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The systems of interest representation and their impact on the industrial policies of peripheral countries; The case of boiler market in Poland

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In the public choice theory – the intellectual root of the state's partial withdrawal from the field of industrial policy, its implementation by bureaucracy, as well as the activities of interest groups advocating public action were viewed with discernible suspicion as displaying rent seeking endeavors by the profit maximizing *homo oeconomicus*. Countries that have adopted the Weberian model of administration and a more coordinated model of political economy, will, on the contrary, treat either public administration as well as co-operation with groups of interests with more trust.

We present a historical sketch of systems of economic interests' representation, and different institutional arrangements posing a research question whether the institutional settings of systems of representation of industrial interest influence ability to gain better score in terms of competitiveness. Special attention is given to the Central and Eastern European countries. We investigate whether weakness of their interest representation systems are a result of the variety of capitalism, as described by P. Hall & D. Soskice (2002), or the "enhanced variety" introduced by A. Noelke & A. Vliegthart (2009).

The text is based upon a case study on the solid fuels boiler market in Poland, as well as on trials to regulate it.

1. Interest groups and regulation in classical economics and the public choice theory

After the dominance of welfare economy with its market failure paradigm that justifies state intervention in order to bring back the equilibrium between marginal social costs and benefits, we have, since 1960s witnessed the attempts to withdraw the state activity from, ~~what is being called,~~ the industrial policy.

The intellectual roots of such change seem to reach to the public choice theory. In Olson's classical work on the theory of collective action, the producers are better represented than consumers, as supervision of the members in a smaller group is much more manageable than controlling a larger organization. The greater the group the fewer the incentives to impel its members to act for the sake of the common interest, and the stronger the need to force them to do this.

In 1967, G. Tullock notices that inducing a regulation is motivated by hope to gain profits, however not to meet the needs of the consumers, but by instituting higher prices of goods protected by the

regulation. This phenomenon of rent-seeking causes a regulation-, and not market mechanism-driven distribution of incomes, and a huge part of economic resources is wasted by using them in an unproductive way (lobbying) instead providing goods or services needed by consumers. George Stigler (1971) by presenting an example of the weight of trucks in the US states regulated according to agricultural, railroad and public opinion interests proves that a regulation is an effect of a game of interests, and not the care for the public good.

M. Olson in his 1982 *Rise and Decline of Nations* tries to prove that countries featuring strong and long-term influence of interest groups, represent smaller growth rates, only due to the prevalence of particular interests. The distribution of resources is based on administration instead of the market mechanism. Owing to the inefficiency of the public sector, Tullock (1965; 221-224) proposes a decentralization which would unleash tax competition between countries and states as well as reduce public spending, and 2) cut the amount of public intervention in economy. Becker (Chicago School) states that the best industrial policy is none at all.

These proposals found their advocates in the policies of M. Thatcher and R. Reagan in the 1980s. They have then spread throughout the world as a result of the Washington Consensus rules– especially across the weak developing countries, as the credits from the World Bank or the IMF were granted upon the condition that the states withdraw their requirements.

2. Weberian tradition and modern industrial policy

However, the literature of the public administration models identifies numerous countries – especially in the continental Europe (Pollitt & Bouckaert 2004, 2011, Lynn 2008, Mazur 2016) that, opposite to the Anglo-American pattern, rather modernize than marketize their public sectors. Such a model of public administration has been called the Neo-Weberian State (Pollitt & Bouckaert 2004, 2011, Lynn 2008, Mazur 2016). The continental Europe and its administrative tradition are still being built on the Weberian tradition and an active role of the state, more prevalent than the market-oriented reforms of the public sector in the spirit of the public choice theory. Although the Weberian model of ideal bureaucracy emphasizes that the most important features of administration are impartiality and acting without regard to personal considerations, there is a certain exception to the principle of impartiality and the primacy of administration, which consists of the inclusion of certain social actors in the process of devising public solutions of an economic nature due to their expert knowledge, without which the implemented solutions would be less efficient. “Expertise is surpassed only by the bureaucracy, in the sphere of the economy, the expertise of people engaged in private business” (Weber 1922). This is because the entrepreneurs’ knowledge of market conditions determines their fate. The modern revival of the industrial policy is an example confirming observations made by Weber, stating that an efficient administrative body planning its economic activities always draws on the knowledge of the business sphere experts. (Gawlikowska-Hueckel 2014; Stiglitz et al. 2013).

Rodrik & Hausmann point to the fact that in the process of obtaining the knowledge necessary to shape the industrial policy, the discovery of new areas of activity by business people plays a major role (Hausmann, Rodrik 2002), hence entire branches of the national economy are modified according to a unique process of self-discovery (which is reflected in the title of the article: *Economic development as a self-discovery*). Owing to the fact that the profits and losses of companies exert social impact as a

result of economic experiments, the state enters this relationship as a partner. On the basis of agreements with entrepreneurs, it co-creates regulatory conditions conducive to obtaining competitive advantages by domestic companies in international markets, (Rodrik 2004). "Industrial policy is (...) conceived as a process whereby the state and the private sector jointly arrive at diagnoses about the sources of blockage in new economic activities and propose solutions to them. [...]" (Rodrik 2006, p. 24).

Ball (1995): To the extent that this information enables governments to choose better policies, lobbying can enhance welfare.

3. Functions of employers' associations

The basic functions of chambers of commerce and employers' organisations thus include the capacity to circulate information, deliberate, and mobilize members (Culpepper 2002).

Sikora 2005 identifies additional functions of chambers of commerce that are of primary importance not only to their members, but to the whole society and its economic interests as industry stakeholder. They are:

- linking economic environment to the public administration at the local, regional, national and European levels;
- providing authorities with opinions regarding planned legal acts;
- ensuring arbitrage between the sector's members;
- creating export development programmes;
- organizing vocational training;
- supervising the market while it is being entered by new entities.

In terms of industrial policy functions the two following aspects are most important: analyzing and consulting planned legal acts and participating in the creation of export development programmes. In the last 30 years, a strong ecological argument in favor of undertaking industrial policy actions and introducing of new economic legislation proposed by the interest groups gained its contemporary importance. Contemporary regulatory strategies aim at stimulating technological change and achieving a significant level of pollution prevention. They are based on the presumption that health, safety, and environmental goals can be co-optimized with economic growth through technological innovation (Ashford 1993).

Porter (2001) describes the positive aspects of green regulations by giving an example of a Swedish air-conditioner producer – the strict noise parameters introduced in Sweden forced this company to enhance its devices' specifications. While other countries were imposing higher standards in the field, the company had already had a technological and time advantage when expanding to these markets. Janicke (2008) or OECD (2011) remind us that eco-innovation is the effect of interplay between the need for regulation and interests of particular innovators, who need support for their technologies. For instance, The Phillips Company supported the directive introducing energy-saving light-bulbs at the EU level, because this legal act enabled them to gain a better market position.

These eco-innovations are regulation-driven and imposing such standards is targeted to both meeting the environmental goal and eliminating cheap competition of dirty technologies. These are represented by the producers from developing countries. Because it would be impossible and not viable to withdraw the regulatory activity from the sphere of environmental protection, the "free

trade” notion seems to be a kind of utopia. From this point of view regulation and trade barriers are beginning to be perceived not as predatory on public interest, but as a way of protecting it.

We may guess that entrepreneurs are aware of the fact that the existence of regulation ensures their competitiveness to a great extent. What happens if these interests cannot be coordinated or pronounced?

4. Case study – the boiler market in Poland

The problem of interest representation appeared during our research on industrial policy within one of sectors of Polish economy dominated by small and medium enterprises producing fuel boilers, mainly for the domestic market. We analyzed the market and the process of establishing the regulation by interviewing 7 boiler producers, 2 representatives of supporting and competitive industries and 2 other stakeholders and experts.

4.1. The environmental problem

Air quality in Poland is very poor. The worst problem is noticed by Malopolska’s and Silesian towns due to their location in valleys. The particulate matter standards of emissions below 10 micrometers (PM10) and below 2.5 micrometers (PM2.5) as well as (benzo[a]pyrene) are exceeded. After the collapse of communism in Poland nobody expected that small sources of emissions, such as detached houses, can discharge the greatest amount of air pollutants. Now – houses are the greatest emitters of particular matters and benzo[a]pyrene. The right figure shows the correlation between benzo[a]pyrene concentration in the air and the season.

Poland is the greatest producer of solid fuel boilers in Europe, and one of the greatest in the world. In the 2000s, the Polish industry of solid fuel boilers used to produce up to 200 thousand boiler per year. The 70% of households owning a detached house use coal boiler as a heating device– the older the house, the more popular the coal boilers. Even in the houses built after the year 2000, coal boilers are still the most popular appliances, but over 60% use other sources of energy (28% gas and 24% wood).

And until now we have not established standards on the quality of small boilers (below 1 Megawatts), the quality of fuels (coal), and any standards on individual houses’ emissions (except for the enforcement of fines for rubbish burning). Other European countries follow procedures for a total elimination of coal fired stoves.

- England after 'The Great Smog of 1952' in London.
- In Germany the coal lost its significance as a source of dust in the air after downsizing its use for heating purposes, according to the 1997 Ordinance.
- In the Czech Republic the requirements for coal boilers provide gradual standards enhancing.

There have been several attempts to regulate this problem locally. But in vain.

- a) In 2015 it was decided that European ECODESIGN Directive (2009/125/EC) will be viable after 2020: only the 5th class boilers would be sold to individual households, which should greatly assist in reducing the problem.

- b) In 2015, the new government let the local authorities decide on the air quality protection measures introduced on a local level.
- c) At the beginning of 2016, the city of Kraków introduced a ban on solid fuel boilers from the year 2019 on.
- d) In September of 2016, the government signaled the will to introduce a prohibition on the sale of all boilers below 5th class in Poland after 30 September 2018.

4.2. Interest representation in the legislative process

From the point of view of representation of interests theory, we may observe the.

Circulation of information and mobilization of economic actors' failure:

- a) A lack of a long-term vision of the development of the whole industry. Individual producers create their own individual strategies;
- b) some of the minor manufacturers are still not even aware that in 4 years they will be unable to sell boilers exhibiting features below certain standards (a year after the introduction of the Ecodesign directive);
- c) Lack of organization – prior to Ecodesign directive negotiations in Brussels no representation of boilers producers was present– they had no occasion to present their point of view;
- d) Creating a boiler manufacturers body under the name of a Platform of Solid Fuel Boilers Producers was an initiative of an external actor: a voluntary scientist connected to coal industry;
- e) . The regulation is convenient for the greatest producers who benefit the most, as they are already able to produce high class boilers, which are more expensive and give higher margins of profit. On the other hand it affects negatively the poorest, who cannot pay the doubled price for a boiler, which can decrease the demand for solid fuel boilers, and eliminates smaller competitors, who cannot afford to pay for innovation or certification procedure.

In evolutionary terms, the government does not try to impose the dynamic efficiency instead of the allocative one. For example in the EU-countries wooden pellets are promoted as a domestic source (instead of imported gas), and as a renewable source of energy (biomass). In terms of technology, coal boilers can easily be adopted into pellet-ones, so individual strategies of producers take it into account but not the strategy of the government.

From the point of view of representation of interests theory also at the level of the state we observe the information and mobilization failure. We have identified an information failure in the diagnosis of regulation initiative and its potential economic effects: not only the government has no information from the producers, but it also seems to have a limited view of the cost-benefit effects for the economy.

From the perspective of the classical Ricardian comparative advantage perspective, the solid fuel boilers market in Poland exhibits a strong tendency for development, as it has been operating on low labour cost and low margins. This, however, cannot be utilized on international markets due to trade constraints in form of product standards protecting air quality. Has the development of the coal boiler market been supported too long, it would have prevented the development of a new higher value

added markets. This has been pronounced clearly by a representative of the heating pumps industry – a competitor of boiler branch.

In evolutionary terms, the government does not try to impose the dynamic efficiency instead of the allocative one (Dosi, Pavitt, Soete 1990). In the EU wooden pellets are promoted as a domestic source. It increases the domestic value added in the energy production chains opposite to imported gas and is important element of energy safety. Additionally, wood is a renewable source of energy (biomass) enabling the fulfillment of the requirements set by the EU on renewables' share in energy production. In terms of technology, the production of coal boilers can easily be switched into pellet-ones, so individual strategies of producers take it into account. The case of Kraków's prohibition of solid fuels shows that the fear of burning with poor quality coal endangers also one of potential field of dynamic competitive advantage of the economy.

The key additional element of the regulation should be complementarity of regulations concerning both: boilers and fuel by which they are fed.

Without this element the legislative initiative of the government seems to be too limited also in order to eradicate the problem of bad air quality. The regulation should be focused on the whole process of the quality and burning of solid fuels and not only on the boilers. No standards for fuels have been established after the year 2004, and as a result, the individual users gained access to the worst quality coal. It helped the coal mining industry to repair their poor economic situation. Such a delay in regulation results from the strong position of coal mines that are against introducing any standards on coal use for individual households. And burning coal-slime, even in the 5th class boilers wouldn't improve air quality.

5. What type of capitalism - liberal or dependent market economy?

How to anchorage this case study in the institutional economy?

At first we tried to make use of the theoretical insight offered by the Varieties of capitalism scholars, e.g. Hall and Soskice (2001). One of the important features of liberal market economies and coordinated market economies is the role of chambers of commerce. In LMEs (and some CMEs), under the private law model in the English-speaking countries like the USA, Canada or the UK and Ireland, companies are not required to be a member of the chamber. Under the compulsory or public law model, firms of certain types or branches are obliged to become members of the chamber, which is common across the continental Europe (e.g. France, Germany, Italy, Spain, Austria). The chambers hold the authority of the public administration in various fields.

According to Duvanova (2015) the majority of Central and Eastern European countries with pre-communist legacies that were associated with the Austro-Hungarian Empire – Hungary, Croatia, Slovenia, Slovakia – have recreated the compulsory-chamber system, whereas countries ruled by the Russian Empire, as well as Bulgaria and Romania, have adopted voluntary pluralist arrangements. The compulsory system, for the most part, did not live up to the high expectations of either the business community or government. These countries eventually abandoned the compulsory membership clause (Slovakia 1996, Hungary 2000, Macedonia 2004, Slovenia 2006). After the renaissance of market economy in 1989, all chambers in Poland are new and voluntary, however, during a prewar episode a French model (1927) with compulsory membership and administrative role of economic self-government was adopted. In 1950 the communists terminated all activities of capitalist institutions. (Wykrętowicz 2004)

Do the institutional arrangements in Central and European Countries regard the chamber of commerce and other forms of coordination to be the LMEs' type? According to Noelke and Vliegthart (2009) warn that the "identification of individual institutional parallels between ECE capitalism and either the CME or the LME model is misleading." From their perspective, these economies signify "the emergence of a third basic variety—a dependent market economy (DME) type of capitalism. DMEs have comparative advantages in the assembly and production of relatively complex and durable consumer goods. These comparative advantages are based on institutional complementarities between skilled, but cheap, labor; the transfer of technological innovations within transnational enterprises; and the provision of capital via foreign direct investment (FDI)." They have baptized this variety to be the "dependent market economy" since its overriding feature is the fundamental dependence on investment decisions by TNCs. Thus, the hierarchy between TNC headquarters and local subsidiaries replaces markets (LME) and associations (CME) as a typical coordination mechanism within these economies.

Our case study seems not to be sufficient enough to verify the thesis about the dependent character of Polish economy. Because the boiler market is of relative low attractiveness, and a subject of severe competition, there are relatively a small number of big or foreign companies interested and capable to compete on it. Alternatively regulated market with bigger entities and with FDI present on it should be analyzed in order to check how the process of coordination and regulation under private law is being organized, and whether it ensures equal influence of economic actors and protection of the public interest. Two more symptoms need to be the subjects of deeper insight:

- 1) The significant role of foreign owned companies in exports activities. To a great extent they are carried out within intra-corporate cooperation chains (Hausner 2013). Exports promoting programmes or self-organizing of producers are thus obsolete when these chains seem to be sufficient.
- 2) The membership of the greatest players in few private organizations with strong influence on the legislative system. The dispersion of power between smaller and bigger enterprises is quite concentrated in such environment. Moreover, there seem to be undertaken actions of these organizations in order to prevent changing the system into more co-ordinated which would empower smaller economic actors and involve them stronger into the system of interest representation and consulting of legal acts.

Instead of conclusions we may sketch several more peripheral countries' or DME-typical failures of public policy:

- a) Poorly informed public policy in its impact analysis limited to the most visible direct economic consequences of regulations;
- b) No active role of the government in promoting the co-ordination of economic and ecological perspectives, and in treating particular markets as the potential competitive advantage fields of the economy.
- c) A reactive, and not proactive policy (which could have joined environmental and economic goals) – legislative initiatives are reactions to:
 - the legislation at the EU level
 - alarms from the public opinion.
- d) The impact of strongest interest groups prevails, and the official bargaining system is only a cosmetic for the hierarchy. In a weak system of representation of interests the stronger gain

at the cost of the weaker and more sensitive, such as small producers and the poorest with no compensation schemes.

Rather than beginning, we may finish with posing the research questions just to outline the research which should be undertaken in order to verify whether the system of interest representation in Poland:

- 1) Displays differences a'la liberal market economies versus coordinated market economies?
- 2) Justifies identification with the third group of capitalism: dependent market economies?

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