Significance of Institutions for Economic Development - Comparative Research

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Introduction

In the Washington Consensus, which was adopted in 1908s and 1990s by developing and former socialist countries, deregulation, liberalization and privatization were seen as most significant. Openness and privatization strategies in the last 15-20 years have become worldwide processes covering many world countries. This process had many elements of universal significance, but there were also many elements specific for the group of countries with similar socio – economic structure and a certain position in the world economy.

Research review and results

In the last several years I have conducted research of developmental processes in the underdeveloped and medium developed countries in the Central and Eastern Europe, South America, Asia and Africa.[1] After the analysis the following conclusions can be drown which are relevant for the majority of researched cases:

- Undoubtedly reforms of the public sector and privatization prevented establishing other ineffective state-owned enterprises. Mere privatization, however, without formation of competitive environment and effective pro-market institutions could not fulfill the hopes which were placed in it.
- In many countries the institutional system turned out to be inefficient (Latin America, Asia) or does not exist at all (Africa).
- General insecurity and instability in such areas as property rights or copyright, etc make economic subjects unwilling to get involved in long-term enterprises and thus there are no necessary investments in fixed assets.
- The example of some countries (e.g. Indonesia) shows that even positive economic parameters are not able to prevent financial and state crisis. Political crisis, or rather socio- political crisis, is as dangerous as upsetting macroeconomic balance. It leads to the loss of investors' confidence in the authorities' activities in a given country. Fragility of this trust is particularly obvious in the countries with common corruption, nepotism and the so called "crony" capitalism. Market is ineffective in the conditions of weak or lack of necessary financial, social, legal or political infrastructure.
- The example of other countries (e.g. Argentina) shows that market reforms should be a natural consequence of broadening of market freedom. This country is a good example of low effectiveness of market transformation if institutional reforms are not realized, if there are no competitive conditions and if corruption and nepotism are not limited.
- In the researched countries one can confirm the thesis of key significance

of effective institutional and legal systems for development. Those countries have weak state institutions and law. Their distinct setback is the lack of structural reforms, huge income stratification, fragile investors' confidence and corruption. The thesis of lack of discipline, poor organization, low or inadequate education and knowledge of society can also be confirmed.

• On the example of the researched countries it can be argued that a strong state is necessary precisely in the aspect of formation and providing effectiveness for institutions.

A Nobel Prize winner Douglas C North (1993) wrote in the World Bank report that it is essential to motivate people, so that they will want to invest in better technologies, increase their capacities and organize effective markets. Such motivation is placed in institutions. What primarily differentiates rich countries from poor ones is the existence and quality of some institutions. We do not mean governments creating next bureaucratic bodies, government agencies, commissions or institutions. The institutions supporting the market do not have to be public and they do not even have to be formalized.

The most important tasks of institutions include: lowering transaction costs, costs of launching new products and facilitating access to information. Institutional environment of market acquires key significance when the issue of transaction costs is taken into account. It is known that the play of supply and demand depends on the level of social confidence and transparency of functional conditions, which is the result of the legal system quality, moral principles and mentality of economic subjects. In other words, market effectiveness, and consequently, the level of transaction costs, depends on the institutions. Institutions and transaction costs these are two sides of market effectiveness.

Rodrik divides the system of market institutions into four basic categories:

• market – creating institutions, such as property rights, rights guaranteeing contract execution

• market regulating institutions – such as external effects, production scale, information about company activities, etc

• market – stabilizing institutions – such as monetary and fiscal policy management, etc.

• market – legitimizing institutions, such as social protection, insurances, etc.[2]

According to the World Bank institutions can be divided into public and private ones. The public institutions include law and court system, property rights, copyright, inheritance law, rights regulating and protecting competition as well as "transparency" of government institutions and private enterprises. The private institutions include: trade chambers, loan and loaner registers, principles of inheriting land, mutuality of business partners, etc.

For the market to function properly there must be an effective legal – institutional infrastructure, the system must be transparent and property rights must be guaranteed. The better guarantee of property rights and the better system of debt execution, the easier it is to do business for companies. Strong institutions are particularly important for smaller and weaker subjects. Corruption and poor debt execution are plagues increasing transaction costs. The institution providing for reliable contracts are a necessary condition for effective markets, which lie at the foundations of rich societies. Institutional stability is a condition for exchange in space and time. Lack of conditions for concluding reliable contracts is an essential cause of stagnation both in developing and in former socialist countries.

Economists agree that **competition** is the best stimulus for economic development. The role of the state should include competition protection and drawing up effective regulations in this area. It is the law that is the most important state institution supporting the market. The more effective it is, the lower transaction costs are for enterprises. Effective market economy should be the main drive of any development strategy but its final success depends on effective competition policy and effective legal – institutional system. Deregulation, liberalization and privatization serve to achieve those goals, but their effectiveness is limited if they are not accompanied by complementary reforms.

At present economists dealing with economic development *generally agree with the following opinions:*

- Existing development models were rather short- term ones and as such they have often led to negative results. It means that a long term has a key significance for economic development.
- Investments in human and social capital have fundamental significance for success in long-term development.
- Institutions determine developmental efforts, and currents solutions in this field in developing countries are not sufficient or even anti- developmental. Adaptation of institutional system (it's worth remembering that the market itself is an institution) to requirements of market economy has key significance.
- Cultural conditions of individual countries should be analyzed in more detail.
- Incentive system both for individuals and the whole society is essential as well as including these solutions into developmental policy;
- Private sector has key significance for economic development.

There is no agreement, however, among development economists in the following issues:

- Methods of reducing poverty and general economic growth acceleration;
- Role of state in initiating developmental processes (interventionism in relation top- bottom or a bigger role of liberal individual choices even at a price of growing social inequalities).
- Role of political factors in developmental processes
- What is the best way of mobilizing social support for development of human capital in a given country, population programs, physical and information infrastructure development, formation of proper financial institutions, as well as for the issues of exchange rate policy, inflation objectives, international capital flow, etc..

Of course a question arises if the experience of other countries, particularly of medium developed ones, can be referred to Poland. Undoubtedly, we deal with different economic, political, social, institutional and cultural conditions. It is not easy to transfer institutional systems from one country to the other, as in each country there are individual cultural circumstances. Nevertheless, in all analyzed countries there are striking experience similarities related to economy liberalization.

Firstly, privatization without effective competition does not fulfill hopes which were placed in it.

Secondly, effective legal – institutional infrastructure is necessary. Pro-market institution system seems to have a key significance for economic development. At the same time fundamental importance is attached to effectiveness of institutions which create, protect and execute law (which must be logical and coherent). The whole system of social institutions must also act effectively. In this area the state must be strong and efficient.

Thirdly, in the era of information civilization, development of knowledge – based economy has key significance.

Fourthly, corruption and nepotism, similar to the lack of political stability, lead to the loss of trust among investors.

Fifthly, cultural factors may play an important role in braking or accelerating development. Thus, broad education of the society plays a fundamental role in overcoming cultural barriers.

Undoubtedly those conclusions may be fully relevant to our Polish situation. On the present level of Polish development, particular significance should be attributed to the creation of competitive environment, cultural factors (including mentality changes), fight against corruption and nepotism and formation of effective pro-market institutions.

Final remarks

I am in favor of the thesis supported by many specialists that in the realization of those tasks, the mature institutional system of the European Union (through the adoption of acquis communautaire) may play a particularly positive role. Effective adaptation of the EU institutional system seem to be as important as aid in kind (including financial one).

Bibliography

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