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**Evolution of institutions
and economic performance**

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Abstract:

The essay is based on the knowledge that institutional quality may influence economic performance. From this viewpoint, it is possible to demonstrate that under certain circumstances, governmental policy is able to increase economic efficiency and performance by creating, maintaining, and cultivating suitable social institutions. However, this approach does not imply the enforcement of the dominant role of the state, but rather the effort to accept and/or to cancel measures, which substantially affect the long-term potential of the economy. It is a concept of the guarantee and the co-creator of the basic rules and institutions. The authors also point to the effect of informal institutions, which undoubtedly form the basic social environment.

The paper is structured as follows: After looking back at the history, the second part focuses on new institutional economics, whereas the third and fourth part deals with the definition and classification of institutions. The following chapter seeks to summarize the main direction of the effect of institutions. The final part presents an overview of a number of studies, which were focusing on the relationship between the quality of the institutional environment and economic growth, it also outlines fundamental institutional quality measurements and provides a set of several basic institutional quality indicators.

Keywords:

institutions, rules, D. C. North, economic performance, institutional quality, new institutional economics

JEL Classification: D02, D23, H11, O11, O12

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***Motto:** In the analysis of economic performance through time it contained two wrong assumptions: first that institutions do not matter and second that time does not matter.*

Douglass C. North¹

1. Introduction

The essay² is based on the knowledge that the quality of institutions influences economic performance. From this viewpoint, it is possible to demonstrate that **under certain circumstances**, governmental policy may lead to an increase of economic efficiency and performance by creating, maintaining, and cultivating suitable political and economic institutions (political and economic design). Even though one cannot avoid the trial-and-error strategy, thanks to studying and sharing knowledge, there is a possibility of partially and men-made substituting the spontaneity of long-run development or informal institutions. In any case, it does not imply state engineering, but rather an effort to accept and/or to cancel measures, which substantially affect both the existing production capacity of the economy and its long-term potential capacity. An analysis of institutions would not have a practical impact, if it did not lead to the conviction that defining certain explicit and "well-established" rules and their implementation into real life may present a path for stimulating economic performance.

The authors do not forget the analysis of the impact of informal institutions, which undoubtedly create the "hot-bed, from which everything grows", but the possibility of their change is largely long-term. If from this narrow point of view and regardless of the fact what system is established for its political representation, power distribution, etc., the state is comprehended in its minimal role, i.e. as the guarantee and the **co-creator** of the basic rules, or, in other words, of the institutions, a rational economic policy should be able to influence this process in a manner decreasing transaction costs and increasing economic performance.

Most approaches are limited to perceiving institutions within the meaning of "governance" and to the effort of evaluating its impact on economic performance. The aim of this study is focusing its attention more on clarifying the large-scale issue of institutions rather than on this aspect. After a historical insight on both the worldwide as well as on the Czech institutional economics sphere, the major part of the work focuses on defining and classifying institutions from the perspective of their impact on performance. Here in particular, it was necessary to select an interdisciplinary approach and to share knowledge with other social science disciplines. The subject of interest is also the influence of institutions and economic performance with the aim to summarise the main direction of the effect of institutions. The final part of the work provides an overview of several studies, which have attempted to document the relationship between the quality of the institutional environment and economic growth, it also outlines fundamental institutional quality measurements and presents a set of institutional quality indicators, which the authors deem as relevant when studying the issue of institutions.

¹ See Jonáš, J. and composite authors (1994, p. 754).

² The text was discussed at the seminar held on December 15, 2004, where L. Mlčoch and M. Sojka stood up as opponents. The final form of the text responds to some of the comments, including the written remarks of P. Pelikán.

1. 1 Historical Insight

The interest in the role of institutions in the economy has a more than a hundred year old history. In 1899, Thorstein B. Veblen's (1857-1929) book was published in the USA under the title *The Theory of the Leisure Class: An Economic Study of the Evolution of Institutions*³, due to the author became one of the founders of a new theoretical trend in economy – institutionalism. The founder of the theory grounded on the conviction that "institutions play an essential role in the formation of human economic behaviour and in achieving specific economic performance and that the institutions alone change through time and often react to the influence of economic indicators" (Sojka, 2000, p. 248). The second, although different in his approach, co-founder is considered to be John R. Commons (1862-1945), with fundamental works *Legal Foundations of Capitalism* published in 1924 a *Institutional Economics* published in 1934. The titles of the works alone imply the different focus of both authors – Veblen's concept is characterised as social and psychological, while Commons is deemed as the founder of the legal direction. Despite these divergent approaches, some mutual characteristics of institutionalism may be found, namely those embracing a range of authors endorsing institutionalism. These are the following characteristic features (for comments see Sojka, 2000, pp. 249-250):

- The main subject of research are institutions, which are broadly concerned (they namely include social organization, rules, behavioural standards, organization, legal standards),
- Institutions change over time as a result of evolution in combination with human experience in the process of achieving objectives – thereby giving rise to a process of institutional evolution,
- The objectives of economic institutions and economic activity do not need to be the same,
- Institutional research is aimed at solving practical problems.

Apart from the American institutionalism (represented by Veblen and Commons and a number of their followers) also the direction called *New Institutional Economics*⁴, found its way into the textbooks on the history of the evolution of economic thinking, the origin of which dates back to the 1960s and it is yet again associated with two names and two winners of the Nobel Prize in Economics. Ronald H. Coase (born in 1910, received the Nobel Prize in 1991) and Douglass C. North (born in 1920, received the Nobel Prize in 1993).

R. Coase, who is considered to be the discoverer of transaction costs, formed his theory as early as in the course of years 1932-1937 and published his conclusions in an article "The Nature of the Firm" (*Economica* 4, November 1937). However, he achieved true recognition only after 1960 by publishing his article "The Problem of Social Cost" (*Journal of Law and Economics*, 3, 1960, No. 1), which has become "perhaps the most quoted article in modern economic literature" (Sojka, 2000, p. 265). Douglass C. North

³ It is not without interest that since 1912, the title of Veblen's book has changed to *An Economic Study of Institution*. The work was published in Czech by SLON Publishing in 1999 under the title *Theory of the Leisure Class*.

⁴ At present, there are two high-quality textbooks on economic history available on the Czech market. The book of M. Sojka (2000) depicted above and the book by R. Holman (1999). In both these works, the author of the chapters entitled "Institutionalism and New Institutional Economics" is M. Sojka, owing to whom the Czech economic community received its original Czech economic terminology in this field.

commenced with his highly valued publishing activities in 1961 with his work *The Economic Growth of the United States from 1790 to 1860*, however, from with respect to the development of institutional economics, his book *Institutions, Institutional Changes and Economic Performance*, introduced in 1990⁵ is considered as fundamental.

Although new institutional economics "began to develop as a significantly heterogeneous trend" (Sojka, 2000, p. 261) from the 1960s, its common interest were partially formulated and determined as late as in the 1980s. The questions asked may be summarised in the following manner:

- How do the alternative sets of institutions and organizations affect the behaviour of people, resource allocation, and balance,
- Why does the form of the economic organization of various economic activities differ under conditions of a similar legal framework,
- What is the economic logic of the basic social and political rules in production and exchange,
- How do these rules change through time.

Another incentive for expanding the interest in the role of institutions in economic development was induced by the transformation process of centrally planned economies to market economy in the early 1990s. Despite the growing interest in institutional economics, the efforts to unite new institutional economics into a single and at least partially consistently defined idea trend is not successful on a worldwide basis; so far there is no prestigious textbook on new institutional economics and its continuous heterogeneity only documents its classification into various directions and trends. The actual depth of the problem may be demonstrated on such a fundamental problem as defining institutions⁶ (see below).

At present, Douglass C. North⁷ is considered as the highest and most respected authority on new institutional economics, who when accepting the Nobel Prize on December 9, 1993, delivered a "synthesizing" lecture on the topic "Economic Performance through Time" (Jonáš, 1994, pp. 754-758). The lecture is divided into seven parts, of which the

⁵ As fundamental and apart from the above-mentioned works of D.C. North, Sojka (2000) also indicates the works *Institutional Change and American Economic Growth* (1971, co-author L. Davis), *The Rise of the Western World: A New Economic History* (1973, co-author R. Thomas) and *Structure and Change in Economic History* (1981).

⁶ The situation is also complicated by the fact that as basic unit institutions are not a purely economic category. Politology as well as sociology deals with institutions, they are a term applied in both the theory of law and the organization theory. For example: the above mentioned book *Theory of the Idle Class* was published by Sociologické nakladatelství (Sociological Publishing) under the editorship of sociologist M. Petrušek, who designates T. Veblen in the afterword as an American economist and sociologist, while in the fly-leaf the reader learns that "... to this day, the American sociologist and co-founder of the so-called institutional economics, Thorstein Veblen (1857-1929), belongs to the most discussed and the most read sociologists".

⁷ Also Ronald H. Coase, who preceded D. C. North not only by his date of birth but also by an earlier date of publishing his works and thus, by receiving the Nobel Prize (1991) earlier, focuses on institutions in his works. For example in his Prize Lecture he states: "What I have done is to show the importance of the working of the economic system of what may be termed the institutional structure of production." Nonetheless, the main are the area of microeconomy and the relationship between law and economy. Coase is the founder of the transaction cost theory and for his teaching, which in a way branches out from new institutional economics, a separate name has become commonly used, i.e. "the property rights theory".

first three are important with regard to our topic, based on which the essential starting points of the work are established. In brief, the fundamental ideas of the author may be characterised as follows:

- Economic history deals with the performance of economies through time.
- In the analysis of economic performance through time, two wrong assumptions were accepted: first that institutions do not matter and second that time does not matter.
- Institutions form the incentive structure of a society. This implies that the political and social institutions are the underlying determinant of economic performance.
- In relation to economic and societal change, time is the dimension in which the learning process of human beings shapes the way institutions evolve.
- Institutions are the constraints devised by human that structure human interaction. They comprise formal constraints (rules, laws, constitutions), informal constraints (norms of behaviour, conventions, and self imposed codes of conduct), and their enforcement characteristics. Together they define the incentive structure of societies and specifically economies.
- Only under the conditions of costless bargaining will the participants reach the solution that maximizes aggregate income regardless of the institutional arrangements.
- It is the interaction between institutions and organizations that shapes the institutional evolution of an economy. If institutions are the rules of the game, organizations and their entrepreneurs are the players.
- Economic change is a ubiquitous, ongoing, incremental process that is the result of the decisions individual actors and entrepreneurs of organizations are making every day.

1. 2 New Institutional Economics – the Czech Reality

In general, institutional economics and particularly new institutional economics stood out of scientific as well as common interest for a long time in the post-revolution period of the renaissance of Czech economic science as such. The main reason may be attributed to the fact that the original concept of the transformation of Czech economy, which was significantly influenced by the Washington Consensus, almost did not implement the role of institutional factors in its initial form (for a more detailed explication of the issue see Kouba, Vychodil, Roberts, 2004, pp. 10-15). An increased interest in this trend of economic thinking resulted, to put it cautiously, from two fundamental and basically non-associated incentives. The first being (not only in terms of time) the principal criticism of the accepted and implemented transformation concept on the part of institutional economics (the main representative of such criticism was and is to the present day L. Mlčoch), the second being the revision of the Washington Consensus⁸ along with the reaction to the text of J. E. Stiglitz published in connection with the tenth anniversary of the commencement of transformation of the countries of

⁸ In the above mentioned text, K. Kouba refers to three works of J. Williamson (1989, 1991, 2002). We would like to point to another essay of the same author (1997), referred by G. W. Kolodko, who, in our opinion, clearly points to the differences between the Washington Consensus I and the Washington Consensus II, particularly in the area focusing on the creation of a suitable institutional environment (see Kolodko, 1999).

central and eastern Europe, entitled "Whither Reform"⁹, in which the author states at the very beginning: "...reform models based on conventional neoclassical economics are likely to under-estimate the importance of informational problems, including those arising from the problems of corporate governance; of social and organizational capital; and of the institutional and legal infrastructure required to make an effective market economy." (Stiglitz, 2000, p. 1).

The approach to new institutional economics in the Czech environment has two fundamental, obvious and simply separable levels. Firstly, we cannot omit the fact that the "Institutional Economics" subject was introduced at the Faculty of Economics of the University of Economics in the academic year 1994/1995 and subsequently at the Faculty of Social Sciences of Charles University in 1995/1996. At the University of Economics it began with seminars dealing with the texts of the Czech exile economist, Pavel Pelikán,¹⁰ which gradually expanded into an independent course of Institutional Economics for the master degree and subsequently, for the doctor degree, which is a part of the curriculum to this date. It was at the Faculty of Social Sciences of Charles University, where L. Mlčoch taught a course on Institutional Economics, for which he in 1996 wrote and published a course book¹¹, and who succeeded in reaching of operating independent Department of Institutional Economics at the Institute of Economic Studies of the Faculty of Social Sciences. Today, apart from a number of other tutor, namely P. Pelikán is delivering his lectures and who is leading the "Institutions, Evolutions and Economic Policy" course along with M. Gregor. Moreover, K. Kouba is a member of the Department of Institutional Economics, who in his research as well as pedagogical work endorses one of the newly emerging trends of contemporary theoretical economics – i.e. constitutional economics. The effort to classify the newly conceived scientific approach facilitates precise delimitation of the new institutional economics as an area of interest and an independent branch of science. K. Kouba's texts are inspiring particularly in this connection. At the Czech Economic Society seminar in February 2000 dedicated to constitutional economics, he delimited constitutional economics "as one of the main trends of thought, which have evolved within the discussion concerning the unsatisfactory properties of the traditional mainstream analysis in the 1960s. The critical discussion gradually defined the following differentiable disciplines:

⁹ A highly polemic essay of Dambrowsky, Gomulka and Rostovsky entitled "Whence Reform?" – A Critique of the Stiglitz Perspective (2000) reacted to Stiglitz's text, however, not disputing the predication on the absence of the role of institutional factors in transformation concepts.

¹⁰ Pavel Pelikán is a professor of economics at the University of Economics, Prague and at the Sorbonne, Paris, he resides in Sweden. Apart from works specified in the bibliography, he also elaborated a text for the area of institutional economics studies, the title of which, in our opinion, documents the author's focus on and interest in more than sufficiently – i.e. "The Needs and the Requirements of Industrial Dynamics" (1999).

¹¹ In this connection it should be pointed out that although the text of L. Mlčoch is in its way avant-garde, it is not a textbook in the true sense. The author focuses on describing the issue, which is being solved by institutional economics, explains applied terms and describes the view of this school on concrete national economy issues, including a concretisation with respect to economic transformation. However, the problem of the institutional economics textbook is broader. Institutional economics is a direction too heterogeneous to unite the ideas into a single consensual framework. It is not only a Czech problem. Neither the text "Institutional Economic" of W. Kasper and M. E. Streit (1999) is a textbook or the website of the home institution of D. E. North, i.e. the "Center for New Institutional Social Science" (<http://cniss.wustl.edu>), a fundamental, synthesizing course book cannot be found.

- The public choice theory, from which constitutional economics had arisen
- Economics of property rights
- Law and economics or the economic analysis of law
- Political economy of regulation
- New institutional economics
- New institutional history (Kouba, 2000).

In his study written for the Institute of National Economy of Josef Hlávka, K. Kouba modified his overview in the following manner. "Mainly the winners of the Nobel Prize in Economics F. von Hayek, R. Coase, G. Stiegler, H. Simon, J. Buchanan, as well as a number of other pioneers of this articulate research project belong among the protagonists of the various trends of evolutionary analysis and new institutional economics. These comprise: 1. the Public Choice Theory, 2. Constitutional Political Economy, 3. the Theory of Property rights, 4. the Theory of Regulation, 5. Law and Economics, 6. the History of Institutions" (see Kouba, Vychodil, Roberts, 2004), whereby he documents the dynamics of the changing views of economic science on one hand, and the already mentioned heterogeneity of the institutional economics approaches on the other. Therefore, in the following text we shall perform a certain inventory of the definition of institutions with the aim to clarify our own standpoints and thus, to create our own basic precondition for further work, which constitutes an analysis of the influence of institutions on economic performance and competitiveness.

Another distinctive level is the application and critical level. The critical approach and the arguments of L. Mlčoch¹² based on institutional economics and aimed towards the accepted and particularly at the implemented method of transformation in the Czech Republic gave rise to a dispute¹³, which divided the institutional economists to a certain extent and consequently, slowed down the evolution of the institutional economics theory in the Czech Republic by "ideologizing" the whole issue.^{14, 15}

At present, the Czech Republic is experiencing a significant renaissance of interest in the institutional approaches towards economics. The reasons may be found in a certain global trend of rising interest in the influence of institutional factors on economic growth stemming from the effort to explain the divergent growth performance of

¹² Lubomír Mlčoch uses methodological approaches characteristic for the contemporary new institutional economics, which emphasize the importance of historical time, the evolution of institutions, dependence on past development, property rights and transaction costs (Machonin, Mlčoch, Sojka, 2000, p. 10, introduction).

¹³ In brief, it is possible to state that it is a dispute concerning the role of institutions in the concept of transformation between L. Mlčoch and V. Klaus. Mlčoch's arguments may be found basically in all of the works quoted in the bibliography, while the reaction of V. Klaus is presented in an interview published by Political Economy (Politická ekonomie) (Klaus, 1999), and finally in the Economist (Ekonom) weekly, issue 40/2004, in the article "A Dispute over the 90s" (Spor o devadesátá léta).

¹⁴ For example: At a seminar held at the Department of National Economy of the Faculty of National Economy of the University of Economics, P. Pelikán disavowed the criticism of L. Mlčoch, who, unfortunately, does not publish his works in Czech, yet his standpoint may be documented by material, which he prepared for his lectures at the University of Economics, Prague. The following explanatory note is indicated in the already mentioned text: "About fines, but not for speeding, and about remedy, but not revitalization", which may be understood as a reaction to Mlčoch's "The Price for Speed" (Cena za rychlost) (see Mlčoch, 1997b).

¹⁵ In this connection, the bibliography provides references not only to the texts of L. Mlčoch, as well as other associated texts of M. Sojka, J. Havel, P. Machonin, O. Vychodil a J. Roberts, V. Klusoň et al. Sociological works are not listed in the bibliography.

countries with identical or similar initial conditions of the running transformation processes, as well as in the change of view on the role of institutions reflecting in e.g. the already mentioned revision of the Washington Consensus. In the Czech Republic, this increased interest particularly exhibits itself in academic institutions and in their research activities. K. Kouba describes the situation at the Institute of Economic Studies of the Faculty of Social Sciences in the following manner: "In a number of courses and research projects of our IES FSS we focus on the issues of institutional analysis with a group of talented doctor's degree postgraduates." (Kouba, 2004). He defines the initial theoretical approach in the following manner: "We seek the prospects of the theoretical status of institutional economics in continuous empirical evidence and in a meaningful formalization of theoretical findings." Within the frame of the Institute of Integration of the Czech Republic into the European and World Economics Eva Klvačová (2003) focuses on institutional issues at the Faculty of International Relations of the University of Economics. Since January 1, 2005, the Centre for Research of the Competitiveness of the Czech Economy¹⁶ has been operating at the Faculty of Economics and Administration of Masaryk University in Brno. The work of Václav Klusoň "Institution and Responsibility" (Institute a odpovědnost¹⁷) is another distinctive contribution to the newly emerging interest in institutional economics.

1. 3 Definition of Institutions

The heterogeneity of the new institutional economics mentioned hereinabove and its multidirectional nature, which is represented by e.g. the economic, political or sociological approach towards it, creates one of the fundamental problems associated with the issue of institutions – its definition. Each of the independent branches of sciences, despite certain similarities, defines institutions more or less differently, and not even the economic view on what the institutions are or are not is not unified. The general formulation, in which "institutions are contemplated rather widely as established and accepted norms of group behaviour" (Berger, Luckmann, 1999, p. 58), merely delimits an effort, though creditable, to roof the problem. Today, D. C. North's definition is the most accepted and the most disseminated base. However, apart from it, there is a whole range of definitions detailing, synthesizing or alternating, an overview of which, even if far not comprehensive, is discussed in this paper.

Douglass C. North defines institutions as "*the rules of the game in a society*" and as „*humanly devised constraints that shape human interactions*" (North, 1990, p. 3). In other words, they are "*constraints that human beings impose on themselves*" (ibidem, p. 5). The main function of institutions is based on decreasing the insecurity of everyday life, whereas institutions defined in such a manner establish a specific stable structure of human relations.

¹⁶ The centre was founded based on the results of a competition announced by the Ministry of Education, Youth and Sports within the frame of the national research programme – Project M1. Apart from the FEA of the MU the Grant Fund of the University of Economics and Management (particularly in the area of research of the state of institutional quality) and the National Education Fund are also involved in the project.

¹⁷ The work was funded by the Institute of National Economy of Josef Hlávka by means of a scholarship, whereas, this work was published as a study of the NÚJH No. 7/2002. Its publication was secured by Karolinum Publishing (2004).

These structures may acquire *formal*, as well as *informal* (customary or ethical) rules. Their most important task is to facilitate political and economic exchange. Formal constraints (legal in short) may have three forms (ibidem, p. 47):

- Political rules, i.e. the structure of the political establishment and government,
- Economic rules, i.e. property rights,
- Contracts, i.e. agreements and contracts on exchange derived from property rights.¹⁸

Informal constraints are "*socially transmitted information*" which are a part of culture (ibidem, p. 37). These comprise customs, traditions, building social networks, e.g. on a family and a relation basis, as well as other topics belonging to the field of anthropology. Informal constraints may be (ibidem, p. 40):

- An extension, elaboration or modification of formal rules,
- A socially sanctioned norm of behaviour (see e.g. gentleman's behaviour),
- Internally enforced rules of behaviour.

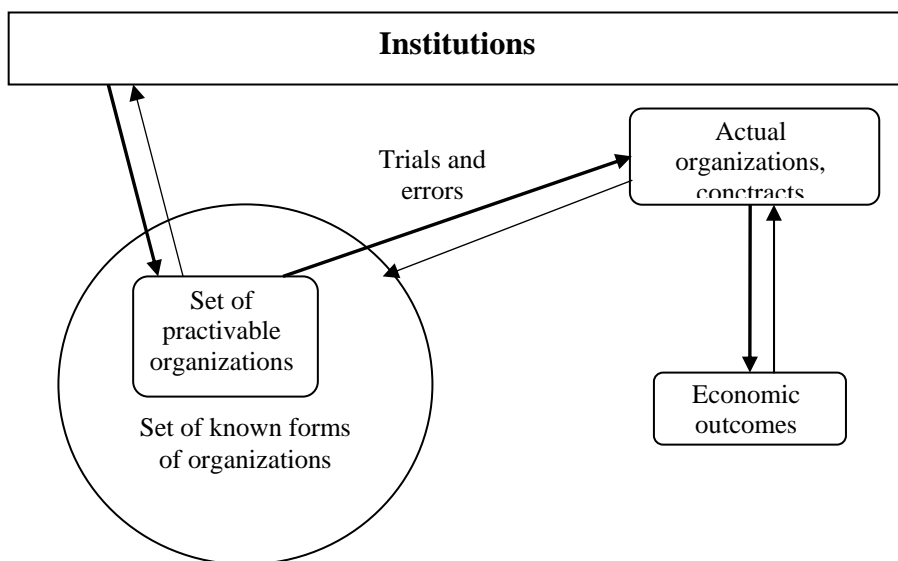
Both types of rule are strongly complementary and a change or their mutual substitution is a long-term affair. Yet, rules alone are not sufficient. Without their observation and especially an effective system of enforcement, they become ineffective.

By constraining certain conduct and/or by selecting between conduct, which is either permitted or prohibited, create a framework for further opportunities. These incentives or stimuli, which establish a certain structure of the society, also facilitate to a certain extent the framework of predictable and non-predictable behaviour, or, in other words, an (overall) framework of the stability or instability of the environment. Based on these opportunities, organizations may be founded, which North sees as mutually interconnected groups of actors acting under the pressure of specific institutions (ibidem, p. 5) or "*groups of actors playing the game*" – following a concrete objective. This differentiation is clearly in contrast with the generally understood conception of the term *institution*. Whether such opportunities are exploited or not, institutions reversely influence institutions (see e.g. an interest group lobby or logrolling). Therefore, it is not feasible to unambiguously insist on unilateral causality or impact directed from the institutions towards organizations. Figure 1 illustrates the basic relation between institutions and organizations.

The issue, although not new, as North explicitly pointed to it as early as in the 1960s, may be summarized as the "*institutions matter*". In general, it stands against the neoclassic concept, in which the preconditions of uniqueness and competition are implicitly grounded on the perfection and cost-effectiveness of property rights and the inexpensiveness of information acquisition. Nonetheless, within the institutionalism concept, the real behaviour of the society is characterised by nonzero transaction costs and institutions are the essential variable affecting their volume.

¹⁸ Political institutions are the rules for political processes (election cycles, voting procedures, the rules for the foundation and operation of political parties, relations between politicians and bureaucracy in the representation model, etc.), economic institutions guide economic processes (defining property rights, guiding change, creating conditions for entering and exiting the industry, opening markets, etc.).

Figure 1: The Relation between the Institution and the Organization (Direct Relation and Feedback)



Source: Customised based on Eggertsson (1996, p. 11).

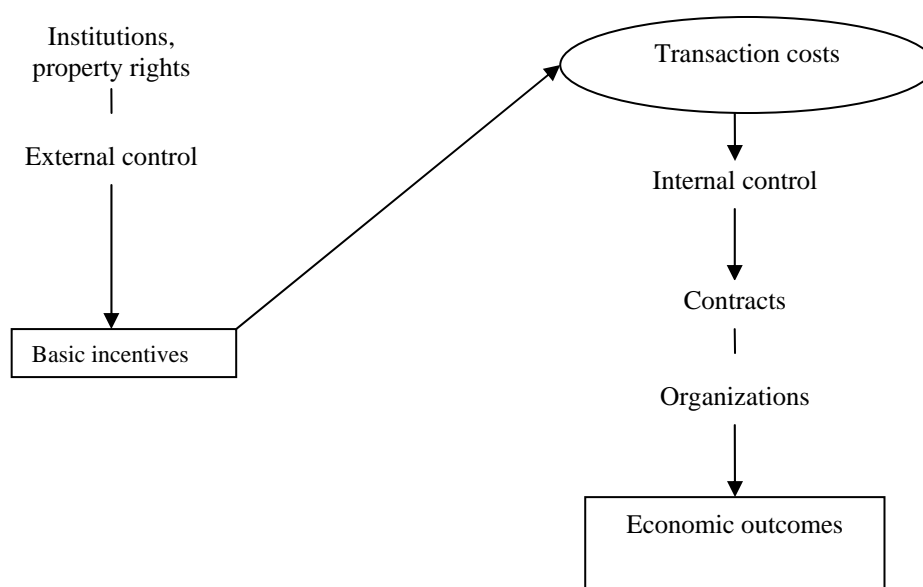
The approach of the Iceland economist, Thráinn Eggertsson (1996), is somewhat different and it is often generally understood as synthesizing. In essence, Eggertsson follows North's concept and also builds on the connection between transaction costs and institutions. Contrary to North's formal and informal institutions, he proposes differentiation based on origin. Thus, he is attempting to integrate the factor of internal and external control into the diagrams shown above. If we, for example, contemplate the institution of property rights, external control is affected by rules limiting the behaviour of the involved actors as well as outsiders (e.g. constitution, articles of association, regulations, laws, enforcement and sanctions).¹⁹ While internal controls are only established by the members (involved actors) and apply only to them (their purport is to control valuable resources, monitoring, limiting, hiring private guards, etc.). Thus, they constitute activities, which unambiguously lead to the conclusion of contractation and to the creation of organization (see Figure 2).

A discussion on other approaches should be introduced with certain animosity, which may be traced between the "individualistic" or "egoistic" approach of economics and the "collective" or "organized" approach of sociology. While economics lay emphasis on choice (choice following behaviour), sociology does not attribute an essential role to choice and it lays stress on rules (rules following behaviour). According to sociology, order has the form of a collective action and cannot be explained from the individual and efficiency point of view (see Durkheim, 1978; Parsons, 1956), whereas it depends on socialization, on the internalisation of norms respectively. Moreover, Berger and Luckmann contemplate institutionalisation as a "process of standardisation of habitualised activities by their promoters" by means of externalisation, exteriorisation and internalisation for effective transfer and construction of social realities (Berger,

¹⁹ In North's terminology, these are institution in the true sense.

Luckmann, 1999, p. 58). By contrast, the economic model of rational choice underlines self-interest, yet concurrently admits subordination to the explicit and implicit choices constraining free behaviour. In the course of time, these disputes are slowly dulling, however, the animosity can be still felt with respect to the issue of rules and their establishment. Absolute predominance was gained by North's concept, which is generally acknowledged as providing a sufficiently general explanation and that any other approach seems as plagiarism or an unsuccessful attempt to apply findings from several other disciplines to the institution theory.

Figure 2: Relation between Institutions, Transaction Costs and Economic Performance



Source: Customised structure based on Eggertsson (1996, p. 8).

If we put aside the divergent methodological inter-branch problems, all other definitions start from economics, which implicitly or explicitly draw from North. For example: R. Nelson's definition views institutions as routine, i.e. as "*stable, specific method of playing games*" (2002, p. 11).²⁰ Other approaches are mostly trying to widen the definition with additional partial aspects. One example for all of them may be the approach of the "evolutionary economics" presented by P. Pelikán. Evolutionary economics is mainly interested in evolution and change, drawing its inspiration from such disciplines as evolutionary biology, medicine, etc. and occasionally reaching interesting and inspirational results. Pelikán (2003d, p. 23-24) divides the main areas of the evolution of rules and economic processes into three basic levels:

²⁰ The definition is also close to sociological approaches. Particularly Nelson's concept differs from North's by a conflict between general and specific rules of the game. In this connection we should mention the interpretation of P. Pelikán, who divides the definitions of institutional economics into three groups:

- Rules of the game (North, Pelikán),
- Specific methods of playing the game (Schotter, Sugden, Nelson),
- Diversified approaches ("old institutionalists", Hodgson, Mlčoch).

- a) Evolution of production and performance (Y) of existing organizations (S) within given rules (R),
- b) Evolution of organizations (S) within given rules (R),
- c) Evolution of the rules themselves (R).

The first level is the standard material of "general", i.e. non-evolutionary economics, monitoring variables, such as production, consumption, mutual goods and services transactions between entities, etc. Its limitations are based on the fact that instead of monitoring allocation processes, it only deals with the conceivable and achievable equilibrium. The problem of such equilibrium is excessive idealization – it is either relies too much on perfect rationality of organization or on their sufficient knowledge and cognitive abilities. The second type comprises not only product innovations, but also qualitative production changes and corresponds to the neo-Schumpeter evolutionary economics of market competition and selection of firms, technology, and industries (see the theories of Schumpeter, Alchian, Nelson, and Winter). The last level has been explicated theoretically only in the recent years, especially in connection with the issue of the transformation of the economies in central and Eastern Europe. Particularly, in this area the trend stresses its difference from the non-institutional, constitutional and "Law and Economic" trends. Contrary to them, it does not focus on production and performance, but on origin and on the possible evolution of rules.²¹ Various evolutions inside each level stem from this classification: the evolution of rules takes place on the legislative and cultural level, the evolution of organizations on the organizational, structural and technological levels. Nevertheless, it does not apply that all evolution may be beneficial and problem-free. Quite on the contrary, problems may arise both on the side of the market,²² as well as the government.²³ Thus, these evolutions may lead to blocking, excessive waste or lead in a completely adverse direction.²⁴

If, among other things and as mentioned above, the task of this work is to clarify the general theoretical background of the subject issue and to create its own theoretical base for further research activities, it is necessary to define own institutional approach right now, preferably by conceiving its own basic definition of by accepting some of the quoted approaches. The basic definition should meet the following criteria:

- To create theoretical support for further research,
- To satisfy the views describing potentially usable data,
- To facilitate the formulation of economic and political recommendations to increase the institutional quality of social processes.

The basis is the definition of D. C. North, which determines institutions as: as "*the rules of the game in a society*" and as „*humanly devised constraints affecting human relations*", namely due to the reasons below:

²¹ Even if there are exceptions as well – see North, von Hayek or Vanberg mentioned above.

²² See the part-dependence and lock-in issue (see David).

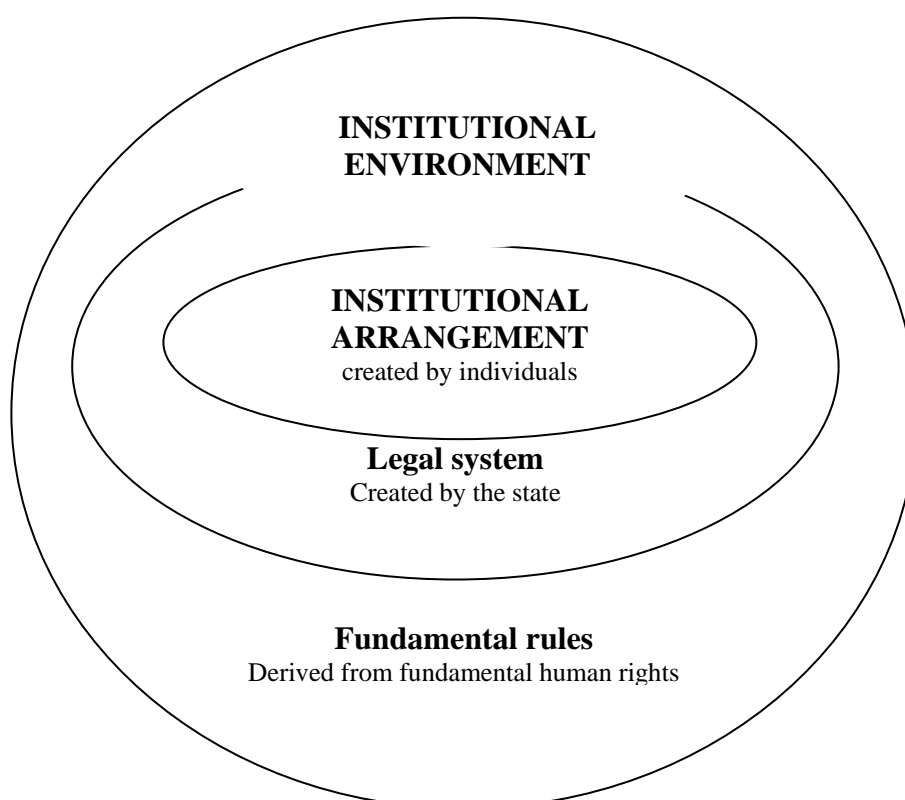
²³ See the issue of rent-seeking, interest groups, bureaucracy and stick decision-making structures dealt with by Tullock, Buchanan and Niskanen.

²⁴ From this point of view, it seems that evolution, which leads into blind alleys, the influence of which weakens over time, is not as lethal as a bad direction if a lesson is learned therefrom.

- The scientific front widely accepts the definition, not only because of the natural authority of its author, who is perceived as the founder of the direction, but also owing to the fact that with its generality, it satisfies the majority of the authors involved in the issue of institutions,
- There is a certain consensus at the international level that institution defined in such a manner at minimum enable to construct indexes at the theoretical level, which could/should reflect institutional quality.

This, rather widely understood concept of institutions may be narrowed hereinafter, in compliance with the set objective of analysing institutional quality. Within further research, we will not focus on the whole area of institutions, but only on the relations affecting economic performance and/or "governance" relations within the meaning of administration quality on both the macroeconomic and the microeconomic level. This limitation will enable us to better observe the impacts and consequences of economic and political measures or enable us to conceive such recommendations, which would eliminate the negative effects of bad institutions. On the other hand, we are not abandoning the possibility to perceive economic coherences in a wider context if considered necessary or required in terms of a complex explanation of the examined phenomena and processes. In this context, Bodmer differentiates three institutional environment levels (see Figure 3).

Figure 3: Three Levels of Institutions



Source: Customised based on Bodmer et al. (2004, p. 30).

1. 4 Institutions and Performance

The basic question to be solved in this part is based on the cognition that the quality of institutions influences economic performance. In this case, it is possible to demonstrate that under certain circumstances, governmental policy may lead to an increase of economic efficiency and performance by creating, maintaining, and cultivating suitable political and economic institutions (political and economic design). Even though one cannot avoid the trial-and-error strategy, thanks to studying, sharing knowledge, and lessons learnt there is a possibility to artificially substitute the spontaneity of languid development or informal institutions by governmental solutions in cases, when current problems may be solved in such a manner. In any case, it does not imply state engineering, but rather an effort to accept and/or to cancel measures, which substantially affect not only the existing production capacity of the economy, but also its long-term potential. An analysis of institutions would not have a practical impact, if it did not lead to the conviction that it is possible to reach the following conclusion: that defining certain explicit and "well-established" rules and their implementation into real life may present a path for stimulating economic performance.

The authors do not abandon the analysis of the impact of informal institutions, which undoubtedly create the "hot-bed, from which everything grows", yet the possibility of their change is largely long-term.²⁵ If from this narrow angle of view and regardless of the fact what system is established for its political representation, power distribution, etc., the state is comprehended in its minimal role, i.e. as the guarantee and the co-creator of the basic rules, or, in other words, of the institutions, a rational economic policy should be able to influence this process in a manner decreasing transaction costs and increasing economic performance.

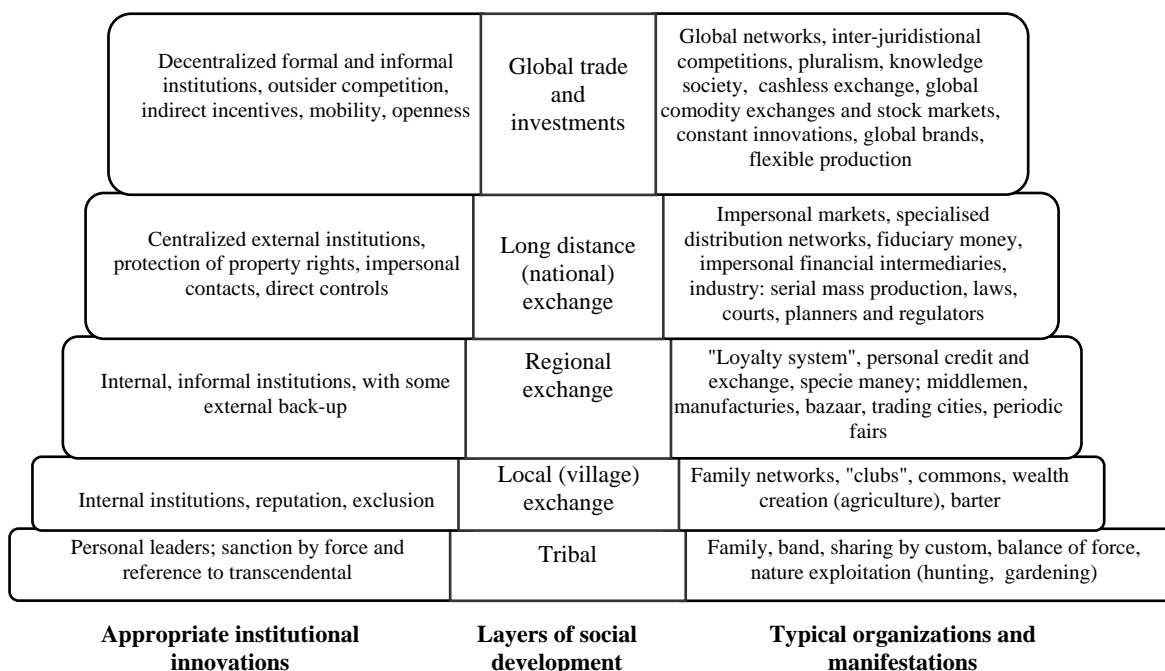
By limiting the institutional approaches to the area of "governance" and the effort to evaluate its impact on economic performance, we reach the question of how necessary it is to mention coherences and the classification of institutions. At first, it is necessary to mention the development of institutions, or the source, origin and consequences behind the institutions. Numerous parallels may be found in anthropological studies, yet let us present at least one for illustration. Kasper's diagram combines social, economic as well as institutional development (see Figure 4).

²⁵ For example Williamson (2000) expresses himself to the long-term concept, differentiating various hierarchic levels of institutions and assigning the following time periods to them (customised):

Degree of hierarchy	Time period
I. Social structure of the society, long-term (inertial), changes after shocks (revolution) or a social crisis	from 100 to 1000 years
II. Institutions changing "the rules of the game" (property rights and legal system)	from 10 to 100 years
III. Institutions relating to the "game" itself (contracts within the society)	from 1 to 10 years
IV. Institutions relating to the "allocation mechanism", regulation, control, social system, incentives, etc.	Operative

Another interesting argument concerning this issue is Dahrendorf's estimate of the time coherences of the transformation economies: the creation of a basic legal framework will take 6 months, the economic transformation will take 6 years and the formation of a civil society at least 3 generations.

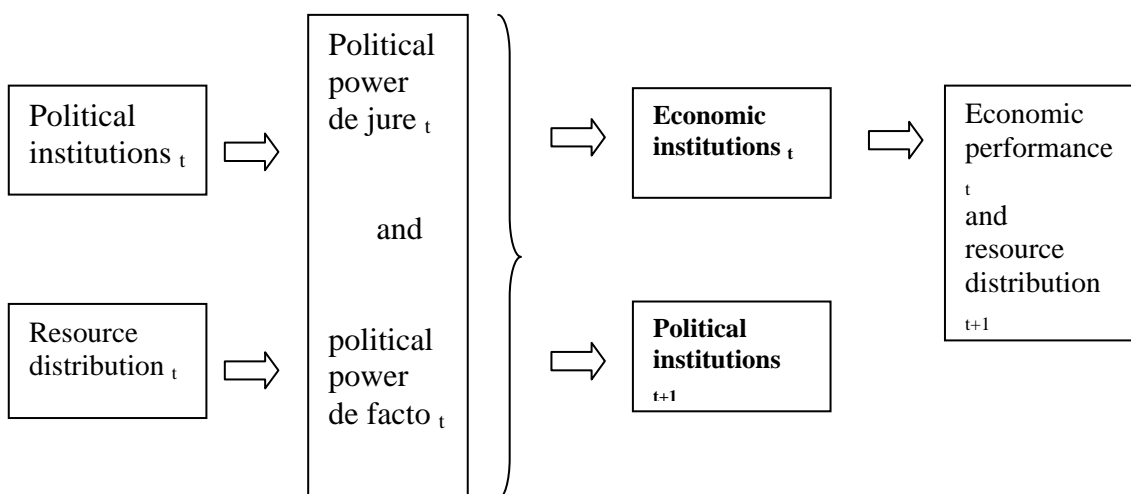
Figure 4: Social, Institutional and Economical Development of the Society



Source: Kasper (2002, pp. 11-12).

The topic is closely associated with the issue of institutional change. As early as in 1937, R. Coase showed in his book *The Nature of the Firm* that transaction costs are behind the existence of firms, or that the firms exist in consequence of nonzero transaction costs. D. C. North believes that patent rights and business secrets not only increased the return of investments, but that it mainly leads to returns from innovation and to the development of the research industry. In a way, the existing institutional framework contains a direction and a method of creating knowledge and skills.

Figure 5: Role of Political Institutions and Resource Distribution with Respect to Economic Performance



Source: Acemoglu et al. (2004, p. 6).

According to D. C. North, there are two main sources of institutional changes: on one hand, it is the change of the relative prices and on the other hand, the change in preferences. Here, the change is understood as "an adjustment to a set of rules, norms and enforcements across space and time" (1990, p. 83), while societies rather incline to stability, i.e. to a certain set of constraints (routine, customs, traditions, conventions). Let us first stop at the first case. If relative prices change, the institutional balance²⁶ is violated and conditions for new negotiations are established, the aim of which is to change contracts, integrated into a certain hierarchy of rules, which are modified thereby. Similar results are achieved in case of the change of preferences and taste (e.g. see antislavery and feminist movements). If potential profit from changed rules and their enforcement significant, it is beneficial to create intermediary organizations in the form of "offensive" and "defensive" lobby groups, which step in between economic organizations and political bodies (North, 1991, pp. 84-87). Their impact affects both formal and informal institutions and the character of the change is mostly discontinuous (e.g. a revolution). The time aspect of the influence of political institutions is illustrated by Figure 5.

The diagram clearly shows the effect of political institutions and the method of resource distribution on the other variables within the system. While political institutions form the distribution of political power in the society *de jure*, the distribution of resources alone affects the distribution of political power *de facto* in the relevant time. The political power variables influence the selection of economic institutions and the future development of the political institutions themselves. Economic institutions determine economic performance, i.e. the economic growth rate and the method of resource distribution in time $t+1$. Although economic institutions are the main factor forming economic performance, they alone are endogenous and determined by political institutions and the method of resource distribution in the society (Acemoglu et al., 2004, p. 6).

The main task of the institutions is to create (reproduce) a predictable environment for recurring activities, whereby they decrease transaction costs as well as the risk associated with the retrieval of new information. As mentioned above, according to the level of formality, institutions may be divided into two mutually interlinked "layers": *formal institutions* embrace the constitution, laws, property rights, regulations etc., including a system of sanctions, while *informal institutions* namely comprise socially sanctioned norms of behaviour (for details see Berger, Luckmann, 1999), internal standards of behaviour and a modification of the existing formal rules. Some analyses have shown that especially in the underdeveloped countries, informal institutions play an indispensable role and that to a certain extent they may alternate the role of the currently not established formal institutions (see WB, WDR, 2002).

In a certain respect, the classification of institutions based on instrumentality is similar, i.e. to *ceremonial* (status, which themselves are a "sufficient reason", a kind of "magic", "transcendence", an example being the constitution of the fundamental "vested" human rights) and *instrumental* (tools and techniques applied in problem solving, e.g. implementing decrees and procedures) (see Bush, 1987). Both the components are present in a society with different intensity. If the ceremonial component is dominant, absorbing

²⁶ It is characterised by the fact that given the specific bargaining power and the specific set of contracts and agreements, which form the overall economic exchange, it is not advantageous for any of the players to deploy resource in a change of the agreements (i.e. the significance of relative returns and costs).

new knowledge and technological innovations is very difficult for a society, as it usually distorts the existing value structure of the society. Bush has identified three types of ceremonial lock-ins: (1) past commitment (tradition); (2) future commitment (knowledge and know-how control); (3) the Lysenko effect (an effort to achieve instrumentally unachievable results through ceremonially guaranteed behaviour patterns – corruption and manipulation with sciences for ideological purposes).

Figure 6: Classification of Institutions Based on Subordination to Rules and the Method of Creation and Enforcement of Sanctions

		Formation of Institutions	
		Internal institutions	External institutions
Enforcement	Spontaneous decentralized feedback	Informal institutions	Spontaneous decentralized evolution within society Design and imposition by outside (political) authority Appear only occasionally: A disturbance of the hierarchy of superior rules is sanctioned by moral reproof or by public criticism (e.g. enforcing "political correctness")
	Family organized procedures of sanctioning	Formal institutions	Customs and good manners socially sanctioned in the "eye for an eye" or "tooth for a tooth" manner or by exclusion and banishment from the society Professional code of conduct, administered by a specific body (e.g. club rules) A legal code enforced with the aid of court and police procedures

Source: Kasper (2002, p. 37).

Bush's classification is very close to differentiating institutions as *spontaneously* formed or *artificially* construed. For example, Kasper (see Figure 6) considers as one of the main criteria, whether:

- Subordination to the rules is voluntary or somehow enforced,
- The norms were created spontaneously or artificially,
- Sanctions are applied spontaneously (social feedback) or whether they are imposed by a group.

Other point of view to the institutions may be based on the method of accepting institutions. They are either *exogenous*, i.e. they invoke something transcendental (religion, mythical heroes, etc.) and thus, are not dependent on small changes, or *endogenous*, i.e. they are a part of a specific system and if the system changes, the relevant institutions change accordingly.

According to the field, in which they operate, institutions may be divided to:

- *Legal* (constitution, legal system, laws, as well as the system of law – continental or Anglo-Saxon – or the method of law enforcement),
- *Economic* (rules, which determine the method of distribution and allocation),
- *Political* (election rules, voting system, party system, power control system, etc.),
- *Social* (approach to education, health care, social security and gender balance) (see Jütting, 2003).

Moreover, Jütting offers his own well-arranged presentation of Williamson's concept of the different hierarchic levels of institutions (according to Williamson, 2000). The classification summarised in Figure 7 shows how each "hierarchic level" differs from one another – not only in the light of the gradual dominance of formal institutions over informal institutions, but also possibilities in terms of speed of the changes of individual levels. Even if it is a mere model generalization, these levels cannot be separated from each other easily. In addition, the diagram deserves our attention in comparison with the anthropologic concepts of society development or with the similar Kasper's diagram of social, institutional, and economic development (see Figure 6). We should realize that whether we wish or not, informal institutions are an ever-present bed, a base, from which formal institutions began to grow sooner or later.

Figures 4 and 7 may be interlinked to a certain extent. Apart from the four hierarchic levels, Williamson's concept offers better generalization, nonetheless Kasper's diagram is beneficial especially to detail the coherence of exchange, institutions, the reduction of transaction costs and their consequences for the growing distribution of work and knowledge. The first institutional level is socially anchored, informal and demonstrates a strong path dependency, lock-in (pleading traditions, religion etc.). Its change is very complicated, and transaction costs are high.²⁷ This level corresponds to tribal societies or exchange in the local context – there is low distribution of profession-based knowledge according (everyone knows everything necessary) and low specialisation, barter is predominant and property rights are defined on a tribal basis, not individually. On the other hand, an almost equal distribution of goods secures low societal differentiation and inequality. In this layer, a range of anthropologic constants common to most societies manifests itself most distinctively, which are the basis for further institutional development (for a detailed explanation see Murphy, 2004, and partially also Kasper, 2002). The second level already creates the basic formal rules for the running of the society, i.e. the core of the legal system is constituted. The main objective is to peacefully harmonize divergent societies and their interests on a regional, or national and supranational level (apparent influence of trade expansion). Apart from the rules of the game, the method of playing the game is also important. The third level establish rules for playing individual games and in many cases, this results in the formation of specialised organizations, such as governments, state agencies or non-governmental organizations. They are affected by both the first and the second level (they possess a strong potential when influencing the fourth level), however, they alone have the ability to affect retrospectively the previous levels to a certain extent. The last fourth level defines the scope of adaptation by means of money or volume and the mechanism of resource allocation itself.

The higher level of development and thus, higher institutional progress lead to a gradual reduction of transaction costs, to increased specialisation of work as well as knowledge (it is particularly apparent in Kasper's diagram). It is also obvious that compared to informal institutions, formal institutions are more elastic and flexible, but as far as the rules of individual games and the institutions associated with the allocation mechanism are concerned, they are more easily susceptible to "actual moods" of the creators of

²⁷ However, this does not mean that they are excessively high or unstable. We may presume that the particular level of transaction costs is reflected into not only economic reasons in the overall institutional setting. Their unbearability mostly manifested itself at times of major changes and crises and forced the societies "to arrange things differently".

formal rules. The difficulty of institutional change is thus augmented by the slow variable of informal institutions.

Figure 7: Classification Diagram of the Hierarchic Levels of Institutions

Level	Change frequency	Effect	Origin of norms	Examples
4 th level: Institutions associated with the allocation mechanism	Short-term horizon and the present	Adaptation to prices and output, incentives to establish balance	Endogenous	Rules relating to resource allocation, e.g. capital flow control, business flow management, or the social security system
3 rd level: Institutions associated with "playing games"	Medium-term horizon (1 – 10 years)	Leads to the establishing and formation of organizations	Endogenous	Rules defining the regime of the private structure of the country and contractual relations (e.g. business contracts)
2 nd level: Institutions associated with the "rules of the game"	Long-term horizon (tens or hundreds of years)	Defines the overall institutional environment	Exogenous or endogenous	Formal rules defining property rights and the legal system
1 st level: Institutions related to the social structure	Very long-term horizon (hundreds or thousands of years), but changes may also occur in critical periods and at times of crises	Defines the way of behaviour of the society itself	Exogenous	Informal institutions, such as traditions, social norms, and customs, personal leadership, reputation, honour

Source: Adaptation of Jütting's (2003) presentation of Williamson (2000).

1.5 Impact of Institutions and Economic Performance

Why is not similar performance of all economies secured? Is performance characterized only by a combination of work, capital, and technology, or also by a set of valid laws, functioning organizations and cultural (informal, if you like) practices?

If we standardly understand economic performance as economic growth and the neoclassical production function in the form of $Q = \kappa \cdot f(K, N)$, where K is capital, N work, and κ is the aggregate productivity of factors of production, economic growth may be achieved by increasing the physical volume of inputs (i.e. by a population explosion or accumulation of capital) or by technological progress, which, whether we like it or not, also reflects the state of the institutional environment. For a very long time, the former of the paths was chosen and the trend overturned in the previous decade; the questions remains, whether changes in central and eastern Europe contributed to this, where apparently identical starting conditions lead to different results in the economic growth rate and overall economic performance. This turnover is associated with Barr's research of the significant effect of political decisions when catching up with the economic level of rich countries (see Barro, 1991) and of the theories of endogenous growth models, which explained the "residual" differences between countries inside the model itself. Nonetheless, the differences disabled the testing of the empiric prediction of the growth rate and they were explained by the impact of political and cultural variables, which, according to certain theories, lie

outside the model, and therefore, they may be influenced by political decisions. It simply proved that the production capacity of the economy is mainly determined politically and institutionally, i.e. that political institutions affect economic institutions – and Solow's residues have become the most fundamental characteristics of the model. Thus, it is a question of a shift from the policy emphasizing capital accumulation to "institutional" policies. The necessity of this distinct differentiation and research has been offered by a number of studies.

Figure 8: Institutional Factors Affecting Economic Growth

Conditions	Circumstances and agents (factors)
General	<ul style="list-style-type: none"> • Dominant ideas and opinions in the society • Historical development of society
Social and psychological	<ul style="list-style-type: none"> • Comparatively stable characteristics of the social system that has changed the evolution of the society • Psychological features of people who live in this society • Special role created by the national culture, mentality and ethic behaviour patterns
Political	<ul style="list-style-type: none"> • Quality of the constitution and method of cooperation between the state and business, political culture, informal rules and traditions
Economic	<ul style="list-style-type: none"> • Strict "rules of the game" for classification of activities to effective and non-effective • Precisely defined property rights • Functions and social rules of trade • Effectively working financial and banking system • Appropriate methods of management of risks and insurance system • Accepted and not disturbing tax system • Multi-centre structure of economy (not centralized) • Basic assumptions of the economic institutions, which have a positive effect on long-term growth

Source: based on Horodecka in: Piech (2003, p. 8).

Even though it was not always feasible to evidence the direct strong influence of all political institutions on economic growth (democracy, freedom of the press, openness or political stability), the quality of political institutions indisputably has a significant impact on the quality of economic institutions. As one of the main variables that affect institutional quality, the study offered the force and the power of the state on one hand, and responsible involvement of the state on the other. The growth of force and involvement, so criticised in developed economies, has shown a positive effect on the quality of institutions in underdeveloped countries (see Bodner et al., 2004). Nevertheless, it would be difficult to present arguments against the fact that it is a question of implementing some visible hand of the state or WB or IMF type international organization. If we include cultural institutions in the analysis, then the state apparently does not possess merely the administrative capacity to increase taxes or to allow uncontrolled growth of bureaucracy and corruption. Hereinbelow, we will attempt to preserve the classification to economic, political, and cultural institutions, when presenting partial studies.

Institutional quality as a whole manifests itself directly on economic performance especially by means of economic institutions. The width of the issue mainly flows from comparative study. Let us try to show the fundamental institutional factors affecting economic performance, whereas we will start from Israel's classification to general, social and psychological, political and economic (Piech, 2003, p. 8).

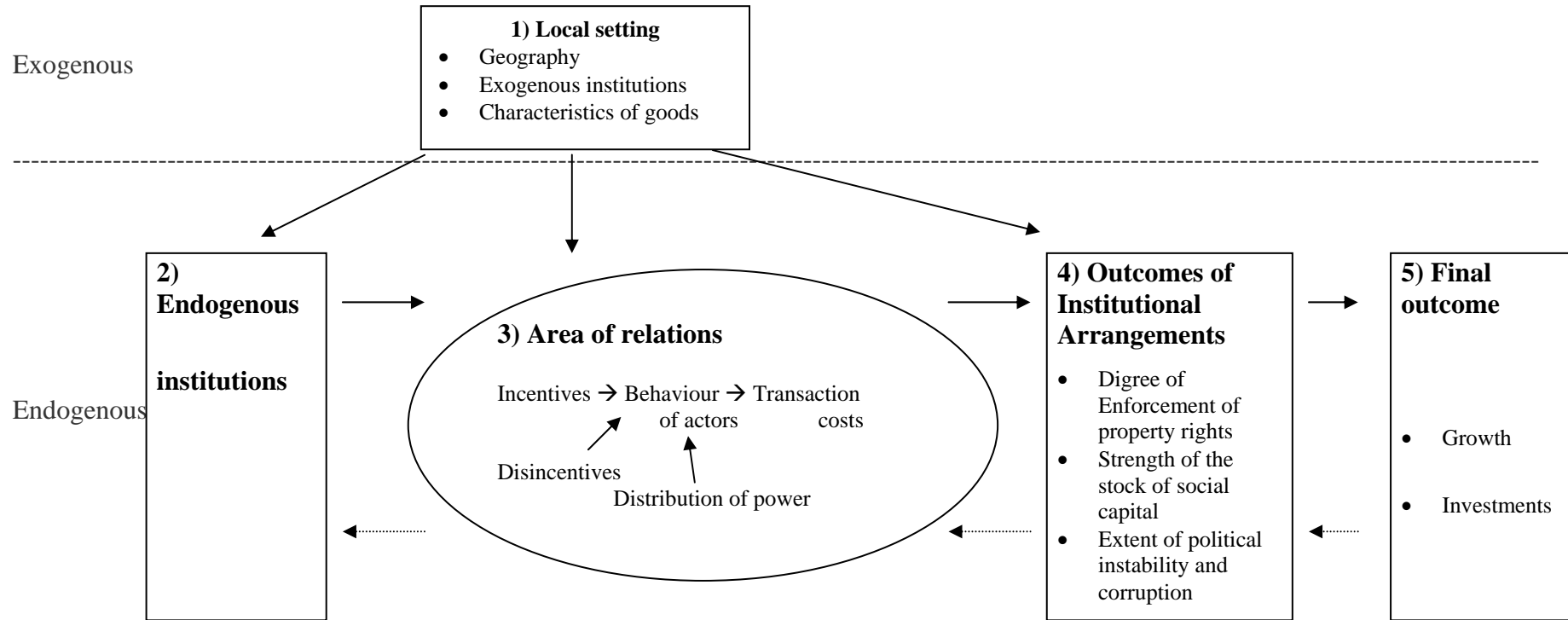
Theoretical approaches that start from the belief that institutions affect economic performance are seeking to define institutions from various angles of view, to characterize them in time and to organize them, they attempt to delimit the area of the origin and functioning of institutions, including an overview of institutional factors, which have an impact on economic performance. If we want to measure and compare the effect of the impact of institutions through time, the understanding of all these approaches is an essential, nonetheless still a starting condition. Let us try to define the general framework to analyse the influence of institutions on the development of the society and let us find in the set of offered measurements those that have a major predicative ability on one hand and those that best characterize only partial, yet significant factors in terms of effect. Jütting's approach (see Figure 9) offers itself as the best option for defining the general framework, whereas the following text is dedicated to evidence and to describing possible measurement and evaluation approaches.

1.6 Options for Measuring Institutional Quality

Currently, there is a wide range of approaches of measuring and evaluating the quality of institutional environment and which may be used to characterize the influence of institutions to the growth performance and competitiveness of the economy. That is one side of the coin. On the other hand, we must realize that there probably is no aggregate institutional quality index. In the following tables, we would like to show some of the indexes, which are more or less monitored on an international scale and which may at least partially reflect or to directly focus on a specific segment of institutional quality. Table 1 shows regularly published indexes, which may be used for the characteristic of the impact of institutions and with which may monitor their development in time on a long-term basis. Table 2 shows some case studies, which reflect the role of institutions in relation to economic growth. As a rule, individual institutions are not observed in detail, the researchers content themselves with general indexes and they do not separate the effect of individual institutions on overall economic growth.²⁸

²⁸ The tables do not include some indexes showing "some impact of some institutions" on partial fields, industries or areas of the economy. There must be a vast number of these impact and influence measurements and we count on using them, if necessary, with view to the significant predicative ability of the indexes. As an example of such, we may name e.g. the work of Lohlein et al. (2003) focusing on informal institutions when sharing risks to employees in the health sector from the point of view of the approach towards health care in relation to modernization, and the work of Atien (2001) focusing on formal and informal institutions of borrowing funds and their effect on limiting access to loans, with impact on economic performance.

Figure 9: Framework for Analysing the Influence of Institutions of Development



Source: Jütting (2003, p. 33).

Table 1: Regularly Published Indexes Associated with Institutional Development

Data source	Index characteristics	Link
<i>World Development Indicators</i> (WDI) World Bank	Data include approx. 800 indicators in 87 tables divided into 6 basic areas: World Characteristics, Population, Environment, Economy, State and Markets, Global Coherences. The tables cover 152 economies and 14 groups of countries with basic indicators, and basic data are available for additional 55 countries. Data availability: 1960-2002, annually.	http://www.worldbank.org/data/wdi2004/index.htm
<i>Government Finance Statistics</i> (GFS) World Bank	Annual data offering classification according to the income source or the expenses of the specific sector at all governance levels. They are frequently indicated as the GDP share.	www.imf.org/external/pubs/pubs/statpack.htm
<i>Balance of Payments</i> (BP) International Monetary Fund	Data covering a wide area of flows associated with foreign trade and the international investment position. Such information includes foreign currency liquidity, external indebtedness and payment flow balance.	www.imf.org/external/np/sta/bop/bop.htm , www.imf.org/external/pubs/pubs/statpack.htm
<i>Doing Business</i> World Bank	A database providing a comparison of 85 countries at the end of the 1990s based on social security, employment, and collective bargaining laws.	http://rru.worldbank.org/DoingBusiness/default.aspx
<i>The Index of Economic Freedom</i>	Data available on an annual basis, starting from the year 1995 for approx. 160 countries of the world.	www.heritage.org
<i>Economic Freedom in the World</i>	Economic freedom data, available for 123 countries.	www.fraserinstitute.ca
<i>Corruption Perception Index</i> (CPI), <i>Bribe Payers Index</i> (BPI) Transparency International	Published annually, the CPI tracks the extent of corruption in the country and embraces over 140 economies, the BPI covers 20 largest world exporters.	www.transparency.org
<i>Governance Matters III: Governance Indicators</i> World Bank	An index covering a total of 6 dimensions in 199 countries.	http://www.worldbank.org/wbi/governance/pubs/governance3.html
<i>The Business Environment and Enterprise Performance Survey</i> (BEEPS) World Bank	A survey conducted in approx. 4,000 companies in 22 economies undergoing transformation, periodically once every three years.	http://info.worldbank.org/governance/beeps/
<i>Opacity Index</i> PWCoopers	A five-component index (CLEAR) covering approx. 30 transformation countries.	www.opacity-index.com
Human Development Index	An annual report on human development informs on the progress in the area of human rights and freedoms on a worldwide basis.	http://hdr.undp.org/reports
World Competitiveness Yearbook, IMD	An annual report informing about the competitiveness of nations – it provides an analysis of approx. 320 criteria of the competitiveness of the environment and enterprises. It covers 60 nations and regions.	http://www02.imd.ch/wcy
Global Competitiveness Report, World Economic Forum	An annual index of the growth of competitiveness comprising three pillars: the quality of the macroeconomic environment, the state of public institutions, and the technological preparedness of countries.	http://www.weforum.org/site/homepublic.nsf/Content/Global+Competitiveness+Programme%5CGlobal+Competitiveness+Report
Freedom in the World	Annual data on political and civil rights in 192 countries of the world.	www.freedomhouse.org
International Country Risk Guide, PRSC Group	Data on the political risk associated with international investments, comprising economic risks, the investment potential, the legal system, bureaucracy quality, etc.	www.icrgonline.com/icrgMethods.asp
Business Environmental Risk Intelligence, BERI	Risk evaluation, analyses and forecasts for 140 countries of the world. The index is divided into two parts – the political risk index and the functional risk index.	www.beri.com

Table 2: Indexes Reflecting the Role of Institutions in Relation to Economic Growth

Author (year)	Institutional measures	Dependant variable	Objective of analysis	Findings
Sachs (2003)	Institutional quality	GDP per capita	Influence of geographical position on performance	Malaria undermines performance
Beck et al. (2002)	Origin of law	Financial development	Historical comparison, political or other adjustment channels	German and British law have a much better effect on financial intermediaries and markets, and on the protection of property rights
Dollar – Kraay (2002)	Legal system index	Business and growth	It is very difficult to ascertain the separate influence of institutions and growth	Changes in institutions resulted in major changes in growth; in the long-term, the impact of institutions is significant
Rodrik et al. (2002)	Enforcement of property rights and the power of the legal system	GDP per capita converted based on PPP	Associated with position and business involvement	Institutional quality surpasses everything else and has a positive effect on integration
Easterly (2001)	Institutional quality index	Ethnic conflict "results"	Relationship between institutional quality and ethnic diversity and the influence of ethnic conflicts	It is necessary to differentiate, whether the ethnic conflict is destructive or whether it is inside the rules of the game. Ethnic diversity plays a role in weak institutions, quality institutions reduce the possibility of war and genocide .
Aron (2000)	Quality of private and public institutions	GDP growth	Classification based on 5 indicators: quality of formal institutions, social capital, social characteristics, character of political institutions and stability	The significance of formal and informal institutions, distinctive impact on growth indirectly through investments
Gaviria et al. (2000)	Managing conflict	Growth	Institutions aiding in conflict management react more flexibly to economic shocks	The large-scale limitation of politics and the medium level of political fractionalism is associated with more expedient restoration after a political shock
Campos – Nugent (1998)	Comparative institutional development index	Growth	19 Latin American countries with the application of the standard Solow model	A link exists between institutional development and the GDP rate per capita via creating human capital
La Porta et al. (1998)	Protection of property rights, quality of bureaucracy, efficiency of public expenses and democracy	Governmental performance	A dataset of 152 countries focused on governmental interventions and efficiency, the size of the public sector, democracy and public services	Performance of the governmental sector, influence of history and institutions (cultural and political differences); associating the size of the governmental sector with poor governance may be misleading
Knack – Keefer (1995)	Index ICRG a BERI	Investments and economic growth	Relationship of institutional environment and instability	Institutions that protect property rights support growth and investments, institution control is essential.

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