Transformation Of The Institutional Structure Of Western Balkan Countries

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Abstract

Transformation of the institutional structure affects economic development both from the cost of transactions aspect and the operating costs. In development theory it is usual to define development as economic growth plus structural change. But in the framework of institutional economic theory development could be defined as economic growth plus appropriate institutional change, meaning institutional changes which facilitate further economic growth.There are several factors influencing reforms in the Western Balkan countries. Those countries prove that institutions can successfully change at the time of crisis. Although the general rule shows strong correlations among the many reform measures, some institutions develop independently of other measures of institutional or organizational reform. As it is emphasized on the role of institutions in growth and development, it should be also recognized that institutions can change regardless of undesirable environmental factors.

Keywords : institutional change, economic transition, Western Balkan Countries

1.INTRODUCTION

Transformation of the institutions in a new market economies have been mostly radical in an astonished and unpredictable direction. Numerous factor influenced reforms that followed in liberalization of prices, privatization, opening of economy to the foreign investments, liberalization of the foreign exchange market, and the reduction of foreign trade restrictions.

The main dimensions along which various national capitalist systems can be placed are the corporate governance and macroeconomic institutional environment (Cernat, 2001). Corporate governance and business-state relations influenced choice and path that economies in transition undertaken. Regardless of strong efforts, disintegration of these economies suffered severe contraction due to collapse of export demand from former trading partners, while domestic demand declined.

Post-Communist Transition was mainly confronted with institutional transformation. Different concepts of institutions created different paths of transformations. At the beginning of the 1990`s, Central and Eastern European Countries (CEE) and Former Soviet Union Republics started with transformation towards market economy. Both the economic and the institutional frameworks were significantly changed. Today in the CEE's there are developing guarantees of private property, new banks, new economic and administrative organizations, and other formal institutions imposed in a transitional time and by political resolution.

Transformation of the institutional structure affects economic development both from the cost of transactions aspect and the operating costs. It will be argued further on that key challenge for governance in Western Balkan post-conflict period was institutional transformation required for successful and sustainable economic growth.

Transition is a very complex process, since in the market economy the capital and labor allocation is completely different than in the centrally planned economy. All the formal institutions such as stock exchange, banks, investment funds, trade unions, property rights, enterprise confederations, and others are new. Their development is slow and affected by a learning process. Because of that, a shock therapy was a poor strategy and likely brought important recession in Western Balkans in the early 90's (Tridico, 2005). Anglo-Saxon variant of capitalism, or so called „Atlantic" capitalism (Hodges and Woolcock, 1993) has certain specific fundamental institutional characteristics. Those characteristics involve the role of the state to maintain a stable environment for markets to operate freely from any political or social interference.

2.Objectives of the economic institutional structure reforms

There is general agreement that systematic transformation of the institutions implies fundamental reforms in most of the areas. Such areas and institutional reforms are recognized in many political party programs of transitional countries, like in Bosnia and Herzegovina (Avdic and Međedovic, 2006). Many of above mentioned structural transformations already started in Western Balkan countries but had not been successfully implemented to the end. Reasons for those failures are complex, and most common one is missing political willingness to implement reforms.

Usually decision makers are promoting reforms, especially in pre-election periods, but in reality they try to preserve situation unchanged and to continue to rule in the same manner. Sometimes decision makers did not achieved previously necessary institutional changes, so reforms are prevented to go faster. Very common in transition countries is lack of knowledge and expertise among policy decision-makers, which could not be overcome except with foreign support (Filipovic, 2006).

3.The negative effects of institutional transition

In the first years of transition, the most important aim of Government was macro-stabilization: the fight against inflation, the reduction of debt, the liberalization of prices, the budget balance and privatization. All these aims were considered necessary by international organizations and main stream economists to allow economic growth. Nevertheless these results were not sufficient to stimulate long-term and sustainable growth. Transition economies are affected by very high unemployment rates, a growing inequality rate, a considerable index of poverty, a chronic current account deficit and a considerable foreign debt. Moreover informal economy and corruption levels strongly persist.

Economic transition countries of the former Yugoslavia, experienced tragic events, civil wars, crime domination and economy of chaos. Therefore they did not implement any institutional policies which would allow for an institutional governance, for the protection of weaker and poorer people, or for conflict management. On the contrary, the sudden introduction of the market economy and the end of social policies, welfare state and income redistribution policies caused an increase in poverty, inequality and unemployment (Adam, 1999).

In order to expand human capabilities institutions are needed. Institutional policies would allow for improving the three essential capabilities for human development: leading long and healthy lives, being knowledgeable and having a decent standard of living. This approach assumes that economic growth requires first of all investment in human development. Countries which implemented institutional policies, social policies and a governance recovery, increased their level of human development. On the contrary, countries which did not implement such institutional policies did not increase their level of human development, and their economic growth was neither fast nor sufficient to recover the pre-1989 level of GDP per capita (Tridico, 2005).

4.Present position of Western Balkan countries

Western Balkan countries proven after twenty years that only radical transformation of the institutional structure can lead them to the successful EU economy. Certain attempt to make small or incremental changes to the old institutional solutions, sooner or later become ineffective and just time consuming. Such small changes to the institutional arrangements happened quite frequently, though, so they produced a variety of organizational solutions based on old institutional framework.

Considering advancement in development of the institutional structures, today we can classify all transition economies into three main categories (Filipovic, 2006):

(a) The most successful economies in transition that provides stable economic growth rates, establish institutional framework comparable with developed economies and that already deeply enter into European integration (or become a full member states of the EU);

(b) Relatively successful economies in transition that has temporary episodes of successes measured by economic and social performances - first of all through low level of inflation, high rate of GDP growth and avoiding of mass unemployment, but also followed by short

episodes of destabilization and worsening of their performances. Typical representatives in this group are some of Western Balkans countries, like Croatia, Serbia, Montenegro, etc.;

(c) Third group of countries in transition are the most obsolete countries, with slow and not in depth institutional changes, countries that are still at the beginning of the transition process and that miss enough courage to cope with the changes transition must comprised. In this group are most of the former Soviet Union members.

The most successful transition economies, mentioned above, already becomes a full member of EU, accepting European standards, organizational structures and most important European institutional framework. Those countries liberalized their markets and open it to foreign direct investment inflow in early 1990's, so most attractive investments and profitable opportunities for old EU investors are already reduced. On the other hand, in Western Balkan countries there are still some obstacles for their faster integration in European institutional framework: most of them lack transparent and effective judicial system, there is still inefficient implementation of laws, every new election are considered as potential change and turbulence in economic system.

5.Institutional structure reforms in Western Balkan countries

The socialist economy was characterized by strong state intervention in economy which manifested itself through all-encompassing price control, subvention of enterprises, etc. Elimination of subventions and liberalization of market and prices at the beginning of 90s, together with an inadequate production structure, caused accumulation of losses in state companies. In spite of their losses, yet, the companies continued to operate. Their preservation was motivated by the avoidance of huge social costs which might arise in the case of their closure (Golubovic, 2005).

The European Bank for Reconstruction and Development (EBRD) summed up, using transitional indicators, the advancement of structural and institutional reforms in the year 2010 for 29 countries in transition. Eleven transitional indicators encompass six main transitional areas: liberalization, privatization, companies, infrastructure, financial institutions, and the legal environment. Each indicator shows a synthesized assessment of improvement achieved in a certain area, based on various data, narrative information and analyses (EBRD, 2010).

Countries in transition continued to advance in their structural and institutional reforms with various levels of success in last decade. Countries of South-East Europe advanced significantly, Baltic states and Central and East European countries achieved some advancement, while the advancement in newly independent states was modest. Comparison of the average yearly transitional index between economies in transition shows that in 2004 21 countries (scope 2,6-3,9) were more advanced than Serbia, Montenegro, and Bosnia and Herzegovina, while only Turkmenistan, Belarus, Uzbekistan, and Tajikistan showed results that were lower (EBRD, 2004).

	Albania	Bosnia and Herzegovina	Croatia	FYR Macedonia	Montenegro	Serbia
Population mid-2010 (million)	3,2	3,8	4,4	2,0	0,7	9,9
Private sector share of GDP mid-2010 (EBRD estimate in per cent)	75	60	70	70	65	60
Large-scale privatisation	4-	3	3+	3+	3+	3-
Small-scale privatisation	4	3	4+	4	4-	4-
Governance and enterprise restructuring	2+	2	3	3-	2	2+
Price liberalisation	4+	4	4	4+	4	4
Trade and foreign exchange system	4+	4	4+	4+	4	4
Competition policy	2	2	3	2+	2	2+
Banking reform and interest rate liberalisation	3	3	4	3	3	3
Securities markets and non-bank financial institutions	2-	2-	3	3-	2-	2
Overall infrastructure reform	2+	3-	3	3-	2+	2+

Table 1: Transition indicator scores 2010. - Enterprises Markets and trade Financial institutions Infrastructure. *Source: EBRD, 2010.*

According to the EBRD assessment, in 2010 Albania has made steady progress with structural reform, despite having to overcome serious institutional weaknesses and one of the most difficult starting points for transition. In 2009, Albania submitted a formal application for EU membership. However, the country faces major reform challenges in a number of areas. The need to improve the quality of the infrastructure is a requirement, although the

government does have major investment plans for roads, railways and electric power. The banking sector has limited reach as a source of finance outside of the main cities, and non-bank financial institutions are at a very early stage of development.

Bosnia and Herzegovina's progress in transition has been effectively stalled for some years, and as a result the country lags behind all others in south-eastern Europe. The country's complicated political and constitutional structure is a major hindrance to reform and good governance. A significant privatisation agenda lies ahead but, in the FBH at least, there appears to be little appetite for bringing major enterprises slated for sale to the market. As a result of the reform paralysis, the country also lags behind other EU candidates or potential candidates in the region in terms of EU approximation.

Croatia has long been considered among the most advanced of the transition countries, with a broadly liberalised economy, a relatively high degree of sophistication in financial services, and a country where significant progress has been made on infrastructure reform. The banking sector weathered the financial crisis well and remains sound and liquid. However, some major enterprises and financial institutions continue to rely on state subsidies although the level of subsidies has fallen significantly since 2005. The quality of the business environment remains a concern, according to cross-country surveys, and reflects the need to tackle obstacles to doing business, such as the cumbersome permit process, as well as the need to implement urgent public administration reforms.

Progress in reform in FYR Macedonia throughout the transition period has been steady if somewhat slow, as the country has been hampered by weak administrative and institutional capacity. In the financial sector competition among banks is less vibrant than in neighboring countries and the development of capital markets is in its infancy. The country's infrastructure also faces significant investment needs in the coming years.

The Montenegrin authorities have made important advances in several areas, notably in price and trade liberalisation and financial sector development. Privatization is advanced, with most state assets having been sold off. The banking sector had grown very rapidly in the years before the crisis and progress has been made in strengthening supervisory and regulatory structures. Lastly, Montenegro has had some success in creating a favorable business climate and in attracting reputable foreign investors. Nevertheless, the country still has a significant transition agenda ahead. The challenges are particularly large in the infrastructure sector, notably in the power sector, which is crucial to supporting economic activity.

Serbia began the transition later than most other countries, but has been catching up steadily over the past decade. Nevertheless, a major structural reform agenda still lies ahead. The challenges are particularly large in most infrastructure sectors, especially in the energy sector, which remains dominated by one state-owned company. A significant number of large enterprises also await privatisation once market conditions improve, both in the corporate sector and in parts of the financial sector, including the largest insurance company (EBRD, 2010).

6.CONCLUSIONS

Effective institutional restructuring is not a question of adaptation of foreign rules and standards, but more the question of gradual and persistent time consuming process. Societies have different own norms and tradition, and their institutional building of formal rules are based on informal one. Transformation of these formal rules are often radical, especially when organizations with different interest emerge, and when institutional change cannot be mediated through the existing institutional framework.

During transitional period, a great deal of effort of the international financial institutions was devoted to support of institutional building, as it was recognized as priority in transition economies. The reform index is both proven as a measure of the extent of reform, and a measure of institutional change. Economic growth is powerfully associated with that index.

Western Balkan countries prove that institutions can successfully change at the time of crisis. Although the general rule shows strong correlations among the many reform measures, some institutions develop independently of other measures of institutional or organizational reform. As we emphasize the role of institutions in growth and development, we should also recognize that institutions can change regardless of undesirable environmental factors.

The change of the financial sector reform in the Balkan countries in transition was different from the transition economies of Central Europe, since no radical changes took place in this sector in the Balkans. The Balkan countries accepted a gradualist approach to the financial sector reform stressing some other aspects of transformation. These countries' experiences in the nineties points out that partial institutional changes do not create a favorable environment for structural changes. Rather, structural reforms require integral and harmonized changes in all its segments. Both formal and informal structural change can contribute to growth, and the more structural transformations are made, the more rapidly the economy grow.

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