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ARE THE INSTITUTIONS IMPORTANT FOR THE ECONOMIC GROWTH?

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Abstract

In recent years, comparative economics experienced a revival, with a new focus on comparing capitalist economies. The theme of the new research is that institutions exert a profound influence on economic development.

This literature tries to explain what institutions are, how they arise, what purposes they serve, how they change and how they may be reformed. Special attention is paid on the role that institutions have on the economic growth and the key institutions for that, at the same time giving answer to the ione of the frequently asked question, and that is: Why some countries are rich and others poor.

Key words: institutions, organizations, transition economies, economic development

Institution Development

An institutional story of long run economic change begins by examining the changing initial conditions confronting diverse groups of individuals.

"As tribes evolved in different physical environments they developed different languages and, with different experiences, different mental models to explain the world around them. To the extent that experiences were common to different tribes the mental models provided common explanations. The language and mental models formed the informal constraints that defined the institutional framework of the tribe and were passed down intergenerationally as customs, taboos, myths that provided the continuity that we call culture and forms part of the key to path dependence." (North 1993a, 3)

With growing specialization and division of labor the tribes evolved into polities and economies; the diversity of experiences and learning produced increasingly different societies and civilizations with very different degrees of success in solving the fundamental economic problems of scarcity. The reason for differing success is straightforward. The complexity of the environment increased as human beings became increasingly interdependent, and more complex institutional structures were necessary to capture the potential gains from trade. Such evolution required that the society develop institutions that will permit anonymous, impersonal exchange across time and space. But to the extent that "local experience" had produced diverse mental models and institutions with respect to the gains from such cooperation, the likelihood of creating the necessary institutions to capture the gains from trade of more complex contracting varied. The key to this story is the kind of learning that organizations acquired to survive.

"If the institutional framework made the highest pay-offs for organizations piracy, then organizational success and survival dictated that learning would take the form of being better pirates. If on the other hand productivity raising activities had the highest pay-off then the economy would grow." (North 1993a, 4)

Institutions vis □ vis organizations

When analyzing the economic development, the dynamic of the economic changes has to be taken into account, in order to have the desired consequences. And a dynamic model of economic change entails as an integral part of that model analysis of the polity since it is the polity that specifies and enforces the formal rules.

"Development economists have typically treated the state as either exogenous or as a benign actor in the development process. Neo-classical economists have implicitly assumed that institutions (economic as well as political) don't matter and that the static analysis embodied in allocative-efficiency models should be the guide to policy; that is "getting the prices right" by eliminating exchange and price controls." (North 1993a, 5)

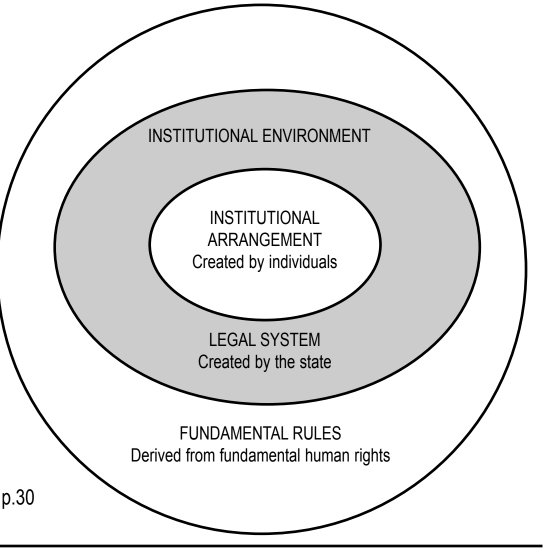
In fact the state can never be treated as an exogenous actor in development policy and getting the prices right only has the desired consequences when you already have in place a set of property rights and enforcement that will then produce the competitive market conditions.

Before going further it is essential to distinguish clearly institutions from organizations.

Institutions are the rules of the game of a society or more formally are the humanly-devised constraints that structure human interaction. They are composed of formal rules (statute law, common law, regulations), informal constraints (conventions, norms of behavior, and self imposed codes of conduct), and the enforcement characteristics of both.

Figure 1.

The Three Levels of Institutions



Source:
Borner, Silvio, Bordner Frank and Kobler Markus,
"Institutional efficiency and its determinants", OECD 2004, p.30

Formal institutions exist on three levels. First, fundamental rules, derived from basic human rights, are normally laid down in a country's constitution. Second, based on the fundamental rules, the legal system contains property and contract laws as well as rules about the structure of the state and the political decision-making process. Among other things, these political institutions define the degree to which a state is democratic or autocratic. The fundamental rules and the legal system together constitute the institutional environment. Third, within this constitutional environment, individuals and organizations enter into contracts or institutional arrangements to coordinate their activities. The three levels of institutions are strongly interdependent. Crucially, the value of an arrangement between two or more individuals or organizations depend decisively on the quality of the institutional environment. "Talk is cheap", but so is a paper contract - unless the quality of the institutional environment renders it "dear". (Borner, Bordner and Kobler 2004, 29)

Informal constraints derive from the culture, the are disseminated from generation to generation by learning and imitation of the knowledge, norms and other things that affect the behavior. They are conventions that solve the everyday problems of coordination: expansion, explanation and modification of the formal rules, social sanctioned norms of behavior and the behavioral standards that have to be obeyed. Because of the slow change, the informal rules do not react on the formal rule change immediately. As a result: the same formal rules and/or the constitution determined in different societies will give quite different results.

Organizations are the players: groups of individuals bound by a common purpose to achieve objectives. They include political bodies (political parties, the senate, a city council, a regulatory agency); economic bodies (firms, trade unions, family farms, cooperatives); social bodies (churches, clubs, athletic associations); and educational bodies (schools, colleges, vocational training centers). The institutional framework affects the appearance and the development of the organizations. The organizational activities that are directed to the goal accomplishment of those organizations change the institutions (formal and informal) and affect their development path.

The essential characteristics of institutional change are:

1. The continuous interaction of institutions and organizations in the economic setting of scarcity and hence competition is the key to institutional change.

2. Competition forces organizations to continually invest in skills and knowledge to survive. The kinds of skills and knowledge individuals and their organizations acquire will shape evolving perceptions about opportunities and hence choices that will incrementally alter institutions.

3. The institutional framework dictates the kinds of skills and knowledge perceived to have the maximum pay-off.

4. Perceptions are derived from the mental constructs of the players.

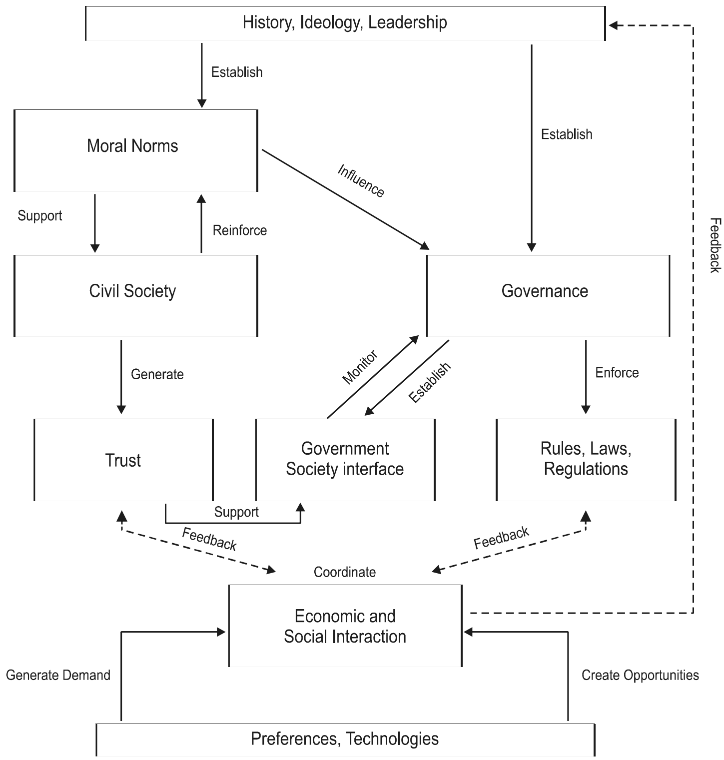
5. The economies of scope, complementarities, and network externalities of an institutional matrix make institutional change overwhelmingly incremental and path dependent.

Formal and informal institutions and institutional reforms

In Figure 2, the various formal and informal institutions are presented in boxes, the formal ones on the right and the informal ones on the left, and their functional interrelationships are represented by arrows. The top and bottom of the figure are taken as largely exogenous. On the top are the history, ideology and leadership as exogenous conditions that determine what particular set of institutions is present in a given society at any one point in time. At the bottom of the figure are the preferences and technologies. These are factors typically considered to be exogenous by economists Technologies and preferences also influence the institutional framework, because they determine the costs and benefits of compliance with a set of formal and informal rules. In the figure preferences and technologies influence institutions only indirectly through the process of social and economic interaction. Note that the feedback arrows to formal and informal institutions are broken, to express the idea of path dependence.

Figure 2.

Formal and informal institutions



Source:
Raiser, Martin, "Informal institutions, social capital and economic transition: reflections on a neglected dimension", EBRD Working Paper 0025, August 1997

The main body of the figure 2. is filled up with six boxes, standing for the broad sets of formal and informal institutions that are to some extent present in all societies. The box at the top left is the set of moral norms. The morality is influenced by ideology and leadership as much as by historical convention. The presence of a specific type of moral norms feeds into the emergence of a civil society, understood as comprising all non-governmental organizations, such as the press, leisure clubs, churches, neighborhood associations and so on. The existence of a working civil society in turn tends to reinforce the moral predispositions of individuals. It also creates "trust" among economic actors, thereby facilitating economic exchange under imperfect information. The sequence of boxes on the left side of Figure 2. represents a stylized model of how "social capital" is accumulated.

On the right hand side of the figure is presented the sequence that leads to an efficient set of formal institutions and a particular form of governance. Again, the form of governance that evolves is partly a result of exogenous factors, as noted above, but it is also influenced by the existing set of moral norms. A society that values honesty, solidarity, modesty, etc. is less likely to end up with a dishonest, predatory and wasteful government than one in which cheating does not meet sanctions, individualism prevails and social prestige is connected with an exuberant display of wealth. The form of governance impacts on the enforcement of a system of laws and regulations that formally structure social interaction and economic exchange. The sixth box is placed in the middle and represents the interface between government and society. What role is accorded to this interface is partly a function of the government's willingness to engage in policy dialogue, but also crucially contingent on the existing level of trust in government institutions. However, it could also take more informal forms, for instance when politicians become active members of social clubs and thus exposed to monitoring by their constituencies. There are strong complementarities between the existing level of trust (or social capital) and the effectiveness of government. When trust in government institutions is low, the pressures on public officials to deliver better governance are weak. Bad governance in turn undermines trust because it generally leads to inferior economic outcomes. As a result the social capital of a society depreciates.

The above model identifies several levels of action in bringing about institutional change. First of all, institutional change is brought about by exogenous shocks, either from the polity (i.e. a change in ideology or political leadership) or from the economic sphere (a change in technologies or preferences). Second, institutional change may occur from inside the institutional framework. Governments can change the formal rules, either in response to an exogenous shock, or in anticipation of future changes, or, less benevolently, in maximizing their own returns from a position of power. Governments can also improve incentives for better governance by public officials, through reducing the scope for policy discretion, increasing job competition and raising public sector pay. Third, governments can attempt to influence positively the interaction between formal and informal institutions by engaging civil society in a policy dialogue. However, this will depend on the given level of trust in government and its formal institutions. When social capital is low, the government's best chance is to enhance its credibility through signaling reform commitment and hoping that real economic improvements will in time feed back into a higher level of social trust (Raiser 1997).

What does this suggest for the challenge of systemic reform faced by the transition economies? There are three possible reform strategies that form the basis for the typology of patterns of institutional change in transition economies to be developed in this paper. One strategy is to emphasize the importance of stability of the formal institutional framework and to change laws and regulations only gradually. The attempt in this strategy is to reform the formal institutional framework in step with changes in informal institutions so as to minimize the potential for friction. However, when exogenous shocks are large, the inefficiencies resulting from failing to rapidly adapt the set of formal rules may outweigh the costs of friction with a more slowly changing set of informal institutions. Institutional stability, which is the aim of this strategy, could be undermined from within, as compliance with formal rules becomes too costly and attempts to budge the law increase. The second strategy, diametrically opposed to the first, is to change the formal institutional framework at one stroke to conform to the fundamental requirements of a new economic system. This strategy wagers that enforcement costs of the new rules will be substantial for quite some time, because they are not matched by a set of self-enforcing informal rules. Both the first and second strategies presuppose the existence of an effective government able either to maintain institutional stability or to implement rapid institutional change. The third strategy accepts the limitations of government, particularly in most transition economies. Institutional design in this strategy is oriented towards political feasibility. This implies that institutional reforms will be more rapid in areas where the costs of adapting to new rules is lower, because of their simplicity, ease of implementation and lower demands on changes in people's behavior. Political economy considerations often force the adoption of the third strategy. However, it runs the danger that institutional reforms remain blocked by powerful insiders or become bogged down in interest group conflict. Arguably, focusing attention on the sociopolitical interface is of particular importance in this third case and varying degrees of success may be attributed to varying degrees of existing social capital.

Institutitional changes (transitions) in the last 30 years

Despite the tendency for institutional persistence, the evidence of the past 30 years suggests that rapid institutional change is possible, helping raise living standards more than was previously thought possible. Several profound changes since the 1950s appear to have significantly improved the potential for institutional improvements. First, the collapse of colonial empires altered an institutional system geared toward the systematic extraction of rents and removed one major beneficiary of that system. Second, rapid technological improvements increased the opportunities for industrialization across a range of sectors and away from rentintensive sectors. Third, globalization afforded hitherto-unavailable economic opportunities against the backdrop of declining transportation and communication costs. Finally, the fall of communism in the late 1980s and early 1990s radically altered the governance structures in many formerly communist nations, taking away another major source of institutional persistence (Table 1.).

The institutional transition can be economic or political. The analysis of recent transitions suggests that economic transitions were often, but not always, proceeded by political transitions (Figure 3.). The transition periods are different in different regions. If we analyze the CEE region we can conclude that the political transitions are more concentrated in the 1990-95 periods, which are basis for the economic transitions in the next period. Big reason for the transitional initiatives is the possibility for the EU entrance, which acquires political and economic transformation of the countries.

Table 1.

Frequency of Institutional Transitions

Political Transitions by Region and Decade[2]

Decades	Africa	Central and Eastern Europe	CIS and Mongolia	Developing Asia	Middle East	Latin America	Newly Industrialized Asian Economyes	Total
1960s	0 (0.00)	0 (0.00)	0 (0.00)	0 (0.00)	0 (0.00)	0 (0.00)	0 (0.00)	0 (0.00)
1970s	0 (0.00)	0 (0.00)	0 (0.00)	0 (0.54)	0 (0.00)	3 (1.30)	0 (0.00)	4 (0.38)
1980s	0 (0.00)	1 (0.63)	0 (0.00)	1 (0.52)	0 (0.00)	8 (3.48)	2 (5.00)	12 (0.89)
1990s	18 (3.77)	12 (7.74)	4 (3.08)	2 (1.00)	1 (0.78)	8 (3.48)	0 (0.00)	45 (3.23)
2000s	1 (0.53)	2 (3.33)	1 (1.92)	1 (1.25)	0 (0.00)	0 (0.00)	1 (5.56)	6 (1.11)
All years	19 (1.00)	15 (2.16)	5 (0.87)	5 (0.61)	1 (0.18)	19 (1.89)	3 (1.70)	67 (1.17)

Economic Transitions by Region and Decade[2]

Decades	Africa	Central and Eastern Europe	CIS and Mongolia	Developing Asia	Middle East	Latin America	Newly Industrialized Asian Economyes	Total
1970s	0 (0.00)	0 (0.00)	0 (0.00)	1 (1.23)	0 (0.00)	0 (0.87)	0 (0.00)	2 (0.45)
1980s	3 (0.97)	0 (0.00)	0 (0.00)	2 (1.48)	3 (4.00)	1 (0.40)	1 (2.50)	10 (1.13)
1990s	10 (3.03)	8 (6.35)	1 (5.00)	3 (2.14)	2 (2.50)	12 (4.80)	1 (2.50)	37 (3.75)
2000s	2 (1.01)	8 (8.33)	2 (11.11)	0 (0.00)	0 (0.00)	4 (2.67)	0 (0.00)	16 (2.59)
All years	15 (1.53)	16 (4.75)	3 (4.41)	6 (1.33)	5 (2.15)	18 (2.35)	2 (1.39)	65 (2.18)

Sources: Marshall and Jaggers (2003); Gwartney and Lawson (2004); and IMF staff calculations.

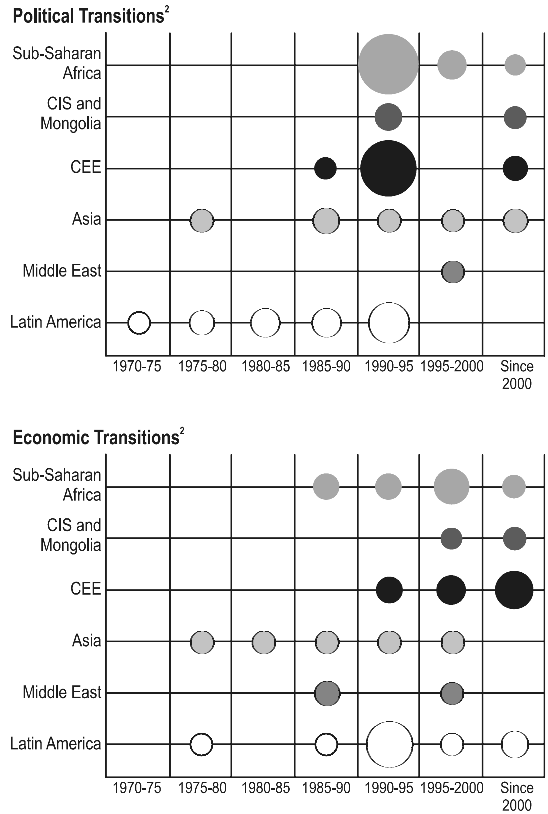
Most countries of the Commonwealth of Independent States (CIS) were generally slower to transition in terms of economic institutions, even when large changes in political institutions took place relatively early. Transitions to more representative political systems across many countries in Africa after the end of the Cold War also led to significant changes in economic institutions in some countries. In Latin America, too, political transitions generally preceded economic transitions, but they often followed major economic crises.

From the perspective of what policies can do to improve institutions, it is of interest to analyze those developing countries that have experienced rapid institutional transitions.

Figure 3.

Number of Institutional Transitions by Region

(Size of bubble represents the number of transitions over five-year intervals)



Sources:
Gwartney and Lawson (2004); Marshall and Jaggers (2003); and IMF staff calculations.

1 Only developing economies are included except for Asia, which also includes any transitions in the newly industrialized economies.

2 In some countries, transitions cannot be identified owing to the limited availability of data.

Are institutional transitions frequent or rare?

The exercise identified political transitions in 67 countries, and economic transitions in 65 countries (Table 1.). At a broad level, a country would have had about a 20 percent chance of experiencing an institutional transition in any given decade. To undertake a more in-depth analysis, a probit model was estimated linking the probability of an institutional transition to the country's level of openness, accountability, education, natural resources, developments in neighboring countries, foreign aid, and other potential explanatory factors. Several conclusions are relatively robust to various specifications (World Economic Outlook 2005, 138) :

◆ *Trade openness is significantly associated with a greater likelihood of institutional transitions.* Indeed, a move from complete autarky to full liberalization is associated with about a 15 percentage point increase in the probability of transition. This is consistent with the hypothesis that greater openness allows for a greater role of export sectors that are rent-proof and require innovation, and creates momentum for positive institutional changes. In addition, increased import penetration reduces the ability of domestic producers to sustain monopolistic rents, which impede institutional improvement.

◆ *Transitions are also more likely in countries with high levels of press freedom, which is a broad indicator of the accountability of political institutions in a country.* Greater accountability of political institutions is associated with policies and institutional reforms that are beneficial for the broader economy, with the political leadership answerable to a broad cross-section of the population, which favorably aligns the incentives of the leadership with that of the whole economy.

◆ *Countries are also more likely to experience institutional improvements if their neighbors have higher institutional quality.* This is consistent with the view that a strong regional effect is present for institutional transitions-economic transitions are more likely to happen in clusters of countries within a region around the same time. This is reflective of both the direct impact on institutional improvements in countries that are close competitors and the demonstration effects of regional success stories.

◆ *The probability of economic transitions is also higher for higher levels of education.* This is consistent with the notion that more educated populations are more effective participants in broader decision making.

◆ *In contrast, aid levels in the probit estimates appear to have a negative impact on the probability of transition to a higher institutional level.* This may, of course, reflect the fact that countries receiving higher aid flows are those that suffer from a broader set of disadvantageous initial conditions, impeding their likelihood of experiencing an institutional transition. A more detailed discussion of the impact of aid is contained in the section of this chapter on "Institutions and the External Environment." In addition, higher initial per capita income has a negative impact on the probability of transitions, consistent with the observation that countries with a higher per capita income in the sample typically already had a high level of institutions at the beginning of the sample period. Somewhat surprisingly, the impact of fuel exports is not found to be statistically significant in affecting the probability of transition in economic institutions.

Debates about the role of the institutions on the economic growth

A great deal of economic research in recent years suggests that institutions are vital for economic development and growth. Typically, economists have looked at the level of economic development, as measured by per capita GDP, and have found that differences in per capita incomes are closely related to differences in the quality of institutions.

How strong is the relation between the institutional quality and the economic performances?

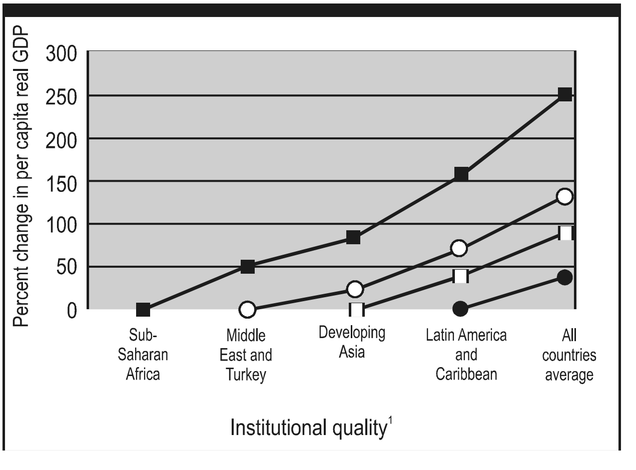
Hali Edison gives an answer to this question by studying the relation between the institutions and the level of economic development, growth, and volatility of growth. Studies show that the institutions have an important influence on the economic performances, substantially increasing the level of the per capita GDP. Empirical evidence can be seen from figure 4.

Figure 4.

Impact on income

Source:
Edison, Hali, "Testing the Links-How strong are the links between institutional quality and economic performance?",

Finance and development, IMF, Washington DC, June 2003, p. 35



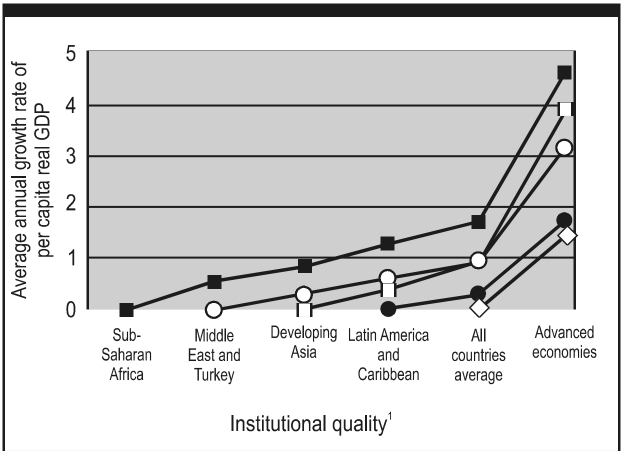
The studies show that the economic results can improve significantly if the developing countries strengthen the quality of their institutions. For an example, the potential benefits to sub-Saharan Africa continue to rise markedly as its institutions improve. There is a 2!/2-fold increase in regional income if sub-Saharan Africa's institutions are strengthened to the all-country average; the income gain is much larger if institutional quality rises to the level of advanced economies (Edison 2003, 35).

Figure 5.

Impact on growth

Source:
Edison, Hali, "Testing the Links-How strong are the links between institutional quality and economic performance?",

Finance and development, IMF, Washington DC, June 2003, p. 36



The institutions also have a strong and significant impact on per capita GDP growth. This impact may partly reflect the role of institutions in enhancing the sustainability of policies. The implications of institutional improvements for growth across different regions are illustrated in Figure 5. Again, the empirical results suggest substantial gains. For instance, annual growth in per capita GDP in sub-Saharan Africa would increase by 1.7 percentage points if countries there had institutions as good as the average quality for the entire sample. Countries from other regions would also gain from adopting higher-quality institutions, as shown in the figure.

The results also indicate that institutions have a strong effect on volatility (measured as the standard deviation of the growth rate of per capita GDP): the better the institutions, the lower the volatility of growth. In addition, the impact of institutions appears to be significant even when policy measures such as differences in inflation, exchange rate overvaluation, openness, and government deficits are controlled for.

Tremendous differences in incomes and standards of living exist today between the rich and the poor countries of the world. The two main candidates to explain the fundamental causes of differences in prosperity between countries are geography and institutions. The geography hypothesis, which has a large following both in the popular imagination and in academia, maintains that the geography, climate, and ecology of a society shape both its technology and the incentives of its inhabitants. It emphasizes forces of nature as a primary factor in the poverty of nations. The alternative, the institutions hypothesis, is about human influences. According to this view, some societies have good institutions that encourage investment in machinery, human capital, and better technologies, and, consequently, these countries achieve economic prosperity (Acemoglu 2003, 27). There is also a third hypothesis, integration view, that emphasizes the role of international trade as a driver of productivity change and income growth (Rodrik and Subramanian 2003, 31).

If geography is the key factor determining the economic potential of an area or a country, the places that were rich before the arrival of the Europeans should have remained rich after the colonization experience and, in fact, should still be rich today. In other words, since the key determinant of prosperity remains the same, we should see a high degree of persistence in economic outcomes. If, on the other hand, it is institutions that are central, then those places where good institutions were introduced or developed should be richer than those in which Europeans introduced or maintained extractive institutions to plunder resources or exploit the non-European population (Acemoglu 2003, 30). If institutions are so important for economic prosperity, why do some societies choose or end up with bad institutions? Moreover, why do these bad institutions persist long after their disastrous consequences are apparent? Is it an accident of history or the result of misconceptions or mistakes by societies or their policymakers? Recent empirical and theoretical research suggests that the answer is no: there are no compelling reasons to think that societies will naturally gravitate toward good institutions. Institutions not only affect the economic prospects of nations but are also central to the distribution of income among individuals and groups in society- in other words, institutions not only affect the size of the social pie, but also how it is distributed.

Meltzer believes that certain conditions encourage stability and growth. "Not all market economies prosper," he says. "The difference between countries or periods depends greatly on the presence or absence of internal and external institutions that produce stability and the willingness of countries to join the international system and make the internal reforms that permit the market to function well. Accepting the rule of law, fiscal discipline, openness to trade, and private property are key elements." (Meltzer 2003, 8)

"What fosters growth, is no longer a secret because we have run the experiment and we've seen what happens. Why was it true that Cantonese who moved to Hong Kong-then a British colony-were, by the mid-1990s, 30 times richer than the people in China that they left behind? The answer has very little to do with the people who moved and a lot to do with the institutions that they came to. In Hong Kong, they came under British institutions that had protection of property rights, the rule of law, and all that. Even though they did not have democratic accountability, they had a very effective, humane government operating under British rules and institutions. And growth occurred without very many resources, including the fact that they had to buy their water from the land that they had left. It is a tremendously dramatic story of how institutions make so much difference in world development." (Meltzer 2003, 8)

The key institutions for economic growth

As it was shown there exist a number of debates and hypothesis about the primacy and the role of the institutions for the economic development in one country, and why some countries are rich, and others poor.

Most of the recent work on institutions and economic growth has focused on the importance of a particular set of institutions, namely, those that protect property rights and ensure that contracts are enforced. We might call them market-creating institutions since, in their absence, markets either do not exist or perform very poorly. But long-run economic development requires more than just a boost to investment and entrepreneurship. It also requires effort to build three other types of institutions to sustain the growth momentum, build resilience to shocks, and facilitate socially acceptable burden sharing in response to such shocks. The market-creating institutions are important because they deal with the property rights which boost the investments in machines, human capital and technology.

◆ *market regulating* - namely, those that deal with externalities, economies of scale, and imperfect information. Examples include regulatory agencies in telecommunications, transport, and financial services. The market imperfection allows existence of the natural and commercial monopolies, positive and negative externalities, asymmetric information etc, so the state regulating (interference) is needed, so that the negative impact of these will be eliminated.

◆ market stabilizing-namely, those that ensure low inflation, minimize macroeconomic volatility, and avert financial crises. Examples include central banks, exchange rate regimes, and budgetary and fiscal rules. These institutions allow the economy to function on the potential GDP, because only that is the path to the economic growth without the negative consequences of the inflation or the recession to be felt. Part of this group of institutions are those that have to deal with the financial crises, that should extract the country from the crises with as much as possible lower costs and negative impact on the economy.

◆ market legitimizing-namely, those that provide social protection and insurance, involve redistribution, and manage conflict. Examples include pension systems, unemployment insurance schemes, and other social funds. In order to achieve social welfare and reduce the border between the rich and poor, fair distribution of the income should be made with the instruments of the tax policy, also with the social transfers. The social funds, pension and health funds, in a great dimension affect the living quality of the people, which from the other hand affects the economic growth of the country, because healthier population and the one that has assured future existence in the older years is in a great deal more productive then the one that is not healthy and has no insurance in its future.

Republic of Macedonia's Reality

Let us focus a little bit on the reality of the Macedonian economy. How is the situation in Macedonia when speaking about the institutions? This can be seen and felt through the conditions that exist in our business environment. The business environment is a mirror of the good functioning of the institutions. The quality of the institutions reflect the business environment, so by analyzing it we can give a little resume on the institution quality in our economy.

The latest Doing Business 2008 report of the World Bank gives detailed information on the situation in Republic of Macedonia. As can be seen from the Table 2. our economy is listed on the 75 place out of 178 countries. The situation related to different topics is as shown below.

Table 2. Doing Business: Republic of Macedonia

Ease of…	Doing Business 2008 rank	Doing Business 2007 rank	Change in rank
Doing Business	75	..	..
Starting a Business	21	82	+61
Dealing with Licenses	76	102	+26
Employing Workers	128	127	-1
Registering Property	91	88	-3
Getting Credit	48	45	-3
Protecting Investors	83	81	-2
Paying Taxes	99	104	+5
Trading Across Borders	72	98	+26
Enforcing Contracts	84	83	-1
Closing a Business	127	127	0

Source: The World Bank, Doing Business 2008 report, Washington D.C., 2007

As we can see we have great improvements in doing business in the Macedonian environment. Out of 175 countries in the year of 2006 Macedonia was ranked on the 92 place and the latest information show that now Macedonia is ranked on the 75 place out of 178 countries. Great improvements are made in the sphere of starting business, dealing with licenses and trading across borders. We still have negative results on the field of registering property, enforcing contracts and closing business. Why do I stress these ones? It is because the good functioning of the institutions is strongly related with good protected property rights and contract enforcement.

Republic of Macedonia is ranked among the top reformers in 2006/2007. Economies are ranked on the number and impact of reforms. First, Doing Business selects the economies that reformed in 3 or more of the Doing Business topics. Second, it ranks these economies on the increase in rank on the ease of doing business from the previous year. The larger the improvement, the higher the ranking as a reformer.

Figure 6. The top 10 reformers in 2006/07

Economy	Starting a business	Dealing with licenses	Employing workers	Registering property	Getting credit	Protecting investors	Paying taxes	Trading across borders	Enforcing contracts	Closing a business
Egypt	✓	✓		✓	✓			✓		
Croatia	✓			✓	✓					✓
Ghana	✓			✓	✓			✓	✓	
Macedonia, FYR	✓	✓					✓			
Georgia	✓	✓		✓	✓	✓				✓
Colombia						✓	✓	✓		
Saudi Arabia	✓	✓			✓			✓		
Kanya	✓	✓		✓	✓					
China		✓			✓					✓
Bulgaria		✓					✓		✓	

Source: The World Bank, Doing Business 2008 report, Washington D.C., 2007

Republic of Macedonia has made 3 reforms out of 10 in the Doing Business area. The number of steps that the entrepreneur has to under taken to start a business is reduced from 10 to 9 compared with last years' results. Also the number of days needed for this procedure is reduced from 18 to 15 days. Also the minimum capital required to start a business is grounded to zero compared with 112% of GNI per capita in the year 2006 (GNI per capita in 2007 is 3,060.00 $). There are a significant improvements made in the sphere of dealing with licenses where the number of days needed for obtaining necessary licenses and permits, completing required notifications and inspections, and obtaining utility connections to build a warehouse are significantly reduced from 222 in the year 2006 to 192 in the year 2007. Macedonian economy has also positive results in reducing the number of documents and the time for trading across borders, it is export and import. Comparing with the data from the previous analyzes where the number of document was 10, with a time for export and import, 32 and 35 (respectively), this years data show that the exporters or importers now need to fulfill no more than 7 procedures and no more than 19 and 17 days time for ending the delivery of the shipment.

A lot of reforms still have to be done, but if Macedonia continues on this path of reforms we can expect a better economic performances and higher economic development in the days to come.

And at the end let us make a little resume on how the institutions have an impact on the economic development of a country. If you reduce the transaction costs in the economy, then more money can be used for other goals, starting from additional economic activity or if you want and savings. These lead to a higher economic activity in the economy as a whole, also higher investments although usage of the unemployed resources in the economy, and turning the actual GDP toward the potential GDP, a state that is most preferable for each economy. On the other hand if you have an environment where the contracts are fulfilled and where the property rights are respected, then that environment is a good basis for an investments (domestic or foreign), which on the other hand have also a positive impact on the economic growth and development of a country too.

As it can be seen the institutions really do matter and are important, and that's why building of a good and quality institutional environment can be of a great importance for one countries successful future.

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