gain if the environment in which they act remains more or less the same. Introducing new management methods is likely to be regarded with distrust. They tend to favor redistributive policies and interventionist governments.

As shown by a large number of recent studies, the logic of bureaucracy is to grow (Gunning 2003; Niskanen 1994). The behavior of the typical bureaucrat is to increase the size and budget of the organization for which they work. One of the implications of Niskanen's theory of bureaucracy has become a focal point of recent policy proposals: the quantity of output is larger than the optimal quantity from the

point of view of the consumers. Scarce resources have been wasted producing goods and services through bureaucracy; other goods and services never had the chance to be produced. It is usually impossible to assess the efficiency of bureaucratic production (Mises 1944). The optimal size of a public organization (e.g. a governmental agency) is unknown. There is no market for the output of such organizations. As Mises suggests, they are “isles of socialism”, extremely different from the profit-seeking, private enterprises. The consumer-oriented actions of the private firms are replaced by rules and regulations that the state agencies must follow. Initiative is non-existent in bureaucracy; the most beneficial conduct for a bureaucrat is to follow instructions strictly.

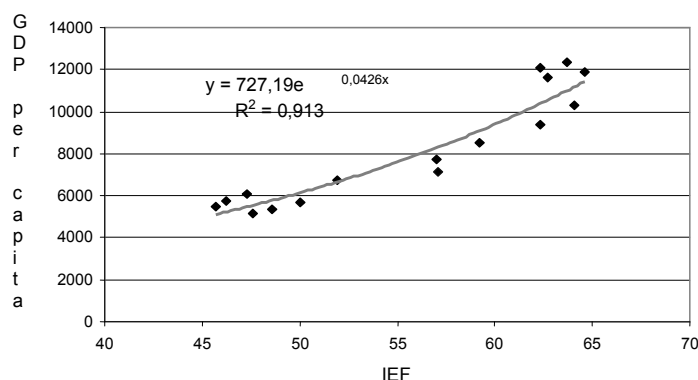
Romania and Bulgaria Compared

After the fall of communism, both Romania and Bulgaria have begun the transition to greater economic freedom. The overall entrepreneurial framework has become more streamlined and efficient.

As *Figure 2* and *Figure 3* show, there is a strong correlation between economic freedom and prosperity both in the case of Bulgaria and Romania. In Bulgaria, economic freedom has constantly improved over the last fifteen years. Economic reform and trade liberalization have led to annual growth of GDP with an average of 4,1 % over the past ten years, supporting considerable increases in investment and job creation. The correlation between economic freedom as measured by the Index of Economic Freedom and per capita GDP follows an exponential curve: constant increases in economic freedom are related to growing increases in per capita GDP. The high value of R square ($R^2 = 0,913$) indicates that the correlation between the two variables is strong.

Figure 2

Economic Freedom vs. Prosperity, Bulgaria, 1995-2010

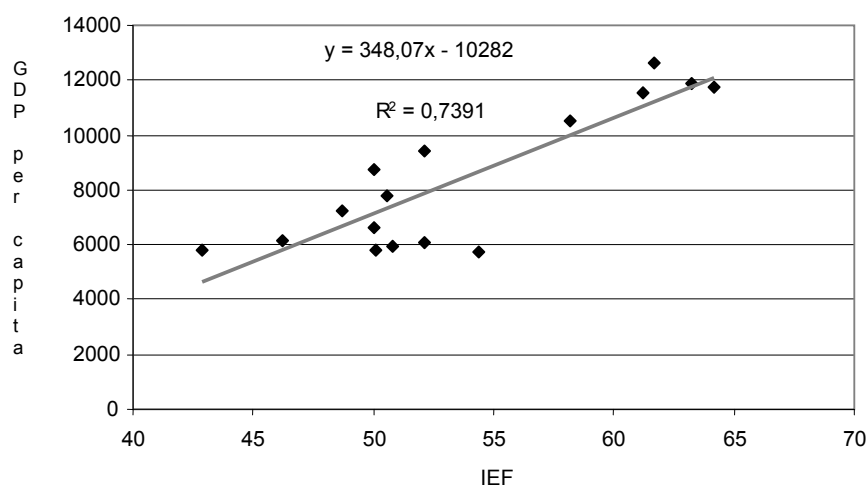


Source: author's calculations using data provided by Gwartney, J., J. Hall & R. Lawson. 2010. Economic Freedom of the World: 2010 Annual Report and IMF, World Economic Outlook Database, October 2010.

In the case of Romania, the real GDP has increased in the last ten years with an annual average of 4 %. The degree of economic freedom that Romanians enjoy also increased over the last decade. Moreover, the correlation between the economic freedom as measured by the Index of Economic Freedom and per capita GDP is strong ($R^2 = 0.7391$).

Figure 3

Economic Freedom vs. Prosperity, Romania, 1995-2010



Source: author's calculations using data provided by Gwartney, J., J. Hall & R. Lawson. 2010. Economic Freedom of the World: 2010 Annual Report and IMF, World Economic Outlook Database, October 2010.

Table 1 shows the evolution of economic freedom in Bulgaria and Romania as well as one component that indicates the size and scope of the economic activity of the state: the government spending.

As mentioned earlier, the economic freedom measure the degree in which the economic policy of a country is consistent with basic human rights to own and use property. The activity of the state is regarded as one of the most important threats to economic freedom. Hence, the more people rely on the state to provide goods and services, the less the degree of economic freedom. The size of the state is an indicator of the degree to which the society is economically repressed.

Table 1

Bureaucracy-Related Indicators Published in '2010 Index of Economic Freedom',
Romania vs. Bulgaria, 1995-2010

Year	Bulgaria		Romania	
	Economic freedom	Government spending	Economic freedom	Government spending
1995	50.0	50.5	42.9	52.2
1996	48.6	30.6	46.2	64.9
1997	47.6	37.3	50.8	65.5
1998	45.7	48.8	54.4	64.3
1999	46.2	46.3	50.1	65.1
2000	47.3	54.4	52.1	63.3
2001	51.9	67.3	50.0	79.7
2002	57.1	49.6	48.7	58.9
2003	57.0	56.7	50.6	62.4
2004	59.2	64.5	50.0	74.8
2005	62.3	53.4	52.1	68.9
2006	64.1	49.8	58.2	68.9
2007	62.7	57.8	61.2	71.0
2008	63.7	56.0	61.7	70.8
2009	64.6	58.7	63.2	70.0
2010	62.3	48.3	64.2	59.8

Note: A score close to 100 indicates a high degree of economic freedom.

Source: Miller, Terry and Kim R. Holmes, '2010 Index of Economic Freedom'.

To better understand the economic freedom of Bulgaria and Romania a thorough analysis of the evolution of bureaucracy is needed. In *Table 2*, we have selected a panel of indicators published in the *Global Competitiveness Report 2010-2011*, the annual report of the World Economic Forum. The authors define competitiveness as the set of institutions, policies, and factors that determine the level of productivity of a country. The level of productivity, in turn, sets the sustainable level of prosperity that can be earned by an economy (World Economic Forum 2010, p. 4). The first pillar of competitiveness is institutions. The institutional environment is determined by the legal and administrative framework within which individuals, firms, and governments interact to generate income and wealth in the economy (*idem*). The indicators that we considered are: 1.07. Favoritism in decisions of government officials; 1.09. Burden of government regulation; 1.11. Efficiency of legal framework in challenging regulations; 1.12. Transparency of government policymaking. World Economic Forum draws its data from two sources: international organizations & national sources, and the Forum's Executive Opinion Survey. The following questions were used to determine the scores:

To what extent do government officials in your country show favoritism to well-connected firms and individuals when deciding upon policies and contracts? [1 = always show favoritism; 7 = never show favoritism]

How burdensome is it for businesses in your country to comply with governmental administrative requirements (e.g., permits, regulations, reporting)? [1 = extremely burdensome; 7 = not burdensome at all]

How efficient is the legal framework in your country for private businesses in challenging the legality of government actions and/or regulations? [1 = extremely inefficient; 7 = highly efficient]

How easy is it for businesses in your country to obtain information about changes in government policies and regulations affecting their activities? [1 = impossible; 7 = extremely easy]

Both Romania and Bulgaria display competitive weakness in the quality of bureaucratic environment. According to the responders' opinion, officials show favoritism (rank 111 for Bulgaria and 123 for Romania, out of 139 countries studied), complying with regulation is regarded as burdensome (rank 76 for Bulgaria and 98 for Romania), the efficiency of legal framework in challenging regulations is low (rank 119 for Bulgaria and 111 for Romania), the transparency of government policymaking is among the worst in the world (rank 130 for Bulgaria and 137 for Romania).

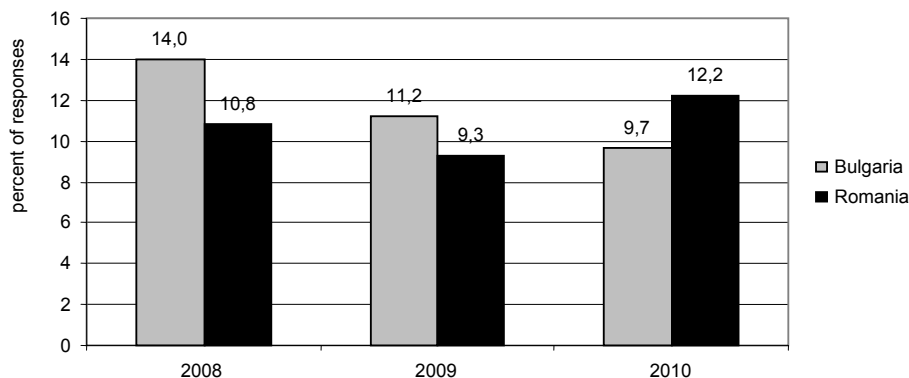
Table 2
Bureaucracy-Related Indicators Published in 'Global Competitiveness Report 2010-2011', Bulgaria vs. Romania

Indicators	Bulgaria		Romania	
	Score	Rank/139	Score	Rank/139
1.07. Favoritism in decisions of government officials	2.6	111	2.4	123
1.09. Burden of government regulation	3.2	76	2.9	98
1.11. Efficiency of legal framework in challenging regulations	2.8	119	2.9	111
1.12. Transparency of government policymaking	3.5	130	2.9	137

Source: World Economic Forum, 'Global Competitiveness Report 2009–2010'.

The research program of the World Economic Forum also identifies the most problematic factors for doing business in various countries. From a list of 15 factors, respondents were asked to select the five most problematic for doing business in their country and to rank them between 1 (most problematic) and 5. *Figure 4* presents the percentage of respondents that selected *Inefficient government bureaucracy* as the most problematic factor for doing business in the case of Bulgaria and Romania. For Bulgaria, the percentage of respondents concerned about the governmental bureaucracy declined from 14% in 2008 to 9.7% in 2010. In the case of Romania, although 10.8% of respondents were troubled by the governmental bureaucracy in 2008, the same indicator increased to 12.2% in 2010.

Figure 4
Bureaucracy as a problematic factor for doing business, 2008-2010, Bulgaria vs. Romania



Source: World Economic Forum, 'Global Competitiveness Report 2009-2010'.

The World Bank research program titled Doing Business investigates regulations that enhance business activity and those that constrain it. Doing Business presents quantitative indicators on business regulations and the protection of property rights that can be compared across 183 economies (World Bank 2009, p. 1). One of the areas investigated is the efficiency of the government agencies that collect taxes and the total tax rate that results. Doing Business Tax Survey records the effective tax that a small and medium company must pay and the administrative costs of doing so. Three indicators are constructed (World Bank 2009, p. 25):

- Number of tax payments, which takes into account the method of payment, the frequency of payments and the number of agencies involved in our standardized case study.
- Time, which measures the number of hours per year necessary to prepare and file tax returns and to pay the corporate income tax, value added tax, sales tax or goods and service tax and labor taxes and mandatory contributions.
- Total tax rate, which measures the amount of taxes and mandatory contributions payable by the company during the second year of operation. This amount, expressed as a percentage of commercial profit, is the sum of all the different taxes payable after accounting for various deductions and exemptions.

Table 3 shows the score obtained by Bulgaria and Romania in 2010 for the indicators that the World Bank uses to assess the efficiency of the tax system. Although Bulgaria requires fewer payments per year than Romania, the time spent for paying taxes is far greater in Bulgaria than in Romania. As a result, the total tax

rate as a percentage of profit in Bulgaria is considerably below the EU average, while in Romania it is very close to the European average.

Table 3

Paying Taxes, Romania vs. Bulgaria, 2010

Country	Indicators		
	Payments (number per year)	Time (hours per year)	Total tax rate (% of profit)
Bulgaria	17	616	31.4
Romania	113	202	44.6
EU average	18	231.1	44.5
EU best practices	Sweden 2	Luxembourg 59	Luxembourg 20.9
Best practices*	Maldives 1	Maldives 0	Timor-Leste 0.2

* The economy with the lowest tax rate is included as a benchmark.

Source: World Bank, 'Doing Business 2010: European Union'.

As Ludwig von Mises (1944) showed, the public administration is the essential form of bureaucracy. In the attempt to assess the size of bureaucracy in the economy, we put together the official numbers published by the statistical authorities for the following categories: Public administration and defense, compulsory social security; Education; Human health and social work activities. Although not exhaustive, the proposed gauge of bureaucracy has the advantage of being relatively easy to compile for a large number of countries as statistical authorities publish data in a similar format.

Table 4 presents the structure of bureaucracy in the case of Bulgaria for the interval 2000 – 2009. The component titled Public administration and defense, compulsory social security increased rapidly until 2007. The remaining components – Education; Human health and social work activities – had a steady state.

Table 4

The Structure of Bureaucracy, Bulgaria, 2000-2009

Year	Bureaucrats (thousand)				Annual percentage growth
	Public administration and defense; compulsory social security	Education	Human health and social work activities	Total	
2000	90	215	141	446	-
2001	96	202	133	431	-3.39
2002	97	198	132	427	-0.84
2003	112	194	132	438	+2.56
2004	119	194	134	446	+1.78
2005	131	193	125	449	+0.78
2006	134	191	127	452	+0.61
2007	135	185	125	445	-1.56
2008	129	171	126	427	-4.01
2009	129	166	131	427	-0.07

Source: National Statistical Institute, Republic of Bulgaria.

Table 5 presents the structure of bureaucracy in the case of Romania for the same interval. The bureaucratic labor force has increased from 860000 in 2000 to over 1000000 in 2009. The component with the greatest increase was Public administration and defense, compulsory social security. The annual percentage growth of the bureaucratic labor force was positive over the entire studied interval. For example, the rate of growth of bureaucratic labor force was greater than 5 % both in 2007 and in 2008.

Table 5

The Structure of Bureaucracy, Romania, 2000-2009

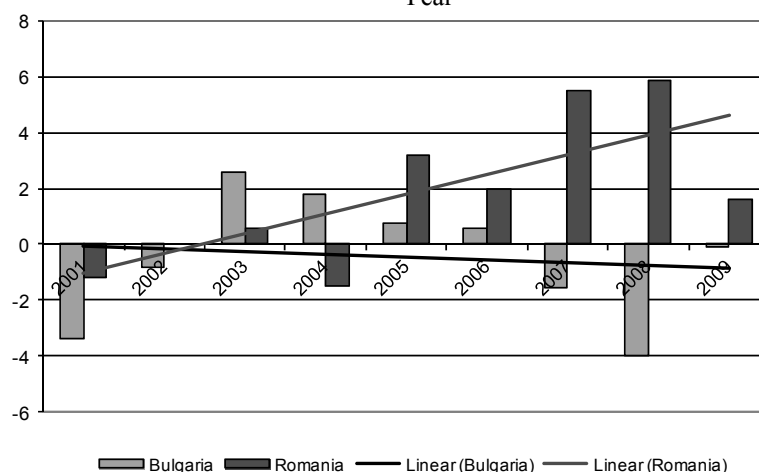
Year	Bureaucrats (thousand)				Annual percentage growth
	Public administration and defense; compulsory social security	Education	Human health and social work activities	Total	
2000	148	407	305	860	-
2001	143	403	304	850	-1.16
2002	147	390	313	850	+0.00
2003	152	390	313	855	+0.59
2004	155	381	306	842	-1.52
2005	167	381	321	869	+3.21
2006	175	383	328	886	+1.96
2007	198	394	343	935	+5.53
2008	217	404	369	990	+5.87
2009	229	395	382	1007	+1.63

Source: National Institute of Statistics, Romania.

Figure 5 compares the rate of growth of bureaucracy in Bulgaria to the one in Romania. Bulgaria's trend is negatively sloped, while Romania's trend is positively sloped.

Figure 5

Annual Growth of Bureaucrats, Romania vs. Bulgaria, 2001-2010, % of Previous Year



Sources: National Statistical Institute, Republic of Bulgaria; National Institute of Statistics, Romania.

Table 6 shows the dynamics of bureaucratic labor force in relation to total labor force in the economy in the case of Bulgaria. The indicator labeled Employees in profit-seeking enterprises measure the working force employed in market-oriented private and public companies as opposed to the bureaucratic labor force. The indicator Bureaucrats as a percentage of total employees has steadily declined from 23,46 % in 2000 to 17,67 % in 2009.

Table 6
Bureaucrats vs. Employees in Profit-Seeking Enterprises, Bulgaria, 2000-2009

An	Bureaucrats (thou.)	Total employees under contract (thou.)	Employees in profit- seeking enterprises (thou.) (2) - (1)	Bureaucrats as a percentage of total employees (%)
(0)	(1)	(2)	(3)	(4)
2000	446	1901	1455	23.46
2001	431	1900	1469	22.67
2002	427	1928	1501	22.16
2003	438	2080	1642	21.06
2004	446	2152	1706	20.72
2005	449	2177	1728	20.64
2006	452	2268	1816	19.94
2007	445	2380	1935	18.70
2008	427	2467	2040	17.32
2009	427	2405	1978	17.75

Source: National Statistical Institute, Republic of Bulgaria.

The Romanian case is shown in Table 7. Unlike Bulgaria, the trend of the bureaucratic working force relative to total employees in the economy has been increasing. In 2009, no less than 21 % of the employees were bureaucrats.

Table 7
Bureaucrats vs. Employees in Profit-Seeking Enterprises, Romania, 2000-2009

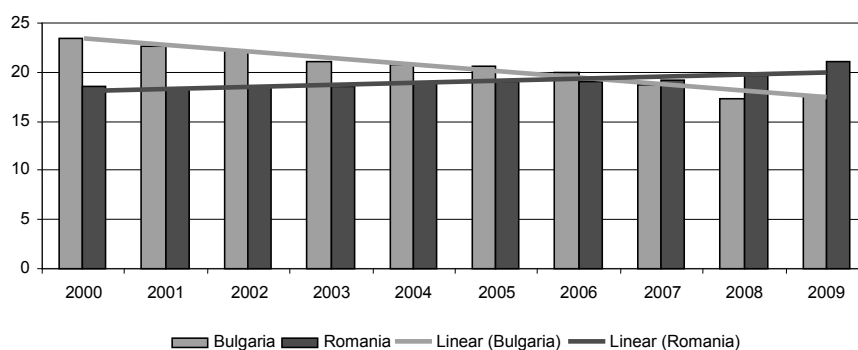
An	Bureaucrats (thou.)	Total employees under contract (thou.)	Employees in profit- seeking enterprises (thou.) (2) - (1)	Bureaucrats as a percentage of total employees (%)
(0)	(1)	(2)	(3)	(4)
2000	860	4623	3763	18.60
2001	850	4619	3769	18.40
2002	850	4568	3718	18.61
2003	855	4591	3736	18.62
2004	842	4469	3627	18.84
2005	869	4559	3690	19.06
2006	886	4667	3781	18.98
2007	935	4885	3950	19.14
2008	990	5046	4056	19.62
2009	1007	4774	3768	21.07

Source: National Institute of Statistics, Romania.

Figure 6 compares the evolution of the percentage of bureaucrats in total employees for Bulgaria and Romania. The trend for Bulgaria has a negative slope, while for Romania it has a positive slope.

Figure 6

Bureaucrats as a Percentage of Total Employees



Sources: National Statistical Institute, Republic of Bulgaria; National Institute of Statistics, Romania.

Conclusion

In their path towards increased competitiveness, both Bulgaria and Romania have serious weaknesses in the regulatory behavior of the state. As stated by the business people and analysts, bureaucracy is one of the most persistent factors that obstruct businesses. However, over the last decade, Bulgaria has made serious improvement in the institutional environment for doing business; bureaucracy has diminished its impact. At the same time, Romania's advance is weaker: state bureaucracy has increased, the regulatory impact has degraded, and the overall competitiveness decreased.

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