

INSTITUTIONAL DEVELOPMENT AND ECONOMIC GROWTH OF EUROPEAN TRANSITION COUNTRIES

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Abstract: Institutions in a broader sense represent the adopted norms and rules of behavior in society. They define the necessary constraints that a society has adopted in order to shape and direct human interactions. Institutional change is a positive targeted adjustment of these constraints in line with social development. Due to the existence of a synergistic effect, any institutional change can cause significant social and economic changes.

The goal of the European transition countries to join the EU is at the same time a strong driver of their needful institutional transformation and necessary institutional harmonization with the EU countries. This strategic goal, which originally stems from social consensus, has a strong capacity to promote, consolidate and implement the necessary reform processes. Harmonization of institutions and, consequently, full membership in the EU generates a safer and more predictable social (and thus economic) environment. Strong institutions do not tolerate a large sphere of discretionary decision-making, creating a basic precondition for increasing domestic and foreign investments. However, the institutions also fundamentally depend on the cultural heritage of transition countries, which cannot be compensated and balanced so quickly with the traditional market economies of the EU. Institutions are a complex category whose description is not simple. Respect for democratic principles of functioning of public institutions is especially important for the presence and level of corrupt social activity. It is generally accepted that corruption, as abuse of authority in order to gain illicit benefits, is a serious obstacle to social and economic advancement, significantly reducing the possibility of successful implementation of state measures and decisions. Institutions reduce uncertainty and increase the predictability of decisions of all actors in the economic life of the country.

The eight transition European economies that were leaders in institutional development dynamics and became the EU members in 2003 had a GDP of \$ 36,855 pc at the end of 2018, which is an absolute increase of \$ 28,165. Three European countries in transition that last became the EU members, together with five countries of the Western Balkan as countries with relatively undeveloped institutions, in 2018 had an average GDP per capita of current international \$ 22,114 compared to 4,092 in 1990. In addition, GDP pc by five-year periods data show that the leading countries of institutional development were far less affected by the 2009-2010 crisis. We should always keep in mind the fact that these countries' institutional convergence towards the developed market economies institutions must not be an aim in itself, but a way to achieve better business conditions and ultimately more dynamic and quality economic growth and development.

A review of numerous studies confirmed the fact that institutions have a strong influence on economic performance.

Keywords: institutional development, economic growth, transition countries, EU

1. INTRODUCTION

There are many partial and composite indicators of the achieved level of institutional development of countries. A large number of partial and composite indicators of the achieved level of institutional development of individual countries are in circulation. Composite indices often contain data that are correlated with each other and in which the problem of simultaneity comes to the fore, which necessitates additional caution when interpreting them. However, despite the shortcomings, such ways of measuring the institutional development of individual countries create methodologically consistent databases that have been developed over the years for many countries in the world.

At the beginning of the transition process of European countries, institutions were largely shaped by a decades-long way of life. This has led to different speeds of institutional change, but also to the achieved level of economic development of certain transition countries. Consequently, some transition economies became members of the EU as early as 2004 (Estonia, Latvia, Lithuania, Poland, Czech Republic, Slovakia, Slovenia and Hungary), and some in 2007 (Bulgaria and Romania) and 2013 (Croatia). A number of countries are still on the path to EU membership (Montenegro, Serbia, North Macedonia, Albania, Bosnia and Herzegovina). For that reason, the question of the influence of certain dimensions of institutions on the economic growth of countries in transition arises. It is important to note that the transition in the case of the former socialist countries of European countries is not seen on

this occasion as a process that ends with their entry into the European Union. On the contrary, EU accession only changes the form of transition, or it changes its basic goals.

The paper discusses European transition countries and is divided into two groups. The first group consists of 3 EU member states from 2003 and 2007, and 5 late transition countries - Western Balkans. The second group consists of 8 EU member states since 2003.

The structure of the work consists of three sections. After the first, which is of an introductory character, in the second section, data on the movement of GDP per capita of the observed countries in the period 1995-2019 are given. The third section gives a brief overview of the relevant theoretical and empirical research of the impact of institutions on economic growth.

2. ECONOMIC GROWTH OF SELECTED TRANSITION COUNTRIES IN THE PERIOD 1996-2019

Table 1 shows the Gross Domestic Product (GDP) per capita of the observed transition countries. By 1995, Poland, the Czech Republic, Slovakia and Hungary had managed to achieve significant GDP per capita growth compared to 1990. Compared to other countries mentioned in the work, Slovenia had a relatively high GDP per capita at the beginning of the transition, so its lower growth rates are largely the result of that fact. These are the countries that became members of the EU in 2003. Particularly impressive is the GDP per capita growth of the group of countries of the former members of the USSR (Estonia, Latvia and Lithuania), which quadrupled only in the period from 2000 to 2019. The GDP per capita growth of Bulgaria and Croatia (with the partial exception of Romania), which are classified in Group 1 in this study, was significantly lower in the same period of time.

Table 1. GDP per capita, PPP (current international \$) and five-year indices

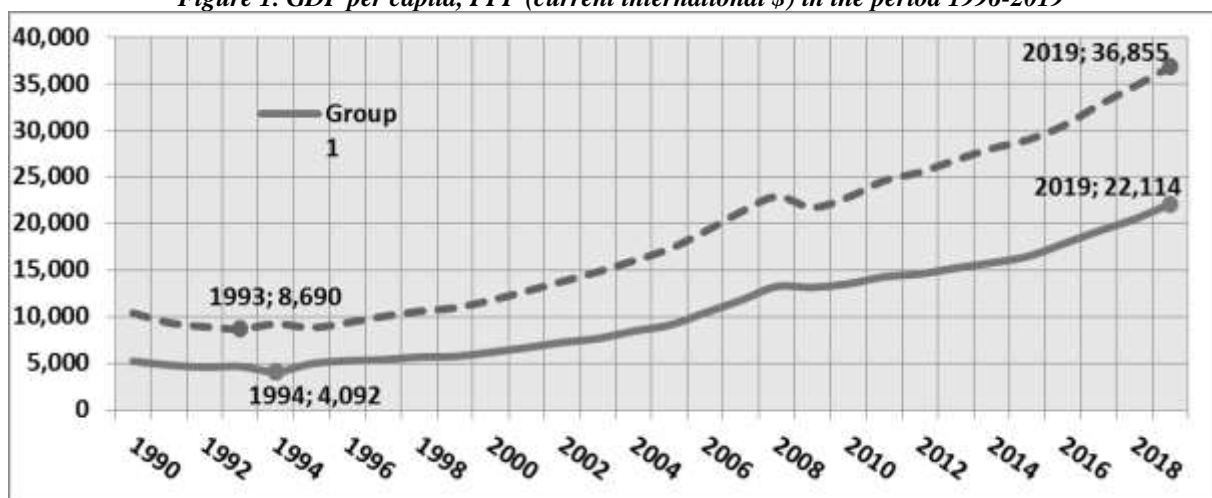
Country	1990	Index		2000	Index		2005	Index		2010	Index	
		1995	95/90 u %		00/95 u %			05/00 u %		10/05 u %	2019	19/10 u %
Albania	2,549	2,665	105	3,862	145	5,865	152	4,094	164	14,495	150	
BIH	..	1,209		4,549	376	6,480	142	4,636	144	15,792	169	
Bulgaria	7,537	7,729	103	6,424	83	10,291	160	6,810	145	24,561	165	
Croatia	..	7,959		10,604	133	15,304	144	13,924	129	29,973	152	
Montenegro		6,004		8,314	138	6,682	164	22,989	168	
N.Macedonia	5,526	4,948	90	6,129		7,760	127	4,543	145	17,815	158	
Romania	5,271	5,419	103	5,850	108	9,602	164	8,210	177	32,297	190	
Serbia	..	4,827		6,021	125	9,182	152	5,735	139	18,989	148	
Average	5,221	4,965	100	6,181	162	9,100	148	6,829	151	22,114	163	
Czech R.	12,656	13,749	109	16,195	118	21,956	136	19,808	126	42,576	154	
Slovak R.	..	8,682		11,381	131	16,639	146	16,727	151	34,178	136	
Estonia	..	6,460		9,437	146	16,625	176	14,791	131	38,811	178	
Hungary	..	9,175		11,858	129	17,074	144	13,114	126	33,979	157	
Latvia	..	5,490		8,018	146	13,837	173	11,348	127	32,204	183	
Lithuania	..	5,922		8,460	143	14,526	172	11,957	138	38,214	191	
Poland	6,174	7,663	124	10,655	139	13,896	130	12,600	152	34,218	162	
Slovenia	12,357	13,603	110	18,008	132	23,853	132	23,510	117	40,657	146	
Average	10,396	8,843	114	11,751	136	17,301	151	15,482	134	36,855	163	

Izvor: World Bank. (n.d.)

It is clear that the reasons for these evident differences in growth are very complex. The most important reasons for differences in the dynamics of economic growth of the analyzed countries in this century are the following: a) very different initial conditions of transition due to different historical heritage, b) different strategic approaches to the transition process (from shock to gradual development of institutions), c) different approaches to privatization and

market liberalization in individual countries. The initial conditions, in addition to directly affecting economic growth, largely determined the degree and speed of institutional reforms undertaken by governments (Havrylyshyn, & van Rooden 2000).

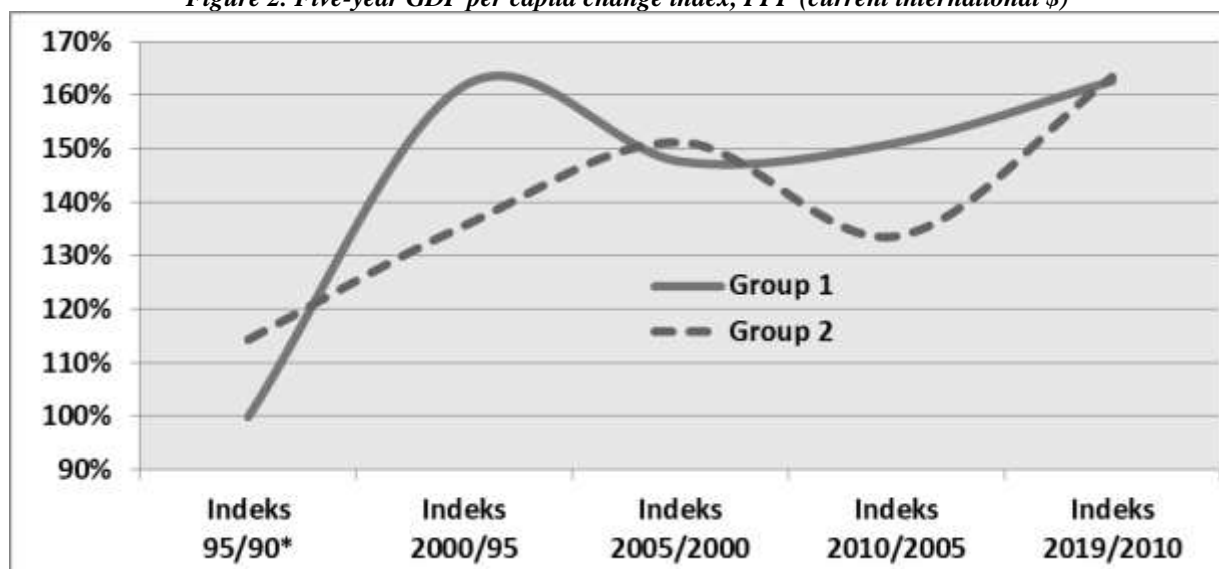
Figure 1. GDP per capita, PPP (current international \$) in the period 1996-2019



Source: Author's calculation

By the insight into the data contained in Table 1, but also from Figure 1, it is possible to observe a certain matching of GDP per capita growth rates of the analyzed groups of transition economies in this century.

Figure 2. Five-year GDP per capita change index, PPP (current international \$)



Source: Author's calculation

From the diagram presentation (Figure 2) it can be seen that the decisive difference in growth rates between the countries from Group 1 and Group 2 occurred in the years of the first half of the last decade of the previous century.

3. THEORETICAL AND EMPIRICAL RESEARCH INSTITUTIONS AS A FACTOR OF ECONOMIC DEVELOPMENT

The topic of economic growth and development, with its complex problems, is certainly one of the most propulsive areas that economic research deals with, and which, with its prevailing topics, occupies economic thought of different theoretical orientations. By chronological point of view, postwar theories of economic development have paid primary attention to studying the role of the market and the price mechanism in driving economic activity.

Clarifying the complexity of economic growth requires economic models that rely on (but are not limited to) the concepts of the function of aggregate production, the utility function of the representative consumer, the declining yields of individual factors of production.

The profiling of the dominant approach to the study of causal relations in economics has generally moved towards the endogenization of technical progress, through the high valuation of technological innovations, the concept of human capital, economies of scale and externalities, etc.

The belief that the modeling of key factors of economic growth is based on relevant empirical research and sufficiently reliable evidence to quantify assumed relationships and links between economic phenomena is spread among economists.

Despite the significant analytical value of existing growth models, the demands of empirical adequacy have encouraged economists to expand their research toward identifying more economic growth factors. Thus, the group of "factors" (Solow or Harod-Domar growth model) and "territorially" based models is supplemented by research that sees the explanation of economic growth as a consequence of the effects of institutional factors existing in the economic and social sphere. Although attempts to identify the interdependence between quality of institutions and economic growth have been present from the very beginning of modern economic science (history school, old institutionalism, Austrian school, etc.) representatives of the new institutional economy have played a key role in extending conventional economic analysis and introducing institutions to the subject of economic science. Regardless of the fact that they accept the neo-classics of scarcity, competition and economics as the science of choice, new institutionalisms do not see the primary impediment to development solely in the insufficiency and low efficiency of use of factors of production and disadvantages. For them, the link between economic growth and the functioning of an efficient institutional structure is much more relevant, as the research of the economic history of some Western countries shows quite convincingly.

The study of the impact of institutional flows on economic activity became an inspiring area of research during the 1990s and 2000s, followed by intensive production of scientific papers and empirical studies in the field. The findings of the aforementioned research significantly expanded the body of empirical evidence on the positive impact of institutions on dynamizing economic activity and overcoming various developmental problems. Quite convincing arguments have been presented about the greater relative importance of institutions in relation to geographical, integration and other factors of economic growth and development (Rodrik, Subramanian, & Trebbi, 2004; Acemoglu, & Robinson, 2012). Instead of advocating an exclusive reliance on factor accumulation, less developed countries are taught how they can improve their economic efficiency and reduce the lagging behind of the developed world by improving their own institutional arrangements.

Although the dominant scientific work in this field is aimed at confirming the strong links between the economic prosperity of countries and the quality of their institutions, it should be remembered that these are very complex relationships associated with the limited ability to analyze the fluid and multidimensional characteristics of institutions. Assessing the effects on economic growth is further complicated by the unequal effect of institutions in the short and long term, reducing the ability to accurately identify and give reliable evaluation of complex and composite indicators of institution quality (Siddiqui, & Ahmed, 2009; Haggard, & Tiede, 2011).

In parallel with the stated reservations regarding measuring the impact of institutions on economic performance, the message is that the economic importance of institutions should not be glorified to the extent that the role of the achieved level of economic development and innovation is diminished. Actually, the dynamics and directions of economic growth, as mentioned, can be significantly influenced by the development of economic institutions in accordance with the requirements of the economy. On the other hand, the level of development of market economy institutions is conditioned by the level of economic development of the country. Therefore, it can be said that any attempt to understand the complex causal link between institutional structure and economic development is a particular research challenge. This is especially true for less developed countries, whose imperative is to adapt the existing institutional structure (organizational forms, relevant pieces of legislation, business code and practices, etc.) to the application of new technology (Nelson, 2004).

Accepting the view according to which the functioning of institutions is a reflection of economic opportunity and the level of development achieved, and among other things, it identifies key determinants of institution quality (Alonso, & Garcimartín, 2013). Discussions about the criteria that can be used in institutional quality assessment are, first of all, concerned with the dilemma of the benefits of a universal approach to measuring it. Contrary to the expediency of unified research procedures and guidelines, the argument that exploring the potentially complex mechanism of influence of institutions in different economic, social, and cultural settings may not always be conducted on the instructions of pre-proclaimed models. Reasons are quite explanatory concerning the analysis of the effects of institutional development in specific situations on the basis of respect for contextual specificities, bearing in mind that the same set of institutions is not equally stimulating for achieving long-term sustainable economic growth in

different countries (Valeriani, & Peluso, 2011; Nawaz, Iqbal, & Khan, 2014).

It turns out that authors approach the conceptualization of the phenomenon of institutions within economic theory in different ways, depending on the preferred functions of institutions and the assumed mechanisms of their action on the productive potential of the economy. To clarify the nature of institutional developments and their relation to economic growth, it is crucial to define potential research fields, linked to the numerous functional dimensions and discrete channels of institutional action. In this regard, research orientations are especially emphasized and their aim is to analyze institutions in the light of fostering mechanisms of economic behavior (Hodgson, 2006). Equally fascinating is the interest in explaining the role of institutions in reducing uncertainty and facilitating economic decision-making (Dequech, 2004).

The prevailing opinion is that institutions influence the stimulation of economic activities primarily through the reduction of uncertainty and economic frictions. This influence is predominantly explained by the action of institutional factors formalized by the concept of rule of law (Haggard & Tiede, 2011), political stability and low levels of corruption (Rodrik, Subramanian & Trebbi, 2004). The definition and implementation of the rules obliges the state bodies to fulfill the basic duties towards the citizens and thus limit the discretionary actions of the state administration and its holders. This is affected through the basic indicators of quality, efficiency and reliability of institutions, which further represents the metrics for monitoring and guaranteeing the protection and realization of the needs and preferences of society as a whole. Consequently, institutions that basically rely on the rule of law imply equal legislation for all individuals, as well as all economic entities. In this way, any group or individual is prevented from applying the legislation in a way that would endanger the rights of other entities. Only such institutions enable the smooth establishment and dynamic development of economic (and any other) activities and limit the potential for economic benefits by usurping a monopoly position in the market or the influence of political power by groups or individuals.

4. CONCLUSIONS

The concept of the rule of law, clearly defined and practically implemented in practice, includes elements of political stability. The knowledge that refers to existing laws and institutions which are permanently stable and not subject to arbitrary change, is necessary to encourage investment. Representatives of public authorities are expected to comply with legal regulations, follow the proclaimed economic and political goals, fulfill their obligations and do not discourage private sector activities.

According to the scientific relevance of research that links long-term sustainable economic development potentials to the effective functioning of private property, a high priority for the prosperity societies is to build an institutional framework that guarantees protection of property and the fulfillment of contractual obligations. In the regime of protected property rights, individuals have clear authority over the resources at their disposal. If the property rights of all agents are adequately protected, then they can enter into transactions without fear that their own resources will be compromised in some illegal way. Exchange security in turn has the effect of reducing transaction costs, contributing to increased exchange and optimal allocation of resources.

In addition to the protection of property rights and contractual relations, growth rates and the standard of living are also linked to the efficiency of the judiciary, the degree of corruption and the development of democratic principles of government. From an institutional point of view, the positive impact of democracy on economic growth is explained by the fact that democracy, as a participatory political regime, is a favorable environment for institution building. The success of democratic political systems to generate positive economic results should be sought first and foremost in involving all relevant stakeholders in key decisions, thereby achieving broader social consensus and ensuring the accountability of governing structures. Among other things, data on higher ten-year growth rates achieved after democratic transformations and political changes in forty countries in Latin America, Europe, Africa and Asia shows that growth in the democratic environment is much more stable than in countries with less democratic traditions.

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