Institutional Change and Economic Performance in Transition Economics: The case of Poland

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SEI Working Paper No 74

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First published in May 2004
by the **Sussex European Institute**
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Institutional Change and Economic Performance in Transition Economics: The case of Poland[*]

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Abstract

Central and East European Countries (CEECs)[1] differ significantly with regards to their economic performance despite the fact that external policy prescriptions are very similar in all these countries. Extreme diversity and fragility in the performance of the main economic variables such as GDP growth, unemployment rates, public debt, trade balance and inflation are evident. Moreover, there seems to be no significant convergence on GDP-level of the European Union but a considerable divergence among CEECs and regions of each single CEEC can be observed.

In the paper, I will argue that the fragility of economic performance is due to a certain level of institutional instability and a lack of consolidating the new institutional arrangements. *The behaviour of economic agents is affected not only by formal institutions such as law, new constitutions and organisations, but also by social norms, old values and habits (informal institutions).* There has been little consistency between formal and informal institutions since the new institutions were built on the dichotomy between old rules and new formal rules. The inconsistency between both seems to affect the economic growth.

This paper will focus primarily on Poland as a case study. In Poland, the accession towards EU and the strong increase of Foreign Direct Investments (FDIs) has had a significant impact on growth and trade as well as on the institutions of the Polish economy. My hypothesis is that the Polish economy is affected adversely by such factors as: inconsistency between informal rules and new institutional settlement, fragility in the attitudes and behaviour of enterprises and problems of trust between economic agents. There is an "inconsistency risk" since the *Old Ethos* (or informal rules) could clash with the new national laws and the new institutions promoted by a need for harmonisation with EU legislation and with the FDI inflows. The paper consists of two main sections. The first section introduces some basic definitions and a brief overwiew of the relevant literature. The second section presents a model which shows the dynamic path-evolution of institutions.

KEYWORDS: Formal and informal institutions, institutional change, transition economics.

[*] *This paper, part of my PhD thesis, was written during my staying, as Marie Curie Fellow, at Sussex European Institute. I am very grateful to Prof. Alan Mayhew, my supervisor at Sussex European Institute.*

[1] Central and East European Countries are considered: Poland, Czech Republic, Slovak, Hungary, Slovenia, Estonia, Lithuania, Latvia, Bulgaria, and Romania. In other words they are the first height Countries candidate to the next Eu accession (except Malta and Cyprus) plus Bulgaria and Romania.

1. Institutions: general definition

Institutional economists argue whether institutions have any effect on the economic growth. This contentious exerts a considerable impact (among others: North 1990; Hogdson 1997). A definition of an institution is contested. Numerous definitions were proposed across the different economic theories. However, as a starting point one can assume that economic institutions, in a broad sense, can involve informal institutions such as behavioural rules, social customs, faith reports between economic agents, habits among the agents, etc. Besides, there are formal institutions: organisations, law, and economic agents themselves[2]. As regards theoretical approaches in institutional economics there are, basically, three different approaches.

The first approach is the Old Institutional Economics (OIE)[3]. The OIE rejects the concept of *methodological individualism* and the concept of a rational individual who maximises his own utility. Instead OIE emphasises the role of habits, behavioural rules and social rules as the basis of the human action. The OIE develops an alternative concept of economic behaviour that finds its own origins in the institutions. The institutions are the rules according to which the enterprises and the consumers respectively "satisfy" and not "maximise" their own return and utility. In this approach of institutional economics "*institution matters*". The institutions are not necessarily created to be socially and economically efficient; conversely they are created to serve and to preserve the interests of some social groups and to create new rules. Institutions, therefore, can be said to be efficient as long as they are committed to their original aims.

The second approach is the New Institutional Economics (NIE). Libecap (1998) claims that "the new institutional economics retains its general attachment to neoclassical economics with its emphasis on individual maximization and marginal analysis, but with attention to transaction costs, information problems, and bounded rationality" [4]. According to Douglass C. North (1998), one of the representatives of this school, "the institutions (...) represent the way through which the several economics face the market failures"[5]. Nevertheless, North rejects

[2] Anyway the distinction between the two definitions is very weak and not always clear.
[3] Here I refer to Thorstein Veblen, John Commons and Wesley Mitchel, and more recently to Geoffrey Hodgson.
[4] G.Libecap, The New Institutional Economics and economic development: A Working Paper, Torino (International Centre for Economic Research, 1998), 4.
[5] North D.C., "Institutions, institutional change and economic performance" - Cambridge U.P., 1990, p.6.

the assumption of efficient institution and he highlights the vital role of power clusters and lobbies upon the institutional agreements. However, North considers *efficient* the institutions that minimise the transaction costs. The most important role of institutions is that of reducing the uncertainty in order to determine a steady framework of social relations.

The third approach is the *pure* Neoclassical theory. In the pure paradigm of the Neoclassical theory there is no allocation mechanism different from market. The only institution admitted is the market where the prices are determined. This allocation does not involve equity, norms or behaviours, and the institutions are exogenously given, to put it differently, they are not considered in the economic analysis. In the neoclassical theory with perfect information the allocation is *price-guided* and the transaction cost is zero. In this case the institutions (except from the market) are not useful, instead they inhibit the economic performance.

I argue that a consistent economic institutional framework is a necessary pre-condition (but not sufficient) for durable growth and good economic performance. My definition of an institution is very close to an Old institutional one. It includes both formal institutions, such as the sphere of the law and organisations, and informal institutions such as the sphere of social norms, behaviours and habits.

Finally, four other essential concepts need to be defined. These are: norms, transaction costs, informal institutions and formal institutions.

1. *Informal institutions*

I refer to them as a set of *social norms*, conventions, moral values, religious beliefs, traditions and other *behavioural norms* that have passed the test of the historical time and that determine the individual's behaviour as well as organisations in pursuit of their aims. The informal institutions can be called *Old Ethos or the Carriers of History*[6]. These informal rules are part of the dynamic evolution of a community and its cultural heritage. In addition, these rules are self-reinforcing in course of time through mechanisms such as imitations, traditions and other forms of teaching. They also serve as sanctions that facilitate the self-reinforcing process such as: community membership, fear of expulsion, reputation and fear to be the only one not to

[6] Svetozar Pejovich, "The Effects of the Interaction of Formal and Informal Institutions on Social Stability and Economic Development", Journal of Market & Morality, n. 2, 1999, pp.164-181.

respect the rules. There is an inbuilt threat in this Hobbesian type of competition[7] that allows the rules to be respected since otherwise the social relationships will become violent.

2. *Norms*

A norm is “a standard of appropriate behaviour for actors with given identity”[8].

3. *Formal Institutions*

Formal rules or institutions are generally defined as the law sphere, with constitutions, regulations and organisations. There is a direct connection between formal rules and the political-economy structure such as governance, property rights, and judiciary system. Thus, the reinforcing of the formal institutions is guaranteed by the legal system.

4. *Transaction Costs*

I define transaction costs as the costs to make an exchange, to transfer the property, to start an activity, to protect one’s own business, to gather information, to change or to preserve the actual institutional framework, etc. Moreover, I include in the transaction cost definition, **the bargaining costs** (very important in my model, see below, third paragraph). Transaction costs, certainly, do not involve only the financial expenses but also time and all resources required to pursuit goals. These resources could be private or public resources and their measure is not only in economic terms but as well in social terms.

2. The “Old Institutional Economics” – an overview

In the institutional economics model of Old Institutionalism, rational choices are substituted by habits produced by social norms and accepted behaviours. In this case, preferences, beliefs, choices, etc. are products of an evolutionary adaptation to new circumstances determined by habits. A change in values and beliefs causes a slow evolution of individual’s habits and subsequently in their choices. According to “Old Institutional Economists”, the connection between institutions and habits is clear and immediate. In Veblen’s (1919) definition, the link between institutions and habits is very clear, “*Institutions are a settled of*

[7] Similarly, Solow speaks about tha in “Il Mercato del Lavoro come Istituzione Sociale”, Robert Solow, Il Mulino, 1994, p. 27.

[8] Finnemore, Martha, Kathryn, Sikkink: “International Norm, Dynamics and Political Change, International Organisation 52, 4, Autumn 1998 p.891.

thought common to the generality of men"[9]. For Hamilton (1932) "*Institution is a way of thought or action of some prevalence and permanence, which is embedded in the habits of a group or the customs of a people*"[10]. On the other hand, Wesley Mitchell (1924) states that "[i]*nstitutions is merely a convenient term for more important among the widely prevalent, highly standardised social habits*"[11].

In accordance with Old institutionalism, imitation and emulation of behaviours leads to the spread of habits and to the emergence or reinforcement of institutions. Institution standardises behaviours and helps to transmit habits to new members of the group. In this way institutions embed *collective action.* All individual actions (which, in Common's words, are defined as *transactions*), are embedded in a framework of collective action. These collective actions are regulated and controlled by laws, social customs, organisations and individual behaviour in terms of bargaining, negotiating, transacting, etc. Therefore, collective action determines all economic relations of individuals,

> *'[i]ndirectly, by establishing the working rules which govern the bargaining relations between people, which establish the permissible limits of coercion and duress which individuals and organisations may bring to bear on each other.*
>
> *Directly, by sanctioning certain rationing devices for allocating such scarcity-values as have not been distributed by bargaining. All governmental tax and expenditures programs are included in this category, as well as the decisions of going concerns like corporations and labour unions.*
>
> *Indirectly, by establishing the working rules on which the production process go forward through the managerial direction by some of the work of others*[12].

[9] Thorstein Veblen, "The Place of Science in Modern Civilization" 1919, Reprint ed. New York 1961, p. 239.
[10] Walton Hamilton, "Institutions", in Encyclopaedia of the Social Sciences, Eds.:Seligman and Johonson, vol. 8, New York, 1932, pg 84.
[11] W.Mitchell, "The prospects of Economics", reprinted edition, in The Backward Art of Spending Money and Other Essay, New York, 1950, p.373.
[12] Neil W. Chamberlain, "The Institutional Economics of Commons", in Institutional Economics, Lectures by J. Dorfman, C. Ayres, N. Chamberlain, S. Kuznets, R. Gordon, University of California Press, 1963, p. 75.

To conclude, from Commons' point of view, economic relations among agents and economic distribution of goods depend on the way which collectives actions affect transactions (or individual actions).

A majority of the "Old Institutional School" would be ready to subscribe to the statement that "most of what people do is governed by institutions of their society". This "institutional preposition" means, in a wide sense, that culture defines the permissible and the forbidden, defines right and wrong, the admirable and its opposite, gives content to these definitions with rules for behaviour and so provide opportunities as well as limits (Neale 1988)[13].

There is a substantive amount of literature that refers to Old institutionalism. First of all Hodgson (1998) who tried to give a broad definition of institutions. This definition involves five characteristics:

1. *All institutions involve the interaction of agents with crucial information feedbacks.*
2. *All institutions have a number of characteristic and common conceptions and routines.*
3. *Institutions sustain, and are sustained by, shared conceptions and expectations.*
4. *Although they are neither immutable nor immortal, institutions have relatively durable, self-reinforcing and persistent qualities.*
5. *Institutions incorporate values and processes of normative evaluation. In particular, institutions reinforce their own moral legitimation: that which endures is often - rightly or wrongly - seen as morally just* [14].

In according with Paul Bush (1988), "[s]*ociety may be thought of as a set of institutional system[s]. An institutional system may be thought of a set of institutions. Institutions may be defined as a set of socially prescribed patterns of correlated behaviours*"[15]. We can continue this line of thought by asserting that behaviour is correlated with values. At the bottom of this structure there are certain values and institutional change takes the form of a change in the value structure of institutions. Still, Neale (1988) defines institutions in according with the

[13] W.C.Neale, "Institutions", in Foundations of Institutional Thought, edit by Marc Tools, Vol. 1 1988, pp.227-256.
[14] G. Hodgson , "The approach of Institutional Economics", Journal of Economic literature, vol. XXXVI, March 1998, pp 166-192.
[15] Paul D. Bush, "The Theory of Institutional Change in Evolutionary Economics", in Foundations of Institutional Thought, edit by Marc Tools, Vol. 1 1988, pp.149.

Old Institutionalism definition, "[a]*n institution is of the nature of a usage which has become axiomatic and indispensable by habituation and general acceptance*"[16]. However, Foster adopts a more simple but in my view more useful term to define institutions, "[p]*rescribed patterns of correlated behaviours*"[17].

All these definitions have a great impact on the building of new economic theoretical models. The "institutional proposition" deeply troubles the neo-classical approach of rational choice and the maximising individual. It changes the terms of decision in order for economic agents to make choices. Social norms and habits channel and regularise economic agent's behaviours. They limit the range of rational choices and they constrain economic actions and transactions.

Another important contribution to institutional economics came from Douglass North (1990). In fact, North is sometimes considered to be a *bridge* between Old Institutionalism and New Institutional Economist theory[18]. North provided an alternative definition of institutions - they were considered as "*...the rules of the game in a society or, more formally, are the humanly devised constraints that shape human interaction*"[19]. Here, institutions are means by which to reduce uncertainty in economic relations; and again, institutions remedy market failures. North's institutional theory approach is in fact close to the Old Institutionalists' thought when he states that institutions should not be necessarily efficient - *"[i]nstitutions are not necessarily or even usually created to be socially efficient; rather they, or at least the formal rules, are created to serve the interests of those with the bargaining power to devise new rules"*(North 1990)[20].

Moreover, imperfect information, agents' bonded rationality, different sort of asymmetries, cause a rise in transaction costs. In this "imperfect economic world", institutions reduce uncertainty and give more stability to economic relations. North states that the total cost of production is constituted by input costs of labour, land and capital (transformation costs) and by transaction costs, costs derived from exchanging, protecting and enforcing propriety rights, acquiring information.

[16] W. C. Neale, "Institutions", in Foundations of Institutional Thought, edit by Marc Tools, Vol. 1 1988, p. 227,
[17]Fagg Foster, "The Effect of Technology on Institutions", Journal of Economic, Issue 15, Dec. 1981, p. 907.
[1818] J. Groenewegen, F. Kershtholt and A. Nagelkerke, "On Integrating New and Old Institutionalism: Douglass North Building Bridges" Journal of Economic Issues vol. XXIX, n.2, 1995, pp 467-475.
[19] D.C. North, Institutions, Institutional Change and Economic Performance. Cambridge University Press, 1990,p.3.
[20] North (1990) *Ibidem,* p. 16.

"Once we recognize that the costs of production are the sum of transformation and transaction costs, we require a new analytical framework of microeconomic theory" (North 1990)[21].

3. A new theoretical approach: *Transaction Costs and Collective Action* in the institutional change model of CEECs.

Based on Nugent's definition (1995), I will define institutions as *a set of behavioural rules, established to govern the social interaction*. According to this definition, two notions of institutional economics, i.e. transaction costs and collective action are important. North explicitly links economic theory and social relations with an economic analysis. This means that groups of power have a role in creating and changing the rules, in accordance with their own interests - *"[i]nstitutions are not necessarily or even usually created to be socially efficient; rather they, or at least the formal rules, are created to serve the interests of those with the bargaining power to devise new rules"*(North 1990)[22]. Moreover, imperfect information, agents' bounded rationality, different sorts of asymmetries, cause a rise in transaction costs.

In my model both transaction costs and collective action play a crucial role. But transaction costs do not emerge solely by imperfect information, bounded rationality and asymmetries as in the NIE paradigm. In its classical form NIE suggests that transaction costs are constituted by:

1. Service costs, such as lawyer costs, account costs, intermediary financial costs.
2. Costs of collecting information, costs of exchanging, costs of protecting and enforcing propriety rights.

I add to those transaction costs another category of costs. I call this category of transaction costs, **bargaining transaction costs.** They are the costs, *sensu strictu,* to bargain a contract and to bargain a sale and a purchase of every single good, resource or service. Hence, not only exchanging costs of goods are included as represented by retail services in the NIE

[21] North (1990), *Ibidem,* p.28.
[22] *Ibidem,* p. 16.

approach, but bargaining costs of selling and buying as well; not only property rights protection costs but costs of negotiating contracts as well. These bargaining transaction costs derive from transactions made by economic agents who are directly in contact with one another, who do not have the same information, who do not know each other's preferences, and who have different aims and strategies as well as different set of values. This category of costs can be very wide because it could involve legal, semi-legal and illegal costs. In fact, bargaining transaction costs can concern every market transaction. In such a situation it is evident that costs will be affected by power of clusters, social position of agents and political decisions. Therefore, this category of costs – bargaining transaction costs - could strongly bias neoclassical market prices (deriving from production process). Moreover, in this new approach, the neoclassical definition of competition would change.

Hence, in my model a significant part of transaction costs will emerge from the inconsistency between formal and informal rules in the economic transactions as well as from actions of power clusters which act in opposite direction to reach their own interests. This could include lobbying activities; organised crime and corruption; new and old organisations; adverse attitudes of people not willing to change in order to conform to the new rules. The existence of values that differ from the ones promoted by these new formal rules would push people to behave in different ways. The formal framework prescribes different rules, often contrasting with the behaviour of people who act in accordance with previous values. This inconsistency causes uncertainty in economic relations, inefficiency in economic process and waste of time and resources. The direct consequence will be much higher than stemming from "normal" transaction costs. In fact, they are not usual transaction costs, as defined by NIE, which are caused by economic exchanges, protecting, and enforcing property rights, and information acquiring. Instead, they are extra-costs. This category of costs, bargaining transaction costs, is very complicate to measure and to quantify. However it seems that economic relations between economic agents and transaction costs are affected by them.

In the case of transition economies bargaining transaction costs can be very wide and very spread out in the society because in those countries, property rights, although regulated by law, are still evolving. Formally (by design) there is certainty in the property rights distribution but informally the certainty of property rights is not yet consolidated. In such a situation a bargaining, under the conditions we stated above (agents directly in contact, who do not know each other's preferences, asymmetric information, different set of values) will cause important transaction costs, i.e. extra transaction costs.

In addition, collective actions, as Commons explained, constrain people's behaviour, in all types of transactions. The Commons' concept of institutions is immediately connected with the definition of collective action: "...[w]*e may define an institution as Collective Action in control, liberation and expansion of individual action*"[23]. Collective action, according to Commons, ranges all the way from social customs to the many organised *Going Concerns.* In other words, Commons refers to collective action as "Going Concerns" meaning *activities* of organisations such as: trade unions, families, corporations, banks, governmental agencies, etc. They are organised groups, containing conflicts of interest among themselves and opposing other organised groups. A conflict of interests arises from scarcity of resources. In addition, Commons refers to collective action as social customs and law, patterns of conduct which society sanctions or approves. One can say that lobbies and social groups are very important actors of collective actions. For instance, when an individual sells or buys a good or a service from another individual, he acts within the sphere of collective action represented by social rules, contract laws, habits, propriety rights, membership to an organisation, membership to such a powerful family, etc. Therefore, a collective action determines all economic relations of individuals, but it can easily happen that, while formal institutions suggest a particular behaviour and a strategy to reach such aims, informal institutions suggest an opposite behaviour. Hence, lobbies, new laws, old social customs, new and old organisations, interact with one another disharmoniously, affecting people's behaviour, causing inconsistency among economic agents and, therefore, uncertainty and instability in the economic relations.

In this framework, economic behaviour is far from being price-guided, or at least, the prices are far from being determined by competitive markets. Instead, economic behaviour is "institution-guided", that is, individual actions are controlled by collective actions and they are not necessarily economically efficient. Individual actions will follow, and will be constrained by, institutions, lobbies, social norms, habits, values and organisations, which have nothing to do with the concept of price-guided rational agents' attempt to maximize

[23] John R. Commons, Institutional Economics, New York, Macmillan 1934, p. 69.

utility.[24] Hence, in my opinion Collective Actions affect individual actions and transaction costs emerge, among others, from inconsistent interaction of agents, causing high costs, as explained above.

4. An Institutional Change

By studying institutional change, a useful comparison can be made between the extent to which the end of colonialism has affected differently the economic development in Asian and African Countries, and the extent to which the end of planned economic systems in Central and Eastern Europe has resulted in different outcomes in terms of economic performance among those countries. Despite the fact that similar constitutions and new formal rules have been adopted by different countries[25], socio-economic development of those countries has differed drastically. Therefore, we can legitimately suppose that not only formal institutions affect social and economic development , but also that informal institutions have an impact. North (1990) explains how differences in economic performance are fundamentally influenced by the way in which institutions have evolved. Moreover, institutional evolution depends on specific factors, such as country's history, values and traditions, which in turn gives its context specific features. Therefore, the evolutionary path of institutions can be very different among countries as far as it is not determined only on the basis of formal rules and constitutions. Given the above and the Old Institutionalist assumption, which stipulates that institutions clearly affect economic performance, the question is how institutions evolve and what determines the institutional change.

Hodgson, representing the Old Institutionalism, finds many similar features between evolutionary process of institutions and natural world, in the same vein as the Darwinian process, institutions evolve adapting behaviour to new circumstances because human habits - procreator of institutions - are constrained in a sort of natural selection (Hodgson 1995)[26]. Following this approach the change of institutions is strictly endogenous. Socio-economic

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[24]Even in financial markets – which tend to have many of the characteristics of the perfect neo-classical framework - we can state that institutions matter. As Matzner (1993) suggests, "the stock exchange of New York, the nearest approximation to a market with perfect competition, is not governed by the *walrasian tattonement,* towards equilibrium price, but by prices which are influenced by regulations defined at the discretion of the association of traders, and sanctioned by authorities" Egon Matzner, "Policies, Institutions and Employment Performance", in M. Tool (ed.), Institutional Economics: theory, method, policy, Kluver Academic Press, 1993, p.234.

[25] For instance, many Latin American countries, which adopted similar constitutions to US constitution during the nineteenth century.

[26] G.Hodgson, The Evolution of Evolutionary Economics, Scottish Journal of Political Economy, Vol. 42 No. 4, November 1995, pp.469-488.

evolution is considered to be the transformation of a system through endogenously generated change.

I claim that there are four ways through which institutions can evolve. The path that the change will follow could be described as follows:

1. Technology → formal and informal change → new behaviours and habits.
2. By design → formal change → new behaviours and habits → informal change.
3. Change in the values → new behaviours and habits → informal change → formal change.
4. Revolution → formal change → informal change.

The passage from formal to informal change and the reverse is not immediate. In fact, an interaction will be occurring. In the beginning, inertia will occur by hindering the evolution of an institution, because new institutions need to be absorbed and accepted by people's behaviour, which are affected by former rules and habits. Four factors of institutional change listed above, could be represented by the relevant institutional literature. Veblen's idea of cumulative change explains the dynamic of the progressive institutional change. Basically, it starts with technological innovation, which alters habits and behaviours in a community, which, in turn, cause innovation in the sciences[27]. Following Veblen's claim, institutional change moves from technological change. In a sense Veblen's idea of cumulative change is also the base for any formal change. That is why , Veblen argued that technological innovation altered habits, directly and indirectly throughout change in the formal framework. Moreover, as Neale rightly stated, "[a]*n institution does not stand alone. It fits into a system of institutions, so changing institutions means that the rules of other institutions must adapt and so change*" (Neale 1988)[28].

A Change in the values is another spin on institutional change (Fadda 2002). Following this approach, an imaginary chain of the process of creation and transformation of institutions can be built:

[27] T. Veblen, "The Place of Science in Modern Civilization" 1919, Reprint ed. New York 1961, pp. 231-251.
[28] *Ibidem*, p. 245.

VALUES ⇨ **ATTITUDES** ⇨ **KNOWLEDGE** ⇨ **BEHAVIOUR** ⇨ **HABITS**

⇩

INSTITUTIONS

The change in values is a sufficient condition to create a change of the institutions, but as Fadda argues[29], such change is not a necessary condition because we could have a change in the institutions with unchanged values. In fact, we can have an institutional change by law or by design, even if the values of people in a given area are the same.

Finally, the institutional change can arise from revolutions, change in power relations among social clusters, radical transformation in power organisation, dramatic change in the political and economic system of a state, etc. One of these events will change the formal constitution and the formal framework of a society, but not the behaviour of people (at least not immediately). In fact, informal rules will follow previous norms and patterns of behaviour with a great risk of inconsistency with the new formal framework, which is going to be built. Old informal constraints will still be present and persistent. In the beginning, inertia will occur and the transformation will be affected by path dependency, which in turn will affect the evolution of institutions. The case of post-communist transition economies is relevant when analysing the institutional change and when testing some of the institutional economics theories.

5. Transition Economies: a *sui generis* evolutionary model

The institutions are not exogenously defined and unchangeable. They have a social nature so they evolve, slowly but continuously. Once we stated that, the crucial question is to know what the origin of evolution is and how they evolve. As known, the New Institutional Economics says that the cause of the institutional transformations is the change of the relative prices and the enterprise reactions to them, as opposite to the *Old Institutionalism* for which the change of the price follows the institutional transformations.

[29] Sebastiano. Fadda, Does the change of Economic Institutions Require a Change in Value? 2002,Working Paper of Economic Department, Roma Tre Univesity, p.21

The formal rules are also the product of social evolution. If the change in the formal framework of the society is slow and in accordance with the natural evolution of society values and habits, then the risk of inconsistency is quite low. But if the formal rules are abruptly imposed by an exogenously designed political process, then that risk is much higher.

Many economists agree that the institutional transformation lies at the heart of Post-Communist Transition. However, different conceptions of institution make differences in that statement. After the dissolution of Communist Block in 1989, the East and Central Europe began transformation to market economy. The change was very significant: both the economic and the institutional frameworks were significantly changed. Contrary to the slowness in the evolution of an institutional process, in the Post-Communist Countries the change was exogenously imposed by political and ideological decisions. Thus, a traditional evolutionary model of institutions was no longer sufficient to explain and to interpret the new situation. In the CEECs there are guarantees of private property, new Banks, new economic and administrative organisations, and other formal institutions exogenously imposed in a short time and by political decisions. Yet the behavioural rules are not completely changed. The informal economic institutions are far from completed. The economic agents often continue to think in terms of a previous economic logic. I argue that this inconsistency between formal and informal institutions affects the economic performance. It prevents a linear and high development of CEECs economy because it causes uncertainty and instability in the economic relations.

Given the concept of the institutions, which includes formal and informal institutions, it is no longer sufficient to change the formal institutions to have another system. What is more important is to "change also the mentality" of economic agents. I argue that old institutions may continue to function in the new system even if they are inefficient because current institutions are contingent on the past. There exists a self-reinforcing process which allows for the path-dependency of institutions. Moreover, interaction between new formal rules and old social customs, will affect the evolutionary path of institutions. In fact, in the European transition economies, certain institutions survive, even if they result inefficient, while others disappear. That is why each society, has its history, its path of development, its habits and its behavioural rules. In other words its values.

With regards to path-dependency theory, it is very useful – and legitimate - to explain the origin of many problems of transition as coming from the persistence of the past in the present people's behaviours. Beside to the path-dependency theory, other factors have to be taken into consideration in order to explain an institutional change in CEECs. First of all, the *interaction between formal and informal rules and the inertia caused by this relation*. The interaction between the new formal framework of institutions that is going to be built, and the dominant behaviour of people in a certain period, affects in turn new rules and behaviours. This interaction, and not only the legacy of the past, will also affect the building of new institutions. I argue that the point to take into consideration is how people's behaviour reacts to this formal change. The result of the new institutions is something undefined and uncertain, a *sui generis* model which will depend on different elements such as: the legacy of the past; the interactions between formal and informal rules; and old behaviour of people constrained by the new formal framework. In sum, the informal institutions affect the formal institutions in two ways:

- Firstly, by putting pressure on the institutional framework to cause the change and to influence the change of the formal framework.
- Secondly, by the interaction between the dominant behaviour (informal rules) and the new framework already build (not necessarily consistent with the first).

Hence, in the transition economies of Central and East Europe, a particular type of institutional evolution has been taken place. I would say that it is characterised by several factors such as: path-dependency, new formal institutional framework exogenously imposed by political decisions, change in the structure of market demand, interaction with the outside world, informal institutions still present, conflicts and interaction between discordant rules, generational conflicts because of different values and capacity of the state for implementation and enforcement of new rules. Using the words of Lissowska, *"[d]iachronic relations are prevailing and synchronic discordance is highly probable"* [30].

To sum up, I claim that the model of institutional change which has taken place in CEECs is *sui generis* model because it is characterised by different elements such as: radical transformation (revolution), change in the values, technology and change by design.

[30] Maria Lissowska, "Institutional Change in Transition Countries – constraints and path dependency (on the example of some real estate property aspects)", Warsaw School of Economics, 2001, p.1.

6. The Model

As I clamed in the third paragraph, evolution of institutions can be pushed ahead by four factors movers: technology, change in the value structure (informal change), change in the formal sphere (constitutions and law), and great transformation (such as revolution). Using a concept of Fadda: *The institutional change is a slow historic process, and it starts (because institutions are not longer efficient*[31]*) when the technological or environmental conditions permit for such a change, or the aims of dominant groups support the change or still when power relations among the social groups change"*[32].

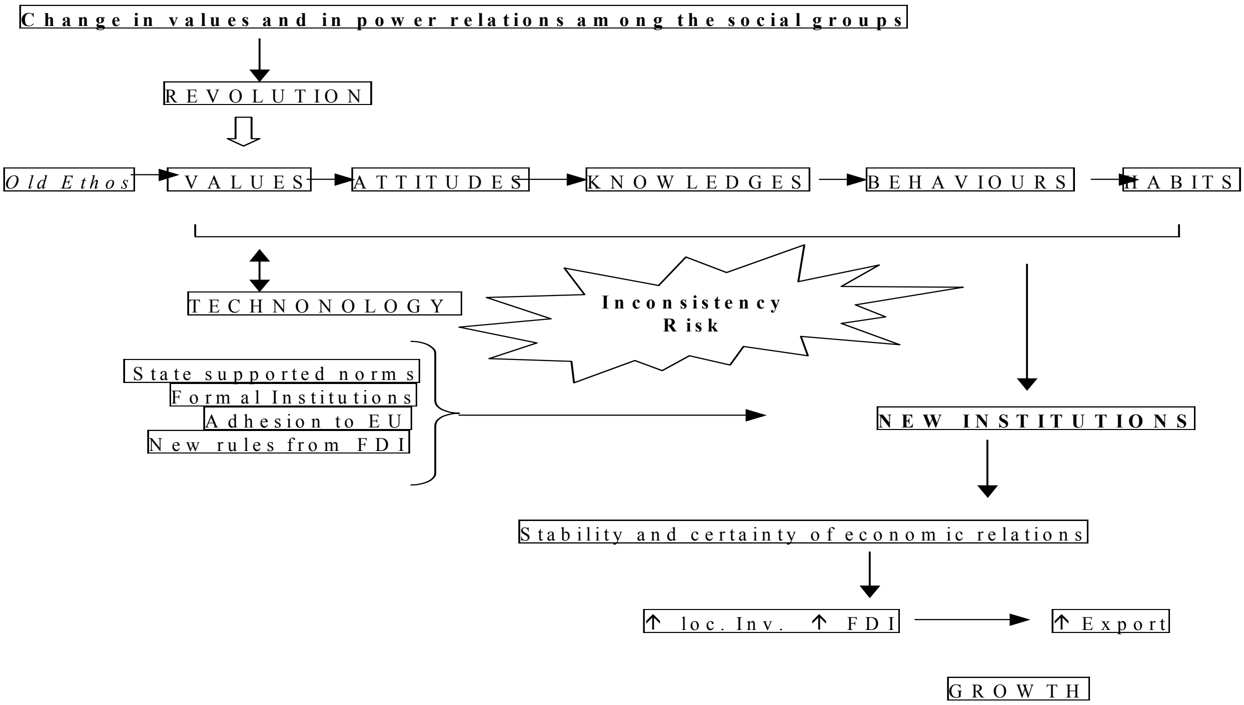
I present a model where all these factors of evolution of institutions are taken into consideration. The point is how those factors can produce consistent change to allow for a steady and strong new institutional structure.

As regards dependent and independent variables, they are the following:

INDEPENDENT VARIABLE	DEPENDENT VARIABLE
Interaction between formal and informal norms	**NEW INSTITUTIONS**

[31] In Fadda's view the concept of efficient institutions is not like in North (efficient in the sense that they minimise transaction costs), but institutions can be said to be efficient as long as they are committed to their original aims.
[32] S. Fadda, "Istituzioni economiche e economia delle istituzioni nei sistemi produttivi locali", Argomenti 2001,fasc. 1 p. 58 (our traslation).

The basic MODEL of institutional change in Central and East European Countries will follow this scheme:



Explanation of the model. This model shows the dynamic path-evolution of institutions. All the movers of institutional change listed above are present. It is obvious that a formation of institutions depends on the interaction between formal and informal institutions. Values and technology are fundamental spin on of evolutionary process in this model. Similarly to Veblen's idea of Cumulative Change[33] I assume that values and technology affect each other mutually. They are not in a subordinate relation. As explained above (in the third paragraph) Veblen's idea of cumulative change explains the dynamics of the progressive institutional change. Technologic innovation alters values and habits, and in turn new values and habits cause innovation in the sciences. There is an "inconsistency risk" because the *Old Ethos* of the former communist Countries and the informal rules could clash with the new national laws and the new institutions established by a need for harmonisation EU legislation and with the FDI inflows. In such a situation the cost of transacting will be very high.

In most CEECs the EU accession process and a significant increase in Foreign Direct Investment have had a significant impact on growth and trade as well as on the institutions of

[33] T. Veblen, "The Place of Science in Modern Civilization" 1919, Reprint ed. New York 1961

the CEECs' economy. The FDI affect economic growth in two ways: first of all, it brings new rules in the economic process such as technology, labour organisation, market strategy etc. Secondly, if institutions will be able to set up stability and certainty in the economic relations (it also means protection of propriety rights), more FDI will arrive, and probably, economic growth will be positively affected. Hence, , on the one hand more and more FDI will be attracted, on the other hand, the economic agents will be able to find information and institutional support to invest and to export.

The link between institutions and economic performance is evident at empirical level when one is to observe economies such as Germany or Japan, or new industrialised countries such as Taiwan and South Korea, or industrial districts phenomenon in Italy, etc. Yet, a lot of differences exist in terms of economic institutions between for instance Germany and United Kingdom, or between Taiwan and Honk Kong. Nevertheless, all these countries, with their own institutional model, reached respectable GDP pro-capite and social development. The point is that each country chooses its own economic institutional pattern, their own rules and institutions, in accordance with their own culture, history and a set of values. Once all these decisions are taken and once new institutions are set up, people and economic agents should follow them consistently and persistently in order to have good performance of the economy. The new rules should be consistent and credible, and a legal system should guarantee institutions such as certainty of ownership, respect of law and of commercial contracts, enforcement and monitoring of property rights, etc.

The idea of the model, which comes from my hypothesis is that in CEECs at the beginning of the transformation the inconsistency risk caused uncertainty in the economic relations and fragility in the economic performance. When the institutional framework is steady and when the inconsistency between formal and informal institutions is reduced, then the growth would be faster, eliminating the fragility in the economic performance. That is why consistency between formal and informal institutions will give stability and certainty in the economic relations and it will reduce the transaction costs. In the next paragraphs, concerning the case of Poland, I will explain, by the dichotomy thesis, why high costs will emerge if institutions are not consistent.

7. *METHODOLOGY*

7.1 Case Study: The Polish economy

I have chosen the Polish economy as my case study for several reasons. First of all, Poland is one of the most interesting case of transition economy. Poland performed well during 90s as regard for example the recovery in the GDP growth after the recession of early 90, but still many problems and economics contradictions are evident, such as one of the highest unemployment rate among CEECs; one of the highest poverty rate (GINI-coefficient); a quite high level of unofficial economy; very high percentage of agriculture sector in the GDP; and finally an obsolete heavy industry with low productivity. Despite this, Poland is one of the first candidate to the next EU accession and the most attractive Country in terms of cumulative-FDI in the region. Secondly, Poland is the biggest Country among CEECs, with a significant market. Still, the case of Poland is interesting because in the Polish economy there are present most of the transformation aspects present in all transition economies. Poland was one of the first Countries, among CEECs, to begin the transformation process. Moreover the Polish transition is characterised either by economic problems and contradictions or by important progress made in the reforms. So the case of Poland could be more easily generalized to the case of other CEECs and transition economies, while the opposite could be quite difficult.

The case of Poland is interesting also for historical reasons. During the past century, Poland experienced several dramatic changes with regards to the political organisation of the society and the choice of the economic system. The first one was the pre-communist society, characterised prevalently by the dualism between *Rank and Class*[34]. In this system, propriety rights were guaranteed and protected by the state. Moreover nobility was the dominant class whom controlled the political and economical power. The second one was the communist time, during which private propriety was abolished and the economic production system was nationalised or collectivised. The political power was strongly held by the communist *nomenclature*. Finally, the third dramatic change came during the 90s, after the collapse of the planned economy system. Because of all these dramatic changes, we can not be certain about the path of transition neither in Poland nor in other Central and Eastern European Countries. In fact, while the formal framework could be introduced by the political decisions of the

[34] Eyal Gil, "Making Capitalism without Capitalist, London: Verso 1998, pp.16-24.

actual dominant group, the informal rules and the behaviours of people could be affected by different and contrasting rules, and by the legacy of the past changing. Even if there is perfect consistency between the new politic elite and the consensus of people.

7.2 Stages in Transition Process in Poland.

The transition from planned economy to market economy passed three steps or phases. The first one is a *Chaotic Phase*. It is characterised by what O. Blanchard calls *vacuum power.* In this phase power groups and policy makers decide to change the system and, therefore, to implement new radical policies. In this phase it is likely that new groups emerge, legal or illegal organisation could easily take advantage of the chaos, crime and mafia exploit the vacuum power "to start up their business" in large scale. Moreover an informal economic network could be set up, unofficial economy will grow up, black and grey markets (already present in the former communist countries) will expand. In Poland, as in other CEECs, such a situation took place between 1989 and 1990[35].

The second phase is a *Stabilisation Phase*. This step is characterised by implementing of macroeconomic stabilisation program. Radical policies are implemented in order to change the system and in order to develop the market economy and its institutions. This phase was much debated in Poland when choosing the "best possible" market economy model. It was between 1990 and 1992. However most of the authors involved in the debate agreed that macroeconomic stabilisation should mean:

> The liberalisation of prices in order to eliminate distortions caused by artificially and badly administrated prices of the former Polish planners. Such a distortion in the prices did not allow for efficient allocation of productive resources and goods. Nuti (1986a) explained, such a distortion was one of the origins of repressed and hidden inflation during 1980s. In socialism the problem was that prices were administered and therefore not free to clear the market. So, elimination of the gap between demand and supply, strongly present in Poland since the second half of 1970s was necessary (B. Simatupang, 1994)[36]. That miss-matching was the origin

[35] In Russia (as in other CIS) the chaotic phase took place a little later and was more dramatic and very well fulfilling the above listed characteristics.

[36] Batara Simatupang, "The Polish economic crisis, background causes and aftermath", Routledge, London and New York, 1994.

of the high inflation in Poland as well as the origin of the well known phenomenon of queues at the retail shops. In order to reach that aim, restrictive monetary and fiscal policies should be implemented.

These macroeconomic stabilisation policies are shared by all the main economic streams and economists involved in the debate, such as L. Balcerowicz, J. Sachs, World Bank and IMF, J. Kornai, M. Nuti and G. Kolodko. Given that, many differences, among those economists and streams, occur in the economic approach to the complex transformation strategy[37]. Besides those two main points of the macroeconomic stabilisation, there are other few, and more controversial policies, involved in the debate of the appropriate stabilisation program package of early 90s. These are:

1. Convertibility of exchange rate, trade pattern and foreign investment regulation.
2. Restructuring of state-owned enterprises, privatisation and deregulations.
3. Market institutions, property rights and legal system.

Apart from the first point, both the second and the third points belong to the institutional change sphere. The extension and implementation of the policies concerning institutional change are part of the third phase of the transformation process. I call it a *Consolidating Phase*. In Poland, initially, this was the phase of economic growth, started in the second half of 1992. In my view this is the most delicate phase of transformation. In few words, simplifying, one can says that in CEECs recovery after the recession in the GDP level depended on stabilisation program, but sustainable growth depends on Consolidating phase. Moreover, neither the accession to the international organisation such as OECD or NATO, nor the accession to Eu would mark the end of that period.

The third phase of transformation is a very important phase of the transition. It follows the macro-economic stabilisation and price liberalisation. The third phase is about the adjustment of behaviour to these macro-economic changes. The Consolidating phase involves social and economic transformation, behaviour and attitudes of economic agents, change in the social

[37] For a clarification about the debate which took place in Poland about the macroeconomic stabilisation and the false dilemma between the so-called "shock therapy"- championed by Balcerowicz - and the alternative approach, (which is not, as could apparently seem, the "gradualist therapy") – supported by Kolodko – see respectively: **L. Balcerowicz**, *Common Fallacies in the debate on the economic transition in Central and Eastern Europe,* London: EBRD working Paper n.11, 1993 *and* **G.Kolodko and M.Nuti**, *The Polish Alternative*, UNU/WIDER, 1997.

norms of people and change in the formal framework of the society. This phase is characterised by the change in the ownership pattern, led by new institutions and a new system of property rights. My research concentrates mainly on the third phase, i.e. the Consolidating phase. During this phase formal and informal institutions interact each other dichotomically building new institutions allowing for economic growth. The extent to which economy will be affected by transaction costs, economic disequilibria, social costs, lost of benefits, will depend on this institutional interaction and on inconsistency between formal and informal set of institutions during the evolutionary process.

The Consolidating phase is the most delicate phase of transformation. In this phase the most important element is the institutional matter. The transition in this phase shows its real face; the economic subjects and the power groups of the society often will be conflicting. Different interests groups will emerge and several social conflicts will accompany the transformation. The transition in this phase reveals that it is about a dialectical process where conflicting interest groups will try to take advantages affecting the evolutionary process of the economy and of the society. My main argument is that inconsistency of formal and informal institutions and dichotomy of groups supporting their own set of institutions will raise the costs of transacting in the economy. The structural cost of transition to the market economy will be very high and the rate of economic growth will be curbed.

The most important policies of the consolidating phase involves privatisation, distribution of property rights, regulation concerning foreign investments, and setting other market institutions. By referring to the third phase of the transition process it should be interpreted the position of institutional and evolutionary economists, according to whom the *"[T]he Big Bang not only ignores the lessons of history, it fails to provide the social and economic condition necessary to create a market economy. The basic error lies in the mistaken belief in the spontaneous appearance of capitalism market economy once property right is privatised, prices are set free, the currency is stabilised and unregulated competitive market are introduced. This error of spontaneity creates serious impediments to discussion of then policies that will have to be formulated in a successful transformation strategy"*[38]. Moreover, on the line of evolutionary economics, Murrel (1992)[39] states that even *"[O]ld, inefficient institution may be better that ones that are planned, but which do not yet exist"*. That it is why

[38] J.A. Kregel and E.Matzner, *Agenda for the Reconstruction of Central and Eastern Europe*, „Challenge", 1992, p. 35

[39] P. Murrel, "Evolution in Economic and in the Economic Reform of the Centrally Planned Economies", in : The Emergence of Market Economies in Eastern Europe, eds. C.Clague, G.C Rausser and Blackwell, Cambridge MA, 1992, p. 51.

–I would say- planned institutions take time to be understood and accepted by people's behaviours, while old institutions, even inefficient, can offer to people, a framework in which they can coherently act.

According to me, these critical positions of institutional economics are to be refereed only to the eventual "Big Bang" of the third phase of the transition process, which does not involve the macroeconomic stabilisation package of the second phase of the transition. In that context orthodox economics fails when suggests the abstention of policies because the market economy will be able to create by itself the necessaries market institutions that it needs throughout a "spontaneous process". On the other hand, in this third phase, planned institutions abruptly imposed by political decisions, could be in contrast with the evolution of institutions depending of many factors discussed in this paper.

In conclusion I think there exists a minimum reform package which should be implemented in order to begin the transition to the market economy. For Poland, this package consisted in the macro-economic stabilisation program and price liberalisation aiming to curb the inflation. The policies tools are inevitably monetary and fiscal policies. How speed these policies should be, depended on how disordered the economy was, how big the gap between demand and supply was, and how much distorted the prices were. How restricted these policies should be, depended on initial conditions, social cohesion and sustainability of the society. At the same time, the policies of the third phase – a *Consolidating phase* - should be consistent (Jerzy Wilkin 1993) [40] and very careful in order to avoid as much as possible a social conflict which could intervene in the distribution of property rights and to allow for economic agents to accept the new rules of doing business such as: competition, new institutions in the labour market, new market strategies, cohabitation and cooperation with foreign investors and so on.

7.3 Interaction and inconsistency between formal and informal institutions in Poland: the dichotomy thesis

The transition from planned economy to market economy is not only an economic transformation but it also involves the capitalism culture, other values, different institutions,

[40] Jerzy Wilkin, "The Sequence and Speed of Economic Transformation", Polish Policy Research Group, Warsaw University, Discussion Paper n. 22, 1993.

property rights, costs and time[41]. In fact I would claim that at the heart of transition is the institutional transformation. Capitalism is not only a different system to allocate resources but it carries "new style of life" as well. During the transition, there is an interaction between formal institutions, determined by the new system, and informal institutions of *the old Ethos*[42] essentially determined by the people's behaviour and contingent on the past.

It could be argued that in Poland (as in other former Communist Countries of Central and Eastern Europe) the new formal rules are in contrast to the prevailing informal rules determined in the past. The discrepancy between formal and informal rules will cause an increase in the transaction costs[43]. By contrast if the formal change is in accordance with the informal rules, the transaction costs are lower and the production of wealth will rise. The problem is that informal rules are not a policy variable. When there is no agreement between formal and informal rules, the policymakers cannot directly change the informal rules; however they can directly influence the formal rules.

Hence, any evolution towards new game rules will take place, it will be affected by the old behavioural norms and by previous rules and prevailing habits in the society. In fact, the groups not willing to change, will try to protect their own interests by *rent seeking*[44] and *lobbying*. Thus, contrasting norms will cohabit and the transaction costs will be much higher than in one harmonious society, with negative effects on the economic performance.

We could have a society in which the economic agents act in opposite directions because of different goals and different strategies to reach them. Two different sets of norms can be identified - one supported by evolutionary groups, willing to change, who think that they could have more chances in the new system. The other one is supported by people who think that they could obtain more advantages with the old rules. This is my **dichotomy thesis.** I use this hypothesis to explain why, high costs - affecting growth – emerge if institutions are not consistent. The interaction and inconsistency between these two forces could be dangerous because it could curb the economic growth. In fact this interaction could be much more

[41] See Mancur Olson: "Capitalism, Socialism and Dictatorship", Harvard University Press, 1996.

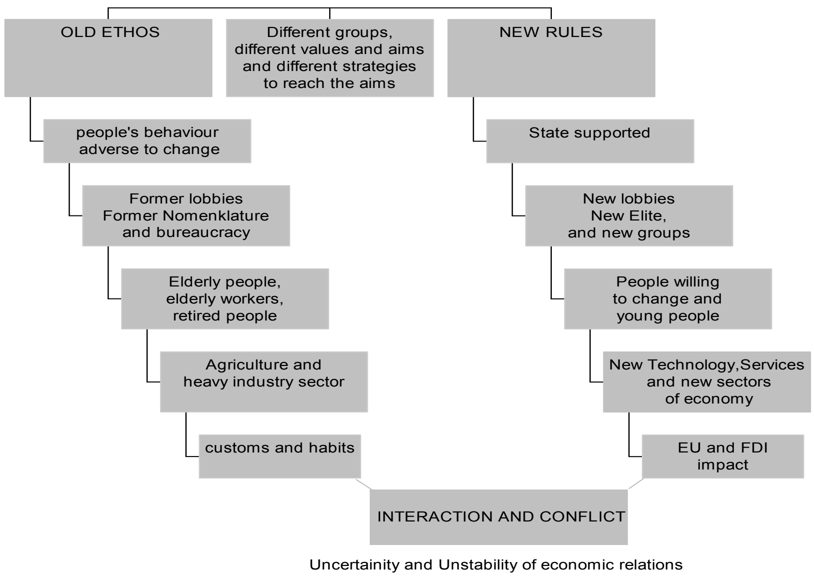
[42]The *Old Ethos* is another way to define the informal institutions like ***the hand of the past*** or the ***carriers of history*** (see above in the definition of informal institution p.3).

[43] We defined the transaction costs as the costs to make an exchange, to transfer the property, to start an activity, to protect or to change the actual institutional framework as well as the to bargain a contract *in sensu strictu bargaining transaction costs.*(See above third paragraph).

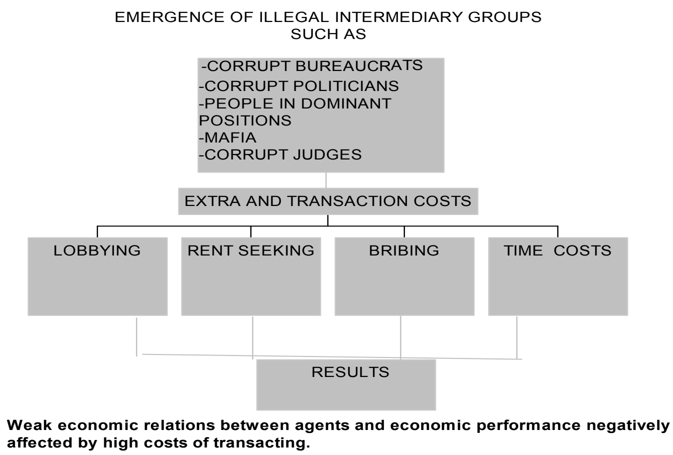
[44] The people adverse to the changes are more willing to pay in order to protect the old framework . They can organise a representative lobby, or a political party to take benefits by their actual position.

costly in terms of transaction costs, lobbying activities, bribes, waste of time and power clusters. Moreover, this chaotic situation could create space for *illegal intermediation groups* such as corrupted bureaucrats, mafia, people who exploit a dominant position for personal interests, etc.

The model of the dichotomy thesis in Poland:



The new institutions build on the interactive dichotomy between old rules and new formal rules, supported by two different groups. The inconsistency between both will affect the economic growth by hindering the stability and certainty of economic relations. Consequently, such a situation will favour the emergence of illegal or semi-legal groups which will affect all the transactions in the economy causing high extra costs.



In such a situation, transaction costs such as information costs, exchanging costs, enforcing and protecting property rights costs will be much higher than in a normal situation. In particular, bargaining transaction costs will be very high. Hence, inefficiency and negative economic performance will be caused by those extra-costs, which, in turn, will curb the growth rate of economies .

My dichotomy thesis is built on the basis of ten episodes and observable stylised facts such as:

1. Resistance of peasants, and heavy industry workers (and connected lobbies) of Poland to the formal change and restructuring of agriculture and heavy industry (brought ahead, basically, by a need for harmonisation with the Agriculture Common Policy prescriptions and to the EU internal market rules).
2. The regional divergence (denoted basically by a considerable difference in the GDP per capita and unemployment) more and more significant between West and East of Poland and between big cities and villages or small towns.
3. Cumbersome bureaucracy, which is not yet well adapted to the new formal institutions of market economy.
4. Prices not really depending on competition and input costs but on bargaining, relationship, bribing cost, social customs, habits, etc.
5. Significant importance and presence of *Grey or Black market.*
6. The difficulty of particular clusters of the society (such as: farmers, heavy industry workers, retired people, bureaucrats, part of former *nomenclature*) to accept the new rules of market economy.
7. Tax evasion and illegal practices (bribing and corruption) in the economic transactions:
    - to avoid too long bureaucratic process
    - to reach more easily their own aims
    - to better run in the new economic contest, avoiding rules and process not yet well-known.
8. An informal sphere of institutions affecting economic relations. One can observe a number of informal economic relations among economic agents in search of information, doing credit, stipulating contracts.
9. A Lack of trust between foreign and local investors.
10. A Minimal use of banking and financial services.

Finally, the way prices of goods and services are determined seems to depend on many elements and it is not clear what the role of competition and factors' costs is. Actually, in accordance with an empirical research of Johonson, McMillan and Woodruff (1999) [45] the determination of goods' price depends only for 60% on the inputs costs and competition (see Appendix), while the rest depends on *special* bargaining, relationship with customers, *bribing cost* and so on[46].

Given the concept of extra-costs mentioned above, I claim that transition process, will be much more expensive than the mainstream economic theory suggests. In fact, Poland, as Central and East European Countries involved in the transition process, would not only incur the "normal costs" of this process, i.e. social costs (unemployment and poverty), financial costs (budget deficit, increase in debt, trade balance deficit), industrial costs (enterprise restructuring and change in industrial and trade pattern), inflation and a cost of disinflation, devaluation of exchange rates etc[47]. Moreover, Poland also incur other costs or a lost of benefits for the society because of the divergent aims, different values, contrasting interests among clusters of the society. In short, these costs, or the lost of benefits, are the consequences of:

- Bribing, corruption and tax evasion
- Bureaucratic and administrative inefficiency
- Persistence of inefficient and obsolete industries
- Low productivity of agriculture and heavy industry
- Political resources involved in protection of particular interest groups
- Conflicts and uncertainty of propriety rights.

Hence, although a macroeconomic stabilisation could take place, as it has taken place in Poland during the early years of transition, at a microeconomic level the inconsistency between formal and informal rules and the dichotomy between the two forces which support those two set of rules will negatively affect the economic performance.

[45] S. Johonson, J. McMillan, C. Woodruff, "Entrepreneurs and the ordering of institutional reform: Poland, Romania, Russia, the Slovak Rep. and Ukraine compared", EBRD Working paper n. 44, October 1999, p.15.
[46] This would confirm my theoretical approach , which emphasised that prices are "institution-guided", perceiving institutions in the wide sense as defined above.
[4747] All TEs have experienced, in a different degree and intensity, such phenomena during the 1990's. Kornai called such costs, "transformation cost", and explained the recession of early 1990's as caused by the dramatic change in the whole system of those countries. J. Kornai, "Transformational Recession: The Main Cause's", Journal of Comparative Economics, 19.1994, pp.39-63.

Final remarks

In the first years of transition, the most important aim of Government was the macro-stabilisation (Balcerowicz 1993)[48]: the fight against inflation, the reduction of debt, the liberalisation of prices and, gradually, the privatisation. All those aims were necessary to allow for the economic growth[49]. Nevertheless those results were not sufficient conditions to stimulate long-term growth. If we look at the economic performance and the social indicators of Poland, we notice that data are quite surprising and contradictory (see Appendix). On the one hand, there is a significant recovery in the GDP, positive annual change in the labour productivity of industry, quite high investment rates and enterprise restructuring, strong capability to attract FDIs, reduction of inflation, and Public Debt comparable to the average of the European Union. In sum, we could say that during the past ten years the stabilisation program in Poland produced almost complete nominal convergence towards Maastricht criteria. On the other hand, as showed in the Appendix, in Poland there is one of the highest unemployment rates among CEECs, a growing inequality rate (GINI-coefficient), a considerable index of poverty (of which, in according with OECD, the percentage of workers represents the majority), a chronic current account deficit and a considerable external debt. Moreover, the economic growth is not every year high like during the middle 1990's. In fact, in the last years the growth rate of Poland was just a little above the EU average .

To conclude, despite the fact that Poland has done remarkable well, relatively to the other CEECs, still the Polish economy is affected by numerous problems, which curb economic performance. In my view one of the most neglected problems is the inconsistency between the new institutional framework and the informal institutions. I have claimed that the stabilisation program of the early 1990's although necessary was not sufficient. Not enough attention was paid to the role of informal institutions. As I emphasised in the theoretical section, institutional framework and, in particular, the consistency between formal and informal institutions are very important for the *economic development*. Informal institutions are also part of the economic process and not exogenously given. This is value-added of the research; the emphasis on the interaction between formal and informal institutions and its effect on the

[48] See L. Balcerowicz,"Common fallacies in the debate on the economic transition in Central and Eastern Europe", London: EBRD working Paper n.11, 1993.

[4949] Marek Belka,"Lesson from the Polish transition", in Poland into the New Millennium ed. by G.Blazyca and R. Rapacki, Edward Elgar 2001, pp.13-32.

economic growth.The informal institutions resist to change or take more time to change because initially, inertia occurred. The interactions between *Old Ethos* and informal institutions and new rules were likely to bring problems for the consistency of people's behaviour with negative effects on the economic performance.

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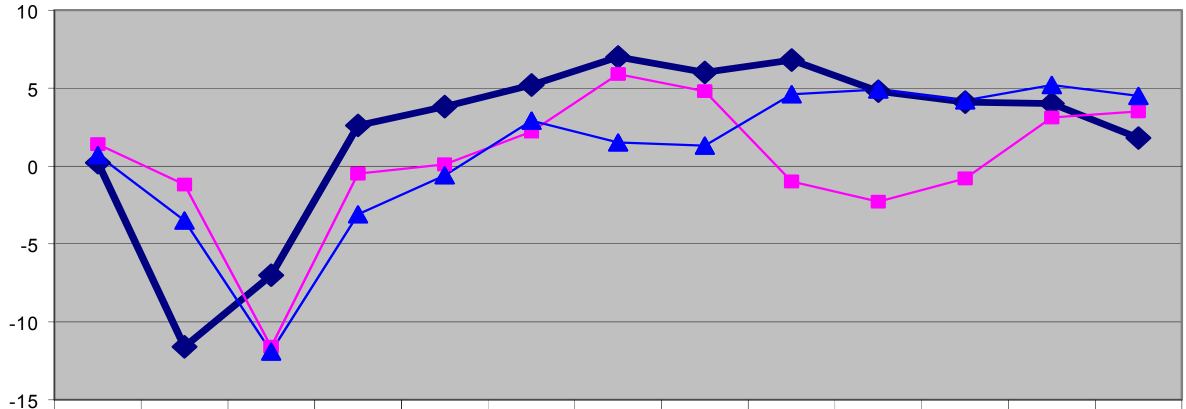
APPENDIX : Controversial data for some selected Central and Eastern European Countries.

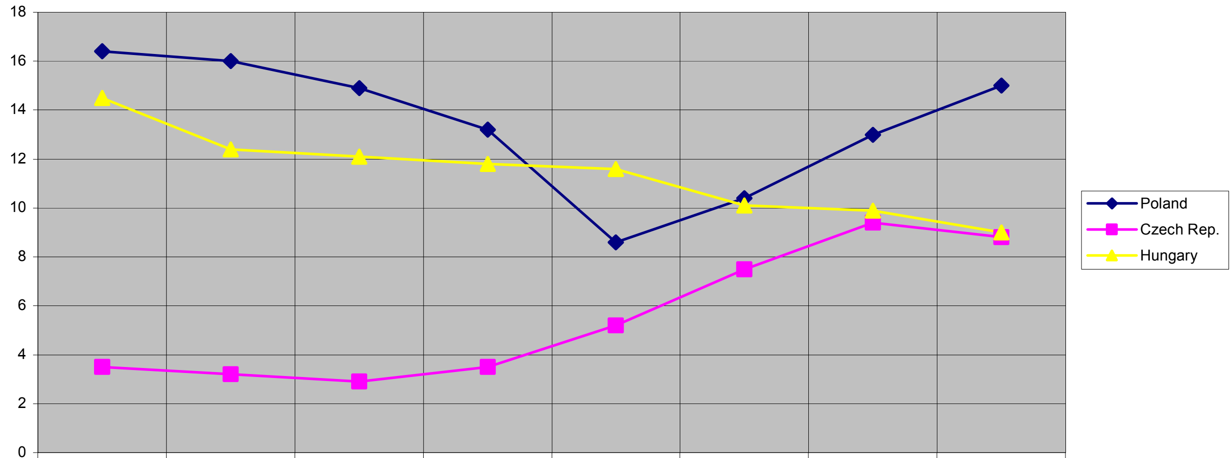
GDP Growth, % change



	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Poland	0,2	-11,6	-7	2,6	3,8	5,2	7	6	6,8	4,8	4,1	4	1,8
Czech Rep.	1,4	-1,2	-11,6	-0,5	0,1	2,2	5,9	4,8	-1	-2,3	-0,8	3,1	3,5
Hungary	0,7	-3,5	-11,9	-3,1	-0,6	2,9	1,5	1,3	4,6	4,9	4,2	5,2	4,5

Source: Economic Intelligent Units, Country Report 2001.

Unemployment rate in %



	1993	1994	1995	1996	1997	1998	1999	2000
Poland	16,4	16	14,9	13,2	8,6	10,4	13	15
Czech Rep.	3,5	3,2	2,9	3,5	5,2	7,5	9,4	8,8
Hungary	14,5	12,4	12,1	11,8	11,6	10,1	9,9	9

Source:Transition Report 2001

GINI-Coefficient

	1988	1995	2001
POLAND	25.6%	32.1%	33%
CZECH Rep.	19.4%	25.8%	27%
HUNGARY	21%	24.2%	26%

Source: Atkinson and Micklewright 1992, 2000. Transition Report 2001

Poverty index

POLAND	18.3%
HUNGARY	9.3%
SLOVAKIA	6.7%
CZECH REPUBLIC	6.1%
Former East GERMANY	6.6%

Source: Beskid. Vienna,1998

Unofficial economy,1995 *(% of official GDP)*

POLAND	19%
CZECH REP.	17%
HUNGARY	29%

Source: Kaufmann and Kaliberda (1995)

POLAND	1995	1996	1997	1998	1999
Informal trade balance	7.2	6.4	6	6	3.6

Source: National Bank of Poland, 2000,Balance of Payments data.

Determination of prices in %

	Poland	Slovak Rep.	Romania	Russia	Ukraine
Prices set by “input/competition	62.5	59.3	63.1	21.1	9.9
Prices set by “bargaining/relationships With customers	31.1	31.9	25.6	64.1	66.8

Sourse: Johonson,McMillan, Woodruff (1999)

OFFICIAL AND UNOFFICIAL ***AND TOTAL COSTS TO DO BUSINESS BY ITEMS***

	Poland	Slovak Republic	Romania	Russia	Ukraine
Phone line					
Official payment (US$)	177	160	162	240	159
Unofficial payment (US$)	34	25	25	426	464
Total payment (US$)	211	185	187	666	623
Unofficial as % of total	16.1%	13.5%	13.4%	64.0%	74.5%
Percentage of firms for which total is larger than official (i.e., make some unofficial payment)	11.4%	26.7%	38.9%	94.7%	94.5%
Initial enterprise registration					
Official (US$)	296	928	120	194	262
Unofficial (US$)	7	19	16	348	526
Total (US$)	303	947	136	542	788
Unofficial as % of total	2.3%	2.0%	11.8%	64.2%	66.8%
Percentage of firms for which total is larger than official (i.e., make some unofficial payment)	1.4%	9.6%	25.4%	86.1%	90.6%
Continuing registration					
Official (US$)	61	60	70	26	51
Unofficial (US$)	2	3	13	50	120
Total (US$)	63	63	83	76	171
Unofficial as % of total	3.2%	4.8%	15.7%	65.8%	70.2%
Percentage of firms for which total is larger than official (i.e., make some unofficial payment)	0.4%	3.0%	19.1%	74.1%	72.7%
Fire/sanitary inspector					
Official (US$)	52	50	15	2	38
Unofficial (US$)	3	17	5	31	86
Total (US$)	55	67	20	33	124
Unofficial as % of total	5.5%	25.4%	25.0%	93.9%	69.4%
Percentage of firms for which total is larger than official (i.e., make some unofficial payment)	2.8%	12.1%	21.8%	64.9%	88.0%
Tax inspector					
Official (US$)	3	53	7	0	81
Unofficial (US$)	14	10	9	133	236
Total (US$)	17	63	16	133	317
Unofficial as % of total	82.4%	15.9%	56.3%	100.0%	74.4%
Percentage of firms for which total is larger than official (i.e., make some unofficial payment)	1%	2%	17%	70%	67%

Note: "Unofficial" payments are calculated as the difference between what firms report as the official and total cost for an item.

Sourse: Johonson,McMillan, Woodruff (1999).

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