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NEW RESEARCH PROBLEMS FOR INSTITUTIONAL ECONOMICS ARISING FROM THE EXPERIENCE OF TRANSITION TO A MARKET ECONOMY: THE EVOLUTION OF INSTITUTIONS

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Abstract
The paper examines some developments in institutional economics with the experience of market transition. The analysis confirms the role of institutions and institutional economics in economic sciences. In a sense, transition has challenged institutional economics itself, pointing to its weaknesses in explaining the process and offering suitable advice. As a result, several areas of research have developed, focusing on the diversity and complementarity of institutions and their impact on macroeconomic performance. The article takes stock of the attempts of the two principal institutional approaches, new institutional economics and evolutionary institutionalism, to thoroughly explain the process of institutional evolution. The current state of research in this area

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is an accumulation of evidence and partial hypotheses relevant to interrelations between formal and informal rules and organizations, studied from the point of view of both diachronic relations (impact of the legacies of the past, on the one hand, and adaptations, on the other) and synchronic relations (complementarity vs. conflict between the three elements). A consistent theory of institutional change taking into account the experience of transition has yet to be formulated.

KEYWORDS: institutional change; formal and informal institutions; path dependence

JEL Classification: B52, D23, D72

Introduction

The experience of transition has confirmed the importance of institutions and their adaptation to a specific socioeconomic system. Indirectly, it revealed the importance of institutional economics among economic sciences despite the overwhelming domination of mainstream economics.

The objective of this article is developed in three-fold. First, it demonstrates how calls for a normative outcome of institutional economics, emerging from the policies of market transition, underlined the importance of the institutional approach as a branch of economics. Second, the paper shows the directions in which the positive research of institutional economics developed under the influence of the transition experience. Third, the article takes stock of research on institutional change and offers a comprehensive model of this process.

Throughout the article, institutions are understood as rules shaping the behavior of economic agents (as in (North, 1990, p. 3)). I took into account authors dealing with institutional economics defined mostly as research focusing on institutions. Currently, two branches of institutional economics can be singled out, new institutional economics and traditional, or evolutionary, institutional economics. The borderline between these two approaches is unclear. It seems that the features that best differentiate them are reductionism (individual behavior as underpinning the social phenomena involved) and the attitude to innovation in institutional change (Hodgson, 1999, ch.6). New institutional economics (e.g. Williamson, 1985) predominately relies on reductionism and avoids references to innovation and change, contrary to evolutionary institutional economics. Nevertheless, a clear typology of institutional research is less and less possible as proponents of both approaches increasingly using similar methods (with “old” institutionalists searching for the underpinnings of global phenomena in the behavior of individuals, and new institutionalists giving up their initial rigorously static attitude).

The article is structured as follows. Section 2 presents the initial attitude towards institutions under transition and the subsequent rise in the importance of institutional issues. Further, the broadening field of research in institutional economics is described, especially in respect to institutional differentiation and the efficiency of institutions. Section 3 takes stock of the different theoretical lines of reasoning on institutional change. To prove their relevance, some empirical findings involving the particularities of the evolution of institutions in the real-world experiment of transition are quoted, without aspiring to offer a comprehensive survey of the abundant literature. Section 4 proposes models of institutional change based on both theoretical and empirical findings from Section 3. The concluding section summarizes the impact of the transition experience on the position of institutional economics and on the development of its positive research, especially research into institutional change.

Institutional economics and its importance as confirmed by transition

To convert central planning into a market economy was an unprecedented historical undertaking that had to be designed and carried out by the state’s administration rather than evolving “from the bottom up.” Nevertheless, the quality and impact of the desired institutional change was not the principal concern of the transition’s architects. One of the reasons was a deep disequilibrium in centrally planned economies at the time. Thus the principal concern was stabilization policy. Another reason was the influence of principal lending bodies tied to the American economic world (IMF and the World Bank) that did not pay attention to the subtleties of different institutional frameworks and cultural legacies, recommending a standard set of supposedly rational institutions of general application. This set of institutions, known as the “Washington Consensus,” was initially formulated for Latin American economies and contained the following recommendations (Williamson, 2003):

- introduce fiscal (budgetary) discipline,

- channel budgetary expenditures mostly to growth or protection of the poorest,

- introduce fiscal reform so as to broaden the fiscal base while reducing marginal rates,

- introduce the rate of exchange assuring competitiveness,

- liberalize interest rates,
- liberalize foreign exchange,
- liberalize the inflow of foreign direct investment,
- privatize,
- deregulate, reduce the barriers of entry and exit,
- put in order and protect property rights.

It was discovered only after some time that such a set was ill-adapted to the different historical and social backgrounds of individual countries, to both the least developed and those undergoing transition.

The transition in Poland as the first country under experiment was introduced under the influence of the "Washington Consensus" (Berend, 2000). From the perspective of a country that had been centrally planned during the previous 40 years, this set of recommendations was too general and lacked many essential institutions. It was not aimed at creating an institutional system for a market economy out of nothing, but to assume their existence and the eventual need to enhance them. It was thus only partly adapted to the needs of the transition to a market economy.

Poland's initial transition program, referred to as the "Balcerowicz Plan," called for rapid stabilization and the introduction of a minimum "reform package" comprising liberalization, privatization and the introduction of basic market-economy institutions and organizations. The phasing of the changes, especially privatization and the creation of market rules, received little consideration, which was actually not surprising given the speed at which the program was prepared. The Balcerowicz Plan in accordance with the standard economic theory paid little attention to institutions. The "Big Bang" theory of the time called for swiftest possible passage through a "valley of tears," while irreversibly cutting out the influence of the interest groups of the past and thus reducing the risk of stepping back (Sachs and Lipton, 1990), (Lipton, Sachs, Fischer and Kornai, 1990). In a sense, it was presumed that other complementary market institutions would emerge by themselves in due time, in some undefined manner, and would begin to function instantaneously.

In this early period, there was little discussion as to the appropriateness of the standard neoclassical theory as groundwork to the process of transition to a market economy. A notable exception was a study by Murrell (1991a) questioning the framework of neoclassical economics explaining why a market economy performed better than a centrally planned system. He made use of the then-recent findings on asymmetric information (disabling efficient equilibrium based barely on price information) and on various market inefficiencies resulting from bounded rationality (such as efficient entry and exit, and optimum product differentiation). Murrell concluded that loosening constraints was not sufficient for a successful functioning of markets and called for the creation of adequate institutions.

In an early institutional contribution to transition, Pelikan (1995) recommended the fastest possible privatization of state-owned enterprises. This recommendation was built on his assumption of an unequal distribution of competence (especially managerial skills) among society. According to his theoretical analysis, the capitalist system is better suited to concentrating capital under the control of more rational individuals. In a more recent paper (Pelikan, 2007), this argument is combined with a recommendation that governments create suitable institutions to enforce the rationality of companies.

A few years later, various analyses by economists (not necessarily those in the field of institutional economics) on the outcomes of the transition recognized the role of institutions and the speed and sequence of their introduction, as well as the role of the state. In Poland, which was the first country in the region to embark on a transition to a market economy, the destruction of the old system was much more successful than the creation of a new properly working system. As a result, before long, the country faced a deep recession and persisting unemployment that attracted critical comments from local economists. Their assessments and normative proposals were clearly underpinned by their diverse theoretical backgrounds.

Wilkin (1995) underlined the necessity of introducing formal rules to a market economy prior to privatization. He called for a gradual adaptive introduction of institutional reform under the supervision of state administration. He pointed out that a potential socioeconomic conflict would endanger reforms by pitting some social groups against each other: those suffering from the loss of their wealth, security and importance, versus businesspeople and the nascent middle class interested in speeding up change.

Hockuba (1995) expressed an opinion that informal market-economy rules should emerge slowly by themselves. Questioning the legitimacy of the "constructivist" creation of formal institutions, he advocated a reduced role of the state, limited to an initial package of reforms and privatization. He thus called for early privatization prior to the stabilization of market institutions. In Hockuba's opinion, this should promote a spontaneous creation of appropriate informal rules at the grassroots level.

Balcerowicz (1999) held a similar view on the need to reduce the role of the state; however he used quite different arguments: the danger of "rent-seeking" interest groups hoping to benefit from broad regulatory/administrative powers. He only permitted a subsidiary role of the state in creating basic rules and ensuring order and security, regardless of the actual contents of these “basic rules” and the method of bringing them into action.

After some time, Kołodko (1999) made a comprehensive account of the principal weaknesses of the early institutions. He pointed to the weaknesses of the organizational infrastructure necessary for the functioning of markets. This especially involved legal, judicial and fiscal systems as well as the shortcomings of financial intermediation ill-suited to the needs of a privatized economy. He also noted the absence of both governmental and nongovernmental organizations to promote competition and support the market. He argued that the weakness of corporate governance was largely due to deficient institutions and inadequate organizations.

The first Privatization Act was adopted in Poland in 1990. At the time, a major part of the Civil Code still dated back to 1964 and was not adapted to market economy conditions. As there was an urgent need for basic regulations concerning the functioning of commercial companies, the Commercial Code of 1934 was revived (it was still in force, but was not used in practice due to the absence of commercial companies under central planning). Companies, both those privatized and those privately owned from scratch, lacked a clear framework for their functioning, especially in terms of their cooperation with other businesses.

In most countries under transition, this eventually produced a deep recession and a surge of unemployment (Kornai, 1993). Moreover, the destruction of the previous economic system was not followed by the creation of new, highly performing networks, especially as far as innovation is concerned (Berend, 2000). Hopes for a substantial spillover effect in the inflow of foreign direct investment were only partly fulfilled. In many cases, multinational companies established enclaves of development (Krifa and Vermeire, 1998) referred to as “cathedrals in the desert”. Contrary to expectations, the performance of privatized companies was adversely affected by insider control over governance (Aoki, 1995). In all these cases, institutional inadequacy was noted.

Those unexpected difficulties in the introduction of “standard” market institutions in different transition economies revealed the importance of institutional economics and confronted institutional economists with an unexpected challenge. They had to take a stand on the ongoing institutional changes, even if these changes, exogenous rather than endogenous in origin, did not conform to the assumptions of their research. A unified normative theory on how to construct successful market economy institutions was lacking (Murrell, 1991b, p.5).

It is thus not surprising that the comments and recommendations of institutional economists were rather general. Roland (2000) criticized the “Washington consensus” as instrumental and mechanical. He argued against the thesis that the introduction of the suggested institutions (based on the experiences of developed countries) would automatically ensure prosperity. Much as other institutional economists, he underlined the fact that the consequences of the introduced institutions could not be determined because it was difficult to assess interferences among various institutions. Informal institutions were particularly important as they could disable the functioning of the reforms if these infringed upon some of the previously respected rules. Such a situation could endanger the social order. He called for a step-wise approach and even a temporary use of transitional institutions.

Institutional economists also urged the introduction of institutions and organizations to ensure a smooth functioning of the market, and especially the fulfillment of contracts (Murrell 2005). To this end, besides a set of legal regulations, a properly functioning police force and well-developed court, banking and insurance systems are necessary, including a sound information system to supply data about potential partners. Liberalization and privatization should not be launched before these institutions are established because otherwise the market may be dominated by network-based or even illegal (mafia-like) forms of cooperation. Pelikan (2007) vigorously advocated rapid privatization (for better use of competencies), advancing the requirement of sufficiently effective institutions preserving the rationality drive of companies.

It has been discovered that, while formal institutions can be quickly introduced, the adjustment of companies takes much more time and may be distorted by an excessive attachment to the rules of the previous system (Murrell, 2005). Thus an essential problem of transition is the emergence of new informal rules capable of supporting the market, building trust and promoting respect for business obligations.

Problems raised by transition exposed the numerous weaknesses of institutional economics from the perspective of positive research. One of the problems was the diversity of institutions and the need to study various institutional systems and their impact on performance. With time, the issue of convergence began to be examined in terms of models emerging in post-transition countries. This involved the convergence of these new models both with regard to one another and in reference to already existing models. All these fields of research visibly progressed under transition.

The multiplicity of market economies was another problem related to the introduction of market institutions in transition economies. Difficulties encountered during the enforcement of Anglo-Saxon-type institutions in transition countries were sometimes attributed to the diversity of the viable configurations of institutions in various market economies. Aoki (2001, pp. 376-393) described a number of coherent institutional models (as the "real world" ones: Anglo-Saxon, German, Japanese and some emerging models potentially generated by ICT and globalization). Aoki perceives them as constituting some kind of equilibrium in the game between historically and nationally conditioned agents. The stability of these models is ensured by diachronic and synchronic complementarities. Nevertheless, as Aoki underlines, the globalization of trade and the overwhelming impact of ICT may promote the convergence of these institutional models.

Fifteen years after the start of transition, a question may be asked about the degree of convergence or dissimilarity of the transition economies, both with regard to one another and compared to the institutional models of developed economies. Besides some general factors that implied similarity in the desired market economy model (mostly imitation imposed by the IMF and World Bank, and, for Central and Eastern European countries, the necessity to adopt the *acquis communaitaire* of the European Union), there was a number of factors that clearly contributed to the differentiation of these models. These included the diversity of the initial conditions and historical aspects, national policy choices as to the transition project (the option for a particular imitated model included), and social specificities influencing further adaptation (Chavance and Magnin, 1997). Currently, at least three groups of countries should be distinguished, namely Central Europe, the Community of Independent States, and Asian countries (China and Vietnam). These three groups display different and persisting institutional characteristics as to the scope and rigidity of newly introduced rules together with the pace of their introduction and the strictness of enforcement, method and outcomes of privatization, types of ownership, organizational structure of the economy together with the coordinating role of networks (Chavance, 2002). The diversity of the acquired institutional features also testifies to the existing divergence (different in each group of countries) as compared to any of the developed market-economy models. It is an open question whether a particular post-socialist market economy model (or models) will stabilize or if some of them fully converge to the already existing models (which is the most probable option for all or some Central European countries), unlike some other models (in particular Asian economies).

Besides the general observation that institutions were needed, a question was put forward about the impact of (specific) institutions on growth, particularly in transition economies.

A survey by Danny Rodrik (2000), conducted on a sample of 100 countries belonging to different socioeconomic systems, revealed the impact of democratic institutions on the positive features of growth such as stability, resistance to crisis and protection against excessive income differences. The most significant institutions were stable property rights and institutions regulating the market (including the state's intervention capacity). Institutions ensuring conflict management in a broader sense (the rule of law, along with the political representation of different social groups and trade union activity) were important as well. Finally, Rodrik found the relevance of institutions assuring macroeconomic stability and those assuring social security in conformity with the culture and customs of a given country, to stable growth.

A survey of studies of institutional changes and their impact on the growth of transition economies has yielded inconclusive results (Wojtyna, 2002). This was chiefly due to a large number of institutions, difficulty of measurement and many non-institutional factors influencing growth. The general conclusions could be formulated in the following way:

- Transition countries (CIS included) are so differentiated from an institutional point of view that they cannot be treated as a homogenous group,

- Differences in growth depend more heavily on policies adopted than on the type of institutions,

- Factors that substantially influence performance include the rule of law, efficiency of the judiciary, police and public confidence in these institutions,

- Early completion of crucial reforms (privatization and liberalization) was decisive to the pace of further institutional changes,

- The quality of governance, human capital and public confidence have recently deteriorated in the Czech Republic, Poland and Hungary; delayed institutional reform may endanger further growth in transition economies.

Recent research by Hodgson (2006) throws new light on the impact of different institutions on economic performance. First of all, the hypothesis on the relevance of features currently perceived as the pillars of effectiveness has not been approved. Econometric research has confirmed no statistically significant impact of property rights, corruption, economic liberty, taxation and civil liberties on growth. On the contrary, the general type of culture of a given society (belonging to the zone of Western Christianism) has been found highly relevant, with a positive impact. Interestingly, ethnic fractionalization and the level of democracy were significant, but with a negative impact. If in the case of ethnic fractionalization (a potential source of conflict) the hypothesis is relatively acceptable, the negative impact of democracy on growth needs more attention in line with the sad conclusion of a politician that transformational societies cannot be governed democratically. According to Hodgson's interpretation, democracy removed repressive constraints on mafia and ethnic-based links as well as activities that tend to dominate over general rules and impersonal norms necessary for cooperation in a modern market economy. The significant role of Western Christian tradition in opposition to the insignificance of the quality of (mostly formal) standard institutions seems to stress the role of informal and deeply rooted habits of autonomy, responsibility and entrepreneurship as more important than formally introduced and often deficiently enforced rules. Nevertheless, Hodgson's findings raise a problem for institutional economics.

The problem of institutional change as revealed by transition

One of the reasons why institutional advice has been largely inconclusive as to how institutions should be reformed is the absence of a commonly agreed upon theory of institutional evolution. Market transition constituted a challenge for the two principal institutional approaches: the new institutional economics and the "old" evolutionary institutionalism (Lissowska, 2004a). The rapid change of the institutional framework was quite irrelevant to the former, which assumed a stable (and rational) framework and applied comparative statistics to examine governance institutions and organizational forms emerging within this framework.[1] The latter, which assumed that a gradual change of informal institutions, would lead to a change of general social rules, was also unable to cope with rapid top-down institutional changes.

Down below I describe some principal hypotheses involving the process of institutional evolution as analyzed by various authors, those within institutional economics and those outside this field (as long as they followed the definition of institutions applied in institutional economics). I avoid classifying these authors into specific fields of research because sometimes this is extremely difficult. Besides, in my opinion, with respect to the evolution of institutions, the hypotheses involved often converge, even if their authors disagree on other matters. I rather try to classify the hypotheses by taking into account the source

[1] With the notable exception of the works of Douglass North, which focus on the history of economies, in particular their institutional evolution.

of evolution (be it individual agents or their interactions, or trends at the level of society as a whole) and their continuous/contingent nature. As different authors expressed different opinions at different stages of their research, their names are sometimes quoted several times.

A. The first group of authors argues that the source of institutional change is a *step-wise change of informal rules,* mostly for endogenous reasons. This view was expressed by North and Aoki as well as Hayek. According to Douglass North (1990, 1993), the leading author on institutional evolution ("appropriated" by both New Institutional Economics and "old" institutionalists), the process of institutional change is endogenous and gradual. Their main vehicles are incremental changes of informal institutions implied by changes in prices and preferences and gradually resulting in an evolution of written, formal rules. Another driver of gradual change is interference between the existing institutional framework and organizations operating under this framework. The activity of these organizations is shaped by rules, but they can incrementally exert an influence on these rules in the desired direction. Even if North allows for the possibility of rapid changes of formal institutions, implied by revolutions, wars or natural disasters, they remain an exception to the general rule of evolution. Thus the launch of a transition to the market, driven by political forces and not by the bottom-up evolution of informal institutions, was not the one studied in North's principal model.

A similar, though more radical, assumption was adopted by Hayek (as pointed out by Chavance (2007)). The principal driver of the change of law (codified rules) is a slow cultural evolution of informal rules approved by group selection. Formal rules are beneficial only if they are compatible with the spontaneously generated order. Thus the top-down manner of change of formal rules is seen mostly as a potential source of disorder.

If, in the model of Aoki (2001), the forces driving institutional evolution are essentially the same as those indicted by North, the mechanism of change is more developed and clearly based on bottom-up reasoning. The very definition of an institution is different, being an equivalent of shared beliefs, thus embracing both informal and formal rules to the degree they are commonly accepted and followed. Institutions understood in this way enable a reliable prediction of the actions other agents will probably take in a given situation. Together with other elements (private knowledge, set of possible choices and inference rules), the existing institutions shape the subjective models of the game that individual agents are engaged in. Dissatisfaction due to either external or internal conditions may destabilize individual game models, leading the parties to take new, previously unpracticed actions.

If marginal dissatisfaction and the alternative choices of agents do not play an important role in the overall institutional setting, the number of agents concerned attains a "critical mass." The general cognitive equilibrium may be affected, together with the value of institutions in their role of assuring a credible prediction of future actions. After a turbulent period of different competing perceptions, a new pattern of activities and shared beliefs on their subject should stabilize.

B. While the previously described process was a bottom-up model (from the level of individuals to that of society), there are also *hypotheses of a top-down drive, or one that takes place in the opposite direction*. North, in the same book (1990), emphasizes the influence of the adopted formal rules for the development of an adequate informal framework aimed at either broadening or adapting them to specific situations. The opposite temporal and logical direction was permitted: that from formal to informal rules. As a consequence, as underlined by Fiori (2002), incoherence, competition or even conflict may take place between slowly changing informal habits and potentially rapid formal changes, its results defying prediction. In this case, informal rules may impede the execution of formal rules, and this situation may result in their administrative prohibition. The study of such a process is highly relevant to transition countries.

C. Many authors note that *system-wise features and interactions between agents have a substantial impact on institutional evolution*. One feature of institutions that has a special impact on evolution is their complementarity. Aoki (2001) distinguishes synchronic and diachronic complementarity, the former focusing on static interrelations between institutions, the latter clearly implying an incremental path of historical changes. Complementary institutions support one another making for a stable and, sometimes, inert, system. This stability is reinforced by organizations created on the basis of these institutions as well as organizations that draw benefits from learning from institutions. Complementarity increases the cost (financial, but also political) of modifying institutions because they cannot be modified separately.

Complementarity is one of the core notions of the theory of *régulation* (Boyer, 1995, p. 329-331). This theory has a much broader focus on the dynamics of transformation and the permanence of production. One of the elements of this dynamic is the mode of regulation defined as "the routine way in which a set of decentralized decisions made by individual and collective agents (or actors) are adjusted reciprocally" (Billaudot, 1995, p. 141). Institutions (institutional forms, according to the terminology of this theory) are one of the factors that influence the behavior of agents (other factors include compromise, the outcome of negotiations between agents, and the value systems). Thus institutional coherence is necessary for the adjustment of decentralized actions. Under this theory, mechanisms leading to the complementarity of institutions include their co-evolution and mutual adjustment, logical links between institutions, adjustment to some principal dominating rules, and subordination to the general paradigms of development (Boyer, 1995, pp. 330-331). The theory of *régulation* also explores the process of institutional change following a major socioeconomic crisis. In this process, it underlines the role of interrelations between institutions and organizations, the impact of compromises and conflicts of interests, strategic behavior and political intervention.

D. The next group of hypotheses calls for the *relevance of continuity (history) modified by contingencies (meaningful events or personalities)***.** The complementarity of institutions is seen as one of the reasons why institutional change is overwhelmingly incremental and path dependent (North, 1997). In particular, the authors supporting an evolutionary approach emphasized the appropriateness of path dependency and the impact of the legacies of the past. The path dependency thesis also suggested a possibility (confirmed by empirical studies) of the differentiation of the national paths of institutional evolution (Chavance, 2002; Chavance and Magnin, 1997). This could also be due to differences in their initial economic and social situation, as well as differences in the policies adopted and in the balance of political forces -the impact of the Solidarity movement on Polish events being a leading example (Nielsen, 2006).

North formulated some observations that may apply to modern societies in general: weaker informal norms strengthen the influence of events (versus history) and the change of formal rules. Such a historical acceleration brings about an acceleration of institutional change. It decreases the role of routines and weakens their coordinating and stabilizing capacity. From a theoretical point of view, it supports an anti-gradualist hypothesis of institutional change.

Various transition studies paid special attention to the role of informal institutions, which lagged behind the new formal framework and entered into potential conflict with it. This could produce different outcomes. According to Fiori (2002, p. 1039), conflict “stresses the role of contingencies in the process of institutional change: the more the rules conflict, the more contingencies can determine the result of the process, and the less the past (embodied in informal rules) is able to condition the direction of change.” Thus the path contingency (rather than path dependency) thesis has been applied to transition economies (Nielsen, 2006). Undeniably, the contingencies in question included the role of Solidarity in Poland, the European Union accession of the countries of Eastern and Central Europe, the involvement of the IMF and the World Bank in transition, as well as the impact of the personalities and decisions of individuals such as Mikhail Gorbachev, Lech Wałęsa, Vaclav Havel, Leszek Balcerowicz and Vaclav Klaus.

E. Another hypothesis focuses on *changes in society-wide attitudes*. Denzau and North (1994) in their collective paper pointed to discontinuous changes in mental models defined as representations of the world and a source of institutional change. The evolution of these models is usually of the path-dependent type, built on learning and past experience. But at times sudden reorganizations of these models may take place, paving the way for a rapid change of corresponding institutions as punctuated equilibria. Such reorganizations may be enabled by the previously mentioned acceleration of time and triggered by historical events (or remain only potential in their absence), but the process of how they appear has not been explained.[2]

The question is relevant if such a rapid change of mental models actually took place and if it triggered institutional change in the countries under transition. This question is even more pertinent in the context of another theory based on the assumption on social cognition.

The problem of social cognition and its impact on institutional change in the countries undergoing rapid institutional changes was studied by Henisz and Zelner (2005). They found that in the case of discontinuous changes, the problem of vulnerability of new ("emergent") institutions is particularly relevant. Initially, they do not enjoy sufficient cognitive legitimacy and, for a prevailing part of society, they enter into conflict with established informal norms. Together with objective uncertainty about their outcomes and even consistency it exposes them to a high political risk of erosion. They become the subject of a struggle between those benefiting from them (initially weak and objectively needing some organized structure pressing for their sustainability) and those losing out and potentially pressing for their reversal. Thus, in this case, the game between interest groups cannot be avoided. The weaker participants of the game may also try to win the support of the general public, which is essentially uninterested, by convincing either a positive or negative impact of these institutions on everyone's situation. This opens the way to media campaigns, lobbying and even manipulation of the public.

F. The previous description of the struggle for the cognitive legitimacy of institutions clearly shows the role of meaningful (often collective) agents, this time of interest groups. The last type of hypotheses of institutional evolution underlines the *structuring role of influential agents and negotiations between*

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[2] This reasoning bears some similarities to Aoki's model of "cognitive equilibria."

them. In his papers written in the middle of 1990s, North developed a model of institutional change that underlines the role of organizations (and interest groups) as well as their learning and perception based on beliefs and a path of change depending on institutional incentives. North (1995, 1997) insists that there is a continuous interaction between institutions and organizations (e.g. enterprises) in the process of institutional change and growth whereby organizations are forced to invest in knowledge to keep abreast of the competition. North also argues that the institutional framework creates incentives for the most rewarding ways of developing skills. Nevertheless, activities undertaken by organizations also depend on their perception of pay-offs and, in this respect, they are constrained by culture and local conditions. To some degree, this capacity depends on political conditions (especially on the willingness to favor impersonal exchanges and the openness of the economy). This feature may strongly differentiate the responses of organizations to similar situations and the overall performance. Negotiations between agents in structuring emerging institutions are also important in the theory of regulation.

The following questions should be asked in research on transition, in the specific context of the radical changes of formal institutions:

- What was the scope of conflict between formal and informal rules after the initial institutional change and its outcomes (the pace of the emergence of new informal rules adjusted to the formal framework, modification of formal rules, path-contingent evolution)?
- What was the role of agents in the transformation of institutions?
- What was the speed of change in mental models, possibly enabled by historical acceleration, and did that influence institutional changes?
- To what extent did the insufficient cognitive legitimacy influence secondary institutional changes? What was the impact of interest groups on these changes?

Authors analyzing cases of transition to a market economy from an institutional point of view underline the importance of institutions on the results of transition.[3] However, their conclusions are mostly negative (they refute several hypotheses and confirm the failure of forecasts), indirectly proving the lack of an institutional theory suited to the revolutionary (or “constructivist” or else “supply-driven” à la Murrell) introduction of institutions (Chavance, 2002).

[3] The account of the research is obviously far from complete. I mostly relied on the studies of authors coming from transition countries or those with a good understanding of the local conditions.

The importance of the legacies of the past interfering with the newly introduced institutions was confirmed in various areas of interest, including industrial ownership (Chavance and Magnin, 1997; Nosova and Bartels, 2006), (Raĉiĉ and Cvijanoviĉ, 2005) and real estate ownership (Lissowska, 2004a, ch. 3). These legacies mostly disabled newly introduced institutional frameworks, sometimes enforcing backward adjustments. Contingencies were of importance in some cases in resolving conflicts between formal and informal rules (partly confirming the thesis of Fiori).

A number of research contributions confirmed the relevance of different complementarities (or rather the negative impact of the lack of complementarity). This issue was much more probable and harmful than in the case of the step-wise shaping of the institutional system in the now-developed economies because of the "constructivist" transition project. The (dis)complementarities described by the authors concerned the following levels:

- Formal institutions with regard to one another

- Formal institutions with regard to informal institutions

- Formal rules and their enforcement

- Institutions and the functioning of organizations.

The most general account of the impact of the lack of complementarity on the deficiencies of the Russian institutional system comes from Aoki (2001 ch. 10.3) and Mesnard (2000). The lack of complementary institutions and deficient industrial structures are indicated in the latter as the cause for the "lock-in" of corporate governance. The importance of complementarity may be one of the reasons of the positive impact of the "general structure" of society (Western Christianism in Hodgson's model) against the insignificance of separate institutions.

The most abundant body of research concerns different types and cases of privatization with its broad consequences, especially for corporate governance and coordination (Chavance and Magnin, 1997), (Vincensini, 2006), (Raĉiĉ and Cvijanoviĉ, 2005), (Nosova and Bartels, 2006). The thesis of Roland (2000) about the limited virtues of sole ownership changes without adequate market institutions was fully confirmed by numerous examples. Changes of corporate governance after privatization were slow or clearly unsatisfactory (as in the case of insiders' control analyzed by Aoki (1995))

An especially significant conclusion for institutional economics involves the importance of organizations and their interrelations with changing institutions.

This element was taken into account by North, but it comes out in a striking manner in the post-socialist reality, which is rich in power relations and interest groups - some of them inherited from the past and others born out of the new industrial elites fighting for the legitimacy of the institutional framework they rely on (Lissowska, 2004 b; Sonin, 2003). The reality reveals the relevance of the rent-seeking theory.

Another important element is the role and consciousness of the society. A relevant observation is that of the differentiation of the economic condition of various social groups with the progress of transition. According to (Hausner and Marody, 1999), for example, Polish society has split into three categories: those who have benefited from transition, those who have lost out, and those whose condition has not changed. This differentiation nourishes a potential conflict over institutions (especially as far as employee protection is concerned) and favors the creation of interest groups. The objective conflict over the advantages of transition leads to potential political instabilities, influencing the institutional framework (with the notable election success of post-socialist parties in many Central European countries).

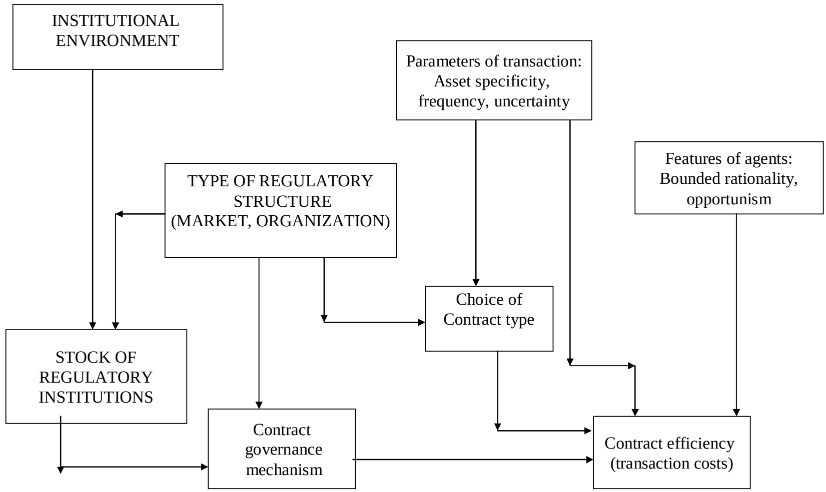
Generally, the hypothesis of the revolutionary change of mental models has not been confirmed. Rather the above mentioned study of Hausner and Marody proves that a decisive change of mental models has taken place only in some social groups. There is evidence also of the impact of companies with foreign capital on promotion of market-related attitudes and behaviors (Hardy, 2006).

The model of institutional change in transition

Institutional changes taking place during transition constituted a significant part of my personal research. The early framework (Lissowska, 1999) of interference between the emergence of new "private" means of governance – which broadened the scope of regulatory institutions of general application – and the change of formal institutions was based on elements that were studied separately by new institutional economics and the evolutionary-institutional approach. My initial objective was to find a way to connect both approaches.

In this approach, some elements of the static model of new institutional economics and some dynamic elements of evolutionary institutional economics are applied according to a static model exhibiting the relationships between choices concerning individual transactions and the general institutional environment. A model of static institutional linkages at different levels is shown in Figure 1, inspired by Lotter (1996).[4]

Figure 1. Static institutional linkages - initial



At the level of the individual transaction, the approach of new institutional economics is_mostly applied with its assumptions on parameters (asset specificity, frequency, uncertainty) and on decision constraints (limited rationality of decision making and opportunism), both determining potential transaction costs. The chosen type of the contractual relation (within one of the types of the regulatory structure: market, organization, hybrid structure[5]) and applied governance structure (within the range of instruments practiced in a given economy) influence the efficiency of a transaction's implementation. The institutional environment (formal and informal rules) is supposed to be stable.

On the elements of this static model are superimposed some elements of dynamics in order to design a model of changes of different institutions, both at the micro- and macro-level. Two types of dynamics are exposed to the

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[4] Elements relevant to individual transactions are lowercase, while those pertaining to the institutional environment are uppercase.

[5] This typology comes from new institutional economics research (Williamson, 1985). The relations between agents within each of them are structured by contracts. It is also the case of organization perceived as a nexus of treaties (see the title of the book edited by Williamson, Aoki and Gustaffson, in 1989).

individual transaction. First, a change in time of parameters (asset specificity, frequency, uncertainty) may take place for the same or repeated transaction. For example, organizational learning may change the degree of asset specificity (in particular, human assets may become more specific) and can limit uncertainty. Opportunism may be better monitored and may decrease under the requirements of reputation. Some changes, under the notion of fundamental transformation, are caused by the very fact of contract conclusion and fulfillment. They induce the change of transaction costs in time; sometimes they enable adoption of a more adapted contractual formula and/or governance structure. Besides, all the transactions are influenced by technical and social evolution (especially, as underlines North, by changes in prices and preferences).

Another kind of dynamics at the level of individual transactions is connected to the fact that the objective level and reasons of transaction costs are perceived by decision makers only subjectively and this perception changes in time. In the transaction costs theory, only the choice of a relatively better (not necessarily the best) contractual formula and governance structure is considered, and this choice is conditioned by the range of known solutions and possibly ad hoc invention. For the reason of sub-optimality of contractual solutions, the field is open to organizational learning. In this way new types of contracts and of their governance may emerge[6]. It should be underlined that the parameters of transaction (frequency, in particular) constrain the possibility of contract improvement. Frequent, repetitive transactions may be easily subject to modifications, contrary to occasional transactions. Transactions of highly specific assets reveal a tendency to rigidity and conservativeness due to natural risk aversion and the fact that (to compensate for the cost of specific assets) those transactions are usually concluded for a long time.

The evolution at the level of the institutional environment is described in the spirit of evolutionary-institutional economics. Formal and informal rules evolve more or less rapidly. The range of contractual formulas and governance structures also changes. This range may be enriched by solutions invented for individual transactions (in the process described above), then approved and selected according to adaptation schemes relevant to the particular regulatory structure. In the case of market regulation, they are subject to elimination through_the competition mechanism, in the hierarchical structure – by obedience and informal pressures. Regulatory structures also have their proper selection blockages that hamper new solutions – monopolist structures in the case of the market and inadequate rigid routines in the case of hierarchical

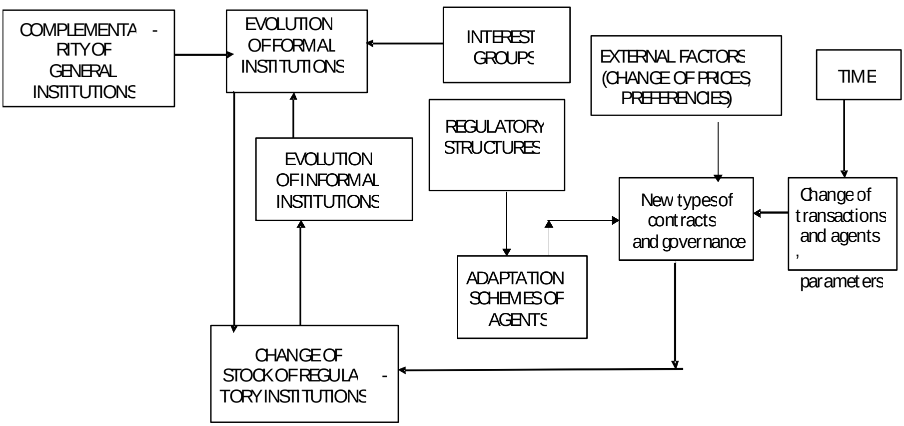
[6] This evolution is usually overseen by the authors in New institutional economics, but it comes out clearly from the works of North and Aoki for example.

organization. The change of formal rules may also be a source of new governance solutions.

The link between the level of the individual transaction and the institutional framework is assured by the assumption that all the contractual processes (search of partners – negotiations, contract formulation and conclusion – fulfillment) take place in an environment formed by rules adopted in a given economy. Formal rules are imposed by the law and informal rules are based on habits, procedures, traditions and conventions. These institutions are usually supported, on one hand, by organizations and mechanisms aiming at their enforcement (judiciary), and on the other, by public opinion, culture and ideology (North 1990). In a stable and coherent economy, informal rules usually support formal ones (enriching, complementing and facilitating their everyday application). The new types of contracts and their governance emerging at the level of individual transactions enrich the stock of regulatory institutions and in some way participate in the evolution of informal institutions. Together with the learning of new types of contracts, this process fills gaps between the individual and social levels.

The basic model of the overall process of institutional change at the individual and global levels is shown in Figure 2, taking stock of the findings of both new institutional economics and evolutionary institutionalism.

Figure 2. Dynamic Institutional Linkages - Initial

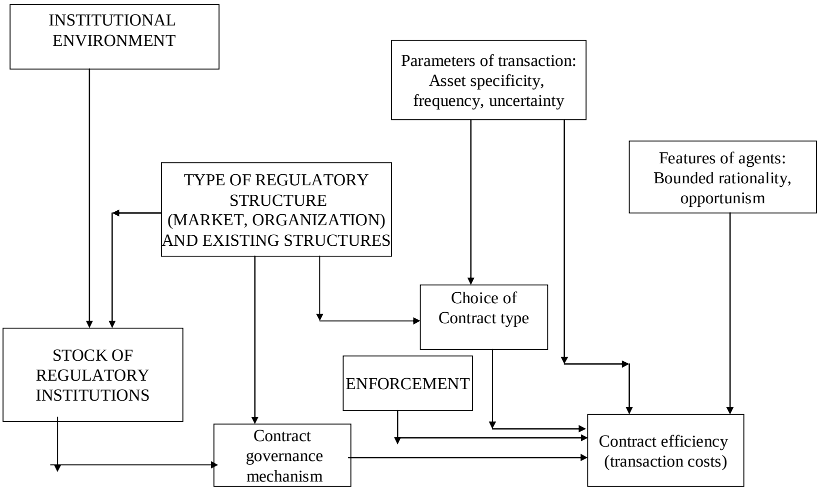


While I find this model still generally relevant, I am gradually more confident that it is necessary to enrich it with complementary elements revealed by varying situations and paths of transition. As to the static model, which mostly describes the determinants of choice at the level of individual agents, it seems necessary to add at least two elements:

- impact of the degree of enforcement of general rules (by courts and other judicial institutions) and of private rules (by social pressure and public ostracism),
- the existing organizational structures (as an element of the mezzo-environment complementing the type of regulatory structure – for example the existing networks of cooperation, organizations supporting business, and dispute resolution systems).

Figure 1 would thus be transformed into Figure 3.

Figure 3. Static institutional linkages - reconsidered



Experience of transition emphasized that “institutional environment” is not homogenous because it embraces both formal and informal institutions with their conflicts and complementarities. Thus the relevant element of the model should be split into two.

As to the description of the evolution of institutions, in light of the outcomes of research on the path of evolution during transition described above, I would add as relevant elements:

- The consciousness of society and its interrelation with formal and informal institutions,

- The historical determinant (“legacies of the past” concerning informal rules and the consciousness of society),

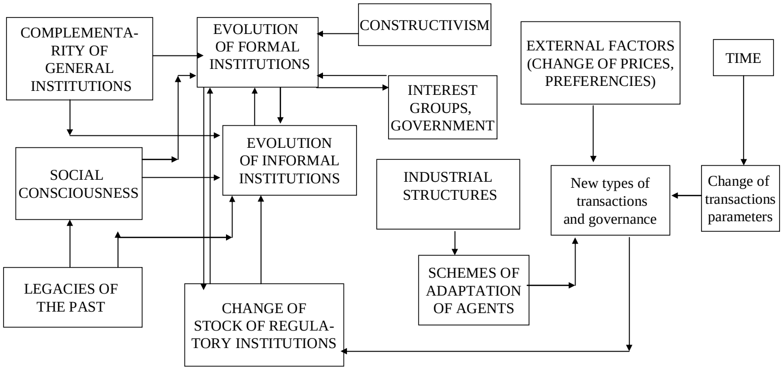
- A double link between formal and informal rules (inference in both directions),

- A double link between interest groups together with government and formal institutions (taking into account the impact of democratic institutions on the strategies of interest groups, the emergence of the loop between possibility to influence norms and/or their enforcement and the strengthening of interest groups),

- Broadening of the complementarity condition embracing both formal and informal institutions.

The outcome – model of institutional evolution taking stock of the experience of transition, is exhibited in Figure 4.

Figure 4. Dynamic institutional linkages - reconsidered



The contents of Figures 3 and 4 is just an account of the empirical findings and partial hypotheses drawn from the experience of transition. Most of the relations, and especially their configurations, require further research. The outline of this model may be applied in a positive research of a limited scope (focusing on a specific aspect of evolution) as an account of elements of the background, potentially biasing the results in a significant manner. It should be taken into account as a warning, while introducing new regulations to enable reasonable predictions of their outcomes.

Conclusion

What has transition taught economics then[7]? First of all, it has exposed some of the deficiencies of contemporary economics with its fallacious belief that a market economy can be built overnight with a standard set of institutions. Transition has clearly underlined the importance of institutions in the real world and the importance of institutional economics in economic sciences. Within institutional economics, it has intensified research into diversified institutional models and the importance of different facets of complementarity and conflict together with performance effects defined in broader terms than just by means of transaction costs.

A principal challenge that the two approaches of institutional economics have been confronted with was that of explaining the process of institutional

[7] Paraphrasing the title of the EACES and CRIISEA Conference.

evolution in the case of the initially “constructivist” and then more spontaneous change. Both new institutional economics and evolutionary institutionalism attempted to meet this challenge, but with moderate success. It seems that future progress will depend on the extent to which they are able to adopt one from another the right research tools. For now, empirical evidence has been accumulated and partial hypotheses have been formulated, especially with regard to interrelations in the “formal rules-informal rules-organizations” triangle (with interest groups, government, and eventually society as a whole), with their diachronic (legacies of the past, adaptive secondary changes) and synchronic (complementarity vs. conflict) aspects. Nevertheless, a coherent theory of institutional change embracing these partial observations has yet to be formulated.

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