

INSTITUTIONAL FACTORS, COMPETITION AND ECONOMIC GROWTH

As the world experience proves, expected tempos of exceed the real growth. As a result it entails scientific and political argumentations and social pressure. The problem is that politicians and economists try to persuade the society *ex ante*, that they can achieve certain aims, then *ex post*, they pass the buck to the others (to politicians and economists) or to the God (too high or too low prices of the oil, crisis of Russia or Argentina, improvement of exchange or devaluation, etc.). Only developed countries were able “to cure completely” of that extra optimism, although possibly not forever, not everywhere and not wholly.

So, almost everybody expects higher tempos than they are worth according to their persistence (or absence), operation and management of quality, institutional maturity and predictions. That sign was noticeable in former soviet republics at the beginning of a transitional period, where the expectation of production and consumption scale and growth tempo exceeded the real poor results, as farther it was found out. It is obvious that only China could avoid that kind of disappointment, as it was able to double its GDP and the only reason for complaint can be the distribution of income and some non-economic factors affecting the activity of the society [1, 38].

Of course, the period of changes happened after the destruction of the Soviets had its features. That was the reason why many important events were really not easy to predict. On the one hand, that partly can be explained by the optimistic statements and expectations and on the other hand – by the great differences in real life. Unfortunately, this phenomenon is not completely researched, but, most probably, Central & Western Europe and CIS countries predicted that in 15 years their national incomes would be twice as much as they had at that moment: on the average almost as much as in

1989. Consequently, it is very important to know the faults of assumption at the present time. Whether the upper-class and the society expect higher tempos of economic growth than they will be able to achieve in 15 years practically and what is the deference between those.

Justification of Growth

At present stage, as structure changes happen, the sources of economic growth can be described by taking into consideration two main factors. The first is increasing of distribution efficiency successively by rational use of resources. It calls for great efforts to stimulate creativity at enterprise, to use resources on micro level and also to improve management quality.

Being at the peak of structural and institutional reforms, countries with transitional economies have a deference comparing with developed countries; in developed countries 1-2% GDP growth tempo is sufficient to stimulate employment and to decrease unemployment, while in Central & Western Europe and CIS the rate of employment will not grow without special activity, until the tempo of GDP growth stands close to 4%.

The second factor is revival of accumulation of capital and tendency to savings (because of reconstruction shock and recession) after deep fall. Growth of savings is necessary in order to keep long term economic growth at high rate, especially when a lot of resources being on surface and available during reconstruction have run out of stock. In this case it is necessary to stimulate not only the internal savings but also to involve portfolio and, first of all, as foreign savings, direct investments. Direct investment creates new production capacity, raises competitiveness and opportunity to export to a recipient country. That helps to increase

economic growth based on export. Of course, such kind of development, first of all, depends primarily on rate and trade policy, but the role of direct investment should not be underrated.

Of course, in non-market economy tendency to savings has also been very important. High rate of accumulation and savings was a characteristic feature for the previous type of economic system. But unlike market economy, savings were sometimes required under socialism.

Transformation from planned economy to market economy can not bring to voluntary savings tendency and reduction of marginal tendency consumption in the long-term period. Nowadays, first of all (in terms of developing market environment) it is necessary to increase the efficiency of savings use in the whole country.

In the long-term period the efficiency of available capital should uninterruptedly grow. At the same time, the investment rate can and should grow in the range of consumption. Therefore, in few years (of course not later than in one or two decades) the only way to raise economic growth rate will be increasing savings efficiency, which means that the part of investment in GDP will not grow. Only in that case we can enter the stage of intensive growth (using the terminology of previous century), unlike prevailing at the moment of extensive growth period.

Creation of Institutions and Training

Both the fall in 1990s and the followed transitional great crisis proved that missing signification of institutions development, important for efficient operation of market economy, and concentration on price liberation or privatization would be paid back. That "receipt" of course is not enough to create a well developing market economy [2]. The worst thing is that the lost opportunities of production are irreplaceable, but social costs are high.

In these days nobody hesitates about the role of institutions, on the contrary, during the last years all these were emphasized by the rapprochement of former members of Central & Western Europe. According to them "the invisible hand" of the market will change

institutions themselves (state property, centralized planning, administrative regulation of prices etc.). Substantially everything is not as clear as it may seem, indeed, all the old institutions should be liquidated, but they should be changed by new institutions, creating of which requires long time and as a rule calls for governmental intervention. The latter mentioned is the most important institution in basic changes activity [3].

Mainly institutions are as the following:
processes regulating by the rules or by a tradition or etiquette,
acts protecting the rights of market participants and regulating norms,
organizations that meet the demand of various participants and political structures, including the government and the Central Bank, stock market and international bodies (that are to enforce market participants to observe the law as a support to the whole social-economic system), trading bank and commodity market,
market culture and spirit institutions.

So, the institutions are not only formed and founded but also taught. Besides, it is obvious, that the process of studying (even though the proper tendency is great) should be long and gradual. The reason is that in social system and in planned economy culture and spirit can not be changed by any political act and turn into capitalistic analogs.

The rules of market economy proper skills are needed, which are not always found in books or somewhere else. Personal experience is very important. It is also necessary to obtain some skills and traditions that were not useful in the previous system. In new conditions old traditions (non-market traditions) form a cargo that should be thrown out, especially by the way of studying a market mechanism. That is, a study is based on experience and it will take a long time. However, in all those countries, where market reforms were successively applied before 1989, it will take not so long as in the countries where the institutions had adopted the "Orthodox" soviet model. That is why the transitional fall in Poland and Hungary took less than that in Rumania, in Ukraine or in Armenia.

Changes in spirit, as a result of system changes, are not limited only by the economic

sphere, but also gradually affect the political, social and cultural spheres. Intellectuals and modern economists as well as premier politicians are eager that changes to be fixed not only in the new economic structure and for market participants but also for the population and leading bodies, as the last will have to follow the limitation of budget and the new conditions of global competition. But those, who implement it, fail to keep up with more classified leaders. As it is supposed, they know how to find the way to *terra incognita* in new market. They will dig their heels in that long journey to achieve the aims. Soon the means of life become common for more people. They are not the leaders of that mission, so they are not able to look at these aims seriously. As a result, they will just slow down further development. So each yield has its time.

In the middle of 1990s Aslund A. came to the assumption that Russia has already become a country with market economy, but the people have not recognized it yet [4]. So if people can not recognize the nature and mechanism of market economy and don't accept the policy in current (which leader economists greet), then it is not a market economy, but an economy moving to that [5]. So, in Central & Western Europe countries system reforms are still going on, although they are already the EU members. Of course, the EU has different indicators of joining it and all our undertaken steps to the market economy are considered as extra optimism.

Such kind of barriers that is partly operating, partly cultural and civilization features slow down the process of getting the "critical mass" and appear as main factors limiting economic growth (without material structures and financial capital). All these barriers determine the presence of difference between theoretical and obtained real results and its extent. However, if it is so then high rates of growth are just extra optimism in these institutional terms. It is impossible to use all the human, social, financial and fixed capital efficiently in terms of institutional insufficiency. Therefore, a two-way approach is needed. On the one hand institutional evolution should always be on right direction, but on the other

hand, you should be able to wait still to stimulate that process simultaneously as a problem of persuading people.

The high rates of consumption and economic growth in America obtained in the last decades were connected with high efficiency of institutions and not with economic policy. There is no bureaucracy in American institutions, as it is noticed in Europe, and they create good environment for competition. Based on American experience, we come to several conclusions that might guide the operating institutions and bring to changes in their policy.

Is It Good or Not?

The adoption of economic privileges associated with system changes and economic growth from a social point of view was careful at its best point [6]. In the former Soviet republics most people are less optimistic, when estimating the reality, unlike, the so called upper-class and economists.

Comparing living standards and the rate of satisfaction surprise people from different countries. There are five factors of estimation: house, family, habitat, health, personal safety, job, incomes, health care.

As it was found out, the best rates of life satisfaction among the EU member- countries (EU-15) were fixed in Denmark and Austria (accordingly 91 and 89%). The worst results were fixed in Italy and Portugal (accordingly 72 and 71%). The most important factors are satisfaction in apartment, family, social life and habitat. Life satisfaction among the new members of EU (EU-10) has a high rate in Slovenia – 81% (which exceed results fixed in the United Kingdom, Germany, Spain, Italy and Portugal) and in Czech Republic (70%) and the last in our list are Lithuania (59%) and Latvia (55%). In the former Soviet Republics a low rate of living standard is associated with such economic factors as job terms, incomes and availability of healthcare. That should be taken into consideration for the development of a long-term economic policy.

As far as Poland concerns, a marginal rate of living standard (64%) was supplemented with family life, apartment, and social life satisfaction (accordingly 46%, 33 and 32%).

The fact is that the lowest living standard was fixed in the countries where policy is not able to cause great damage because people care about themselves. So, economic growth should be rapidly stimulated, as in the concrete sphere implementing of important reforms is possible only in that case [1, 43].

As more people estimate the real situation (comparing with results from analyzing and social parameters) as faster we shall move on. In that case economic growth should meet those requirements. It is obvious that even the best institutions can not promise a good policy automatically (former Soviet republics are too far from it).

The Impact of Institutional Factors on Economic Growth of Former Soviet Republics

There are several arguments brought in the economic literature that authoritarian management may stimulate economic changes on the first stage of transition. First of all, it is associated with problems connected with implementation of political and economic reforms simultaneously. The matter is that transforming from authoritarian system to democratic system entails weakening of government, which in its turn entails weakening of control over taxation and legislation. In this case government may lose control over the situation and insure law protection, which is necessary for activity of new economic system. It would be efficient an authoritarian government (or institutions) to change the law to find a new institution in the old political system and then move to democracy and develop new institutions. Experience in Chilly is well-known, where economic changes were made by authoritarian regime and then regime was changed into democratic government. The same can be said about Korea, Taiwan and Singapore. Democracy in China and Vietnam has not been adopted yet. But some economic institutions have been already developed enough to provide further economic growth and political changes.

Secondly, during democracy period electors may refuse to adopt economic reforms even if they are useful for the most part of electors. As results of reforms are unpredictable it is very risky for the elector and he may be

against their implementation (though they are going to provide good results).

In general, economic and political changes were made in different ways in former Soviet republics. For instance, two kinds of changes were made more quickly and simultaneously in Hungary and Slovenia (the example of Slovenia is considered to be the best). Although in modern Turkmenistan the rate of democracy does not differ much from that in the socialistic period [7]. Dethier Ghanem and Zoli [8] tried to find out in their scientific study how economic changes are associated with political changes during 25 transitional years. The authors used De Melo index instead of economic liberation index [9].

When classifying countries the author found out that political liberation provides economic liberation. But it was not studied how economic and political liberation affect economic growth.

Later, more attention was paid to the institutional side of market changes. The results of reforms entail the following conclusions.

1. On the first stage of transitional period (1990-1994) decrease of production volume are explained by the difference in starting conditions while the intensive reforms explain the difference in rate of growth in the future.

2. New firms, especially small - and medium-sized business are very important for economic reforms and employment growth. Right economic growth policy is based on equilibrium of following two ingredients. They are increasing the number of firms entering the market and strengthening the discipline among operating firms.

3. There are two groups of institutional reforms in the centre of economic policy. The first step is reforming investment environment (safety of individual ownership, simplifying the process of registration, creation of equal terms for new firms in order to make them competitive in traditional segment etc.). In the second place is legislative changing, which is directed to the creation of an effective system of corporative management (especially in traditional segment). This kind of system should include accounting, audit, modern information technologies,

protection of small-scale business, a low of bankruptcy etc.

4. Quality of institutions, investors protection and control of laws form the main factor of the national financing system development, availability of loan and investment in private sector and therefore economic growth.

Although in the second half of 1990s consolidation of market institutions was considered to be not sufficient, in the recent years all kinds of changes made in market are the results of institutional factors. The efficiency of many steps of economic policy (including privatization, decreasing of grants, strengthening

of competition) is associated with quality of institutional environment. Now, there are some surveys of economic growth in the countries with transitional economy. And the number of these countries has a tendency to increase. Almost in every survey authors remark positive ratio between quality of national institutions and economic growth.

The statistic data of trial surveys are put in Table 1. Once more should be mentioned that the positive ratio between economic growth and the quality of institutions in countries with transitional economy was expressed in the survey.

Table 1

Evaluation results of institutional factors impact on the economic growth in transitional countries

| Institutional versions | The results of hypothesis checking | The sources of used information |
|---|---|---|
| 1 | 2 | 3 |
| United index of economic freedom (HERgen) | <i>Havrylyshyn, van Rooden (2000)+**</i> | Published by Heritage Foundation |
| Corruption index (HERleg) | <i>Havrylyshyn, van Rooden (2000)+**</i> | Published by Heritage Foundation in the frameworks of system of economic freedom indexes |
| Level of democratic development (FRdem) | <i>Havrylyshyn, van Rooden (2000)+*</i> | Index of "Nations in Transit", published by Freedom House |
| The level of economic freedom (FRec) | <i>Havrylyshyn, van Rooden (2000)+*</i> | Index of "Nations in Transit", published by Freedom House |
| Index of civil freedom (FRpol) | <i>Havrylyshyn, van Rooden (2000)-*</i> | Index of "Nations in Transit", published by Freedom House |
| The productivity of judicial system (EBRDleg) | <i>Havrylyshyn, van Rooden (2000)+*</i> <i>Moers (1999)+*</i> <i>Beck,Laevan (2005)+**</i> | Index of "Rule of law", published by EBRD |
| Index of institutional environment (WB) | <i>Havrylyshyn, van Rooden (2000)+*</i> <i>Brunetti, Kisunko, Weder (1997)+**</i> <i>Ahrens, Meurer (2000)+**</i> | In World Development Report published indexes by World Bank: (i) government predictability regarding laws and policies, (ii) property rights, (iii) the quality of government-business relationship, (iv) bureaucratic red tape, (v) efficiency of government in providing services |
| Political risk | <i>Havrylyshyn, van Rooden (2000)+*</i> <i>Moers (1999)+*</i> | Index of risks of countries with political risks, published by §Euromoney |
| Productivity of investment laws | <i>Moers (1999)+*</i> | Index §Investment law published by EBRD |
| Corruption index (EBRDgen) | <i>Beck,Laevan (2005)+**</i> | §Corruption index, published by EBRD |
| General level of institutional development | <i>Beck,Laevan (2005)+**</i> | §Institutional development index, published by EBRD |
| Predictions of used | <i>Brunetti, Kisunko, Weder</i> | §Predictability of rules index, |

| | | |
|---|------------------------------------|--|
| laws | (1997)+** | published by World Bank |
| Uncertainty level, which refers to the possibility of political tendency changes used by executive power. | Brunetti, Kisunko, Weder (1997)+** | §Political stability index, published by World Bank |

End tabl. 1

| 1 | 2 | 3 |
|--------------------------------|---|---|
| Reliability on judicial system | Brunetti, Kisunko, Weder (1997)+** | §Judiciary reliability index, published by World Bank |
| Corruption abundance | Brunetti, Kisunko, Weder (1997)+** | §Lack of corruption index, published by World Bank |
| Corruption abundance | Ahrens, Meurer (2000)+** | §Transparency International index |
| Founder of the capital (1) | Raiser, Haerpfer, Nowotny, Wallace (2001)** | Number of the persons taking part in social works more actively (World Values Survey) |
| Founder of the capital (2) | Raiser, Haerpfer, Nowotny, Wallace (2001)^ | Reliability index of governmental bodies (World Values Survey) |

Familiarization: “+ “ - is a positive sign in regression, “*” - statistical importance is at 5% rate, “***” - statistical importance is at 1% rate, “^” - is not important from statistical point of view.

So, we come to the conclusion that the quality of institutions and institutional environment, in general, effects economic development greatly.

Sound political, economic, and civil institutions – characterized by rule of law, efficient civil service, effective provision of public services, and facilitation of a sound environment for business—are essential to national competitiveness. According to the recent GCR, Armenia’s overall institutional quality has changed little. Consistent characteristics include:

major bottlenecks in the performance of public and private institutions;

a private sector is no more effective in its institutions than the public sector;

weaknesses in corporate governance, ethical behavior, and protection of minority shareholders rights;

low levels of crime and violence.

The image of Armenia is lower than of Georgia and Azerbaijan. The development of tendency cause some worries in that field (see Table .2 and Table 3).

Table 2

Performance in Institutions on the Regional Scale

| Institutions | Rank 2009 | Rank change 09/08, points | Score 2009 | Score change, 09/08, % |
|--------------|-----------|---------------------------|------------|------------------------|
| Armenia | 95 | 1 | 3.49 | -0.1% |
| Georgia | 72 | -3 | 3.82 | -2% |
| Azerbaijan | 55 | 7 | 4.15 | 2% |

Table 3

Performance in Corruption Perception Index on the Regional Scale

| Country | CPI score, out of 10 |
|------------|----------------------|
| Armenia | 2.9 |
| EE average | 4.16 |

| | |
|-------------|------|
| CIS average | 2.57 |
| EC average | 4.32 |

For example, as the Transparency International Corruption (TIC) states, intense reformations in the institutional field of Georgia (especially in educational and health fields) bring to the development of the country. In 2008, Armenia improved its places going up from 79 to 67 levels (20% improvement of unity). On the contrary, corruption levels in Armenia have relatively increased, and went down to 109 from 99 in its places. Unity in Armenia (from possible 10 units only 2.9) concedes its places to the middle level of East European and Eurasian crossroads, but exceeds the medium units in CIS.

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