Underestimating Institutions?

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Abstract

The article examines the significance of institutional quality for economic performance during transition. Institutions are the rules of the game. In any economy the most important institutions are the legal system and its quality, the state, the structure of the financial system and the system of international relations. The process of economic transition was mainly a process of massive institutional changes which were spurred by economic causes and also themselves had significant economic consequences. The article examines the institutional changes in transition economies and shows that institutions matter. To prove this, first a simple descriptive method was used, followed by econometric testing: a panel data analysis and an extreme bounds analysis to check the robustness of the results.

Keywords: *economic transition, institutions, economic growth*

JEL Classifications: O11, O57, P16

1. Introduction: Institutions and the Process of Economic Growth

Modern mainstream neoclassical economic theory neglects the importance of institutional quality as a possible explanation for different development trajectories in seemingly similar economies. But nonetheless in alternative economic theories institutions appeared as one of the possible explanations for the differences. Today the comparative analyses of economic performances speak in favour of the thesis that economic growth is a complex process that goes beyond the scope of capital accumulation and technological progress, but is affected significantly also by softer factors, even by such factors as are language and culture.

What are institutions? Institutions are the rules of the game in a society, more formally – they are the limitations to free behaviour imposed on the individual by the society, shaping the relationships among individuals. Consequently they

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have a lot of impact on political, social and economic relationships in the society. Institutional changes shape and contribute the evolution of the society in time and affect the history (North, 1990, p. 3). Rodrik (2000, p. 4) emphasized the importance of the following institutions for the process of economic growth: property rights, regulatory institutions, institutions for macroeconomic stabilization, institutions for social insurance and, institutions of conflict management.

But is it reasonable to believe that the quality of the legal system, the amount of corruption, the quality of the government, the protection of private property rights and so on actually do matter. Already in 18th century great theorists like Hume, Quesnay and Smith emphasized the power of individual interests, but these could only be promoted in a suitable institutional framework. By today, a number of empirical studies have confirmed the importance of institutions as a co-determinant of economic performance; to mention just two: Rodrik (2000) presented one of the most thorough analyses of the role of institutions in the process of economic growth. The analysis took under consideration the role of property rights, regulatory institutions, institutions for macroeconomic stabilization, institutions for social insurance and institutions of conflict management. Although there is some diversity among countries regarding economic growth and the structure and efficiency of the institutions mentioned above, countries with higher quality institutions marked higher rates of economic growth. Caballero and Hammour (2000) present a very interesting article on creative destruction and economic growth and the role of various institutions in the process of economic restructuring and growth. Efficient institutional framework is of core importance in implementing new technologies, labour force reallocation and keeping up with latest developments in the world economy.

Over the last decade, the changing global and political environment has lead to a renewed interest in institutions in economic theory. If there is one subset of countries, for which institutions can be reasonably expected to be most important, it is the transition countries. Transition countries are going through a period of pervasive institutional transformation. At the onset of transition at the end of 1980s, the socialist coordination mechanism was ruined overnight. But despite very optimistic expectations, new market coordination mechanism took time to be built and economic subjects took or are taking time to get used to it. Even a very shallow analysis of transition economies reveals what a more in-depth analysis confirms: institutions do matter for economic performance in transition economies. They matter for growth itself and they matter for FDI. The following analysis will illustrate the differences in institutional quality among the transition economies, and the importance of these differences for growth performance. Following a short introduction and presentation of some basic facts on economic performance in socialism and institutional characteristics of socialist economies, a comparison of the changes in institutional framework during transition will be given. And last, to confirm the importance of the quality of institutional change for the success in transition econometric testing will be used.

2. The Impact of Institutional Quality on The Process of Change

Have institutions contributed also to different trajectories of transition economies? Transition economies today can be divided into three groups: the members of the EU, the South-Eastern European economies, which are beginning to experience growth, and former Soviet Union economies, which are mainly still struggling with the changes. Economies differed significantly in their policies after the onset of transition. Slovenia, Czech Republic and Slovakia, Estonia, Hungary are the winners. Are they winners also due to the successful institutional changes? Possibly. These economies were the first to implement deep economic and institutional reforms. The desire to enter the EU drove the governments to accepting the standards of modern capitalist economies and thus accelerated institutional changes. To be able to understand the nature of the scope of the institutional changes, it is important to be familiar with the nature of the socialist system.

2.1. The Legacy of Socialism

Is the overall performance of socialist economies to be considered a total failure? Sometimes the system is credited for having brought an underdeveloped country like Russia out of backwardness, although it was pushed by inappropriate policies back into poverty. Could another regime achieve the same results at lower cost? The socialist system was applied forcibly after the World War II into the already industrialized countries of Eastern Europe. The ideology of the communist regime from Berlin to Vladivostok stressed economic growth based on high investment shares, rapid expansion of the manufacturing sector and priority was given to heavy industry. The inefficiencies started to show already in the 1950s, but the crisis in the 1970s led to the final collapse of socialism (Estrin, Lazarova, 2001). Table 1 presents the data on economic growth in selected transition economies in the period from 1970 – 1998.

The essence of socialist ideology was encapsulated in a famous 1931 speech by Stalin: „We are fifty or hundred years behind the advanced countries. We must make good this distance in ten years. Either we do it, or we shall go under.“ (In: Ellman, 1989, p. 13.)

Table 1

Real Growth Rate in Transition Economies, 1970 – 1998

	1971 – 1998	1971 – 1980	1981 – 1990	1991 – 1998
Albania	2.4	7.9	1.4	–3.8
Czech R. (Czechoslovakia*)	0.5	3.4	0.8	–4.2
Hungary	2.8	4.9	1.1	2.3
Romania	3	9.4	0.4	–2.4
Estonia	2.1	5.3	–0.1	0.7
Russia (Soviet Union*)	1.5	5.5	3.3	–6.8
Slovenia	3.7	5.7	–1	7.4

* Prior to 1990 data for Czechoslovakia and Soviet Union are presented.

Source: Estrin et al., 2001, p. 679.

This goal was to be achieved by means of the chosen strategy and institutional framework. Despite remarkable investment rates, fast industrial development, even technological excellence (Soviet Union), the socialist experience failed. Socialism as an economic system was marked by three basic inefficiencies or paradoxes, which according to Gomulka (1995) were all a sign of rising problems. These paradoxes of socialist economies are:

1. Low inflation and high employment: prices in socialism were controlled, thus prices of final goods and wages are controlled without the check of unemployment. The side – effects were important: due to distorted prices shortages were common, forced substitution and forced savings were present, which led finally to monetary overhang. This was an important reason for massive price jumps at the beginning of transition. High employment growth was a consequence of a dual economy, employment of women, population growth. Altogether the employment growth was dramatic; growth process in the East was without much doubt very extensive.

2. A period of high growth was followed by stagnation and recession. Rapid growth was the result of a dual economy growth model (Gomulka, Lane, 2001); initially there were huge unemployed resources and alongside with capital accumulation high growth was possible. Later the growth of labour force slowed down, duality was lower, the complexity of the economy became bigger and planning became more difficult, thus efficiency was lower.

3. The rate of investment was very high in the sectors in which profit rate was low, especially in heavy industry.

There were several other characteristics of socialist economies, which proved to be very problematic. The socialist economies had a very specific sectoral structure, based mostly on manufacturing, and very specific size distribution of firms. Despite the fact, that industrialization was a process evident after World War II all around the world, the emphasis on the industry, especially towards the 1990s was too heavy. Service sector was not developing at the pace it took in the

Western World. The size structure of the firms in the economy was a source of additional imbalances and also inefficiencies. The main characteristic was prevalence of large firms in state ownership; medium and small firms were scarce. This size structure might not be so problematic if state firms were motivated to innovate. But as already Gomulka (1986) pointed out – the main innovation drive in socialism came from the centre, due to the fact that decision making freedom and resources available to enterprises for implementing innovations, which originate at the enterprise level, were limited. Also, if firms did innovate, they were usually motivated by the need to overcome supply difficulties (so innovation is a defensive strategy). Enterprises innovated little on their own also because they did not need to in order to survive. Overall, the level of innovation in new product development was low and also the rate of implementing innovations into the production process was slow. Overall, socialism as an economic system failed, which is evident from Table 2, presenting historical levels of GDP.

Table 2

Historic Levels of GDP in Central and Western Europe (in 1990 USD per capita)

	1935	1955	1970	1992	1998
Poland	1 597	2 788	4 428	5 038	6 774
Spain	2 792	3 995	7 291	14 767	16 412
Ratio:Poland/Spain	*0.57*	*0.7*	*0.61*	*0.34*	*0.41*
Hungary	2 471	2 480	5 028	6636	7 450
Greece	2 526	2 560	6 327	12 607	13 504
Ratio: Hungary/Greece	*0.98*	*0.97*	*0.79*	*0.53*	*0.55*
Czech Rep.	2 410	3 922	6 460	10 220	10 820
Austria	2 926	5 087	9 813	21 029	22 896
Ratio: Czech/Austria	*0.82*	*0.77*	*0.66*	*0.49*	*0.47*

Source: Estrin, Lazarova, 2001, p. 681.

Institutional characteristics of socialism were subjected to political ideology and the nature of socialism. Under socialism institutional framework was marked by: (1) high levels of government control and spending, too much was spent on subsidizing inefficient companies, which led to lack of incentive to perform well, profit motive did not work, welfare state was too big for the given level of development, taxes were inefficient and not fair, (2) the structure of the economy was not balanced, too much emphasis was put on the development of industry, services and traditional sector were neglected, allocation was not led by market signals but was ruled by the government, private enterprises were not allowed or just in small number, (3) financial system was underdeveloped, the main shortfall being the total dependence of central bank, prices were controlled by the government and therefore could not provide the right signal to companies, also inflation was caused by monetary overhang and characteristics of the financial system, (4) currencies of the countries were not convertible, trade was conducted mostly in CMEA, a lot of it was barter trade, trade with the developed was poor, exchange in foreign capital and financial markets was not existent due to financial underdevelopment and property rights characteristics, (5) state ownership was typical for socialist economies. The lack of private property led to the lack of incentive and additional inefficiencies.

Tables 3 and 4 present data on institutional development[1] in transition economies prior to transition. Freedom House data (Table 3) presents data on political rights and civil liberties and gives an overall assessment of freedom (including economic). Table 4 presents an overall index of economic freedom published by Fraser Institute, which is a weighted average of 7 areas. Both indices show that institutional development in transition economies was rather poor prior to transition. They were mostly unfree (Freedom House) or had markedly lower values than developed economies (Fraser Institute).[2] Both tables present selected countries and years.

Table 3

Institutional Development at the End of Socialism (data on economic freedom, by Freedom House, selected countries and years)*

Year	Bulgaria	Czecho-slovakia	DDR	Hungary	Poland	Romania	USSR	Yugoslavia	USA
1974 – 1975	7, 7, NF	7, 7, NF	7, 7, NF	6, 6, NF	6, 6, NF	7, 6, NF	6, 6, NF	6, 6, NF	1, 1, F
1979 – 1980	7, 7, NF	7, 6, NF	7, 7, NF	6, 5, NF	6, 5, PF	7, 6, NF	6, 6, NF	6, 5, NF	1, 1, F
1984 – 1985	7, 7, NF	7, 6, NF	7, 6, NF	6, 5, PF	6, 5, PF	7, 7, NF	7, 7, NF	6, 5, PF	1, 1, F
1988 – 1989	7, 7, NF	7, 6, NF	7, 6, NF	5, 4, PF	5, 5, PF	7, 7, NF	6, 5, NF	5, 5, PF	1, 1, F

*The characters representing scores for each year are, from left to right, political rights, civil liberties, and freedom status. Each of the first two is measured on a one-to-seven scale, with one representing the highest degree of freedom and seven the lowest. „F," „PF," and „NF" respectively stand for „free," „partly free," and „not free." Countries whose combined averages for political rights and for civil liberties fall between 1.0 and 2.5 are designated „free"; between 3.0 and 5.5. „partly free"; and between 5.5 and 7.0 „not free."

Source: Freedom House, 2004.

[1] The issue of measuring institutional quality is still open to debate. Several institutions in the world (Freedom House, Fraser Institute, Hertage Foundation, EBRD, etc.) form indices that measure institutional quality. There are several problems with that: (1) the definistion of institutional quality differs, since different organizations define institutional quality differently, (2) indices are being formed on the basis of some subjective and objective observations (how do we measure the extent of government involvement and corruption and be objective at it – just as an example), (3) since indices differ in definition, they can not be directly compared, although calculations show a large correlation among them.

[2] Some data on some countries are not available and were therefore also not included in the analysis (data for countries in the FSU prior to 1990, countries in former Yugoslavia, Czech and Slovak Republic).

Although several countries undertook some market oriented reforms already in the 1960s, 1970s and 1980s (especially Yugoslavia), the absolute collapse of the socialist system was inevitable and followed the crisis that happened at the end of 1980s in most of the countries. Everything changed. The economy moved towards market coordination, institutions followed.

Table 4

Fraser Institute Index of Economic Freedom (selected countries and years)

Country	1970	1975	1980	1985	1990	1995	1999
Hungary			4.52	4.76	4.73	6.88	7.11
Poland				3.60	4.64	6.28	5.70
Romania				3.63	4.24	4.23	3.82
USSR		1.61	1.60	1.59	1.51	4.81	3.86
Slovenia						5.86	6.15
USA	7.65	7.99	8.35	8.51	8.76	8.74	8.73

* The Fraser Institute Index of Freedom is a weighted average of seven areas. It can take values from 1 to 10, 10 being best institutional quality, 1 being worst. The following areas are being evaluated: (1) size of government: consumption, transfers, and subsidies, (2) structure of the economy and use of markets (production and allocation via governmental and political mandates rather than private enterprises and markets), (3) monetary policy and price stability, (4) freedom to use alternative currencies, (5) legal structure and property rights, (6) international exchange: freedom to trade with foreigners, (7) freedom of exchange in capital and financial markets.

Source: Fraser Institute, 2004.

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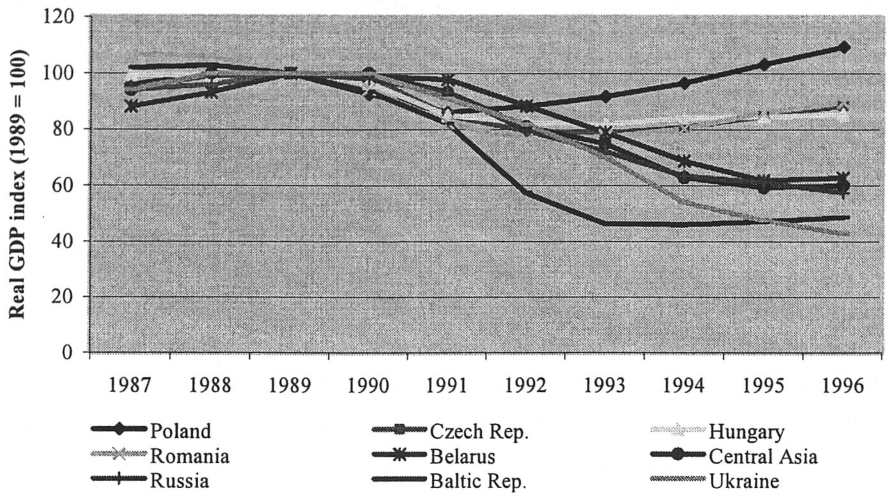
2.2. Transition Begins, Spurring Economic and Institutional Changes

Rosati (1994, p. 419) said: „Most observers tend to agree that while the shift from central planning to a market system was bound to lead to economic recession, hardly anyone anticipated the recession would be so long and massive." Figure 1 presents the extent of the drama. Economic activity fell dramatically, mostly in Soviet Union, up to 60 % in some republics. Poland was hurt least and came out of the transformational recession first, was also the first to reach the pre-transition output. Its success was followed by Slovenia and then the rest of the economies. Was Poland successful also due to fast and efficient institutional change?

Transformational depression was a terrifying mix to economists, a mix of supply and demand side factors and was as such hard to tackle. Countries first focused on macroeconomic stabilization, followed by microeconomic liberalization (prices and monopolies), privatization and the establishment of safety nets to ensure social cohesion. At this point I will not go any deeper into the economics of transition, but will instead focus on institutional changes.

Figure 1

Output in 1987 – 1996 in Selected Transition Economies



Source: Gomulka, 1998, p. 18.

Given the initial conditions of the socialist economy (with or without a history of reforms), what are the main tasks involved in transforming the economy toward a well-functioning market economy? Which are the required institutional changes? In terms of objectives, the following are broadly agreed on (Roland, 2000, p. 11):

1. Improving allocative efficiency by correcting the distortions of socialism through the introduction of flexible relative prices and the creation of a competetive market environment open to the world economy.

2. Stabilizing the economy which is necessary for a correct functioning of the price system.

3. Providing better initiatives and corporate governance arrangements to make firms respond to market signals. Privatization at a large scale is a key component of such changes, but so is encouragement of entry of new private firms and the creation of an entrepreneurial class.

4. Creating government institutions adequate for a market economy. Economists have different views of what the adequate government institutions are, but there is a relative consensus on (a) the need for political and institutional stability and (b) the need to protect private property rights from encroachment (by government but also by the Mafia) and to protect taxpayers from rent-seeking behaviour of pressure groups toward government.

Roland presented the required institutional reforms well. But the speed and success in these reforms differed among economies. Thus also the results.

Table 5

Share of Each Country in Total Output of TEs

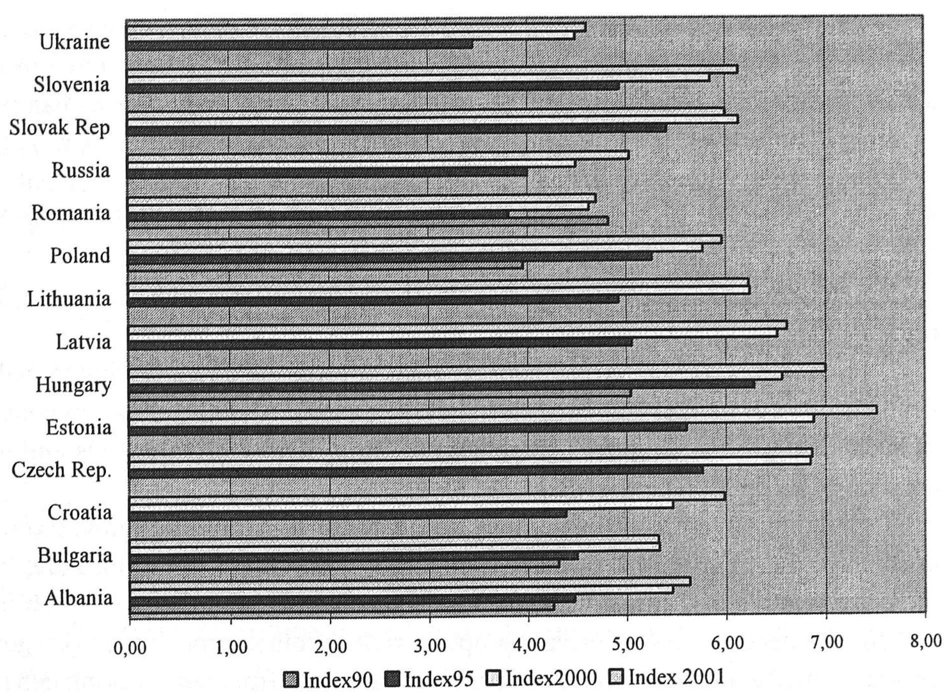
	1991	1998		1991	1998
Albania	0.3	0.5	**Latvia**	0.7	0.6
Armenia	0.7	0.5	**Lithuania**	1.1	1.1
Azerbaijan	1.2	0.8	**Macedonia**	0.4	0.4
Belarus	3	3.3	**Moldova**	0.7	0.4
Bulgaria	1.9	2.1	**Poland**	8.1	15.8
Croatia	0.9	1.3	**Romania**	4.3	5.4
Czech Rep.	4.5	6.7	**Russia**	45.6	36.2
Estonia	0.4	0.5	**Slovakia**	**1.7**	**2.7**
Georgia	1	0.7	**Slovenia**	1	1.6
Hungary	3	4.6	**Tajikistan**	0.6	0.3
Kazakhstan	3.5	3.3	**Turkmenistan**	0.6	0.4
Kyrgyzstan	0.7	0.6	**Ukraine**	11.5	6.6
			Uzbekistan	3	3.6

Source: Economist Intelligence Unit, 2004.

Let us first have a look at the data to get the first shallow impression of the changes in institutional quality. Figure 2 very clearly indicates the changes in the overall institutional quality, a comparison between the years 1990, 1995, 1999, and 2001.

Figure 2

Fraser Institute Index of Economic Freedom: Overall Standings*



Source: Fraser Institute, 2004, *data for 1990 not available (no blue line).

On average transition economies moved much closer to developed market economies, whose average index was 8 (out of 10). Transition economies improved institutional quality significantly. Still, some countries (especially those in the Eastern Europe) still have a lot of work to do.

Countries obviously took different speed and approaches to institutional changes. Has this decision for radical and fast changes in institutional framework, ensuring efficiency of the economy, contributed to the success of transition? Are Slovenia, Estonia, Slovakia today as successful as they are also due to their efficient move towards the institutions of modern capitalist economies?

3. Institutional Quality and Growth Performance in Transition Economies

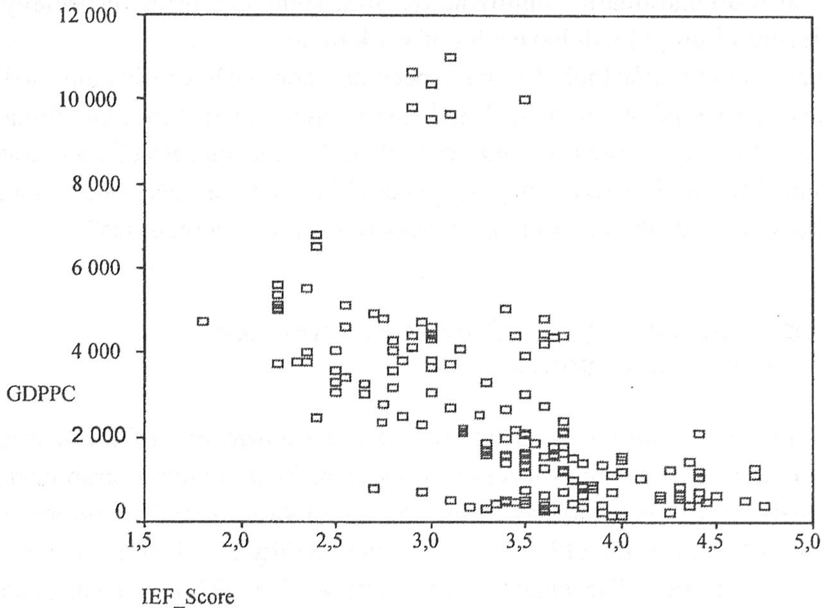
The aim of the article is to investigate the significance of the institutional quality and changes for the success in transition. First, a simple graphical correlation analysis will be performed, followed by a more in-depth econometric testing in order to isolate the effect of institutional quality as a factor impacting economic performance.[3] The analysis was performed on 24 transition economies (excluding Georgia, and Serbia and Montenegro) for the period 1995 – 2002.

Figure 2 clearly reveals that the winners of transition (Slovenia, Slovakia, Hungary, Estonia etc.) are also the economies with the best institutional quality. Hence, the data gives the impression that institutional changes, if done well, have contributed to better growth performance. This relationship is also depicted in Figure 3. Heritage Foundation Index[4] was used as an indicator of institutional quality – the relationship is negative, as expected, and fairly strong. Again, it appears that the economies with better institutions have grown faster and have higher GDP pc.

[3] I would like to stres sat this point that I am aware that seemingly an innocent decision on the use of a specific index (in my case the decision for the Heritage foundation Index) can affect the results. As I already said, the definitions of indices differ, thus also the stress of a given index. But at the moment these (internationally recognized) indices are the best measurement of institutional quality and we are forced to use them as an indicator of institutional quality. But, the indices are highly correlated, which gives more confidence to potential users. Also, the availability of data for specific periods in time may also dictate the use of a given index; this is one of the reasons why I chose Heritage Foundation over Fraser Institute Index. Also in empirical analysis the EBRD evaluations of institutional quality were used: a principal component was formed out of the indices they present.

[4] Heritage foundation index runs from 1 (best) to 5 (worst) and incorporates the following evaluations: (1) trade policy, (2) fiscal burden of government, (3) government intervention in the economy, (4) monetary policy, (5) capital flows and foreign investment, (6) banking and finance, (7) wages and prices, (8) property rights, (9) regulation, and (10) informal market activity. The reason why Heritage Foundation Index was chosen is the fact that it is available throughout 1995 – 2002 on a yearly basis. Fraser Institute has changed its definition on institutional quality and in the time this paper was created an updated database for a sufficient number of years for an empirical investigation was not yet available.

Figure 3
Heritage Foundation Index of Freedom and per capita GDP



Source: Heritage Foundation, 2004 and Economist Intelligence Unit, 2004.

Despite the fact that correlation analysis is very illustrative, it is also very non-reliable. The positive relationship or the strength of it might just as well be a consequence of some indirect effects of other variables affecting both GDP performance and institutional changes, for instance of EU accession preparation and consequently opening up of the economies. To confirm and above all isolate the importance of institutional quality also panel data analysis was run. Again, regardless of what data was used (Heritage Foundation data, EBRD data) as an indicator of institutional quality, institutional quality was among the variables, whose impact on economic performance, measured in log of GDPpc was significant. The regressions also included other variables, potentially important for economic performance, to isolate the effect of institutional quality. Besides institutional quality also gross fixed capital formation, secondary school enrolment, budget deficit and regional dummies were important for output performance.

The analysis above confirmed the importance of institutional quality, namely, the quality of the legal system, the protection of private property rights, the quality of regulation, the quality of the government and so on, for economic performance. The winners of the transition process are obviously the economies that were faster, more efficient at adapting their institutional framework to the requirements of the market economy.

Table 6

Regression Results, Log of GDPpc as Dependent Variable

	Regression1		Regression 2		Regression 3	
lngdppc	*Coef.*	*P* > |*t*|	*Coef.*	*P* > |*t*|	*Coef.*	*P* > |*t*|
lngfcf	.254	0.000	.443	0.000	.469	0.000
lnsecsch	.712	0.015	.476	0.286	1.400	0.000
ieflag1					–.105	0.033
heritfc1			–.128	0.021		
heritfc2			.002	0.938		
ebrdfact	.430	0.000				
psbr	–.004	0.483	–.014	0.047	–.013	0.058
tdumfsu	–.032	0.014	.003	0.847	–.002	0.891
tdumsee	–.034	0.004	.022	0.112	.0162	0.247
d99	–.108	0.000	–.098	0.007	–.092	0.015
d00	–.140	0.000	–.103	0.005	–.090	0.017
d01	–.076	0.013	–.036	0.325	–.039	0.313
_cons	5.93	0.000	4.193	0.000	4.709	0.000
R2	0.73		0.52		0.54	

heritfc1 – first principal component from the Heritage foundation index (could be named institutional quality),
heritfc2 – second principal component from the Heritage foundation (could be named tax misery index),
ebrdfact – principal component from the EBRD data. All variables were used lagged (–1),
lngfcf – ln of gross fixed capital formation,
lnsechsch – ln of secondary school enrolment,
ieflag1 – lag of Heritage foundation institutional quality,
psbr – budget deficit,
cara – current account deficit,
tdumfsu, tdumsee– dummies for FSU, SEE economies,
d99 – d01 – year dummies.

Source: Own calculations, 2004.

The robustness check of the results done by the extreme bounds analysis (for explanation of methodology see Levine, Renelt, 1992) also confirmed the importance of institutional quality for economic performance. Namely, the significance is not just a lucky mix of variables. Extreme bounds analysis is based on the idea, that inclusion of some other variables, possibly significant for GDP performance (for example war, investment, population growth etc.) should not affect the significance of the coefficient of interest. The inclusion of initial GDP, population growth, war dummy, unemployment, population growth and the share of industrial production in different combinations did not affect the significance of the results. Institutions have thus significantly contributed to economic performance in transition economies and their impact is robust.

4. And the Winners Are...

Estonia. A country that emerged from the former Soviet Union's rigid socialist institutional framework and has today one of the best, if not even the best institutional framework and is recording also very high growth rates. Also Slovenia, Poland – the two countries that were the fastest after the initial slump bounce back to their pre-transition GDP levels. Slovakia, Hungary, Czech Republic, Latvia, Lithuania: all countries with very good economic performances and rather good institutional frameworks. The biggest loser – Belarus.

Institutional aspects of economic transition, as one part of the transition reforms, are of crucial importance for the performance of these economies in the past decade and in the future. The importance of the differences in institutional quality were studied first by a simple look at the data on overall institutional quality, which showed that the countries of the former Soviet Union had, while still in socialism, the most strict socialist coordination mechanism, while for instance Yugoslavia, Hungary, Poland were closer to capitalist economies. The expectation that the countries with less gap to close would adjust faster to the demands of market coordination was fulfilled. The Fraser Institute data shows that after ten years of transition, the countries of the former Soviet Union (except the Baltic states) were still struggling with institutional reforms, while Slovenia, Hungary, Poland and several other already came very close to the capitalist economies. A simple look at the data on economic performance already confirmed that these economies were also the winners of the transition process. The empirical results, based on the Heritage Foundation data, confirmed the hypotheses. The expected results, that the better the property rights protection, regulation, the lower the fiscal burden and so on, were confirmed.

And the lesson other transition economies might distil from this story? The economies should establish the basic pillars of the capitalist economy: private property, the legal system, a normal monetary and financial system. Of course, different institutional environments within these boundaries might work, but the basic needs of any good capitalist institutional framework are not questionable.

Institutions do matter. Transition economies should take this into consideration. They are currently in a very sensitive stage in their development. Although some decisions are hard on the current generations and therefore politically unpopular, the nations should find the strength to pull the reforms desirable for long- term growth. Building efficient institutions is of pre-eminent importance.

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