

## INSTITUTIONAL CHANGES IN EMERGING EUROPE

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*The recent global economic crisis has created new conditions and situations for the economic environment and therefore, in this context the rethinking of the institutional system is mandatory.*

*The present paper seeks to propose an empirical model and aims at capturing the interdependencies between the institutional changes and the economic progress in the European emerging countries, in order to emphasize that institutions are the key elements in the process of economic growth. After briefly reviewing the most relevant literatures that have documented the variety of the institutional changes, the paper focuses on the amplitude of the phenomena of institutional changes from the European emerging countries. The research tries to establish a “stimulus – effect” relationship between the changing of the institutional environment and the rate of economic growth and human development.*

*The conclusions for the methodological aspects illustrate that the level of social and economic development is a natural result of the quality of the institutional environment.*

**Key words:** *economic progress; emerging countries; institutions; institutional changes.*

**JEL Classification:** *O17; O43*

**I. INTRODUCTION**

In an increasingly complex and integrated global economy, a significant challenge for the European emerging countries is navigating various institutionally contexts, each context proposing new opportunities.

The economic environment is constantly trying to adapt to the new market requirements, to the needs and the preferences of the individuals. It is not an unknown fact that the aim of the economic changes is to increase the wellbeing of the individuals, both at material level (by increasing the level of the income and the quantity of the assets held, by increasing the national income) and at spiritual level, ensuring their welfare satisfaction. In this complex economic process, full with difficulties and many challenges, the role of the institutions is to ensure the equilibrium and the economic and social order. In the same time, the institutional system has to keep up with the dynamic economic environment and its new requirements because only the social organization founded on the principles of capitalism can create the conditions for economic prosperity. (Amarandei, 2015, in Haller and Dămăceanu, 2015, pp. 249-268)

The economic and the institutional plan do not overlap completely, since they have different structure and different rhythm of change, but what is desired is that the dynamics of the institutions to be in favor of the economic growth. (Pohoață, 2009)

How and why does the institutional environment change? Institutions, understood as rules of behaviour constraining and facilitating social interaction (North, 2003), are subject to different forms and processes of change. As Stiglitz and Olson correctly assumed, institutions have a natural tendency for inertia (Stiglitz et al, 1998; Olson, 1982). Therefore, the need of changing and adapting the institutions to the new requirements of the dynamic society is mandatory. At first, institutions were assumed to be independent variables and indicating political interests, but there is much more behind the process of institutional change. Because there are formal institutions (like laws and regulations) than can be easily changed overnight. And there are also informal institutions, like customs or national values, which are more resistant to change. Since the economic environment is very dynamic and almost unpredictable, the institutional system has to adapt to these changes and change itself, in order to understand the new economic environment and its requirements. (North, 2003)

The process of institutional change is a complex process due its focus on entire types of organizations from the society and how they are being transformed in response to a rapidly changing world.

The process of institutional change is not a simple one, since it is determined by path dependence and

how the political and economical environment from the past has influenced the institutional environment. The evolution of the institutional environment of each of the European emerging countries has been affected by this issue. In addition, the human variable has to be considered when understanding the process of institutional change, because human beings are the ones that establish the rules that guide their society and they have the control over their institutions. That is why it is desired to have the right people elected in the political and legal system, to make sure that the institutions are focused on the main goal of economic and social development.

Unfortunately this is not an easy goal to achieve and the experience of the European emerging countries clearly proves it: in the past twenty years, they have been going through a complex industrialization effort, a dynamic social activity and business environment and a complex process of institutional transformation and economic openness.

Emerging European countries have made significant efforts in adapting their institutional environment to their very dynamic economic climate, especially after the recent global crisis. In their competition in finding the best solutions for keeping good conditions for their people, the institutional environment has experienced a lot of changes. However, the rate of development has been widely disparate across the European emerging countries with varied degrees of progress made in key areas such as establishing pricing benchmarks, adopting and implementing securities laws and regulations and providing adequate trading infrastructure.

Taking into consideration these theoretical aspects, the purpose of this research is to study the changes of the institutional environment within the European emerging countries and try to establish the impact of these changes on the level of economic and social progress.

The research will emphasize that against the background of globalization, with "the obstacle" of the economic crisis, economic systems have to become more competitive, have to adapt to the new requirements and take into consideration that the institutional change is a key factor in adapting to the new international conditions.

## II. RESEARCH HYPOTHESIS

The fundamental research hypothesis is: *The level of economic and social development from the European emerging countries is the result of the quality of the institutional environment.*

The research hypothesis is an interpretive and evaluative hypothesis type and is focused on establishing a model for measuring the relationships between the institutional environment and the social and economic indicators for development.

For supporting the fundamental hypothesis, the research also relies on the following work hypothesis:

- The European emerging countries with an efficient institutional environment, adapted to the requirements of the society, have experienced positive changes of the economic development.
- The European emerging countries with an inefficient institutional environment have experienced negative impact on the evolution of economic development.
- The European emerging countries with an efficient institutional environment, adapted to the requirements of the society, have experienced positive changes of the social and human development.
- The European emerging countries with an inefficient institutional environment have experienced negative impact on the evolution of the social and human development.
- There is a positive relationship between the quality of the institutional environment and the level of economic and social development.

## III. CONCEPTUAL DELIMITATION

The idea of this research evolved after discovering the concepts of *economic freedom* and *Index of Economic Freedom*, within the pages of James Gwartney's significant work in the Institutional Economics field. James Gwartney considers that the Index of Economic Freedom is the most accurate index for expressing the quality of the institutional environment from a certain country. (Gwartney and Lawson with Gartzke, 2005)

In the construction of the Index of Economic Freedom there are four relevant arias taken into consideration: rule of law, limited Government, regulatory efficiency and open markets. (Gwartney and Lawson with Gartzke, 2005). All these four arias are the fundamental elements for assuring economic freedom within a society based on healthy principles like: individual choices instead of collective ones, voluntary market exchanges instead of political allocation of the resources, freedom to enter and compete on the market, protection of the people and their individual propriety. (Gwartney and Lawson with Gartzke, 2005)

In the long term, there are a lot of significant changes in these four arias highlighted by Gwartney's research; therefore the evolution of the Index of Economic Freedom can be the perfect mirror for the process of

institutional change.

Since the present social and economic environment is becoming more and more complex, the idea of studying the details of the phenomena appeared as necessary. Therefore, this research will develop the research started by Gwartney, by trying to establish relationships between the components of the Index of Economic Freedom and the economic and social development in the European emerging countries.

In fact, the components of the Index of Economic Freedom are the most important characteristics of an efficient institutional environment that is desired by all countries.

Due to these considerations, this research focuses on the ten components of the Index of Economic Freedom as independent variables within the proposed analysis:(Gwartney and Lawson with Gartzke, 2005, <http://www.heritage.org/index>)

- *propriety rights*, meaning the degree to which the individual propriety rights are respected and protected by the national law system;
- *freedom from corruption*, meaning the degree of transparency and lack of corruption within the political and legal environment of a country;
- *fiscal freedom*, meaning the degree of the tax burden imposed by the authorities;
- *Government spending*, meaning the percentage of GDP allocated for Government expenditures;
- *business freedom*, meaning the easiness to which a business can be started, operated and closed;
- *labor freedom*, meaning the correctness of the regulation concerning the labor market;
- *monetary freedom*, meaning the degree of price stability;
- *trade freedom*, meaning the transparency and lack of barriers for imports and exports;
- *investment freedom*, meaning lack of constraints for investing capital;
- *financial freedom*, meaning bank efficiency and independence.

All these ten components will consist as stimuli for the dependent variables, which will reflect the economic and social performances in the most concrete way possible.

Since this research focuses on economic development, it was considered that the simple rate of economic growth expressed as the increase rate of the real Gross Domestic Product (GDP) will be superficial. Therefore, the GDP per capita was considered to be more adequate for evaluating the real economic growth that can express the impact into economic development, rather than analyzing the overall output. After all, the GDP per capita offers a more reliable statistic since it is reported to the population, the “victims” of the economic development.

Since this research is also focused on an inter-disciplinary approach, the second dependent variable is concerning the social environment. In this field, the Human Development Index was considered to be the most accurate variable, since it expresses the level of achievement of human development, consisting in a decent living standard, a healthy and long life and being knowledgeable. ([www.hdr.undp.org](http://www.hdr.undp.org))

The research strategy will be case study type, since the testing of the relationships between the independent variables and dependent variables will be effectuated only for the European emerging countries. The analysis proposes an econometric model than can establish the impact of the components of institutional environment on the economic and social performances.

Based on this research, it will be possible to establish which are the most relevant characteristics of the institutional environment that influenced the economic and social progress in the European emerging countries.

#### IV. DATA COLLECTING METHODS

The necessary data for this research will be collected from different on-line sources, provided by reliable organizations. The data will be collected mostly from the data sources provided by The Heritage Foundation (data regarding the institutional environment), World Bank (data regarding the rate of economic growth) and United Nations Development Programme (data regarding the Human Development Index).

The data will be collected for all the European emerging countries: Bulgaria, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Russia, Turkey and Ukraine.

Due to availability, the data will be collected for the last two decades, for the period 1995-2014. A special attention will be given to the data from the post-crisis period (2008-2014), in order to observe any significant changes within the evolution of certain variables.

#### V. DATA PROCESSING METHODS

Data will be processed using mostly quantitative analysis. However, after analyzing the results of the quantitative analysis, deduction will also be used in order to also have a qualitative approach on the analyzed phenomena.

At first, the data will be tested for consistency and normal distribution, to assure a reliable analysis in the further steps. The quantitative analysis will consist in establishing a regression model between the independent variables and the dependent variables, testing the research hypotheses. The regression analysis will be used to emphasize the impact of the institutional variables on the rate of the economic growth, on one hand, and the Human Development Index, on the other hand. In this analysis, the most important research instrument will be the statistical program SPSS.

Deduction will have a summarization role, after obtaining the results of the quantitative analysis. Based on these results, the deduction will reveal which are the most relevant aspects of the institutional environment that have to be considered as key factors for economic and social progress on the long term.

## VI.CONCLUSION

The expected results of this research will reveal, on one hand, that the institutional changes have an important echo on the evolution of the social and economic development of the European emerging countries and, on the other hand, will emphasize the most important aspects of the institutional environment that must be taken into consideration on the way to social and economic progress.

The empirical model that is proposed in the article will try to reflect how sensible are the rate of the economic growth and the Human Development Index to the changes within the institutional environment, especially on the long term.

Pointing out how simple facts as respected propriety rights, low level of corruption, fiscal freedom or labor freedom can have such an important impact on the long term evolution of the social and economic progress within the European emerging countries, this empirical model will reveal the interdependencies between the institutional and economic environment and that there is more than hits the eye regarding the process of institutional change.

By establishing a causal relationship between each of the ten components of the Economic Freedom Index and the rate of the economic growth, on one hand, and the evolution of the Human Development Index, on the other hand, this research will consist as an important contribution to the literature in the Institutional Economics field and can be considered as an extension of the existing research in this field.

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