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Import of Institutions: Theoretical Aspect and Practical Experience*

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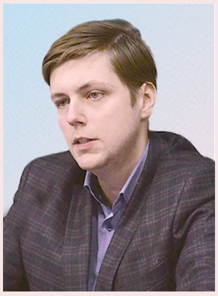

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Abstract. The article is devoted to the problem of import of institutions, which is manifested in the form of society's borrowing of traditions, customs, and norms of behavior that developed in a different institutional environment. Such import is quite often accompanied by atrophy, regeneration of institutions and dysfunction of institutional macrostructure. Emerging so-called institutional traps cause serious risks for development of recipient countries. A historical example of the implementation of such risks was an attempt to transplant institutions of orthodox or radical liberalism in post-Soviet countries which expected modernization of their economies but received a diametrically opposite result – the primitivization of structures. An alternative to this course of events could be the usage of social market economy institutions (SME). Since the essence of the SME concept is a combination of market self-regulation mechanisms

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with a systematic state interventionism, it was possible to carry out a systemic transformation with, first, lower social costs and, second, without total deindustrialization. There is an existing need for a broader perspective on the formation of market equilibrium, which implies the inclusion in a number of independent market entities of the state that seeks to maximize its own function of social utility. It is the only approach that ensures the optimization of modern society's institutional environment in general and criteria for selecting imported institutions in particular. The novelty of the work is the justification of considering the interdependence of an exporting country's institutions, while choosing the most efficient one, and the need to assess consequences of its implementation in a recipient state's institutional environment. The authors conclude that the import of corresponding institutions should be accompanied by a synthesis of "social" and "market". It could be achieved only with the harmony of complementarity of both these aspects, not with the construction of a hierarchy between them.

Key words: transplantation of institutions, institutional traps, market of institutions, social market economy, neoliberalism.

Introduction

Social institutions were formed as a component of a particular type of production relations, inherent for different production methods, after centuries of evolution. In the process of institutional transformation, a society tries to reduce transaction costs: K. Arrow called it "costs of exploitation of economic systems" [1, p. 55]. The increase of transaction costs historically strengthens prerequisites for the destruction of old institutions and the formation of new ones which were developed within the system or borrowed from the outside.

Institutions primarily evolve spontaneously under the influence of various socio-economic factors; they arise "from below", and the state enshrines them. However, the introduction of institutions may be violent. In this case, the ruling class, with the help of the state, imposes new (usually radically new) norms of behavior on an entire society. In this situation, a common case is the import of institutions as an attempt to build social relations that are considered more developed and efficient in a short time with the help of ready-made recipes. After it, as A. Oleynik notes, the role of the state, instead of a purely technical one which is reduced to a formal, legal consolidation of relations of class forces, becomes dominant [2, p. 43].

Such replacement process is inextricably linked to the institution market. Inside of it, the elimination of weak institutions contributes to the survival of ones that provide the greatest efficiency in coordinating actions of economic entities [3, p. 17]. In the institution market, the role of peculiar goods is played by formal institutions and forms of their consolidation. At the same time, informal institutions cannot be the object of purchase and sale, and they appear as the result of the reaction to the movement of formal norms and rules. Demand in the institution market is created by different economic entities: the state, forms, households, etc. For them, the basis of the consumer value of "good-institute" is the possibility of the reduction and increase of transaction costs.

The desire to maximize profits will push economic agents toward reducing costs, including transaction ones. In this case, coordination institutions, such as the protection of private property, freedom of pricing, freedom of capital movement, transparency, and stability of public administration, will be in demand.

When an agent tries to gain advantages (rent) by increasing transaction costs of other participants in the economy, it will put a demand on appropriate distribution institutions: restriction of competition, foreign trade duties, market barriers, exchange rate management, and so on. The offer in the market of formal institutions is traditionally presented by state authorities, and the competition arises between sellers. A winner of a competition is a supplier of institutions who was able to ensure a minimum conflict between formal and informal rules and regulations in own practice. When they do not contradict each other, costs of monitoring compliance with formal rules of a game reduce, decreasing costs of its creation. If such a conflict exists, costs of an offer increase, and the process of implementing an institute becomes more complex. Institutional transactions (the concept introduced by D. Bromley [4, p. 110]) – acts of "purchase and sale" in the institution market, carried out through informal contracts – occur when the introduction of an institution leads to the reduction of transaction costs or the increase of rents for a rational buyer.

Issues of the import of institutions in the context of the role of a state are reviewed by I. Rozhdestvenskaya and V. Tambovtsev [5]. Methodological approaches to an issue of importing institutions and related categories (borrowing, transplantation, cultivation, etc.) were studied by E. Kapoguzov, S. Levin, and K. Sablin [6]. M. Zharikov's work is devoted to contradictions of institutions' import by developing countries with a high rate of economic growth using BRICS countries as an example [7]. This research is devoted to issues of borrowing institutions using problems of the Russian socio-economic model, caused by contradictions in the transplantation of institutions of orthodox or radical liberalism in the post-Soviet period, as an example.

Costs of institutions' transplantation

Borrowing of institutions, developed in a different institutional environment, V.M. Polterovich calls "transplantation" [8, p. 24]. Transplantation and import of institutions are similar terms. However, it would be correct to represent both concepts as phenomena depending on each another. Just as abroad import of goods does not mean its automatic consumption in a buyer's country, "import" of certain rules from an outside world requires its further "implantation" in an organism of national economy and the creation of conditions under which it will not be rejected. The choice of an implant is a market procedure when a recipient (country) purchases a necessary product on the institution market. At the same time, the institution market is subjected to much greater deviations than traditional markets of material goods or services. For this reason, a special role in the transplantation process belongs to non-market forces – to a state especially. Here, one of main problems is the influence on a procedure of selecting institutions, required by agents with different interests, and the establishment of criteria for selecting institutions: which institutions, and from which countries, it is necessary (and even possible) to import.

Usually, import of institutions means borrowing of traditions of a developed country by an underdeveloped one. However, it is often difficult to determine the hierarchy of institutions in terms of its development. It applies to political systems (which country has better developed democracy: one where formal signs of political competition and change of power are observed, or one where people from a social bottom have real opportunities to reach the highest state posts?) and economic models (does an institution of private property always act as a guarantor of political freedom and democracy, or, on the contrary, it creates conditions for the formation of a monopoly dictate?).

G.B. Kleiner, speaking about the quality of institutions, evaluates it from the point of view of the integrity of an institutional system [9, p. 112]. It is understood as a complete interaction and close connection of elements of an institutional system that ensures sustainable socio-economic development of the country, as well as its compliance with the general vector of historical institutional development of this society. This, on the one hand, allows us to evaluate an institutional system in terms of harmonious interaction with cultural, national, historical, and cognitive systems. On the other hand, it restricts a degree of freedom of an institutional system during its transformations. If these conditions are not met, institutions are borrowed in the form of individual fragments of other countries' socio-economic models. As the result, unstable "quasi-institutions" are formed, which are able to perform only a small part of expected functions. G.B. Kleiner notes that such institutions are more like prosthesis than an implant [9, p. 86]. In this regard, institutional design and the creation of tools for institutional stabilization begin to play a particularly important role in the process of institutional transformation. If these conditions are not met, institutional prosthesis may be rejected by society and completely cease to perform expected functions.

According to V.M. Polterovich [10, p. 28], a transplanted institution's atrophy and rebirth occur if it is introduced without coordination with local cultural traditions and an institutional structure of a country. For example, the institution of bankruptcy in the process of transplantation into the model of peripheral capitalism in Russia turned from a tool for improving the efficiency of a system to a way of property appropriation. J. Eaton [11, p. 1310] highlights another example of inefficient transplantation of institutions – the transfer paradox, which means that, as the result of importing an institute, a seller increases gains at the expense of a recipient. For example, the liberalization of economic relations in Russia in the 1990s, when the export of Russian raw materials at low prices, capital outflows, and "brain drain" enriched suppliers of free market institutions by draining the Russian economy.

Since the institution market allows borrowing mostly formal norms and rules, informal institutions' efficiency decreases during its introduction into different environment. As noted by P. Milgrom, D. North, and B. Weingast [12, p. 15], informal institutions are inherently rigid and difficult to transform under the influence of imported formal ones. Rather, on the contrary, informal institutions significantly transform formal ones, and a radical change of institutional environment, especially a short-term one, is practically impossible.

In works of American institutionalists D. North and R. Thomas, the "optimistic" model of institutional evolution was developed. It implies smoothing out differences of economic development, reducing transaction costs, and increasing economic growth for less developed economies as these economies apply imported institutions of developed societies. At the same time, it is noted that borrowing of formal rules is not a problem. However, "the mere existence of such formal rules does not guarantee the efficiency of adaptation", and it does not always contribute to economic growth [13, p. 315]. Development of informal norms and rules, which are not just a simple addition to formal relationships, is equally important. It forms unique environment where the same formal rules begin to operate in different ways.

For example, a number of Latin American countries adopted constitutions based on the main law of the United States after becoming independent. Sovereign states also copied the United States' legal system, but their development took different paths. "Creation of efficient investment and commodity markets is a complex process. The only thing we know is that the creation of such markets requires the addition of informal restrictions and efficient means of enforcing contracts' compliance to formal rules" [13, p. 315].

North tries to answer a question why the smoothing of differences between economies of different levels does not always occur, and development of different societies may often go down diverging paths. At the same time, socio-economic systems tend to reproduce inefficient institutions that may lead to stagnation and decline.

The first reason is an inefficient state. Within the ever-deepening division of labor and specialization, it becomes impossible to reduce transaction costs without a state's active participation. This will not happen if a state does not ensure compliance with rules and regulations but behaves like a "predator", increasing its own income. Often, the less efficient institutions are, the greater higher bureaucracy's revenues become. This is particularly relevant in matters of the property rights' structure, "which, although inefficient, is easier to control, and it creates more opportunities for tax collection" [14, p. 5]. Without sufficient socio-political activity of "bottoms", institutions, borrowed from a society, will not operate efficiently: "Protection and enforcement of property rights are assumed by governments, since they can do this at a lower cost than voluntary informal groups. However, government's financial needs may cause the protection of certain property rights that will hinder, rather than promote, economic growth. Therefore, we have no guarantees that productive options for institutional arrangements will actually emerge" – North and Thomas note [13, p. 48].

The second obstacle to efficient borrowing of institutions is the influence of strong political groups on the legislative process. There is an asymmetry of interests between these groups and a society. As North writes, "even if rulers would want to pass laws based on efficiency considerations, self-preservation interests would dictate a different course of actions, since efficient rules may infringe on interests of strong political groups" [14, p. 72].

The third obstacle is the problem of "path dependence", which often dominates implemented institutions. Old, previously established norms and rules are more easily accepted by the public consciousness than the adoption of new ones. The introduction of new institutions requires significant financial investments, even when old institutions clearly become inefficient and bring constantly increasing transaction costs. A similar point of view is shared by E. Furubotn and S. Pejovich. They note that "new property rights are created, and existing ones change when some individuals and groups believe that it is more profitable for them to rebuild the system, and they agree to bear costs of its implementation" [15, p. 8].

Institutional traps

The choice of erroneous strategies in implementing institutional reforms creates negative effects called institutional traps. These are "inefficient but stable norms or institutions" and "inefficient balances generated by the corresponding norm" [16, p. 5]. An example is the tax evasion system. This norm becomes stable if it becomes unprofitable for economic agents to deviate from it. There is a coordination effect: the more participants of the economy follow established rules, the lower transaction costs of each one are, despite the fact that an economic system may suffer damage. For example, the more companies evade taxes, the lower the risk of liability for each one is. At the same time, the refusal to follow accepted norm creates a special type of costs – transformational. Such costs will be incurred by a company that wants to work "in the white zone", and it bears additional costs for finding similar contractors. "Over time, transaction costs < ... > decrease due to the learning effect: agents acquire skills and invent technologies that reduce costs" [16, p. 7]. To get out of the institutional trap, a state must use economic regulation policies to create a situation when transformational costs are lower than transaction costs. On the one hand, it could be achieved through increasing transaction costs of an inefficient norm by increasing liability for lawbreakers and improving the efficient work of supervisory authorities; on the other hand, through simplifying transactions, making legislation more transparent, supporting honest business, and so on. According to V. M. Polterovich, a society can independently overcome institutional traps by developing a civil culture [16, p. 11].

Institutional traps also might include the problem of the misusage of institutions. It occurs when an institution, which was originally a source of a public good, becomes an instrument for extracting rents in individual agents' hands. This includes manipulation and subordination of institutions, exploitation of information asymmetry [18, p. 12]. As an example, it is possible to mention the institute of tax incentives, which exists to exempt economic agents from a number of tax obligations. Opportunistic behavior of individual taxpayers might be expressed in an attempt to avoid paying taxes: a company takes steps that are not determined by the logic, or goals, of a business but allow it to formally meet the criteria of the recipient of benefits and enjoy privileges intended for other market participants. The emergence of institutional traps is directly related to costs of failed imports of institutions. Thus, the institute of bank deposits' insurance, which was initially considered a mechanism for protecting interests of ordinary bank customers and increasing their confidence in the stability of the banking system, has become a tool for enriching bank insiders and unscrupulous depositors. As the result, this led to the increase of social costs, not its reduction.

Selection of institutions: expectations and results

To assess the impact of imported institutions on the results of market reforms in post-socialist countries in general and, in particular, in Russia, it is necessary to take into account the institutional background of their socio-economic dynamics. It is about legal norms, cultural traditions, values, and moral guidelines, i.e. formal and informal rules adopted in a particular society. They have had a significant impact on motives and intentions of reformers in the process of transforming one system into another.

Mechanical borrowing of norms and rules, developed in a different cultural environment and other conditions, may be not only ineffective but absolutely counterproductive in terms of expected reforms' results. Significant differences between formal and informal rules play a crucial role here. Informal restrictions cannot change quickly, because they are based on stable patterns of thinking and, consequently, behavior. While formal rules can be changed quickly and radically, informal ones tend to be conservative. This circumstance undermines chances for a beneficial rooting of borrowed institutions.

It is no exaggeration to say that unexpectedly high social cost of Russian transformation (for reformers) is largely caused by the neglect of an institutional component in the design and implementation of the “transit” policy from one system to another. It is not just that the country’s economy has grown, averagely, just by one percent a year over several years of reforms, which is why Russia is among the most underdeveloped countries in terms of economic dynamics. It is not yet possible to stop the processes of primitivization of production, de-intellectualization of labor, and degradation of the social sphere in the country. It should also include the appearance of mass poverty which, during the years of radical changes, rapidly expanded due to the erosion of the middle class established in the late Soviet Union: although it was not too rich by Western standards [19, p. 177].

Various studies of material capabilities of Russian households show that only a quarter of the country’s population actually enjoys the fruits of conducted reforms, and a half of the country’s residents fight the same severe battle for existence similar to Soviet times. It is not surprising that concepts of democracy, market, and freedom are still largely discredited in the Russian public consciousness.

The error of “spontaneity”, or the dysfunction of institutions’ exogenous borrowing, is also natural for Eastern European countries. However, in Russia, the reform policy, based on the dogma of the free market, due to certain features of the public consciousness, has become particularly unsuccessful, which once again confirms serious risks of importing institutions without taking into account informal rules, characteristic for a recipient country.

A good example of this “neglect” in the post-Soviet Russia is the privatization of state property carried out in a way that it was impossible to give it legitimacy, to create an efficient owner, to prevent a series of seizures and redistributions of property, and to avoid the conjuncture re-statism (e.g. return nationalization) of ownership. Reforms failed to create stable state, social, economic, and law enforcement institutions designed to ensure the independence of property from the state – to overcome a historical supremacy of power over property.

What are benefits of institutions derived from the concept of social market economy today?

Was there any reasonable alternative to this course of events? Our answer is “yes, there was”. Everything could be different if the policy of market reforms was based, instead of the ideology of radical liberalism, on, for example, the pragmatic concept of social market economy (SOME) [20, p.100].

The fundamental idea of SOME, which definitely could be considered highly relevant for our time, is the recognition of the equivalence of mechanisms of market self-regulation and state interventionism. Taking into account this kind of “principle of equivalence” has, we can say, an existential significance for current Russia, where a culture of compromises and consensuses is being instilled with great difficulty, and discussions often lead to ideological skirmishes that are similar to a Manichean confrontation between good and evil. The SOME concept and, consequently, the practice of its application in FRG could be extremely useful while choosing the way of Russia’s transition from a centrally managed economy to a market one.

It is necessary to understand that such comparisons are very conditional. Each country is unique, as are conditions for the solution of the same tasks; so we should be very careful about conclusions, especially those that are willingly, or unwittingly, given a universal nature. Still, if there was the need to learn from the experience of others, the most appropriate object in this regard might be post-war West Germany.

The similarity of initial conditions for systemic transformation in FRG and post-Soviet Russia is obvious. First, both countries needed to transition from totalitarian political regimes to systems of pluralistic democracy and a simultaneous formation of a market-based economy. Secondly, in both countries, this kind of a hybrid transition was inevitably accompanied by a material stratification of a society and the decrease of low living standards among the majority of citizens. Consequently, in both countries, it was necessary to implement some kind of a social policy that mitigated hardships of reforms. Third, finally, economic and social policy within the systemic transformation required, at least, some theoretical basis. For this, the SOME concept, which, as it is widely known, enjoyed an impeccable reputation in Europe, in its academic community, and the business world for almost a quarter of a century.

Risks of "non-adjective" market economy

It seemed that time-tested successful story of the theory and practice of SOME would attract the attention of Russian reformers who took up a great task of transforming the country into a modern democratic state with a market economy. However, it did not happen.

The fact is that, after the Great Depression (1929–1933) and the Second World War, anti-capitalist sentiments reigned in the academic world of Europe, while, forty years later, when the systemic transformation of post-socialist countries began, the "spirit of the time" in the world was fundamentally different. The ideological trend changed into an opposite one: a previous rejection of the "free market" turned into its nearly unconditional adoration, which was greatly facilitated, of course, by the collapse of the world socialist system. At the same time, anti-socialist sentiments in Western intellectual elites in the early 80's were so strong that a mere mention of an adjective "social" in a positive connotation was considered somewhat indecent.

It has become accepted that the market economy, if it is efficient, is itself social and, therefore, it does not need to be further defined. Translated from literal German, it sounds like a "non-adjective" market economy (adjektivlose Marktwirtschaft). It is peculiar that, under the pressure of radical liberalism, Germans themselves succumb to the new fashion. A significant part of the German academic community commits some kind of "betrayal" of SOME ideals, rejecting the concept of "social".

All of this, as noted above, led to sad consequences for transformation processes in CEE and CIS countries, which, in our opinion, had to deal with a phenomenon called "historical bad luck". Transition to freedom, democracy, and the market of former socialist countries began at the height of the popularity, if not adoration, of the radical liberalism ideology – unregulated market economy. Within nearly unconditional acceptance of currently prevailing Western theoretical constructs, this circumstance became, paradoxically, a powerful factor that prevents countries from approaching well-being standards of founding states of the European Union.

Obviously, in such circumstances, there could be no question on the demand for the SOME concept by post-socialist countries' elites, especially since international institutions that protected their transit to the market (the IMF and IBRD) were carriers of ideas of market fundamentalism. Isn't it reasonable to assume that, if the transition to the market had taken place here in the middle of the 60s (the Kosygin reform and the Prague Spring), the content of the system transformation would have been fundamentally different? In any case, its social price would have been clearly lower, at least due to the "spirit of the times" that favored justice and freedom which, in fact, is the essence of SOME. The rejection of the social market economy concept had to affect the choice of imported institutions designed to provide the most efficient way of transforming the planned economy into the market economy. As the result, the transplantation of "market" institutions, so to speak, while ignoring "social" ones, turned into an institutional trap.

In our opinion, the most serious miscalculation of domestic reformers was the adoption of a thesis about the harm of social equalization institutions designed to alleviate the hardships of an objectively painful transition from the directive-planned economy to the market one. If the SOME concept implied the mandatory introduction of a progressive tax scale of personal income from the beginning of systemic changes, Russia decided to abandon this institution in order to follow a neoliberal principle of the inequality right, which gained popularity during M. Thatcher's reforms. As the result, income and property inequality in the country was restored, and, moreover, it significantly increased. Before the collapse of the Soviet Union, the average income of 10 percent of the wealthiest citizens was 3 times higher than the average income of 10 percent of the country's poorest population, and, currently, this figure has increased to 15. In countries that are committed to principles of SOME (Western and Northern Europe) and considered exemplary from the point of view of organizing a community, the gap between incomes of rich and poor people is 6–7 times [17, p. 96]. Consequently, the neglect of the social equalization institution led to the fact that the USSR' excessive income inequality was replaced by excessive income inequality in post-Soviet Russia with all previously mentioned negative consequences.

This is just one example of the failed implementation of a "progressive" institution in a reformed economy, which, instead of the expected sustainable development, acquires an opposite, negative dynamics. The same thing happened in Russia with the competition institution. Reformers assumed that it would work on its own after the abolition of directive pricing, the state monopoly on foreign economic activity, and the introduction of private ownership of production means. In fact, it quickly became clear that, without creating a strong competitive institutional environment, the cartelization of the reformed economy is inevitable, which devaluates and discredits basically irreplaceable market mechanisms of self-regulation in the public's view. Government's relentless attempts to extend principles of self-sufficiency and self-financing to so-called humanitarian sector of the economy, which includes education, health, science, and culture, deserve to be mentioned specifically among cases of discrediting mechanisms of the "free market". Disregard for the meritorious nature of locally produced goods leads to its chronic underfunding by the state, which, in turn, blocks development of the country's human potential and slows down the process of its real modernization.

Conclusions

This paper is devoted to theoretical aspects of the problem of importing institutions and their practical manifestation with the example of market reforms in Russia in the 1990s. The results of the research show that it would be useful to draw the following lessons from the Russian practice of borrowing Western institutions. No matter how promising an imported institution may seem, no matter where it comes from, its transfer will do more harm than good if a country does not have an appropriate institutional environment consisting of formal and informal domestic rules. In addition, it is necessary to exclude any ideological preferences while choosing an institution for import. Differences between orthodox and, so to speak, social liberalism, as a synonym of the SOME concept, should not be taken into account, especially since, in essence, orthodox liberalism is just the first part of this concept. In other words, social liberalism is nothing more than a continuation of orthodox liberalism, where institutions of freedom merge with institutions of justice. After receiving an adjective "social", liberalism becomes not just a complete doctrine but also, and it is especially important in this case, a pragmatic concept that offers the state various (sometimes diametrically opposite) options for economic policy. Under such conditions, the ground for simplistic representations of reality disappears, and certain dilemmas become meaningless: everything should be privatized or nationalized; everything should be regulated or deregulated; freedom or security; efficiency or justice. An only non-alternative imperative here is to find an optimal balance, being another the state's responsibility, which has to meet society's needs.

Theoretical economic studies in Western and Eastern countries has recently recognized the existence of a special public interest that is not limited to interests of private economic entities. In this regard, a new interpretation is given to the participation of a state in the modern economy and the formation of its institutional environment [21, p. 55]. It no longer just intervenes the society's economic life but acts as an equal market player in it, seeking to realize this special irreducible public interest. In other words, there is a real need for a broader view on the formation of market equilibrium that implies the inclusion of a state, seeking to maximize its own function of social utility, in a number of independent market subjects. This is an only approach that ensures the optimization of an institutional environment of modern society and criteria for selecting imported institutions.

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