

INSTITUTIONAL REFORMS IN THE CONTEXT OF MARKET TRANSFORMATION: THE GENERAL AND THE PARTICULAR

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UDC 330.341.2

Mikolenko O. P. Institutional Reforms in the Context of Market Transformation: the General and the Particular

The article is aimed to develop a theory of institutional reforms, to study their role and relevance at different stages of development of the market mechanism. Based on an analysis of institutional dynamics of industrial transformation of the post-socialist countries in the cases of Russia, Ukraine, Georgia and Poland, three stages was identified and some regularities of institutional changes at each of them was allocated. At the first stage reforms and new institutional forms originate only in the interior of the old system; they serve as complementary elements of the base elements. At the second stage, institutional reforms are transformed into a factor of degradation of the old and origination of the new system, while the pure institutional balance is dislocated. The third phase is associated with establishment and institutionalization of the integral market mechanism. At the present stage the economic system of Ukraine is characterized by institutional incompleteness and fragmentarity of the complex institutions. Formation of a unified market mechanism makes the importance of the institutional reforms that are transforming and shaping a versatile tool and, at the same time, a major component of the relationship between institutionalization and improving of adaptability and competitiveness of the national economy.

Key words: institutional reforms, market mechanism, State institutions, system transformation.

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Миколенко О. П. Інституційні реформи в умовах ринкової трансформації: загальне та особливе

Метою статті є розвиток теорії інституційних реформ, дослідження їх ролі та значимості на різних етапах формування ринкового механізму. Аналіз інституційної динаміки індустріальної трансформації постсоціалістичних країн на прикладі Росії, України, Грузії та Польщі дозволив виділити три етапи і виявити деякі закономірності інституційних перетворень на кожному з них. На першому етапі реформи і нові інституційні форми зароджуються тільки на підвалинах старої системи; вони виступають комплементарними елементами базисних. На другому етапі інституційні реформи перетворюються на чинник деструкції старої системи і зародження нової, порушується чиста інституційна рівновага. Третій етап пов'язаний з формуванням та інституціоналізацією цілісного ринкового механізму. На сучасному етапі економічна система України характеризується інституційною недобудовою і фрагментарністю складних інститутів. Формування цілісного ринкового механізму актуалізує значимість інституційних реформ, які виступають універсальним інструментом трансформації та формоутворення і водночас – головним компонентом механізму взаємозв'язку між інституціоналізацією і підвищенням адаптивності та конкурентоспроможності національної економіки.

Ключові слова: інституційні реформи, ринковий механізм, державні інститути, системна трансформація.

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Миколенко Е. П. Институциональные реформы в условиях рыночной трансформации: общее и особенное

Целью статьи является развитие теории институциональных реформ, исследование их роли и значимости на разных этапах формирования рыночного механизма. Анализ институциональной динамики индустриальной трансформации постсоциалистических стран на примере России, Украины, Грузии и Польши позволил выделить три этапа и выявить некоторые закономерности институциональных преобразований на каждом из них. На первом этапе реформы и новые институциональные формы зарождаются только в недрах старой системы; они выступают комплементарными элементами базисных. На втором этапе институциональные реформы превращаются в фактор деструкции старой системы и зарождения новой, нарушается чистое институциональное равновесие. Третий этап связан с формированием и институционализацией целостного рыночного механизма. На современном этапе экономическая система Украины характеризуется институциональной недостроенностью и фрагментарностью сложных институтов. Формирование целостного рыночного механизма актуализирует значимость институциональных реформ, которые выступают універсальным інструментом трансформації та формоутворення і в то же время – главным компонентом механизма взаимосвязи между институционализацией и повышением адаптивности и конкурентоспособности национальной экономики.

Ключевые слова: институциональные реформы, рыночный механизм, государственные институты, системная трансформация.

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Globalization processes and the transition of post-socialist countries from a centrally controlled to a market economy have facilitated the emergence of a new unexplored phenomena and processes that require understanding and identifying the systemic transformation laws and regularities. The post-socialist transformation is connected with two types of intra and inter-system transition; it is characterized by disequilibrium and uncertainty in any sphere of life: «The destruction of the system struc-

tural integrity, the gain of equilibrium and the miss of conjugation in the industrial, financial, social and institutional mechanisms take place» [1, p. 54]. A positive sense in the destructive processes is the emergence of free energy and material that become a foundation for new system creation. During the transition, the role of institutions and institutional structures that accumulate transformational potential rises. «The system in transition is more institutional than functional» – O. L. Yaremenko points out [2, p. 46].

According to the standpoint of economic synergy: «Institutional changes of transforming socio-economic systems are defined as a complex process of systemic interactions resulting in a motion of institutional system to the bifurcation point and existence of several possible ways of its development» [1, p. 50]. In this case, the uncertainty and alternative development of non-equilibrium institutional system does not mean the planned improvement of its qualitative characteristics, and the results of institutional reforms in post-socialist countries are the proof.

There is a considerable interest in the works of such foreign authors: L. Balcerowicz, J. Kornai, J. Marangos, G. Roland, J. McMillan, B. Naughton, O. Blanchard, M. Kremer, V. Polterovich, V. Papava and others. Market transformation processes in Ukraine are considered in the works of A. A. Griksenko, O. L. Yaremko, V. M. Geyets, V. M. Sobolev, V. P. Reshetylo and others.

The *purpose* of this article is the development of the institutional reforms theory and the study of their role at different stages of market transformation.

The term «reform» is regarded to be a one of the transformation tool. «This is a targeted change of institutions that bases on the consideration that there are economic agents, who develop and implement a transformation plan» [3, p. 9]. There are several models of transition to a market economy: Central and Eastern European as well as Chinese, based on «shock therapy» («big bang») and gradualism (evolution). Despite the supportive arguments of the reforming «big bang» – achieving critical level of the private sector during privatization process, increasing its efficiency [4], decreasing the risk of resisting [5] – «shock therapy» has had the most unpredictable and profound implications for society.

Systematic and comprehensive reforms under the influence of external information (due to the increasing degree of openness) and internal factors (resource, technological, institutional constraints) made it impossible to perform the reforming even at the early stages. Reformers didn't take into account the special characteristics of transition economy. The behavior of transforming system near bifurcation points becomes more complicated because of increased chance factors that generate additional risks, uncertainties and transformation costs for degrading and collapsing system. Actually reforms were not carried out anywhere fast, lower than the pace of liberalization, and have become a tool of planned and forced institutional forming.

«The market economy is always institutionalized ... effective market activity out of more or less mature and integrated system of institutions is simply impossible» [2, p. 79]. If the coordinating market mechanisms are not created or don't work, the economic performance of stronger functioning is realized through strengthened state regulation only. Therefore it resulted in primacy principle of institutional reforms, but this principle is not the same at different stages of institutionalization. The analysis of the industrial transformation dynamics of the post-socialist countries – Poland, Georgia, Russia, and Ukraine – allows dividing it into three stages (the countries has been selected on the basis of the similarity of transition processes).

The *first stage* is pre-institutional. Reforms and new institutional forms at this stage are generated only within the old system; they act as complementary to the basic elements. Often, they are entrusted with functions that are not inherent for them in market economy. Thus, the stock exchanges acted as intermediaries of the primary share sales of privatizing companies for a long time, although classically stock exchange provides a secondary securities circulation. In general, institutionalization at this stage is characterized by internal system inertia, connected with interweaving of transformational potential with the initial conditions: 1) social, institutional and cultural; 2) macroeconomic factors and structural imbalances of the economy. The effects of the influence of initial conditions on potential institutional changes are studied in works [6, 7]; it is concluded that the more imbalances are materialized in sectorial structure and foreign trade in fixed assets the hardest to overcome it [8, p. 11]. The similar devastating phenomenon was «disorganization effect» [9]. Georgia and Ukraine inherited the greatest disparity in the economy (over 50% of GDP) in contrast to Poland; Russia – 39%. 3) Efficiency of state institutions. The economic reforms required an active participation of state institutions that had the most effectively organized structure in Poland, the least – in Russia and Ukraine during the reform. Its complete absence in Georgia determined the failure to fulfill eight of the eleven-point «Balcerowicz plan» [10, p. 28 – 30]. The role of the state at the first stages of market transformation couldn't be limited by its deregulation due to its legislative function of building the institutional frameworks. The sharp decline in government revenues and expenditures, particular for «ordinary government», had weakened the financial strength of the states, destroyed the basic public institutions that caused a deep drop in production [8, p. 15], illustrated by the data in *fig. 1*.

The importance of the state in the transition period just only rises, because the reduction in the efficiency of the basic state institutions made its levers incapable to maintain law and order, counter crime, and provide the conditions for establishments of market mechanism. In addition, due to the active liberalization processes the freedom of choice has become the problem of adaptability, flexibility and responsibility for the majority. It triggers the institutional conflict in society because of the state paternalism traditions. E. Gurvich in his study of economic freedom comes to the conclusions that the effect of economic freedom is limited, and this effect is not a linear [11, p. 45]. For the post-socialist countries the relationship has «threshold» form: the elimination of the most significant barriers and constraints of emerging markets only results in increase of economic efficiency.

The *second stage* is formal institutionalization. The institutional reforms are considered to be catalysts of old system destruction and facilitate the emergence of new system; therefore the net institutional balance is been broken. The main initiator of the reform is the state in the form of personalized structures. Rationally selected effective institutional patterns trigger the institutional changes. Y. Pakhomov says that the states achieve the success when they consciously, purposefully adapt only some elements of western institutions to their own civilizational conditions, but not a complete western institutional system [13]. «A more

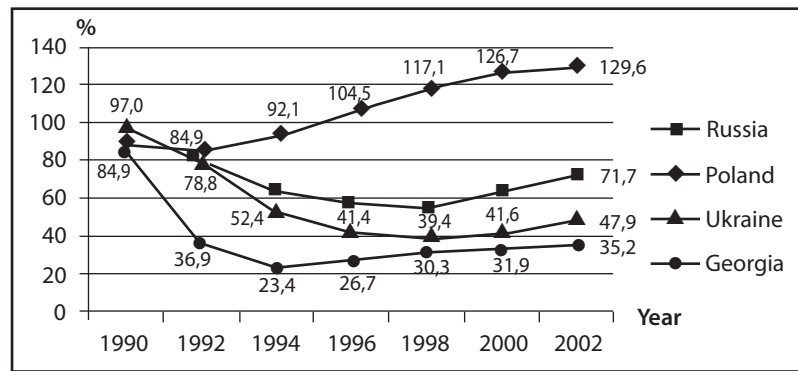


Fig. 1. Real GDP changes in the analyzed countries (1989 = 100%)

Source: compiled by the author on the basis of data [12].

sophisticated strategy suggests transplant modification in order to facilitate its adaptation to a new environment» [14, p. 36]. An experimental implementation allows starting the process of spontaneous evolution as a result of horizontal competition. In the transformational economy the competition is likely to be between economic actors, who offer a variety of institutions, than between institutions themselves.

The closer system to its integrity, the more developed elements are been introduced, and the lower transaction costs all economic actors bear [15, p. 173]. Excessive institutionalization of transition economy just only raises these costs. The transforming system is been broken down into simple institutional forms that creates higher institutional risks as a result of the implementation of complex institutions. «The more complex institutions – the greater potential for opportunistic behavior, when one actor uses institution to detriment and against the interests of their counterparties» [16, p. 21]. Institutional environment, which doesn't have tools and mechanisms to prevent the negative consequences (speculation, fraud), is not capable to organize it quickly.

Having considered that institutional reforms at this stage is been transformed into destruction factors of the command economy institutional framework, the system is been deepened with informal institutions that quite rapidly fill the emerging institutional vacuum. More often the deformed formations appear on their roots, which create additional high risks; and its underestimation leads to great social and economic negative consequences. The most common forms are institutional pits, gaps, voids, hinges and other deformations [17, c. 819]. Institutional pit occurs if mechanisms of institutional changes are absent; institutional voids are the result of institutional uncompleted buildings. Institutional conflict arises from the apparent distinguishes between institutional conditions of donor and recipient [14, c. 32]. One of the forms of such conflict, which exists in Russia and Ukraine in the system of corporate governance, is a joint-stock company as an instrument of struggle for the available capital and property, but not the joint of private capital for major investment projects. Deformalization (atrophy) or distortion of the functional role of a new rule is the result of its adapting to the narrow interests of certain pressure groups. Institute in this case is a legitimate basis for the implementation of informally rooted business practices. For example, the bankruptcy law in Russia and Ukraine (1992)

launched the bankruptcy procedure to the enterprises that actually were far from unprofitability, and became the legal basis for its capture by local authorities. [18] Institutional hinges are likely to appear due to non-compliance of entrusted institutions' functions and those economic processes they (institutions) have to ensure that results in a permanent extinction of the processes themselves. Having regarded the analysis of the stock market institutionalization conducted by S. Arhiereev and Y. Zinchenko, the existing institutional hinge between the stock market formations, particularly its classical function and the development of joint-stock company is identified [19].

Partial apply to the implemented institutions leads to a mixed institutional equilibrium of the system. For example, if the rules got from the «top» are not adapted or tested for a complementarity from the «below», they trigger mechanisms of institutional gaps. Negative complementary reforms lead to the formation of a new system of incapacitated market institutions. In countries with developed market economies, the protection of private property rights and contract enforcement are regarded to be governed by a decentralized market mechanisms, which are absent in almost all analysed countries at the first stages of reforming. «Relational» networks that are based on personalized, long-term relations and contracts with contractors become an alternative of appealing to the courts [20].

The *third stage* is a real institutionalization of the immature market economy (Russia, Ukraine, Georgia), and the institutionalization of the mature economy (Poland), which is connected with the formation of an integral institutional market mechanism. In all analysed countries the transition period is likely to be completed, that does not preclude the continuous transformation processes, which have become an objective reality. The core of the current processes is professional corporate institutions [2, p. 35].

A mature market is been self-regulated and self-organized when a system of economic governance is based both on market and state (bureaucratic) coordination leverages [21, p. 37]. It encompasses the state management and civil service. Institutional reforms have the great significance in the resumption of the lost active subjective foundations, the distribution and professionalization of risks, reducing the role of random processes. In our days a subjective component of the transformation processes belongs to the bureau-

cracy as a system of government, so the development of the system depends on the quality of state institutions. There are specific regulatory models, that are dependent on participation and diversity of state functions, which combine both administrative and market leverages [22, p. 4].

During the period of reforming the bureaucracy becomes dangerous if it hinders the economic and social progress and appropriate institutional reforms [2, p. 39]. There is the annual World Bank project «Worldwide Governance Indicator» (WGI) that reports individual governance indicators for six dimensions of governance (-2,5 to 2,5 with higher values corresponding to better governance): voice and accountability (VA), political stability and absence of violence (PS), government effectiveness (GE) – quality of public services and civil service, the quality of regulatory quality (RQ) – sound policies and regulations that permit and promote private sector development, rule of law (RL), control of corruption (CC). Fig. 2 shows the institutional profiles of the state governance in the analysed countries.

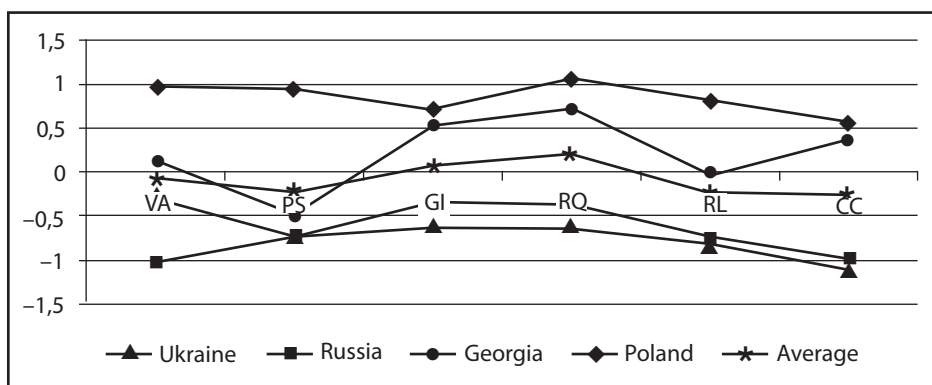


Fig. 2. Institutional profile efficiency of state governance in 2013

Source: compiled by the author on the basis of data [23].

Having considered this analysis we can come to conclusion that there is no institutional resources that would contribute more effective reform in Ukraine, on the contrary, any changes are more likely to be blocked by bureaucratic structures, especially the negative trend is noted at the level of the rule of law and control of corruption. This creates the effect of «vicious circle»: the more corruption is prevalent among the government officials the less opportunity to strengthen market institutions and competitive mechanisms left [24, p. 11]. Institutional reforms actualize the measures to improve the professionalization of the state apparatus, limit the negative impacts of corruption and its reproduction, particular in terms of the quality of contract enforcement, property rights, police and courts, as well as the level of crime. If the courts have relatively greater independence and better protected rights the conditions for intensive growth in these countries are better provided [25]. This aspect is actual of value for Ukraine and Russia because the countries are covered with the most destructive kind of corruption at the national level in the form of dualistic monopoly so much so that made the state absolutely dependent from oligarchic structures. Georgia has the contradictory experience to make the attempt to curb the corruption during the reforming. In the post-reform period a number of actions to mitigate the parliamentary power and economic

crime were undertaken that qualitatively improved business environment. At the same time together with significant achievements in curbing of massive corruption more sophisticated elite of its form have been organized. So, there has been a practice of business «voluntary donations» to the off-budget accounts since 2001 [26, p. 9]. The distorted re-privatization has been carried out, which results in a redistribution of private property in a favor of closest to government business. Gross violations of law have been marked in the privatization process after 2004.

Conclusions. The economic system of Ukraine at the present stage is characterized by institutional fragmentation and filled with unfinished complex institutions. The forming of the integral market mechanism actualizes the importance of institutional reforms that are regarded to be a universal tool of transformation and institutional forming, at the same time, a major component of the relationship mechanism between institutionalization, adaptability and competitiveness of the national economy. ■

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