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# Similarities and Differences of Institutional Change in ENP and Other Catch-Up Countries

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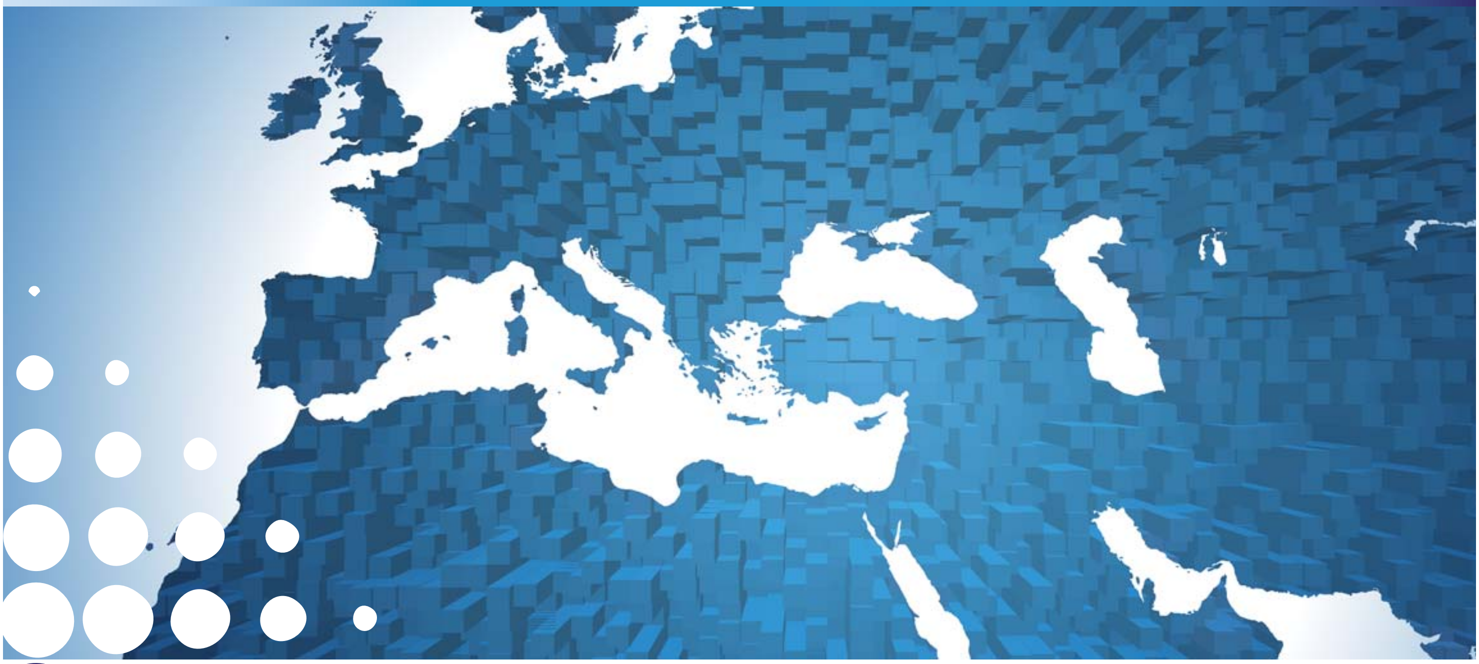

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# Similarities and Differences of Institutional Change in ENP and Other Catch-Up Countries

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**Abstract**

The working paper consists of the following parts: introduction; a chapter on the role of institutions for catch-up, covering a discussion on Washington Consensus and the BeST Consensus as the paradigms of East Asia catch-up economies development; a chapter with conceptual framework discussing whether the BeST Consensus model of successful growth of East-Asian states could be transferred to other transition countries; a chapter on institutional change in the transition economies, former Soviet Union states and the MENA region; a chapter describing existing data on institutional indicators of the economic growth by the World Bank and the World Economic Forum; in the end the working paper introduces the overall summary.

The role of institutions, both formal and informal, for uneven economic growth is clearly proved to be prominent while reviewing theoretical and empirical studies of institutional change in East-Asian countries as well-known catch-up states. By contrast, institutional transformation of the post-Soviet transition states and the MENA region economies shows how the low quality of institutions affects negatively economic transformation. The role of the government in high performing Asian economies is compared to the role of centralized post-communist governments within the perspective of institutional path-dependency and informal institutions being unready to accept formal institutional transformations. A conceptual framework of the paper provides theoretical perspectives of possible amelioration of institutional quality in ENP states using experience of up-front catch-up states, which introduces a possible useful theoretical sketch for the further empirical research in the institutional field of ENP.

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## I. Introduction

It has a been a long-way concern for many scientists today, why some economies develop and grow very fast and change the world economic map dramatically, and other developing countries still lag behind, while the experience of success cases might be replicable. What all the scholars on the topic demonstrate is that besides geographic positioning and trade, which are definitely responsible for the determination of income levels around the world, institutions, specifically the quality of institutional environment, outstrips everything else (Rodrik et al., 2004). It is believed that societies that encourage investment through the means of incentives and high quality institutional environment will be richer rather than the ones, who do not do so (Acemoglu et al., 2002).

Under institutions we mean formal and informal organizations, rules and policies, which encourage enforceability of law, property rights protection, and government support aiming at building up of a high-quality institutional environment. It has been a long debate on the subject of institutions being the same as organizations or not. Evolutionary economic geography implicitly distinguishes between institutions and organizations and institutions and routines, attributing institutions to specific territories and routines to firms. In such a way, institutions bear a territorial character being embedded in specific regional systems (Rafiqui, 2009). We assume informal component of institutional environment as important as the formal one, since as Tridico (2011) highlights it, acceptance and success of the new formal institutions depends on the fit with informal institutions, which already exists in the society. As North (1990) puts it, institutions, being the rules of game, and humanly incorporated constraints that form human behaviors, informal rules, social contracts and business culture, tend to have a limiting effect on how economic agents interact and thus on the whole economic development.

Institutional change in East Asia and other transition economies is specifically addressed in the paper. Institutional evolution as the prerequisite of economic growth depends on some specific determinants, which ensure context specific characteristics of transformation of institutional frameworks over time. Different stories of institutional transition in East Asia and post-Soviet states prove that it is determined by country's values, history, traditions and norms, which in the long run affect the acceptance of formal rules and regulations. Intrinsically analysis of differences and similarities of institutional change between East Asia and post-communist economies goes within the lines of old and new institutional economics. Institutional change, which took place in the independent states after the collapse of the

Soviet Union, can be explained from the perspective of old institutional economics, according to which "old and inefficient economic institutions can persist even when economically inefficient if they guarantee the pursuit of their original objectives, and when the power groups, the guarantors of these institutions, still consider them appropriate for the protection of their interests" (Tridico, 2011, p.125). By contrast, institutional transformation and its impact on economic catch-up for the East Asia states goes in line with the new institutional economics theory, stating that institutions are there to reduce transaction costs and new institutions emerge when the old ones are not able to reduce the transaction costs anymore (North, 1990). In such a perspective, inefficiency of bad institutional frameworks and the influence of institutional environments on economic growth and development is addressed further in the paper.

What exactly brings institutions up front and why, for example, East-Asian countries, managed to profit from their institutional environments and European Neighborhood Policy states (post-Soviet transition economies and Middle East and North Africa states) did not perform as well, facing institutions as obstacles for their development, is put for the discussion. Acemoglu et al. (2001, 2002) and Nagy (2002) refer with their reasoning of unsuccessful institutional development of transition economies towards the initial conditions and historical path-dependency of institutions, which makes them to be inherited by the countries together with their history and therefore the costly process of changing bad institutions for good ones is not attractive for governments. Lee and Mathews (2010) on the other hand, underline that East-Asian countries proved to be high performing and economically successful because they managed to use their institutions for the benefits of economic growth. State became supportive for the economy and economy as a result was seeking for cooperation with the state in Korea, China, Taiwan, Thailand, Singapore, whilst the state from the Soviet times could not transform its controlling role into a supportive one. All this has led to losing faith in the state.

The paper consists of the following parts: Chapter II deals with the question, why institutions are important for the catch-up, discussing in detail the success story of East-Asian countries and the Washington Consensus versus the BeST Consensus. Chapter III covers the conceptual framework and deals with the question if the success story of East Asia can be replicated. Chapter IV discusses the transition of post-Soviet states and the MENA region. Chapter V provides the data of the previous research carried out in terms of institutional assessment of the economies by the World Bank and the World Economic Forum. Chapter VI deals with the summary of the entire paper.

## II. The role institutions for catch-up

It has been largely accepted in the literature that economic systems are organized around institutions (North, 1990; Tridico, 2011). Differences in economic performances of states can be explained by the performance of formal and informal institutions within the specific regional, social and historic contexts. It has been largely accepted by evolutionary economic geographers that knowledge creation and technological development are the drivers of economic growth. Institutions do impact the formation of incentive mechanisms that enable investments in human capital and technology, that later on lead to economic growth (Rafiqui, 2009).

Economic transformations are backed up by certain institutional changes to create context specific conditions and frameworks for these transformations to take place. Institutions are endogenous to economic development, because the latter starts with institutional change aiming at getting the right institutions in place to adapt economic changes to the new circumstances and environments (Tridico, 2011). Hodgson (1995) comparing evolutionary change of institutions to the Darwinian process of biological change, stresses out that institutions are path-dependent and strictly endogenous and the change of formal and informal rules and regulations always comes first before the other transformations take place.

Variation of institutional change over space provides evidence that institutions spatially or geographically related. Thus, looking at Asian, African and Eastern European economies, we clearly see that socio-economic progress of these countries differs drastically. The rapid growth of East Asia has challenged other parts of the world with a firm statement that there is a range of drivers, which enforce such an economic outstrip. Taking a more detailed view into what these drivers are, the question arises what in particular enforced the development in East Asia and lacked in other transition economies while they were lagging behind. Here institutions come up front with examples of high performing East-Asian economies, which managed to outperform economically major economies of the world, having previously established high quality institutional frameworks and government presence in the economy.

### 2.1 Building of an institutional framework: from Washington Consensus to BeST Consensus

The IMF and the World Bank, both institutions based in Washington, were stressing out the importance of deregulation, trade liberalization and the free market formula, which counted mainly for the market taking the lead on the basis of supply-demand law of an economic model. Washington Consensus was introduced by John Williamson in his book "Latin American Adjustment" (1990) and together with a range of factors favoring secure and stable macroeconomic regime, especially in the field of fiscal regime, the consensus promoted free market policies (Lee and Mathews, 2010). It encouraged principally trade liberalization and deregulation favoring in such a way the market in charge of economic growth. Macroeconomic stability reached by the means of fiscal discipline and tax reforms and export growth were supposed to be the prerequisites of economic development.

In 1993 World Bank introduces "The East-Asian Miracle" report, in which it favors neo-classical view, or a "market friendly view", although it also indicates a revisionist view, or a "government friendly view". World Bank challenged an explanation of the East-Asian economies success with raising questions about the relationship between the government, the private sector and the market. Although the government appears to be an important player on the arena, it is mainly expressed through sound macroeconomic policies towards effective macroeconomic management and broadly based education system in the context of such relationships. Moreover, it is clearly stated that an extraordinary growth of high performing East-Asian economies was due to the accumulation of physical and human capital together with an enforcement of FDI investment and technological upgrading (World Bank, 1993). Thus, World Bank promotes clearly the role of market and competition, export growth and macroeconomic stability, increasing savings and productivity change in flexible labor markets in the achievement of economic upheaval by high performing East-Asian countries. Within this perspective World Bank partly supports the basics of the Washington Consensus, giving the floor to deregulation, trade liberalization and privatization as the drivers of growth. Of course, it is hard to argue that these determinants do not work for economic development. What comes up to be important in this respect is the location specific context and historic conditions attached to this context, in which Washington Consensus can work.

East-Asian economies bring an example of context specificity of conditions impacting catch-up with regard to FDI attraction, also promoted by the Washington Consensus. Enforcement of foreign direct investment makes not only an inflow of capital and physical resources, but also an inflow of knowledge assets, human capital and technological transfer, all playing a prominent role in upgrading process and catch-up. Another question is what stands behind such initiatives. Obviously, the role of the market appears to be played rather in the second scene of the play than in the first, when foreign investments are already in the market, property rights are secured and the legal framework is "installed for the business". Primarily, the government is there to establish such an institutional framework, which will create such factor conditions that will enable the market rule by itself. Stiglitz and Yusuf (2001) underline the chronology of government involvement during the catch-up process using an example of China. China used to have a centrally planned system, but its high growth has been largely associated with the dynamic institutional reform which made China grow from a planned to an emerging-market economy. China's transition happened in two stages. The first standing for building new innovative institutions at the advantages of the loopholes in the old institutional framework, whilst the second stage was already aimed at putting constraints on the previous reforms so that economy would develop, establishing modern market systems that would incorporate international institutions of the "best practice". In the first stage the government was an active player in the field, since it was directly involved in corporate governance through its ownership and control, especially considering the fact that existing institutions were very poor. In the second stage, when the main focus was on building market-supporting institutions, government pulled away by means of privatization, corporatization and securitization.

The Washington Consensus, specifically deregulation and trade liberalization on the first place could also  possibly not achieve its initial goals unless there is a reliable legal framework, which makes the promotion of national and international competition possible and therefore, enforces economic growth. In comparison to other developing countries, East-Asian economies turned out to be more successful in creating a strong legal regulatory environment, which enabled property rights protection and rule of law as a good platform for economic development. Rodrik et al. (2004) stresses the importance of property rights and rule of law as the prior rules of the game of a society, yet relying on the context specificity depending on the historical trajectories, geography, political economy and other initial conditions (Acemoglu et al., 2002). Findings indicate that when the property rights are protected, the whole economy is growing better. A proof to this is the experience of Russia and China, whilst the former has the private property rights in place and the latter a social legal system. Chinese entrepreneurs felt sufficiently more secure to make large investments, which also played a prominent role in the rapid catch-up of the country. Whereas in Russia, investors were still afraid to get use of the private property rights, because it was all quite insecure. Institutional quality indicators prove this out with Russia scoring considerably lower than China, which also signals that it is more important to protect property rights than formally legalize them under private property rights regime.

The role of the government is clearly coming up front in the discourse of discussion of an unprecedented growth of high performing Asian economies and failure of Eastern

European countries, specifically Russia and Ukraine, together with North African states to catch up as efficiently as their Asian counterparts did in 1990s. Scholars refer to the orthodox Washington Consensus policies as the reason for poor economic performance of a range of post-Soviet economies after the reforms of 1980s and 1990s did not work out well (Tridico, 2011). Having realized the critical points of the Washington Consensus, international financial institutions proposed the so-called "Augmented Washington Consensus", in which an important institutional platform was introduced. However, the institutional catch in the renewed Washington Consensus still had a limited perspective on broad government policies, market institutions and social dynamics as essential ingredients of the institutional complexity preceding economic catch-up.

Realizing the ineffectiveness of non-government economic regulation and failures of economic growth without solid institutional frameworks, Lee and Mathews (2010) refer to Beijing-Seul-Tokyo Consensus for economic development as a substitution for Washington Consensus. The focus of the BeST is a range of flexible underpinnings of certain policies and strategies that encourage capability building and development of a sound institutional platform (Table 1).

**Table 1. Washington Consensus vs. Augmented Washington Consensus vs. BeST**

| | **Washington Consensus (1989)** | **Augmented Washington Consensus (2000)** | **BeST (2010)** |
|---|---|---|---|
| **Role of the state** | Weak role of the state (liberalization, deregulation and privatization of state enterprises) | Growing role of the state (enterprises under corporate governance) | Strong role of the state (industries and technologies targeting, leading sectors upgrading, gradual phasing out of non-market interventions, pilot agencies guiding the industrialization) |
| **Macroeconomic settings** | Lowering inflation, trade deficit, FDI attraction | Anti-corruption, flexible labor market, inflation targeting, adherence to WTO standards | Stable macroeconomic settings (lowering unemployment, stable inflation, stable budget deficit) |
| **Financial system** | Fiscal discipline, tax reform (no or small growing rate), unified exchange rates, liberalized interest | Adherence to international financial codes, "careful" capital account opening, | Catch-up friendly system ("easy" crediting conditions, financial incentives for upgrading and |

| | | | |
|---|---|---|---|
| | rates | non-intermediate exchange rate regime, independent central banks | opening of new enterprises) |
| **Public expenditures** | Reduction of public expenditures | Public spending for social safety standards and poverty reduction | Public spending for firms' capabilities development and broad based education building |
| **Economic growth potential** | **Market** | **Market + Government** | **Government -> Market** |

Source: Own draft based on Lee and Mathews, 2010; Rodrik, 2004; Tridico, 2011

Contrary to the Washington Consensus and Augmented Washington Consensus, BeST introduced conservative macroeconomic settings, selective opening of industries for incoming FDI flows and industry targeting, i.e. selection and attraction of technological transfers to those industries which were meant for catch-up. A special attention must be paid to the following aspects, introduced by BeST: creation of pilot agencies to guide industrialization, targeting industries and technologies and upgrading of the leading sectors, building broad based education, from primary to tertiary education, provision of advanced knowledge access and firms capabilities building. The whole concept of government interventions into the economy through the means of pilot agencies and industry targeting introduced in BeST supports our assumption that the government has to come first in setting the rule of the game and the market is to come second to play this game. State intervention in East Asia did not paralyze the market self-regulation function. It had more a supplementary role of adding disciplinary functions without any intention of weakening the market discipline. The aim was to target the industries up till that point of time, when they will be able to compete internationally. In order to pursue with these industrialization frontiers, East Asia required definitely strong government and leadership. Stiglitz and Yusuf (2001) underline that for Thailand, Malaysia and Indonesia government interventions played a crucial role for successful development of such industries as agriculture and agroprocessing. Without government leadership, Malaysia could hardly become a major electronics offshore site. While a number of incentives were used for encouraging FDI into the state, the government of Malaysia set up also a successful Penang Skills Development Centre, which helped employees to develop their technical competences, in such supporting the internal local environment.

Industry targeting though should be treated quite carefully. In this respect the major concern is what industries should be targeted and how does the government select the right industries. Targeting should proceed strategically towards those industries, which outperform externalities or market failure in terms of the gap between private and social return. This was the way for Japan's heavy industry promotion in 1950s and for Korea to establish successful telecommunications services industry, oriented for export, which was primarily overtaken by MNCs and JVs. Korea managed to do so only with the help of government, supporting technological transfer, upgrading and building of own manufacturing capabilities of firms. In Japan industry targeting of its own was named "bureau pluralism", which meant that private interests were primarily aggregated into an industrial association and then transmitted to a bureau, which was acting inside of the government and representing the industry's interests under its jurisdiction (Stiglitz and Yusuf, 2001). Technocratic insulation can be also addressed within the perspective of targeting of the right industries. Technocratic insulation means "the ability of economic technocrats to formulate and implement policies in keeping with politically formulated national goals with a minimum of lobbying for special favors from politicians and interest groups" (World Bank, 1993, p. 167). Thailand is a good example of government insulation mechanisms towards low inflation and prudent debt management. Thus, the Budget Bureau of Thailand consulted with the National Economic and Social Development Board about proposed public investments and with the Finance Ministry about expected revenues. Afterwards, together with the Central Bank it determined how much deficit financing can the economy afford without rising inflation. Some East-Asian economies have introduced bureaucratic insulations indirectly. This is explicitly observed within wealth-sharing mechanism, when the marginal cost of lobbying increased after the potential gain to interest groups decreased and therefore, interest groups appeared to be more willing to leave the policy process to technocrats.

Another important institutional component addressed by BeST and not mentioned by the International financial institutions is education. In contrast to Washington Consensus BeST Consensus includes broad based education as one of its core determining factors for economic growth. BeST stressed out the importance of a complete educational system, namely from primary to tertiary education, since for technological upgrading and firms capabilities building these are people skills that matter the most. Education policies are primarily of interest for the development of human capital, accumulation of which is also seen as a prerequisite of East-Asian growth success. Education reflects the level of structural change in the human capital, which is represented by people and their abilities to perform within the economic system which is transforming and their readiness to accept the outcomes of such transformation. Lee and Kim (2009) have also proved that institutions and secondary education as a part of an institutional framework do matter for “lower” income countries during transition from low to middle-income countries, whereas tertiary education and technological innovation are important factors for “higher” income countries when upgrading to high-income groups.

By and large, the role of the state in the catch-up story of East Asia is unprecedented. Interestingly enough is how Asian governments managed to find a balance in the levels of government interventions and their ability to integrate and embed institutions not only into the economy, but also into the society. East-Asian economic growth proves that obviously institutional framework does impact the way economic actors act being in such a way directed by a set of rules, regulations and government support.

**III. Conceptual framework: East Asia success story lead by example?**

The main question arises whether the success of East-Asian countries and the BeST Consensus can be replicated in other developing states, specifically the former Soviet Union states and the MENA regions countries? How institutional factors, being an engine for the East-Asian miracle, can also drive other transition economies growth? And what institutional factors are determining for domestic companies and for foreign owned companies as the drivers of economic growth and catch-up? Catch-up now appears to be viewed as a process. Geschenkorn, A. (1962) points out that the comparative advantage of countries lagging behind is that they can really use the knowledge of the developed counterparts. He calls it a “late comer effect” and explains it through the process of specific institutional imitation enforcement by less developed countries, which in the long run help the latter to catch-up. This is a competitive advantage for countries, which are still economically underdeveloped to learn on the experience of well-developed countries and adopt development scenarios of the latter to their own specific contexts. By specific contexts we also mean the conditions of specific locations. As Martin (2000) puts it, locally embedded institutions create a sort of “institutional milieu”, which in its turn facilitates the functioning of technological clusters. When the latter get established, they further encourage the formation of locally specific institutional systems, which also impact the technological spillover among local economic agents. Therefore, catch-up of the East-Asian countries also has its “spatio-institutional foundations”. This develops further in the notion of “regional lock-in”, when the local institutional regime is so much embedded in the usual regional context, that it just resists any change (Martin, 2000). Regional lock-in happened, for example, in such post-Soviet states as Ukraine and Russia, where the ties to favorable, but inefficient, institutions were so strong, that it was hardly possible to change the old institutions, everybody was used to. This means that replication of the East-Asian model of economic growth towards such former Soviet Union countries as Ukraine and Russia, for instance, should take into account the region specific context of those countries in order to escape the drawbacks of institutional thickness, persistent in the post-communist areas.

Stiglitz (1996) underlines that in principle East-Asian miracle could be replicated, if there was a provision of macroeconomic and political stability; broad investment in education; government policies could adapt to the changing circumstances and environments and focus on encouraging direct investments; governments were efficient in creating market institutions, like development banks and capital markets, so that markets could work more effectively; governments would aim at government-business cooperation, meaning introduction of such programs by the governments that could serve corresponding needs of the business community. An important aspect addressed here is that initially governments of East-Asian states did not aim at replacing markets, but to effectively support their normal functioning through sound regulations and policies. Stiglitz (1996) states that the main mistake of the former Soviet Union countries and other socialist, transition economies was that they tried to replace the market when there was a market failure observed. In East Asia, on the other hand, the government took action and supported the market, never intending diminishing its role in its original sense.

Another important issue, successfully incorporated by the East-Asian governments, was focus on cooperation with local businesses, which developed trust and faith in the state. This played a much more long-term role for the whole future development, because the state has managed to attain positive supportive image from the start. In South Korea, for example, government and private sector relations were quite close and cooperative up to 1980s. Government took the businesses' view into account and included them as a critical policy component. There were meetings between the president, the ministers and top business leaders held, where the most vital topics were discussed. After these meetings the government-initiated discussion groups were gathered with the participation of managers, middle-level government officials and experts or scholars. Within such a perspective of business-government relations, private sector sees the government involvement as positive supporting role and can then focus on effective market competition rather than either waiting for a favor from the government or coming up with a cheating scheme of the bureaucratic elite. Labor relationships are also very useful in establishing a trustful and supporting link between institutions and economy. Governments of Japan, Korea, Singapore, Taiwan and China restructured the labor sector by eliminating trade-based labor unions and creating enterprise-based labor unions. In such a way companies were directly involved in implementation of work-related policies (World Bank, 1993). In such a way faith in government is reinforced, which is a key driver in building sound institutional environment for successful catch-up and further growth. Post-Soviet states need to recover the faith and trust towards the government and formal institutions. To do so, the government should focus on supporting and facilitating role of the economy, especially for domestic and foreign owned firms, as Asian governments did through introduction of special financial incentive schemes for business development, simplification of permits and licenses attainment, physical and intellectual property rights protection, increasing enforceability of laws and regulation policies, regarding those as important determinants firstly, for the functioning of domestic enterprises and secondly, for the attraction of FDI aiming at increasing knowledge and technology transfer from foreign owned firms to domestic companies.

The main prerequisite of FDI attraction is building up of a sound legal platform and securing property rights, both of which has been successfully achieved by the high performing East-Asian states (Rodrik et al., 2004). Thus, institutional framework becomes a system of determinants of building up and development of economic actors. Institutional factors matter for both domestic companies and companies with foreign ownership with regard to their location strategies and business development. World Bank and World Economic Forum have focused on both domestic and foreign owned firms while assessing institutional environments within overall ranking of the world economies on ease of doing business and competitiveness parameters (World Bank, 2012; World Economic Forum, 2011). In Table 2 we can see a range of institutional factors, which are relevant for either domestic firms or foreign owned companies or for both of them within encouraging their economic activities.

**Table 2. Importance of institutional determinants for domestic firms and firms with foreign ownership**

| Institutional determinant | Domestic firms | Firms with foreign ownership |
|---|---|---|
| Starting a business | ✓ | ✓ |
| Registration of a property | ✓ | ✓ |
| Property rights protection | ✓ | ✓ |
| Investors' protection | | ✓ |
| Protection of minority shareholders' interests | ✓ | ✓ |
| Contracts enforcement | ✓ | ✓ |
| Strength of auditing and reporting standards | | ✓ |

| | | |
|---|---|---|
| Burden of government regulation | ✓ | ✓ |
| Bureaucracy and administration barriers | ✓ | ✓ |
| Getting licenses and permits | ✓ | ✓ |
| Getting a credit | ✓ | |
| Paying taxes | ✓ | ✓ |
| Judicial independence | ✓ | ✓ |
| Resolving insolvency | ✓ | ✓ |
| Irregular payments, bribes and personal contacts | ✓ | ✓ |

Source: Own draft by the author, on the basis of World Bank Doing Business 2012 Report; Competitiveness Report 2012, WEF

The majority of institutional determinants turn out to be important for all the firms irrespective of their equity capital structures. Investors' protection and strength of auditing and reporting standards seem to be more important for foreign owned firms rather than for domestic companies, whereas getting credit is a determining for domestic firms, since the origin of funds of foreign owned companies is either the mother company or financial institutions of the mother country and not the recipient state. A range of the above institutional factors also represent the basics of the BeST Consensus, namely facilitation of business regulations and barriers, supporting firms in getting credit and resolving insolvency and securing of property rights. This means that provision of these institutional determinants within the framework of transferability of the BeST model is essential for encouraging favorable conditions for domestic enterprises and attraction of FDI. Governments of East Asia also focused primarily on small and medium-sized enterprises while building up high quality institutional frameworks for domestic and foreign owned companies. Thus, Japan, Korea, Taiwan and China have been very successful in developing successful financial support programs for small and medium sized businesses. In Japan public financial institutions attributed on average 10% of lending towards SMEs together with introduction of government support credit programs for small and medium sized businesses. In 1989, SMEs stood for around 52% of manufacturing value added and sales. Korea also established a good incentives system for SMEs, which resulted in 52% employment in SMEs in 1988. In China and Taiwan, due to the government support, SMEs comprised around 90% of enterprises in each sector (World Bank, 1993). Therefore, the priority in reflecting positive experience of East Asia within the reality of post-Soviet transition should be given to the institutional determinants for the growth and development of small and medium-sized businesses, both domestic firms and foreign owned companies, in such a way ensuring knowledge and technology transmissions and easy access.

One of the reasons why post-Soviet countries were not able to replicate the story of high performing East-Asian economies is that historical background of the Soviet Union meant also a concept of institutions as a burden for economy. Bureaucracy, corruption, unfair standards of planned economy tracing back to the Soviet times led to what Stiglitz and Yusuf (2001) called a "corrupt government view", when government's relationship with the business results in corruption. This led to the formation of specific informal institutions, which comprised characteristic social norms, values, beliefs and behaviors of the society, which influenced the development of business culture and attitudes towards formal institutions. Informal institutions in such a way prove to be important ground for the development of effective institutional frameworks. Stiglitz (1999) supports this view by stressing the role of institutions as a "social glue", especially for transition economies. He criticizes the shock therapy, together with liberalization and decentralization in post-Soviet countries, since the methods did not encourage the development of social and organizational capital in the post-Soviet societies, which led to an absence of social norms and mentality for the transition period. Tridico (2011) has also mentioned that transition of post-communist states should not be view as a simple "economic journey" from one point to another, but it should be an institutional evolutionary process, which will encourage consistency between formal and informal institutions. Introduction of institutional frameworks, formal market institutions should take into account historical past and values of the country. In replication of East-Asian model within post-Soviet transition states it is very important to introduce government interventions in the economy in a form of gradual process of adaptation, rather than radical transformation. In this respect, incremental building up of an informal institutional framework, taking into account existing business culture of the society, should be a prerequisite of economic transition.

## IV. Institutional transition

Transition period is always a challenging process because it involves change of something that has been already settled, a break of the system, and most importantly it always deals with transformation from an old to a new. How much of an old will still be there in the new depends on the quality of the transformation and its complexity, and the readiness of the system to accept the changes. Economic transition traces back to different spheres of social, economic and political life of any economy. Therefore, economic transition occurs together with the change of culture, social norms, habits and institutions. The roots of economic transition lie in the institutional transformation, when the new formal rules, laws and regulations have to interact with old ghosts of the past, namely informal behaviors which frame social behaviors, impact social organizations and in such a way influence the whole economic system (Tridico, 2011). Therefore, we could possibly claim that institutions are path-dependent in their nature and institutional frameworks are already to some extent predetermined by the echo from the past. Furthermore, as Martin (2000) points it out the impact of institutional path dependence is the most significant at regional and local levels, since institutions bring together the local economic histories. Different institutions at different places by interacting with the economic regimes of those places produce sort of a place-dependent path dependency of institutions.

Acemoglu et al. (2001) prove the persistence of institutions from the past in specific places by presenting a theory of institutional differences between countries colonized by Europeans. By using this theory the authors attempted to estimate the impact of institutions on economic performance using mortality rates by the first European settlers were to measure it. The results of the studies proved that settler mortality rates determine settlements, settlements determine early institutions and there is a strong correlation between early institutions and institutions today. Acemoglu et al. (2001) also provide interesting evidence concerning the persistence of institutions. Extractive institutions, which were developed by the colonialists, still are present after the independence. The reasons for such persistence can be different, starting from the fact that introducing other institutions is always costly, governments decide to stay with such an "inheritance", and going along with a statement that extractive institutions always brings benefits to the elite, especially if it is a small elite, so this small elite will always protect the functioning of extractive institutions. This leads to a rationale that institutions stay within a specific geographic entity over time, bringing their inherited rules and the way they are embedded in the society.

### 4.1 Institutions in the post-Soviet transition economies: lost faith in the state?

Transition of post-Soviet economies from a planned economy to a market economy is a perfect example of transformation of an economic paradigm. The Soviet Union collapsed quite unexpectedly, having left behind a range of centrally planned economies from old regime, which eliminated itself by its own means. As Nagy (2002, p. 5) puts it, "excessive centralization and monopolization soon created its antidote: the necessity of decentralization". As a result, huge centralized institutions started to act according to their own rules and interests, managers of big state-owned firms stopped being obedient to central orders, special interest groups strengthened, role of the market was increased, the state as such has been alienated. Such a development after the collapse of the Soviet Union goes in line with Washington Consensus, proving that in contrast to East-Asian economies post-Soviet economies have chosen a "market friendly" scenario of development rather than a "government friendly". The main reasons for this could possibly be the path-dependency of institutions and an endeavor of post-socialist governments to transform economic system without transforming social systems of post-soviet societies. Concerning institutional path dependency, we are coming back to Acemoglu et al (2001), who argued that the reason for European colonizers to leave extracting institutions or existing bad institutions in prosperous places was that these were beneficial for colonizers to take an advantage of institutional loopholes and absence of some rules, and moreover bad institutions were of minor concern because of the costs related to changing them. Ukraine and Russia are good examples of such government strategies in the transition periods. There is no incentive to change the legal framework, which is comfortable for the ruling elite to take advantage for bureaucracy and corruption, because existing rules are either easy to bypass or it is much more convenient to govern when there is no institution to control the governance, leading to rent-seeking and lobbying (Tridico, 2011). Another issue is that it is hardly possible to introduce a new institutional framework, without paying attention and resources for changing the social capital and existing informal institutions embedded in the societies. When the informal institutional framework is not ready to accept the new formal rules, there is just not match in the puzzle to get the initial goals accomplished. Tridico (2011) introduces an interesting concept – the dichotomy thesis, explaining the failure of transition post-communist economies to effectively catch up through the inconsistency of formal and informal institutions. He argues that "old habits, previous behavioral patterns, old ethos and the existence of old lobbies and all the informal institutions curb the dissemination of new formal institutions and their reinforcement" (Tridico, 2011, p. 138).

Importance of fit between formal and informal institutions is also expressed through the fact there should be a cooperative equilibrium between the state and economy agents. Such institutional arrangements are possible when there are social and economic institutions developed to monitor and report for non-cooperation if any. Absence of such an equilibrium in East European states has triggered a whole range of other problems, such as traditional trade unions lost their credibility while they served obediently to the communist regimes; the newly created democratic unions were unable to make commitments; low wages attracted foreign investments, which led to the growing role of multinational companies, which using absence of a sound institutional environment just created powerful new lobbies and pressure groups. Nagy (2002) refers to the role of multinational companies in the transition period of Eastern European economies in a very interesting way. He explains that transition countries depend very much on their integration into the global economy and therefore their relations with multinational companies are very important. It led to an understanding that privatization was necessary to get rid of the inefficiencies of state ownership and central planning. On the other hand, it also triggered somehow the process of selling out the national wealth, when a public monopoly became a private monopoly of some interested groups, only because there was no proper institutional platform which could regulate FDI inflows.

Post-Soviet countries represent also an interesting case scenario for the fact that the Soviet Union with its planned economy and major rule of the government after its collapse left the communist style institutional infrastructure for the independent states. Thickness of this institutional infrastructure was based on bureaucracy, corruption, ineffective market institutions and absence of rule of law, security of property rights in the majority of post-Soviet states. This intuitional thickness resulting in an institutional lock-in has led to the situation that rebuilding of formal institutions was just not accepted by the economy, because it was not ready to incorporate the changes and there was no longer faith and trust in the state, which happened because the so called “nomenklatura” (the government officials in Soviet Union) were always “above the law” and could commit crimes, take bribes, do whatever they wanted as long as were on their powerful positions (Nagy, 2002). Swain (1998) in his comparative analysis of automotive industry in Hungary and coal mining industry in eastern Ukraine refers to “institutional failure” in Hungary and Ukraine, triggered by asymmetrical relations between institutions. In Eastern Ukraine, he argues, local producers and allied institutions were too dominant, because there was a weak national state institutional platforms and absence of specific types of institutions. In Eastern Europe despite liberalization of markets and privatization waves after the collapse of the Soviet Union, the role of state did not diminish, it has just transformed into conglomerates, mafia and banks, which only regarded their own interests. Swain (1998) names three reasons of such an institutional failure: absence or exclusion of particular types of institutions; significant asymmetry in the relative power of different types of institutions and weakness of national state, which all resulted in emergence of barriers towards institutional change; institutional asymmetry triggered by too cohesive institutional frameworks, which also hindered strategic collective action.

Experience of post-Soviet economies proves that institutions are path-dependent and institutional environment has been somehow inherited by the independent states after the collapse of the Soviet Union. Due to no attention to the informal institutions and social capital, the changes that governments tried to incorporate within the years of independence did not have much success, because social norms and behaviors were just not ready to accept them. Lack of government support of the economy rather than government playing the role of a constraining judge resulted in the absence of equilibrium between the economy and institutional framework, which deteriorated the faith in the latter and made it impossible to impact the catch-up process.

**4.2 Institutional transformation for the MENA region**

Middle East and North Africa (MENA) region within the framework of institutional development and its impact on economic growth deals mainly with the reinforcement of domestic institutions and balancing between domestic and international institutional environments in order to get out on the international economic arena. In this respect Mina (2012) introduces two approaches that MENA states can conform to:

- a first best approach - strengthening the domestic institutional functions to approach the performance of industrialized countries;
- a second best approach – signing and entering into force bilateral investment treaties in tandem with improving their institutional functions.

Mina (2012) stresses out that institutional reforms promoted by the World Bank, the IMF or the WTO presume a number of appropriate institutional arrangements to which countries have to conform, so namely a best practice to follow. He finds that the best practice scheme does not involve interactions between institutional features, whereas the second best practice considers a cooperative component in the system of institutional arrangements, which also employs then a transfer of knowledge and experience between the involved actors. In his study Mina uses panel data for the period of 1992-2008 and analyses the first and the second best approaches to reducing the risk of investment expropriation to encourage FDI flows. Mina also assesses the performance of domestic institutional functions at the regional and country levels, comparing the domestic institutional function performance, both property rights protection (PRP) and political, to 24 OECD countries using the ICRG political risk components (a higher score indicates a lower risk) (Table 3).

**Table 3. Domestic institutional functions in MENA (1990-2008)**

| Function | Property rights protection | Political |
|---|---|---|

| | *Investment profile* | *Corruption* | *Law & Order* | *Bureaucracy quality* | *Government stability* | *Ethinic tensions* | *Internal conflict* | *External conflict* | *Military and politics* | *Religion in politics* | *Democratic accountability* |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **Regional level** | | | | | | | | | | | |
| Max institutional score | 12,0 | 6,0 | 6,0 | 4,0 | 12,0 | 6,0 | 12,0 | 12,0 | 6,0 | 6,0 | 6,0 |
| MENA | 7,23 | 2,77 | 4,0 | 1,79 | 9,2 | 4,56 | 9,11 | 9,96 | 3,03 | 3,51 | 2,64 |
| OECD | 9,09 | 4,77 | 5,57 | 3,78 | 8,25 | 4,97 | 11,1 | 11,04 | 5,77 | 5,62 | 5,73 |
| MENA-OECD ratio | 0,795 | 0,581 | 0,718 | 0,474 | 1,115 | 0,918 | 0,821 | 0,902 | 0,525 | 0,625 | 0,461 |
| **Country level** | | | | | | | | | | | |
| Morocco | 8,0 | 3,0 | 5,0 | 2,0 | 9,6 | 4,7 | 9,4 | 9,9 | 3,9 | 4,1 | 3,3 |
| Algeria | 6,8 | 2,3 | 2,4 | 1,8 | 8,3 | 3,1 | 5,7 | 10,4 | 1,1 | 1,2 | 3,2 |
| Lebanon | 6,6 | 1,5 | 3,6 | 1,5 | 7,7 | 4,4 | 7,8 | 6,3 | 2,7 | 2,6 | 4,1 |
| Egypt | 7,0 | 2,2 | 3,6 | 2,0 | 9,2 | 5,4 | 8,4 | 10,1 | 3,0 | 2,5 | 2,8 |

Source: Mina (2012)

The results prove that reducing the risk of expropriation of investment, ensuring government stability as two basic PRP institutional functions has a positive impact on FDI flows. Mina suggests that PRP can be strengthened by entering into force bilateral investment treaties with OECD countries in addition to increasing investor protection domestically. The results also prove that the influence of bilateral investment treaties is not as strong as that of domestic institutional strengthening. The adoption of a second best approach in order to increase PRP impacts positively FDI flows, but its positive influence is dependent on the success of the first best approach. Therefore, domestic institutional functions are to be reformed properly so that the bilateral investment treaties work accordingly.

**V. Data**

World Bank publishes annually Doing Business Report, focusing on the premise that economic activity requires good rules. Good rules and regulations have to be efficient, accessible and simple. Doing Business pays special attention towards regulations, which provide stronger protection of investor rights. It takes the perspective of domestic, primarily small companies and measures the regulations applying to them through their life cycle. Doing business 2012 covers 183 economies, namely 46 economies in Sub-Saharan Africa, 32 in Latin America and the Caribbean, 24 in East Asia and the Pacific, 24 in Eastern Europe and Central Asia, 18 in the Middle East and North Africa, 8 in South Asia and 31 OECD high-income economies. Doing Business assessment is based on the results of the survey, which is carried out with the help of the questionnaire that uses a simple business case to ensure comparability across economies and over time. In 2012 World Bank ranked economies on the basis of ten areas of regulation: for starting a business, dealing with construction permits, getting electricity, registering property, getting credit, protecting investors, paying taxes, trading across borders, enforcing contracts and resolving insolvency. Doing Business index is calculated as the ranking on the simple average of its percentile rankings on each of the ten topics (World Bank, 2012).

We will overview the ranking on the ease of doing business for East Asia (China, South Korea, Thailand and Vietnam) and ENP countries, namely North Africa economies (Morocco, Algeria, Lebanon, Egypt) and Eastern Europe states (Ukraine, Belarus, Moldova, Azerbaijan, Armenia). From East-Asian block only South Korea improved its position in comparison to the previous 2011 year. From North African block only Morocco positively raised its ranking for 21 points. In Eastern Europe block all economies, except for Ukraine, improved its position in comparison to 2011 year (Table 4).

**Table 4. Ranking on Ease of doing business**

| State | Doing Business 2012 rank | Doing Business 2011 rank | Change of the rank |
|---|---|---|---|
| East Asia | | | |
| China | 91 | 87 | -4 |
| **South Korea** | **8** | **15** | **7** |
| Thailand | 17 | 16 | -1 |
| Vietnam | 98 | 90 | -8 |
| North Africa | | | |
| **Morocco** | **94** | **115** | **21** |
| Algeria | 148 | 143 | -5 |
| Lebanon | 104 | 103 | -1 |
| Egypt | 110 | 108 | -2 |
| Eastern Europe | | | |
| Ukraine | 152 | 149 | -3 |
| **Belarus** | **69** | **91** | **22** |
| **Moldova** | **81** | **99** | **18** |
| **Azerbaijan** | **66** | **69** | **3** |
| **Armenia** | **55** | **61** | **6** |

Source: Own draft by the author on the basis of World Bank Doing Business 2012 Report.

If we look more precisely on the ranking on the ease of doing business, namely on the ten areas of regulation, according to which the countries are ranked, we can compare the ranking of different economies towards the average for the region or group of countries, to which the respective economy belongs. Thus, South Korea, which belongs to the OECD high income group, performs worse than the average for the group only on two parameters: registering property and protecting investors. China and Thailand belong to East Asia and the Pacific region. In the case of China, it lags behind on the majority of indicators: starting a business, dealing with construction permits, getting electricity, protecting investors, paying taxes and resolving insolvency. Thailand draws a much more successful picture than China, since only in the area of paying taxes it stands behind the average index for the region. Morocco belongs to Middle East and North Africa Region and performs worse than the region's average towards getting electricity, registration property, protecting investors and paying taxes. Ukraine, belonging to Eastern Europe and Central Asia, lags behind the region's average within all indicators, except for two: getting credit and enforcing contracts (Table 5).

**Table 5. Ranking on the ease of doing business (in comparison to the region's average)**

| Rank 2012 | South Korea | Average for OECD high-income | China | Average for East Asia and the Pacific | Morocco | Average for Middle East and North Africa | Ukraine | Average for Eastern Europe and Central Asia |
|---|---|---|---|---|---|---|---|---|
| **Starting a business** | 24 | **57** | 151 | **95** | 93 | **98** | 112 | **65** |
| **Dealing with construction permits** | 26 | **53** | 179 | **73** | 75 | **91** | 180 | **127** |
| **Getting electricity** | 11 | **54** | 115 | **75** | 107 | **71** | 169 | **129** |
| **Registration property** | 71 | **59** | 40 | **85** | 144 | **82** | 166 | **60** |
| **Getting credit** | 8 | **41** | 67 | **91** | 98 | **119** | 24 | **51** |
| **Protecting investors** | 79 | **63** | 97 | **83** | 97 | **95** | 111 | **68** |
| **Paying taxes** | 38 | **62** | 122 | **70** | 112 | **62** | 181 | **99** |
| **Trading across borders** | 4 | **34** | 60 | **77** | 43 | **79** | 140 | **105** |
| **Enforcing contracts** | 2 | **37** | 16 | **86** | 89 | **114** | 44 | **61** |
| **Resolving insolvency** | 13 | **27** | 75 | **106** | 67 | **99** | 156 | **81** |

Source: Own draft by the author on the basis of World Bank Doing Business 2012 Report.

Thus, coming back to government-business relations, the supporting role of the government towards business, specifically SMEs, and facilitation of rules and regulations in the successful story of economic growth of East-Asian economies, the ranking on ease of doing business also suggests that South Korea is one of the leaders in the OECD high-income regional group within getting credit, trading across borders, enforcing contracts and resolving insolvency indicators. Therefore, institutional framework in South Korea aiming at creation of a supportive business environment with the rules and regulations enforcing business activity stands out to be one of the determining factors in its economic leadership, whereas Ukraine, scoring the worst in the overall ranking among its regional counterparts, is scoring also quite low within the same indicators. Especially trading across borders and resolving insolvency rankings in Ukraine are much lower than the region's average. This means that firstly, internationalization processes for SME's are burdened with complicated and business unfriendly regulations hindering FDI inflow and technological upgrading and knowledge sharing processes. Low scoring on resolving insolvency ranking is also linked to the fact that government in Ukraine lacks business supporting initiatives in order to encourage SMEs development. In contrast, Morocco scores tremendously better within trading across borders and resolving insolvency parameters in comparison to its regional average, which also goes in line with its getting forward in the ranking for 21 positions in 2012 compared to 2011. Therefore, lagging behind on institutional parameters proves to impact economic performance and overall economic growth.

World Bank also carries out Enterprise Surveys since 2002. The Enterprise Survey questionnaire covers such topics, as: corruption, crime, finance, firm characteristics, gender, informality, infrastructure, innovation and technology, performance, regulation and taxes, trade, workforce. In 2005 World Bank has conducted such a survey in South Korea, in 2006 in Thailand, in 2007 in Morocco and in 2008 in Ukraine. The detailed results concerning the answers on the most "institutional topics", such as corruption and regulation and taxes, are provided in Table 6 in comparison with the region's average. From the figures in Table 6 we can see that while Morocco is scoring better that the regional average of Middle East and North Africa within corruption and regulation and taxes indicator, Ukraine is lagging behind. Therefore, corruption and regulation and taxes parameters clearly impact the whole Ease of doing business ranking, in which Morocco moves quite forward in the ranking and Ukraine keeps being low. Corruption parameter, covering mostly the issue of giving gifts with an aim to obtain a certain permit, resembles poor institutional infrastructure, both formal and informal. Regulations and taxes parameter shows how burdensome the rules set in the society are for the latter. Thus, in case of Ukraine, which scores low within all the regulations and taxes indicators towards the regional average, institutional framework turns out to be very "thick", leading to an institutional lock-in and heavy rules rejection by the business. By contrast, South Korea and Morocco score quite well within regulations and taxes. This proves once again how important it is for the government to create real market, supportive institutions and not turn the rules into obstacles to eliminate.

## Table 6. Enterprise Survey in Ukraine (2008) and Morocco (2007)

| Parameter | State | Region | | | | |
|---|---|---|---|---|---|---|
| | South Korea (2005) | High-income OECD countries | Morocco (2007) | Middle East & North Africa | Ukraine (2008) | Eastern Europe & Central Asia |
| **Corruption** | | | | | | |
| Percent of firms expected to give gifts to public officials "to get things done" | 14,1 | 12,1 | 13,4 | 37,0 | 31,8 | 24,9 |
| Percent of firms expected to give gifts in meetings with tax officials | 21,3 | 19,3 | 10,7 | 23,4 | 28,3 | 14,2 |
| Percent of firms expected to give gifts to secure government contract | 25,8 | 17,3 | 6,4 | 37,9 | 38,5 | 18,0 |
| Value of gift expected to secure a government contract (% of contract value) | 0,2 | 1,1 | 0,3 | 3,6 | 3,7 | 1,5 |
| Percent of firms expected to give gifts to get an operating license | - | 0,9 | 0 | 16,5 | 37,3 | 14,3 |
| Percent of firms expected to give gifts to get an import license | - | 1,4 | 20,0 | 22,9 | 2,6 | 16,7 |
| Percent of firms expected to give gifts to get a construction permit | - | 9,2 | 15,3 | 25,1 | 59,1 | 25,3 |
| Bribery depth (% of public transactions where a gift or informal payment was requested) | - | 3,1 | 8,4 | 20,4 | 30,9 | 14,9 |
| Percent of firms experiencing at least one bribe payment request | - | 4,6 | - | 53,1 | 38,5 | 19,1 |
| Percent of firms identifying corruption as a major constraint | 8,5 | 13,9 | 27,3 | 56,5 | 50,2 | 34,5 |
| Percent of firms identifying the courts system as a major constraint | - | 17,7 | 36,1 | 28,2 | 39,2 | 20,6 |
| **Regulations and taxes** | | | | | | |
| Senior management time spent dealing with the requirements of government regulation (%) | 0,1 | 4,2 | 11,4 | 10,8 | 11,3 | 10,6 |
| Number of visits or required meetings with tax officials | 2,2 | 1,4 | 0,9 | 2,5 | 2,1 | 1,7 |
| If there were visits, average number of visits or required meetings with tax officials | 2,2 | 1,8 | 4,7 | 3,9 | 3,8 | 2,8 |
| Days to obtain an operating license | - | 29,2 | 3,4 | 41,0 | 31,0 | 25,7 |
| Days to obtain a construction-related permit | - | 62,8 | 61,0 | 94,6 | 135,4 | 81,2 |
| Days to obtain an import license | - | 27,4 | - | 29,8 | 16,4 | 15,0 |
| Percent of firms identifying tax rates as a major constraint | 15,1 | 29,3 | 55,7 | 47,1 | 55,1 | 39,5 |
| Percent of firms identifying tax administration as a major constraint | 9,1 | 19,7 | 17 | 34,4 | 35,3 | 20,6 |
| Percent of firms identifying business licensing and permits as a major constraint | 7,5 | 10,8 | 9,3 | 29,4 | 32,7 | 16,1 |

Source: Own draft by the author on the basis of World Bank Enterprise Survey Economy Snapshots

Another ranking is proposed by the World Economic Forum, which since 2005 has based its competitiveness analysis on the Global Competitiveness Index (GCI), a comprehensive instrument for measurement of the micro- and macroeconomic foundations of national competitiveness. And competitiveness is defined by the WEF as "the set of institutions, policies, and factors that determine the level of productivity of a country" (WEF, 2011, p. 4). GCI consists of 12 pillars. The first pillar is Institutions. The institutional environment is determined by the legal and administrative framework, which involves all the agents interacting together to generate wealth. WEF (2011) suggests that the quality of institutions has a strong influence on competitiveness and growth, but the role of institutions go beyond the legal framework. What is also very important is the government attitudes towards the markets in terms of bureaucracy, corruption, dishonesty in terms of public contracts, transparency. The World Competitiveness Report 2012 also highlights the importance of private institutions, since private-sector transparency is indispensable to businesses in order to ensure transparency in accounting and management practices.

WEF also divides countries into factor-driven, efficiency-driven and innovation-driven economies. Thus, Ukraine belongs to the transition stage from factor-driven economies to efficiency-driven economies. Morocco, China and Thailand belong to efficiency-driven economies. South Korea belongs to the innovation-driven economies. In order to transfer from one stage to another, certain requirements must be fulfilled. For example, in order to transfer from factor-driven to efficiency-driven economies, basic requirements have to be met, and institutions belong to these requirements, which also underpin the theory of Lee and Kim (2009), that institutions do matter for "lower" income countries. Overall, GCI covers 142 economies in 2012. A closer look on the GCI 2012 ranking of our interested groups of countries is presented in Table 7.

**Table 7. GCI 2011-2012**

| **State** | **Basic requirements rank 2012** | **Institutions rank 2012** | **GCI 2011-2012 rank** | **GCI 2010-2011 rank** | **Change of the rank** |
|---|---|---|---|---|---|
| East Asia | | | | | |
| **China** | **30** | **48** | **26** | **27** | **1** |
| South Korea | 19 | 65 | 24 | 22 | -2 |
| Thailand | 46 | 67 | 39 | 38 | -1 |
| Vietnam | 76 | 87 | 65 | 59 | -6 |
| North Africa | | | | | |
| **Morocco** | **54** | **59** | **73** | **75** | **2** |
| Algeria | 75 | 127 | 87 | 86 | -1 |
| **Lebanon** | **109** | **115** | **89** | **92** | **3** |
| Egypt | 99 | 74 | 94 | 81 | -13 |
| Eastern Europe | | | | | |
| **Ukraine** | **98** | **131** | **82** | **89** | **7** |
| Belarus | - | - | - | - | - |

| | | | | | |
|---|---|---|---|---|---|
| **Moldova** | **102** | **106** | **93** | **94** | **1** |
| **Azerbaijan** | **59** | **68** | **55** | **57** | **2** |
| **Armenia** | **94** | **83** | **92** | **98** | **6** |

Source: Own draft by the author on the basis of Global Competitiveness Report 2012, WEF.

As we can see from Table 6, in contrast to World Bank Doing Business ranking, China, Lebanon and Ukraine improved their GCI ranking in 2011-2012 compared to 2010-2011. And South Korea has fallen two steps behind, although its basic requirements rank 2012 is much higher than of other East Asia countries. In terms of the ranking of institutions, in the East Asia, China is the leader with the highest rank in institutions out of our sample group and the highest GCI ranking after South Korea in the group. In the North Africa region, Morocco leads the institutions rank and overall GCI rank. In the Eastern Europe group Ukraine scores the worst for institutions, although its overall ranking is better than that of other countries of our Eastern European region sample group. China and Morocco prove that when the institutional framework works well, then the overall performance of the country improves. But the case of Ukraine puts some contradiction within this assumption, since bad institutional score did not hinder Ukraine's overall move forward in GCI ranking. Considering the nature of the WEF GCI ranking, namely expert assessment, the specificity of Ukraine's case as a post-Soviet country in terms of bad institutional scoring but progressive overall competitiveness scoring is that in post-Soviet countries institutions have been inherited as those they used to be in the Soviet Union. Bad institutions are path-dependent, which goes in line with the Alcemoglu (2001) assumption of the fact that when bad institutions are inherited, they are rarely changed because they are already embedded in the society. Therefore, post-Soviet countries somehow already learned to live with what they've got. Competitiveness is seen as something reached not with the help of institutions, but rather in spite of them. And we are coming again into lost faith in the state in Eastern transition economies, which seems to grow due to bad institutions.

Overall, we can observe some contradictions between the rankings described above. One reason to this may be, that while World Bank primarily focuses on SMEs in building its Ease of doing business ranking, whereas WEF focuses on expert opinions when developing GCI ranking. Institutions might be treated tremendously different by SMEs and expert assessments. SMEs evaluate institutions from the perspective of the latter being supporting bodies for small and medium size businesses, ease of opening and registering an entity, of obtaining licenses and permits, whereas experts focus more on the overall institutional framework of the country. Thus, Ukraine with its contradicting ranking by the World Bank and WEF is a very good example of such contradictions to take place. In Ukraine SMEs due to not receiving a diligent support from institutions, score the institutional indicator very low and the overall ease of doing business ranking falls dramatically. Experts on the other hand, evaluate the overall institutional framework, more precisely the aspect of its availability and not effectiveness. Therefore, we may conclude as already stated above the role of SMEs in institutional development is important, because SMEs are the indicators of the effectiveness of institutional environment.

## VI. Summary

Many scholars agree that the role institutions play for the economic performance and growth of states is remarkably important. Apart from a range of other factors, especially geographic and macroeconomic determinants, institutions prove to have a clear impact on the latter. This means that institutions may be not the only factor of geographically uneven development, but they do act as constraints of economic growth in territories specific ways (Martin, 2000). New institutional theory links economic growth to the quality of institutions, focusing on the immaterial aspects of institutions, namely social capital, trust and values of the society. Other scientists find the connection between economic progress and governance capabilities of the state, which are expressed through the quality of formal institutional environments and regulation bodies. Therefore, institutions appear to be the first players in the scene, setting the rules of the game.

In this paper we interpret institutions as a set of formal and informal institutions. Behind formal institutions we mean rules, laws and regulations, the legal sphere with its specific bodies and organizations, which form the constitutional legislative framework of the economy. With informal institutions we mean a set of social norms and values, beliefs and attitudes, traditions and behavioral pursuits in achieving human's needs and reacting to the formal institutional environments. Analyzing the catch-up process of East-Asian countries and comparing their economic progress with the one of such transition economies as the post-Soviet states and the MENA region countries by building up a critical discussion around Washington Consensus versus the BeST Consensus, we have come up with a certain confirmation that there is a number of reasons of the post-communist economies lagging behind and the high performing Asian countries outstripping competitors in terms of economic growth. Firstly, post-socialist states did not manage to effectively change the institutions of the old regime for the new efficient ones. Secondly, even the minor institutional changes incorporated failed to work out as planned due to the lost faith in the state and absence of fit with the existing informal institutional environment. In this respect the path-dependency of institutions is addressed with an affirmation of the fact that institutional transformation is endogenous in its sense. Furthermore, we explored that institutions are also place-dependent, meaning that institutional regimes are formed within specific regional contexts and the more institutions are embedded in those regional contexts, the less flexible they are to accept the changes. And thirdly, in contrast to East-Asian states, other transition economies failed to build up government-business supporting relationships, since while in East Asia the government has never intended to replace the market, in post-Soviet states the government has tried to rule despite the market, not in favor of it.

By and large, the paper gives an overview of conceptual paradigms of old and new institutional economics applied to the specific contexts of East-Asian miracle and post-Soviet transition. The conceptual framework formulated deals with the question whether the success story of East-Asian countries could be possibly replicated to the reality of post-socialist states. It is interesting whether the BeST Consensus model with its main features of strong, but supportive, role of the state, stable macroeconomic settings, catch-up friendly economic system and a wide range of public expenditures for firms' capabilities development and broad based education building, could be transferable to other transition economies. In principle the main features of East-Asian catch-up, such as government support of the economy, building up of a high quality legal framework, upgrading of the leading sectors, ensuring knowledge and technology transfer, could be replicated in other countries. What is important is to identify what prerequisites are needed to make this replication effective rather than just "one size fits all" approach. First of all, the BeST model is transferable to other economies only if it is adapted to the local specificity context. Thus, the historical past and the path-dependency of institutions in transition economies should be taken into account. What is definitely needed for the acceptance of BeST Consensus by transition economies is building up of informal institutions, ensuring the recurrence of faith and trust towards government and its interventions in the economy, and at the same time ensuring that the formal institutional framework with all its rules and regulations aims at supporting the economy, business and the market rather than constraining it. One of the ways to achieve this is to start with reformation of the legal system aimed at facilitating the business related procedures, eradication of bureaucracy, securing of financial support for knowledge and technology transfer and provision of high quality education, ensuring close links between business and education institutions. It is also important to build up a cooperative equilibrium between the state and economy agents, encouraging in such a way close ties between the government and business. These ties are essential for the government to set supporting rules of the games for the economy, so that the state is aware of what is really needed by the business.

The research introduced in this paper, however, does not provide a complete strategic framework of how the countries lagging behind could catch up effectively. A more detailed study of the possible ways of assuring the fit between formal and informal institutions together with the actual process of institutional change within the framework of institutional path-dependency are important issues for the future study in the area. Analysis of the impact of institutions in the region specific contexts within the overall multilevel evaluation of institutional environments is another important concern for the future research of institutional change, as well as its influence on economic growth.

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