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Evaluation of Institutions in Innovation-Driven Economies

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Abstract

The aim of the paper is to quantitatively evaluate the quality of institutions in innovation-driven economies. We define institutions as socially approved behaviour models that restrict the rationality of an individual and constrain or encourage specific behaviour. We classify institutions into two groups - governance institutions and value institutions. The analysis confirms that the leaders regarding the quality of institutions are the Nordic countries, Western European countries, as well as Canada, USA and Australia and the laggards - Southern, Central and Eastern European countries. Thus low quality of institutions might impede the economic convergence. Results of the research can be applied to global development policies and regional development policies for geo-political regions, e.g. the European Union.

Keywords: institutions, governance, values, economic development

Introduction

There is a wide discussion on the causes of differences in economic performance around the world. Institutional economics argue that institutions are the fundamental cause of differences in socioeconomic development. Institutions are defined as “the rules of the game in society” ,“the humanly devised constraints that shape human interaction” (North 1990), the “non-technologically determined constraints that influence social interaction and provide incentives to maintain regularities and behaviour” and “are complemented by self-enforcing constraints generated through interactions within these rules” (Greif 1998) as well as the social infrastructure that determines the economic environment within which individuals accumulate skills, and firms accumulate capital and produce output (Hall and Jones 1999).

Following the theoretical assumptions of new institutional economics, the aim of the paper is to propose and implement a methodology for quantitative evaluation of institutions. Detailed evaluations of institutions are especially important for relatively new democracies and developing countries that are transposing not only legislation, but also values and norms that are crucial for a smooth operation of a market economy.

In order to evaluate the quality of institutions, we define institutions as socially approved behaviour models that restrict the rationality of an individual and constrain or encourage specific behaviour. We also classify institutions into two groups - governance institutions and value institutions. Moreover, we assume that high quality institutions encourage an efficient use of limited production resources in order to fulfil the needs of society. The method of the study is descriptive statistics.

Methodology of Research

The evaluation method employs Institution Index which includes Governance and Values subindexes. To measure the quality of governance we used the World Bank Worldwide Governance Indicators: regulatory quality, corruption control, voice and accountability and government effectiveness. To measure values we used results from the World Value Survey – the post-materialism and individualism indexes, as well as indicators developed by the authors using Likert scale and the answers to questions about general trust and responsibility of state versus individual that characterises the level of self-initiative.

Analysis covers all 33 countries with innovation-driven economy and countries in the transition stage to this category; the classification of countries is based on the methodology used in the World Competitiveness Reports produced by the World Economic Forum. Indexes are based on a 100 point scale where the best performing territory is assigned maximal (100) points and the points of other territories reflect their ratio to the best performing territory. We used 10-year (2000-2011) average indicators from the World Development Indicators data base and World Governance Indicators data base, and the average indicators from World Value Survey rounds in 1999-2002 and 2005-2008.

Findings/Results

The Institution Index Matrix shows that the leaders regarding the quality of institutions (I quadrant) are the Nordic countries, Western European countries, as well as Canada, USA and Australia. In these countries the quality of governance and value institutions is higher than average. The best results characterize Switzerland, Denmark and Canada. The II quadrant shows countries with higher than average quality of governance institutions but lower than average quality of value institutions – these are Great Britain, Belgium and Spain. The III quadrant shows the "laggard" countries with lower than average quality of governance and value institutions – mostly Southern, Central and Eastern European countries. The worst results characterize Latvia, Poland and Slovak Republic. Last but not least, the IV quadrant includes countries with lower than average quality of governance institutions but higher than average quality of value institutions. Only Czech Republic is located in this quadrant (Fig. 1).

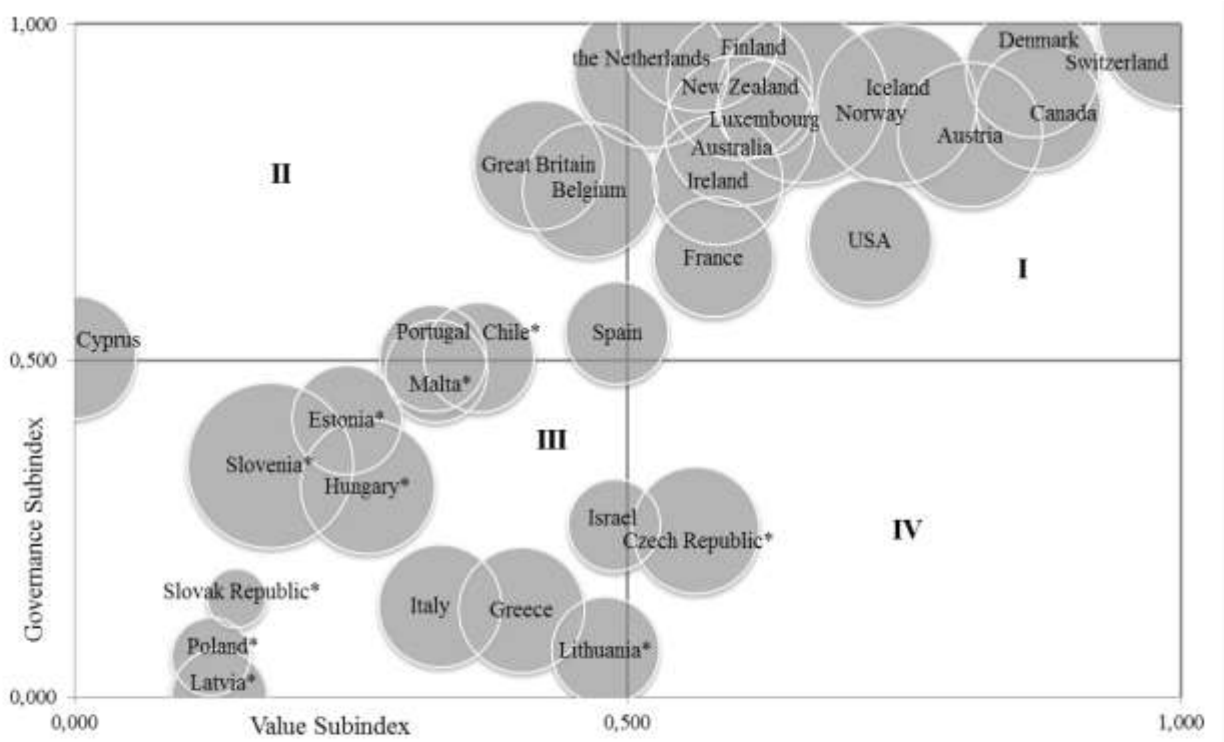

Figure 1. The quality of institutions in countries with innovation-driven economies and countries in transition stage to this category (*); size of the bubble illustrates GDP per capita

Conclusions

Results of the analysis confirms that institutional evaluations are indeed important for relatively new democracies and developing countries, because these countries show lower institutional quality compared to their counterparts in the same geopolitical regions and even compared to countries with a similar income level. Thus low quality of institutions might impede the economic convergence.

Results of the research can be applied to global development policies for less developed countries, as well as regional development policies for geo-political regions, e.g. the European Union by designing public policies to increase the quality of institutions consequently creating preconditions for further socioeconomic growth.

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