ACADEMIC LIFE: Professor Ülo Ennuste, DSc – 80

Last but not least, we supplemented the current journal issue a special section to celebrate a significant milestone in the academic life of Estonian scientists—the 80th birthday of Professor DSc Ülo Ennuste—one of the leading economic scientists in Estonia. He has authored and co-authored 15 books and more than 160 research articles of wide acclaim, and his personal contacts on the international arena and cooperation have strongly contributed to the development and popularization of macroeconomics in Estonia. Dr. Ennuste's current article in BJES enriches the Estonian economic science with a discussion about resources on macroeconomic knowledge in order to facilitate the 'European Semester' processes. Its main message is that the quality of the agents' knowledge structures may play the basic role and importance in reaching effective equilibrium.

Editorial board of BJES

Waiting for the Commission-Strengthened Governance Coordination Leviathans: A Discourse Memo to the Actors in the Macro Game 'European Semester'[1]

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Abstract: *This is an entirely applied paper for additional implementation of extant rich macroeconomics knowledge resources to facilitate the 'European Semester' processes—the novelty may be that in this implementation the sensitive problems of deteriorating institutions and destructive activities are not entirely disregarded, and we are explicitly demonstrating that the quality of the agents' knowledge structures may have the basic role and importance in reaching effective equilibrium projections in this game.*

From the viewpoint of Modern Heterodox General Macroeconomics (Macro) the most powerful economic policy statement by the European Union was made in the 'Lisbon Strategy 2000'—the economy should be knowledge based. This means that the policy projections of the Union's and the Member States' socio-economic institutions and strategies should be designed as knowledge based, meaning that these should be based on modern high-level evolutionary institutional theory, dynamic macro mechanism design theory taking into consideration uncertainties and rare destructive shocks, Bayesian learning, with limited rationality and strategically playing actors, and national knowledge structure idiosyncrasies, etc.

From the Macro view, the latest important governance policy invention from the Commission was the enforcement of the "Six-Pack" Regulations—especially the central package, (The European Parliament and the Council of the European Union, 2011). Regulation "on the prevention and correction of macroeconomic imbalances" introducing the "European Semester" (ES) mechanism for ex

[1] I thank András Inotai, Pekka Ahtiala, Alari Purju and the two anonymous referees of this issue of BJES, whose helpful advice, comments and discussions allowed to significantly improve the analysis.

ante activities in the prevention and correction of macroeconomic imbalances of the Member States in real-, financial- and institutional-economic designs, and strategic policy projections. Last but not least, we add a field of in-depth central coordination enhancing the qualities of national and central knowledge and statistic structures for thither disclosure and transparency (Walker, 2007), and especially for correcting and preventing informational distortions and destructive logical or political skews (Cotton, 2012; Ennuste, 2007a).

Although the Regulation is a narrative it is easy to see that the content may be adequately modelled mathematically as a dynamic informational cooperative game with side-payments for design of equilibrium institutional and strategy policy projections—in the framework played by the actors such as the Commission's professoriate Committees, the EU Parliament, the ECB, the Member States, and others, and complexly coordinated, combined horizontally and vertically, as by consultations and side-payments (material and moral) and by limit-constraints (Ennuste, 1978).

If so, it is most convenient mathematically to rigorously study the necessary and sufficient conditions/postulates for the actors to successively ensure that the game solutions will be implemented (see, e.g., Liu & Luo, 2010; Serrano & Vohra, 2001)— the equilibrium policy projections will be optimally balanced. Most importantly, some of these postulates are in this paper formulated as Memo-points for the Member States as well as for the Central coordinator, and for discourse arguments of these points notes of extracts from corresponding top-level peer-reviewed research papers are presented, including Estonian examples. For a better clarification and to avoid anxieties concerning the 'variable geography' (Pisani-Ferry, Sapir and Wolff, 2012) of the after ESM reform developments in the EU governance complexities, it may be very operational to introduce into the narratives some elements of formalizations (some tentative suggestions in this directions are made in the Annex).

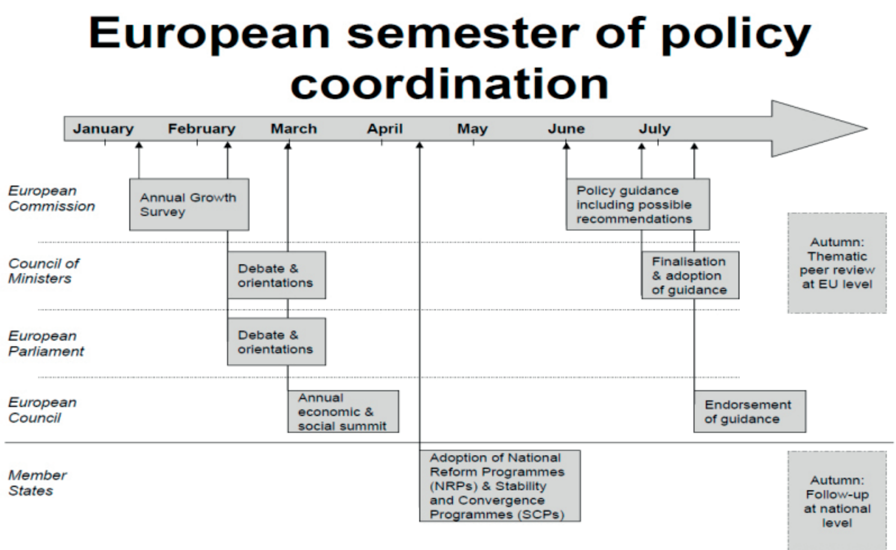
Keywords: *European Semester, macroeconomics, mechanism design theory, Modern Heterodox General Macroeconomics*

Introductory meta-remarks

Coordination theme is the basic socio-economic problem, as Friedman (1962, p. 12) has postulated: "The basic problem of social organization is how to co-ordinate the economic activities of large numbers of people."

Coordination theme in the Modern General *Macro* belongs to the domains of institutional/evolutionary economics and mechanism design theories *(N1)*—the former is happily enough more or less a narrative one, while the latter is nowadays rigorously formalized, based on heavyweight mathematics: "Mechanism design theory is a branch of game theory […] and extends the application of game theory to ask about the consequence of applying different types of rules to a given problem" (Royal Swedish Academy of Sciences, 2007). See also, for example, Ennuste (1978; 2003) on an example of theoretical optimization model of building of national socio-economic institutional and real-economic structure in interactions in a one complex-model—the decomposed solution of this model will derive solution games in the same class presented in ES mechanisms (a complex mechanism combining horizontal and vertical stimulating with side-payments consultation coordination, see Ennuste, 1978; schematically in Fig. 1).

Figure 1. European semester of policy coordination



Source: European Semester, 2010.

From the *Macro* perspective, one of the most promising sections in European Semester seems to be

> *Article 5: In-depth review*
>
> *1. Taking due account of the discussions within the Council and the Eurogroup referred to in Article 3(5), or in the event of unexpected, significant economic developments that require urgent analysis for the purpose of this Regulation, the Commission shall undertake an in-depth review for each Member State that it considers may be affected by, or may be at risk of being affected by, imbalances. The in-depth review shall build on a detailed analysis of country-specific circumstances, including the different starting positions across Member States; it shall examine a broad range of economic variables and involve the use of analytical tools and qualitative information of country-specific nature. It shall acknowledge the national specificities regarding industrial relations and social dialogue. The Commission shall also give due consideration to any other information which the Member State concerned considers to be relevant and has communicated to the Commission.* (Regulation of the European Parliament, 2011)

Naturally, keeping in mind that "a broad range of economic variables" involve social variables like economic inequality, poverty as well as institutions/ mechanisms structures, and national knowledge paces (Ennuste, 2008 with many References), etc. and that "country-specific" idiosyncrasies involve an approach broader than that, e.g. politically sensitive variables like ethnic heterogeneity, etc. Here we have to remember that in the small Member States situated nearby big states, the high ethnic heterogeneity may be such a deteriorating phenomenon (Ott & Ennuste, 1996) and that the problem may not be solved endogenously and deserves coordination on the higher political level.

And most importantly, at that we have to keep in mind Rothstein's anti-devolutionary third argument: "The third argument is that it is unlikely that such mechanisms will be efficiently designed/evolved/adapted endogenously by market agents. Moreover, if such institutions have been created, we should expect market agents to try to destroy them." (Rothstein, 2009)

This kind of "endogenous impossibility" problems may be very important to consider in the central coordination agendas; for example, specifically for the effective institutional design and correction projections: it may be that some mechanisms are coalition-politically skewed (Cotton, 2011) and to the banking and magnate lobbing askew—and there may be the case that the opposition has endogenously not enough bargaining power to correct this endogenously (Ennuste, 2009) without central coordination.

In the context of this 'endogenous' and outside coordination it seems that we have to introduce here the term 'semi-endogenous', see here the interesting extract by Boettke and Fink (2011):

> *We respond by stressing that institutions structure the incentives underlying individual action, secure private property rights are indispensable for prosperity, institutions have a first-order effect whereas policies only have a second-order effect, successful institutional change comes from within a society, and, given the status quo of developing countries, first-world institutions are likely not to be available to them.* (Boettke & Fink, 2011, p. 499)

Of course the article is not trying to advance the understanding that current dominant *Macro* discourse on institutions, economic policies and development should not be taken without any critical examination (see more *N3* below; Chang, 2011).

In the case of Estonia, one of the most urgent in-depth examination examples in the *ES* procedures may be the presently existing anomaly of 'zero profit tax'. It is probably a politically skewed mechanism and, according to many *Macro* conceptions, dysfunctional in the aspects of sustainability—in favour of the "haves" and probably the product of incompetent short-termism of the law making and lobbing of the magnates (Ennuste, 2009). And it seems that there is shortage of oppositional political bargaining power endogenously to correct that in the foreseeable future without exogenous coordination. Indeed, a section from the Estonian government's recent projection by 2020 postulates:

> ***17. Continuing the gradual reduction of taxes on labour and profits and to increase taxes on consumption and use of natural resources.***
>
> [...] *Efforts must be continued to harmonize indirect* ***taxes that have a significant impact on the functioning of the EU internal market and to abolish exceptions in the EU****. Direct taxes and tax systems (rates) reflect every country's specific and unique social and political choices, and thus the principle of freedom of choice of member states must remain in place in this regard.* (Estonia 2020, 2011, pp. 29–30; emphasis in the original)

It is easy to see that this section has fuzzy logic as:

a) the corporate profit tax in Estonia has been for about a dozen years slashed to zero (sic!) and so a gradual reduction of it is an absurdity in the macroeconomic context;
b) it is unethical to speak about local profit tax reforms neglecting harmonization with the Member States especially in the aspect of competition on capital markets, and incompetently neglecting dysfunctionality problems domestically as well (see more in *N3*).

Deus ex machina. It seems that the *ES* process in the peripheral member countries should first of all limit the implementation of bad policies' mechanisms due to incompetent governance based on low-quality public socio-economic knowledge space. Obviously, some "small" governments of these member countries have also not enough political bargaining power against devolutionary camps for the rational implementation of knowledge-based policies and reforms for sustainable development.

In terms of Estonia, sustainability regeneration ES mechanism equilibrium policy does exist in the proper following of the *Macro* concepts proposed in this Memo. Our political administration should focus on trying to apply these efforts constructively.

The European Semester professoriate has an obligation to criticize and improve those policy efforts in the field in institutional designs and as well in intervention strategies, and most importantly not to close ayes in the cases of devolutionary activities.

But if local devolutionary politics is allowed to split the discipline, and communication discourse across that divide continues to break down, the *ES* game actors will forfeit what little administrative coordination power/respect it commands and/or how little respect has been given to the *Macro* concepts and tools especially in the Estonian case to social capital formation and institutional skewness and most of all to the quality of *Macro* competence.

Memo Notes

(A) Macro has progressed towards constructive operational theory (N1)

Especially technically in the field of mathematical mechanisms design (see, e.g., Royal Swedish Academy of Sciences, 2007), and in the field of institutional economics, including political corruption modelling (e.g., Holcombe & Rodet, 2012), and thus also in the classical branches especially considering the limited rationality and Bayesian learning (Royal Swedish Academy of Sciences, 2011), and in the field of uncertainty considerations in the economic policy projections (Phelps, 2006) and North (1990) on institutional change and economic performance, market economic systems concepts (Pryor, 2005), and in general by Phelps (2006) on the macroeconomics' position for a modern economy.

McMillin (2012) writes:

> *In her article 'Macro has progressed', Kozicki argues that assessing progress in macroeconomics by focusing on the use of DSGE modeling is too narrow a focus, and, accordingly, she considers advances in macroeconomics outside the core DSGE framework. As evidence of progress in macroeconomics, she points to enhanced understanding of financial crises, a broadening in the theoretical and empirical treatment of expectations formation and how expectations are incorporated in macro models, and improvements in our understanding of linkages between the real and financial sectors.* (McMillin, 2012, p. 1)

We have to add here to this "narrow Macro" that especially great progress has been made in including financial indicators into large macro-forecasting models that had produced dozens of excellent results in the prediction of the previous global crisis (Bezemer, 2009a).

In the Estonian empirical post-crisis conditions (Ennuste, 2009) and in the framework of the *ES* coordination mechanism the progressed *Macro* concepts and tools may be progressively implicated for the optimization of national economy sustainability probability enhancement—first of all in the enhancement of the quality of national public socio-economic knowledge structure, in the control and regulation of human and real and social capital mechanisms and strategies, and in other fields of public economics—instead of the regrettable presently dominating incompetent use of micro- and meso-economics.

(B) The SE-Estonian equilibrium socio-economic knowledge structures have to be compatible and undistorted (N2)

Macro has many theorems verifying the important implications of the actors' knowledge space credibility levels on the quality of the equilibrium solutions (see, e.g., Ennuste, 2008 and References).

From this aspect, the extant low credibility and slowness of some Member States' public knowledge space should first of all be basically adapted to IT-technology and harmonized with the Eurostat and ECB standards (that should be also improved). This means that the overall statistics are made more transparent and comprehensive, less politically distorted, and more efficient in equilibrium designs and policy projections—for ex-ante prevention of macroeconomic imbalances, and so with the Eurostat.

Unfortunately, at present such significant indicators as Estonia's high national gross external debt, current account and balance of payments, international investment position are not integrated into comprehensive statistical framework. More than that, in administrative statistics there are dominating indicators that in *Macro* sense are not credible, such as PPS currency, especially in comparison to the eurozone countries. In the same sense it is not sufficient to have in the official statistics just one kind of inflation, especially in the Baltic Rim countries (Finland, for example, has introduced two inflation indicators).

In the Estonian case, the national knowledge space is contaminated with politically distorted concept *à la* "we are the best" to hide real strategies of some political camps for the reasons of the political stability like (ironically) "survival in the crisis only of the richest", etc., and other *Macro*-theoretically absolutely non-sustainable boasting concepts like "we have been the first to come out of the crisis", etc.—and filled with fuzzy logic plus populist incompetent outdated market concepts based at best on microeconomics. And the predominant understanding among local management seems to be "no capital outflow taxes" although these may be improving welfare in present situation (Kitano, 2011).

And we must not forget in terms of informational distortions the skewness problems in the sense proposed by Cotton (2012), and that skewness angle is easily measured on the complex plain (Ennuste, 2007b).

These regrettable phenomena, alas, also amplified by the Estonian mass media are helping to play down cognition of the real severity of the present socio-economic hyper-crisis situation, and not enabling the making of high-quality forecasts, and, in turn, significantly magnifying the national socio-economic sustainability risks.

Unfortunately, most of the suggested points stand no chance of easy corrections endogenously. Adopting *ES* coordination policies in these areas would require high competence and quality of political leadership. According to the existing policies, there is a lack of these qualities, and the current Commission staff in Brussels seemingly prefers (according to the existing policies) not to notice these local objective idiosyncratic shortcomings of economically insignificant countries, at least in the bilateral consultation and harmonization processes.

(C) Coordination of institutional changes and designs first (N3)

This *Macro* analytical paradigm is actively promoted by the *Journal of Institutional Economics* and the *Journal of Public Economics*. In a recent publication, Ostrom and Basurto (2011, p. 317) argue: "In order to adequately address the most pressing social and environmental challenges looming ahead, we need to develop analytical tools for analyzing dynamic situations—particularly institutional change."

The most urgent in-depth institutional problems for the Estonian economy are in the field of rationalization and harmonizations of the tax system and corresponding reforms: in the sense of harmonization of investment competition with the Member States and lowering the risks of domestic capital flight without domestic taxing and avoiding worsening of the Estonian international investment position. And, most importantly, presently there is a lack of coordination between income tax law and national pension law—all these imbalances are increasing risks of deepening the imbalanced economic inequalities, impoverishment and emigration.

(D) Equilibrium economic correction and intervention policy (N4)

The crisis has shown that macroeconomic policy in the Baltic Rim region needs to be better coordinated regionally, especially when it comes to protecting the Baltic area from the "free" movement of "all kinds" of labour, credit, investments, financial obligations, etc., considering the seemingly growing economic differences between the Baltic and Nordic countries in the after-crisis. (By the way, to euphemistically redress these inequalities, the Eurostat is using the imaginary PPS "parity prices", which are actually local deflators. These PPS prices are in *Macro* conceptions just blurring the picture and confusing effective coordination and dissemination of grants, at least in sub-region).

As far as fiscal deficiencies are concerned, from the *Macro* angle it appears first and foremost in this game as a symptom: in the Estonian case caused by a highly toxic cocktail from dysfunctional institutions—zero profit tax with complementary misbalanced social taxing, no taxes for capital outflows, plus inflationary indirectly confiscating taxing, with political impossibility for endogenous corrections no national bank's interventions, etc.

Discourse Notes[2]

(N1) Coordination in the Macro

The coordination theme in modern macroeconomics generally belongs to the domains of evolutionary economics and mechanism design theories – the former is happily enough more or less a narrative one, while the latter is nowadays rigorously formalized, based on heavyweight mathematics, see:

a) The 2007 Nobel Prize in Economics: "**Mechanism design theory is a branch of game theory[3] […] and extends[4]** (sic!) **the application of game theory to ask about the consequence of applying different types of rules to a given problem."** And see also an example of theoretical optimization model of building of national socio-economic institutional structure.

b) The 2011 Nobel Prize in Economics considers in the econometric models limited rationality (Sargent & Sims, 2011)

As politicians and lawmakers (the implementers of institutions) as a rule do not know and dislike mathematics and high-level tedious science in general, they try, especially in this very crisis period, to claim that mathematical macroeconomics is to blame as the significant destabilizing factor, not able to forecast important socio-economic events and is no good altogether and whatsoever.

However, this is absolutely not true (Bezemer, 2009a), and is actually slander—first of all, the high-level, such as the Nobel-domain, mathematical macroeconomic theories are in mainstream credible, these contain all the

[2] A caveat: all extracts of argumentation are strictly separated from credible peer-reviewed public non-commercial publications

[3] NB! The generally dynamic Bayesian mathematical game theory – *Author's note.*

[4] For example, in the field of social behaviour, animal spirit, etc. – *Author's note*.

uncertainties and moral hazards of *animal spirit* in all varieties (limited rationality, strategic manipulative distortion of communication, incompetence, greed, etc.), and these theories should be implemented especially in the times of crisis (Bezemer, 2009b).

> *If those with political power benefit from corrupt institutions, rulers might not adopt the rule of law so the ruling class can command a larger share of a smaller pie. An empirical analysis reveals that the size of government is larger in those countries that enforce the rule of law. If government expenditures provide some measure of the ability of the ruling class to command resources, this suggests that those with political power could benefit from imposing a fairer and more objective legal structure. Another conjecture is that those in power maintain corrupt governments to pay off their supporters and enhance their ability to remain in power. However, the rule of law is also positively associated with political stability, so better enforcement of the rule of law also enhances the ability of incumbent governments to remain in power.* (Holcombe & Rodet, 2012)
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> *Several papers that address the issue of progress in macroeconomics are presented in this section, which takes its title from an article entitled "Has Macro Progressed?" submitted to the Journal by Ray Fair. We took the opportunity of the submission of Fair's provocative article to solicit the views of other macroeconomists regarding progress in macroeconomics. Fair's paper along with papers by Peter Howitt, Sharon Kozicki, and Harald Uhlig are presented in alphabetical order in this section.* (McMillin, 2012)
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> *The Royal Swedish Academy of Sciences has decided to award The Sveriges Riksbank Prize in Economic Sciences in Memory of Alfred Nobel 2007 jointly to* **Leonid Hurwicz**, *University of Minnesota, MN, USA,* **Eric S. Maskin**, *Institute for Advanced Study, Princeton, NJ, USA and* **Roger B. Myerson**, *University of Chicago, IL, USA "for having laid the foundations of mechanism design theory."*
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> ***The design of economic institutions***
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> *Adam Smith's classical metaphor of the invisible hand refers to how the market, under ideal conditions, ensures an efficient allocation*

of scarce resources. But in practice conditions are usually not ideal, for example, competition is not completely free, consumers are not perfectly informed plus privately desirable production and consumption may generate social costs and benefits. Furthermore, many transactions do not take place in open markets but within firms, in bargaining between individuals or interest groups and under a host of other institutional arrangements. How well do such different institutions, or allocation mechanisms, perform? What is the optimal mechanism to reach a certain goal, such as social welfare or private profit? Is government regulation called for, and if so, how is it best designed?

These questions are difficult, particularly since information about individual preferences and available production technologies is usually dispersed among many actors who may use their private information to further their own interests. Mechanism design theory, initiated by **Leonid Hurwicz** *and further developed by* **Eric Maskin** *and* **Roger Myerson***, Has greatly enhanced our understanding of the properties of optimal allocation mechanisms in such situations, accounting for individuals' incentives and private information. The theory allows us to distinguish situations in which markets work well from those in which they do not. It has helped Economists identify efficient trading mechanisms, regulation schemes and voting procedures. Today, mechanism design theory plays a central role in many areas of economics and parts of political science.* (Royal Swedish Academy of Sciences, 2007)

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The paper uses the paradigms of the New Institutional Economics to quantify a linear optimal choice model as a way of designing perspective institutional clusters for a national economy. This model uses binary integer institutional choice variables and structural parameter values based on subjective probabilities collected from experts by calibration questionnaires.

The optimisation goal may be e.g. a high expected probability of stable national economic performance under socio-economic development credibility constraints, dependent on the realization of prospective significant events. The model may be useful as a complementary tool for the social design of the effective institutional structure, *and especially for evaluation of the socially optimal values of co-ordinating shadow prices and implementing side-payments in the political institutional design game. We use the Estonian case as an example. The model variables and data calibration table illustrations are provided mainly to demonstrate the broad spectre of issues that may be involved in this analysis.* (Ennuste, 2003)

(N2) The quality of national public socio-economic knowledge structures

The narrative meta-synthetic deduction (Gu & Tang, 2005) of rational conceptions for implementing mechanism building of the public social knowledge structure in the environment of the dynamic post-transformation society is extremely complicated.

First of all, all extant definitions of the structure have their drawbacks (Ramazzotti, 2005), and more importantly, private information of the actors in this area is an intangible invisible asset of complex values: moral and material. So are the preferences of the actors.

We have stressed in our discussions the importance to tackle these public social knowledge structures as active dynamic institutions: as the quality of these structure is not having only relationships with general social developments, but also directly, with future developments of the implementing mechanisms under this very study.

Consequently, the studies comprising more or less the whole system may give only very general results. Still, as this study has proved, this kind of wholeness analysis based on the meta-synthetic design (deductive implementation theoretic and inductive empirical-intuitional), might be highly justified, especially in the case of post-transformation situations. In these cases of rapid structural changes in many social areas the rational regulation/coordination of current beliefs, opinions, expectations, and learning structures is extremely important.

The above abstract discussion argued that the adequate socio-economic information structure implementing mechanisms design should have extremely complicated configuration:

* Complex and parallel coordination networks (e.g., governmental and non-governmental);
* Complex coordinating instruments (e.g., material and moral);
* Complex coordinating principles (e.g., incentives and constraints);

* Moral coordination should contain for actors indicators of credibility in dissemination of messages (non-distortion, non-erroneous and clear and full disclosure), respectfulness in absorption and forwarding others messages, and aggregate indicator of reputation;
* Complex incentive and restriction mechanisms (e.g., may be based on complex number models);
* Complex sequentially interacting mechanisms should be preferred, especially in the field of reduction super-uncertainties (coordinating agents' strategies), and also for reducing fundamental uncertainties;

The results of the survey revealed the importance of taking into consideration significant current idiosyncrasies of the societies under the study, e.g.:

* Types of political systems (e.g., partocratic democracy may be interested in disseminating dominantly populist messages to the public and at irrational closure of national statistics);
* Linguistic heterogeneities of the population (e.g., part of the newly arrived population may communicatively belong more or less to some other society);
* Weight of academic community in the society.

An extremely interesting phenomenon revealed by the survey and deductive speculations was that in the current Estonian context, enhancements and extensions of non-governmental soft (based mainly on moral indicators and self-analyses) coordinating networks and institutions was by the bulk of experts, especially among academic people and high-ranking politicians, strongly supported. The noteworthy exceptions in this point have been the opinions of some governmental officials.

> *In general the study revealed that in the current Estonian context the reputation factors of the actors in the public socio-economic structure building should be more highly appreciated. Importantly, building the track for flexible mechanism changes and adaptation in Estonia in this area should aim toward measures, by adding complementary elements, not obstructing the work of the established credible respective institutions and introducing new uncertainties, and should aim at introducing first of all these policies which are connected with increasing institutional credibility.* (Ennuste, 2008)

On capital controls and welfare:

> *This paper computes welfare levels under different degree of capital controls and compares them with the welfare level under perfect*

> *capital mobility by using the methodology of Schmitt-Grohé and Uribe (2007). We show that perfect capital mobility is not always optimal and that capital controls may enhance an economy's welfare level. There exists an optimal degree of capital-account restriction that achieves a higher level of welfare than that under perfect capital mobility, if the economy has costly financial intermediaries. The results of our analysis imply that as the domestic financial intermediaries are less efficient, the government should impose stricter capital controls in the form of a tax on foreign borrowing.* (Kitano, 2011)

(N3) Institutional changes first

> *Most powerful analytical tools used in the social sciences are well suited for studying static situations. Static and mechanistic analysis, however, is not adequate to understand the changing world in which we live. In order to adequately address the most pressing social and environmental challenges looming ahead, we need to develop analytical tools for analyzing dynamic situations – particularly institutional change. In this paper, we develop an analytical tool to study institutional change, more specifically, the evolution of rules and norms. We believe that in order for such an analytical tool to be useful to develop a general theory of institutional change, it needs to enable the analyst to concisely record the processes of change in multiple specific settings so that lessons from such settings can eventually be integrated into a more general predictive theory of change.* (Ostrom & Basurto, 2011)

Our 'Discourse Memo' is theoretically very much inspired by Cotton (2012) and specifically by the following claims considered there: "(1) the rich have better access to politicians than less-wealthy groups, (2) this access advantage makes the rich better off and skews policy in their favor, and (3) contribution limits can reduce the rich group's advantage and result in less-skewed policy […], which results in more evidence disclosure and better policy." (Cotton, 2012, p. 369)

Let us add here claims that from the modern heterodox macroeconomics position probably (1) "the rich" (tycoons, oligarchs, magnates, CEOs especially of banks, etc., VIPs, dependent think tanks, etc. who are from the macroeconomics' perspective generally "laisser faire" and "small government" parlour) have also better access to, for example, the national public press and formation of national public socio-economic knowledge space, and (2) from the point of political economics, these access advantages are probably skewing national economic policies and national socio-economic knowledge structures in favour of certain interest groups, and (3) national macroeconomics knowledge structures are most probably skewing towards sub-optimal short-termism and towards a preference of myopic and outdated microeconomics market concepts and objectives in long-term development projections, e.g.: short-term growth v. sustainability, *laisser faire* v. taxes and audition, GDP v. NNI, stimulation v. intervention, forecasting v. projections, horizontal v. hierarchical coordination, competitiveness v. wellbeing, consolidation v. expansion, unemployment v. employment and fair economic equality, populist growth indicators v. economic potential, and so on – towards bad policies first of all from the coordinated economic wellbeing of the Union's central player's long-term views with primary priorities like convergence, sustainability, employment, alleviation of poverty, etc.

> *We develop a game theoretic model of informational lobbying between two interest groups and a politician, in which the politician can require political contributions in exchange for access. The analysis considers three claims: (1) the rich have better access to politicians than less-wealthy groups, (2) this access advantage makes the rich better off and skews policy in their favor, and (3) contribution limits can reduce the rich group advantage and result in less-skewed policy. We show that the rich do have better access, with the politician always offering access to the rich groups and only sometimes offering access to the less-wealthy group. This does not, however, mean that the rich group is better off or that policy is biased in its favor. The politician sets access fees to extract the greatest amount of rent from the political process. When only the rich group has access, its expected benefit from gaining access is fully offset by its payment to the politician. In this case, the less-wealthy interest group who is not targeted by the politician is better off. Contribution limits decrease the politician's ability to extract rent, which improves the payoffs of rich interests and decreases politician payoffs. Finally, the paper presents a novel benefit of contribution limits: they can encourage the formation of lobby groups or the search for evidence, which results in more evidence disclosure and better policy. (*Cotton, 2012)

And on institutional equilibrium also:

> *Institutions that serve the interests of an elite are often cited as an important reason for poor economic performance. This paper builds a model of institutions that allocate resources and power to maximize*

the payoff of an elite, but where any group that exerts sufficient fighting effort can launch a rebellion that destroys the existing institutions. The rebels are then able to establish new institutions as a new elite, which will similarly face threats of rebellion. The paper analyses the economic consequences of the institutions that emerge as the equilibrium of this struggle for power. High levels of economic activity depend on protecting private property from expropriation, but the model predicts this can only be achieved if power is not as concentrated as the elite would like it to be, ex post. Power sharing endogenously enables the elite to act as a government committed to property rights, which would otherwise be time inconsistent. But sharing power entails sharing rents, so in equilibrium power is too concentrated, leading to inefficiently low investment. (Guimarães & Sheedy, 2012)

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A European Semester should encapsulate the surveillance cycle of budgetary and structural policies.

It would start early in the year with a horizontal review under which the European Council, based on analytical input from the Commission, would identify the main economic challenges facing the EU and the euro area and give strategic guidance on policies. Member States would take conclusions of this horizontal discussion into account when preparing their Stability and Convergence Programmes (SCPs) and National Reform Programmes (NRPs). SCPs and NRPs would be issued simultaneously, allowing the growth and fiscal impact of reforms to be reflected in the budgetary strategy and targets. Member States would also be encouraged, in full respect of national rules and procedures, to involve their national parliaments in this process before submission of the SCPs and NRPs for multilateral surveillance at the EU-level. The Council, based on the Commission's assessment, would subsequently provide its assessment and guidance at a time when important budgetary decisions were still in a preparatory phase at the national level. In this context, the European Parliament should be appropriately engaged. (Estonia 2020, 2011*)*

Estonian Government projection by 2020 postulates:

17. Continuing the gradual reduction of taxes on labour and profits and to increase taxes on consumption and use of natural resources.

> *Greater taxation of wages and profit will limit economic growth more than the equivalent amount of taxation on consumption and use of the environment. For this reason, we must support at every level* ***a shift in taxation from workforce (direct taxes) to taxation of consumption and resource use (indirect taxes).*** *Besides geographic location and reputation of the state, taxation is one of the most important factors that helps draw foreign direct investment to the country. Favourable taxes are the linchpin for positive investment decisions in cases where other prerequisites (basic infrastructure, education, security) are ensured to a degree comparable with other countries. Thus, as one measure to be established, a ceiling will be set on the pension insurance component of the social tax.*
>
> *Efforts must be continued to harmonize indirect* ***taxes that have a significant impact on the functioning of the EU internal market and to abolish exceptions in the EU****. Direct taxes and tax systems (rates) reflect every country's specific and unique social and political choices, and thus the principle of freedom of choice of member states must remain in place in this regard.*
>
> *Estonia must become the 28th tax system to support the uniform consolidated income tax base on condition that it will simplify the functioning of the entrepreneurial environment and that it is possible to maintain the current Estonian corporate income tax principles. Simplicity, transparency, low administrative costs are of key importance for Estonia in maintaining and increasing the competitiveness of the entrepreneurial environment.* (Estonia 2020, 2011, pp. 29–30)

It is easy for us to see that by all standards of modern heterodox macroeconomics (synthesis of the evolutionary, institutional, Bayesian and other macro theories, e.g., Keynesian and Friedmanian doctrines, etc.) this section is completely skewed towards the interests of the richer Estonian stakeholders and this especially in the EU long-term context, and based first of all on myopic outdated microeconomic and populist concepts such as: "Continuing the gradual reduction of taxes on […] profits (sic! – *Author*) and to increase taxes on consumption"“—(a) profit tax in Estonia has been annulled to zero (sic!) for about a dozen years already, and is thus an absurdity in the macroeconomic context: unethical and not harmonized in the international competition on capital markets, and dysfunctional domestically as it pushes capital out of domestic economy (Eesti Pank, 2012) and unfairly inflicting increasing labour taxes and inflation, and (b) increase of taxes on consumption would first of all be hitting most severely the population in-poverty-risk and material deprivation and (c) this tax policy is macroeconomically almost certainly not sustainable as, for example, indirectly it is stimulating outflows of capital and labour out of the country, increasing domestic economic real inequality, etc., and with great probability inflicting sub-optimal long-term development of the national economy.

And the statement "Estonia must become the 28th tax system to support the uniform consolidated income tax base on condition that it will simplify the functioning of the entrepreneurial environment and that it is possible to maintain the current Estonian corporate income tax principles" is not only skewed but also logically fuzzy in the interests of investors and in trying to perpetuate the idea that the less-wealthy should pay for some public expenses connected with the profit-making of the "haves".

Most importantly, the current populist macroeconomic policy on the basis of distorted low-quality national public knowledge space (dominated by myopic populist liberal microeconomics doctrines such as "flat taxes and small government" and "domestic devaluation") has, in the recent years, turned Estonia's economy on a negative divergence trend in the EU-27 comparison (see Fig. 1: Estonian GDP pc even in the decorative PPS currency in sigma convergence has taken a downwards trend). Remarkably, there is a regrettable Figure 1 but, myopically, no word of responsible explanation about this significant dismal trend in this document. Probably a turn to unsustainability has also taken place (recall as unbalanced amounts of capital and labour is flowing out of the domestic economy)—all that regardless of substantial grants from the EU budget. It is likely that the neglect to analyze these most important negative tendencies becomes possible because Estonia's administrative statistics lacks a clear-cut rubric of 'Sustainability indicators'.

Projections such as *Estonia 2020*, *Europe 2020*, etc., and clusters of official statistical sustainability indicators must also contain information about macro-financial flows and stocks, human capital macro flows and stocks, FDI flows and stocks, different inflation indicators, relevant tax reforms time lines, poverty indicators, etc.

In this respect, "the process of giving strategic guidance on policies to the Member States when preparing their Stability and Convergence Programmes and National Reform Programmes" should be the central role of the *ES*. It may be claimed that this mechanism has been designed according to modern standards of the heterodox mainstream macroeconomics (especially Bayesian informational coordination mechanism with side-payments theories). But as such it may be skewed and in conceptual conflict with the national socio-economic managers and administrators interests of most peripheral Member States and the local interests of international banks and monopolies (high inflation, tax paradise, low wages, etc.), and, most importantly, in contradiction with the national public knowledge spaces mainly formatted on outdated liberal microeconomics' tenets.

> *This information asymmetry phenomenon may hamper or already has impeded the optimal implementation of the European Semester coordinating game mechanisms. And perhaps something has to be urgently done or regulated first of all in this mechanism by the Commission, especially in the field of enhancing the quality of macro-communication mechanisms and improving the quality of national macro statistics (e.g., include sustainability indicators, etc., and publish the comparative GDP growth rates of the member countries* (Eurostat, 2012).

The article tries to advance our understanding of institutional economics by critically examining the currently dominant discourse on institutions and economic development. First, I argue that the discourse suffers from a number of theoretical problems—its neglect of the causality running from development to institutions, its inability to see the impossibility of a free market, and its belief that the freest market and the strongest protection of private property rights are best for economic development. Second, I point out that the supposed evidence showing the superiority of 'liberalized' institutions relies too much on cross-section econometric studies, which suffer from defective concepts, flawed measurements and heterogeneous samples. Finally, I argue that the currently dominant discourse on institutions and development has a poor understanding of changes in institutions themselves, which often makes it take unduly optimistic or pessimistic positions about the feasibility of institutional reform. (Chang, 2011, p. 473)

(N4) On socio-economic policy-strategy and institutions' skewness

First, for a recovery from hyper-crisis perhaps Estonia shouldn't all together rush to exit from the variety of significant, direct regulation mechanisms and instruments like fiscal stimulus and monetary relaxation, intervention policies, etc., categorically. Perhaps it is not yet too late to ensure a proper sequencing of these instruments complementary to budget cuts, with the goal of preventing a hyper- unemployment (20%), massive euro loan-bankruptcies of households and double-dip recession. This, first of all based on domestic recourses (e.g., from the Bank of Estonia, state bonds, etc.).

Second, Estonia should instantly rush to establish "harmonization" with the European Commission regarding the amendment of the extant Maastricht inflation criterion: in present form it is methodologically defective, non-transparent, and with that may cause irretrievable socio-economic and credibility losses for Estonia; and perhaps in the crisis situation, it may be rational for Brussels to move beyond a rigorous adherence to the whole stability and growth pact altogether (see also Sapir, 2009).

Third, a reform of the Estonian tax system is probably instantly necessary: in the sense of harmonization of investment competition with the member countries, for enhancement of Estonian socio-economic sustainability, lowering the risks of domestic capital flight without domestic taxing and avoiding worsening of the Estonian international investment position. And, most importantly, presently there is a lack of coordination between income tax law and national pension law, etc. (Ennuste, 2009)

Annex

A sketch of formalization of the 'geometry' of the EU Macroeconomic Governance Hierarchy according to the ESM Reform and Estonia's position

This sketch is mainly based on Pisani-Ferry, Sapir and Wolff (2012), and partly on Estonia's position as proposed by Purju (2012).

The euro crisis and subsequent policy responses have challenged the assumptions underpinning the governance of the euro area, and the relationship between the European Union's euro- and non-euro countries. The euro policy regime has become increasingly complex and difficult to manage, raising the question of the accountability of decision-making to citizens. The complexity also threatens to create frustration for euro-area members who fear that initiatives to strengthen the euro will be hindered, and for non-euro members who fear that they will be de facto deprived of their say in decisions of major relevance to them.

It is easy to see in this situation of the EU after the ESM reform developing variable complex macro-governance hierarchy geometry with many overlappings of the mechanisms and regulations—for the sake of clarity, it may be very operational to introduce in the narratives some elements of formalizations as on the hierarchical coordination levels as on the Member States' position's structures, simply to classify the complex and multi-dimensional problems more rigorously and transparently and alleviate complexity frustrations.

The General Geographic Model of the EU Macroeconomic Governance Hierarchy (Country Matrix […] + Coordination Mechanism {…}):

R(EU)=EU[(Mec+Mep)+(Mnc+Mnp)]{LT+ESM}

Where *R* – rebuilt; *M* – set/number of the Member States; *e* – euro countries; *n* – non-euro Countries; *c* – core; *p* – peripheral; *LT* – mechanisms based on the Lisbon Treaty; *ESM* – the European Stability Mechanism in complex ('European Semester' … and rebuilt regulations and institutions; note the Regulation Network on the Institutional Matrix).

Table 1. The increasingly complex decision-making

Six-Pack item	Regulation/ Directive No.	Six-Pack Regulation	Applies to:	Voting rule
1	1175/2011	Improving budgetary positions and economic policies	EU27 (with minor exceptions which only apply to euro area+ERM2)	1
2	1177/2011	Improving the excessive deficit procedure	EU27, ECB surveillance only applies to euro area+ERM2 countries	N/A
3	2011/85/EU (Directive)	Budgetary frameworks requirements	EU27, the UK does not have to abide by Articles 5 to 7 (concerning numerical fiscal rules)	N/A
4	1176/2011	Macroeconomic imbalances	EU27	2
5	1173/2011	Enforcing euro area budgetary surveillance	Euro area	2
6	1174/2011	Correcting excessive imbalances	Euro area	3
Two- Pack item	**Regulation No.**	**Two-Pack regulation**		
1	385/2011	Surveillance for member states with financial stability difficulties	Euro area	3
2	0386/2011	Common provisions for draft budgetary plans and excessive deficit correction	Euro area in general (with minor exceptions for members who are subject to macro-economic adjustment programmes or already subject to an excessive deficit procedure)	3
		Agreement		
		Fiscal Compact (TSCG)	EU25 (the UK and the Czech Republic are left out)	4
		European Stability Mechanism (ESM) Treaty	Euro area	5

Voting rules: 1 = QMV, excluding the member state concerned (only euro-area countries vote on euro-area members), Council can reject Commission recommendation by simple majority. 2 = QMV, excluding the member state concerned. 3 = QMV of euro-area countries, excluding the member state concerned. 4 = Reversed QMV (euro-area countries). 5 = QMV or mutual agreement by the Board of Directors and the Board of Governors.

Source: Pisani-Ferry, Sapir & Wolff, 2012

Remarks on the idiosyncrasies' cluster of Estonia's position in the European Semester context in the Mep group (narratives based on (Purju, 2012)), e.g.

Cee = (…Xc-…)

Where *X* may mean Estonia's convergence indicator in the *Mep*, *c* – level not satisfactory, and the minus sign indicating the worsening perspective.

Narratives for finding the most significant indicators

> *Estonia's GDP growth was 7.6 per cent in 2011 and is expected to be 1.7 per cent in 2012 after a 17.5 per cent decline during 2008–2009. The budget deficit is expected to be 2.6 per cent in 2012.* (Purju 2012, p.22)

Estonia's general convergence position regarding the EU countries at the time is detonating—labour and capital is an anomaly flowing out of Estonia, inflation is high, NNI pc is low, gross foreign debt is on the average level compared to the payment facilities, and the tax system is unbalanced, general welfare is declining and real inequality is high and increasing, the ethnic conflict is impeding economic evolution and the country has not enough bargaining to alleviate it, the quality of public national macroeconomic competence is low and the ESM reform is increasing anxiety and populist policies, etc.

> *Estonia is interested in strengthening the euro area, the common financial market and competitiveness of the EU. Economic and financial policy of the EU should be sustainable and the Member States should fulfil the requirement of the SGP, (Estonia's European Union Policy 2011–2015, 2011). […] Estonia is looking forward to that the budgetary rule introduced by fiscal compact will support the achievement of EU priorities.* (Purju 2012, p.22)
>
> *
>
> *Estonia is interested in sustaining its tax system, which is very strongly biased toward indirect taxes, there is a proportional income tax and retained corporate profits are taxed with zero per cent corporate income tax. At the same time, Estonia is interested in harmonisation of rules for value-added tax and excise tax (elimination of exceptions) and some kind of harmonised tax base for corporate income tax, operating on the EU market.* (Purju 2012, p.23)

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