INSTITUTIONS AND CHANGE: NEW HORIZONS IN ECONOMIC THEORY[1]

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ABSTRACT: This chapter is a revised version of a keynote addressing an international gathering of scholars. It was convened to provoke a broad and sincere exchange on new dimensions of state activism as seen through sectoral and country experiences, basically anchored in empirical analyses. What we do in this framework paper is to take a step back and ask if there are *new insights that may allow for broader generalizations at the level of economic theory. We attempt to be specific on how institutions matter for economic change.* First we show how institutions may assist change, hinder change or become hollowed and thus become largely irrelevant. Finally as fourth we try to generalize what follows from all this for broader theory.

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Three decades ago when systemic changes started in the socialist world and the third wave of democratization swept across the developing world there was an overwhelming belief that poverty, oppression and other forms of human suffering may easily be overcome. Change will not be easy, but is within reach, if only we rely on good textbooks, borrowed from the US, and on the wisdom of the international financial institutions/IFI/, as summarized in the Washington Consensus/Williamson,J.ed.,1994/[3]. Let us add: although we did have cautioning voices from both academe and policy-making from the very outset/Winiecki, 1993/[4], the overall mood was by and large that of hope and favorable expectations, which were to become self-fulfilling. Large scale institutional transformation was presented both as necessary and feasible at the level of theory and policy alike.

Thirty years after, the emerging new consensus, both in policy-making and in theorizing, seems to be by and large the opposite. Criticism on both levels abound/cf eg the special issue of *Cambridge Journal of Economics* with authoritative contributions from various periods and written from many angles of

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[3] WILLIAMSON,J.ed./1994/: *The Political Economy of Policy Reform.* Washington,D.C. : a book published by the Institute of International Economics.

[4] WINIECKI,J./1993/: Knowledge of Soviet-type economy and „heterodox" stabilization-based outcomes in Eastern Europe. *Weltwirtschaftliches Archiv,* vol.129.no.2.pp 384-410.

analysis[5]/. While on the onset of changes the role of institutions were though acknowledged, but tended to be subordinate and technical in nature/what is the optimal way to here or there, be that privatization or pension system/, by know the complexity, even the trickiness of institutional change counts among the platitudes of the profession.

Institutions Matter: Heterodoxy in Policy-making

One may draw various borders in the history of economic thought. Staying at the level of policy-relevant theorizing, that we call for shorthand international political economy, we may perhaps take the thin but influential and insightful volume of Nobel winner Douglass North/2005/[6] as a watershed. By that time there were ample lessons from the rather unsuccessful attempts to change post-communist economies in central and eastern Europe[7], from the Asian and Latin American crises of 1997-99[8] and even from the burst of the dotcom bubble in the US in 2001, that regulation and institution building should not be taken as marginal side-assignments of the broader task of inflation stabilization and overall liberalization in emerging markets.

From that time on –with the very partial exception of the United States under the George W. Bush Administration – the role of institutions as being focal to major policy changes were consensually appreciated. If not in pure theory, but definitely in the policy-making literature following – and even more in the one critical of – the line of IFIs. To put it in the language of the IFIs, sustainability of solid policies requires anchoring in the lasting and formalized rules of the game, which are institutions. This insight has been powerful and practical, finding its way in the policy advice of both the European Union and the IMF. The doctrinaire approach of the 1990s has been gradually giving way to what Ilene J. Grabel/2017, pp 29-53/[9] aptly describes as 'productive incoherence'. This means not only accepting that it is not always the smallest fiscal deficit, which is best, or that faster privatization do not necessarily and inevitably be deemed by definition superior to slower ones[10] .It also implied that IFIs and also the EU accepted both the

[5] Thirty years after the fall of the Berlin Wall/virtual special issue, edited and introduced by Michael Ellman/.April, 2019- last retrieved from https://academic.oup.com/cje/pages/berlin_wall on 18 November, 2019.
[6] NORTH, D ./2005/: *Understanding the Process of Economic Change.*Princeton,N.J. : Princeton University Press.
[7] KOLODKO, W./2000/: *From Shock to Therapy.*Oxford- New York: Oxford University Press.
[8] EICHENGREEN,B./2002/: *Financial Crises and What to Do About Them.*Oxford-New York: Oxford University Press; LÁMFALUSSY,A./2000/: *Financial Crises in Emerging Markets.*New Haven/Ct: Yale University Press.
[9] GRABEL, I.J./2017/: *When Things Don't Fall Apart: Global Financial Governance in an Age of Productive Incoherence.*Cambridge/MA- London: The MIT Press.
[10] This consideration had some political- though by no menas professional – justification owing to fears of return of the Communists. Indeed, countries dodging privatization, primarily the new Independent States and countries of Southeast Europe have been faring much worse than their Central European fellow travellers, who privatized and liberalized faster.

need and the time dimension of institution building, provided this was a side condition for solid policies to sustain. In all, a paradigmatic change occurred, but not via revolution, of revoking previous doctrines in the open, but through step-by-step modifications adding up to an entirely new worldview and also novel practices.

In pure economics of the high-brow theoretical departments, as those in the Ivy League, but increasingly also in continental Europe including Germany and much of central Europe, the neoclassical synthesis as hammered out by Samuelson and developed further by Lucas and Blanchard with its institution-less view of the economy triumphed. By contrast, in policy making heterodoxy has found its way. No government in any major economy of the globe has ever subscribed to a hands-off stance, or would have restrained its intervention in the economy to monetary policy in normal times, coupled with a bit of fiscal stimulus during rainy days.[11] Therefore as it could be established already prior to the Great Recession of 2007-2009, *heterodoxy has become a norm rather than an exception in policy-making and the theories shadowing reality* rather than aiming at placement in top ten academic journals.

In the majority view of the period institutions and thus institution-building was seen as *something inherently benign in nature,* enhancing individual and social well-being over and above the trivial levels of excluding predatory behavior and misuses of monopoly positions, two factors appreciated even by 'neoliberals', or as they tended to be called in the antebellum period, the Manchester School. Institutions tended to be portrayed as the bridge between individual and social, national and global concerns, overcoming class and situational conflicts, as between seller and buyers, employers and employees. This holds for the heterodox schools, as Keynesianism, old institutionalism or critical approaches/Marxism-inspired views more than to the Austrian school and public choice/. However, given that political economy scholarship, and policy-making in particular, tends to be eclectic all the times and in all corners of the world, we do not run a high risk if we interpret the huge policy literature of the 1999-2008 decade in this simplifying manner. Starting with World Bank papers issued during the Wolfensohn Presidency to increasingly even the output of the IMF the 'productive incoherence' take on economic reform has become predominant.

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[11] CSABA,L./2009/: Orthodoxy, renewal and complexity in contemporary economics.*Zeitschrift für Staats- und Europawissenschaften,*vol.7.no.1.pp51-82.Cf also the historically based empirical substantiation of similar claims in TANZI,V./2018/: *Termites of the State: Why Complexity Leads to Inequality.*Cambridge and New York: Cambridge University Press.

What did acceptance of the 'institutions matter' paradigm imply? First and foremost that the building of institutions was considered to be important, and even *lapses in improving fiscal performance tended to be tolerated in exchange for a more radical stance on structural reforms.* True, China with its de-emphasis of any formal institution, especially the judiciary, in favor of pragmatic and regionally diverse solutions that differ both from western and other local options, never fitted in this picture/Xu, 2011/[12]. But at the end of the day the idea was that institutions – especially formal ones – are intrinsically good, and lack of them is fundamentally wrong, a shortcoming to be remedied.

The role of regulation and of institutions, cementing and enforcing these have only been underscored by the experiences of crisis management. One of the broadly accepted narratives, circulated in part in the banking community, has been the blame put on the regulators, who allowed the bubble to build up and did nothing to prevent excessive risk taking. This claim counts among the items of common wisdom in the financial literature other than mathematical modelling. In his latest book Robert Shiller/2019/[13] of Yale, Nobel in Economics/financial markets, as of 2013 vintage/, claims that the inability to control the validity of information, especially in the public domain, including rumors, gossips and openly manipulated pieces of news, has played a role comparable to those of viruses in epidemics on the spread of crises/panics in the capital markets. He proposes new analytical techniques and institutions to try to prevent or at least limit these infectious influences.

It is perhaps unnecessary to remind participants to this gathering, currently in the fifth of a series on the subject of return of the state as a major player that in the decade since the Great Recession this view has gained currency. Not only do most analysts accept the enhanced role of regulations, of active fiscal policies, of discretionary interventions in order to achieve redistributory objectives as given. Similarly to the 1930s and the 1950s and 60s state interventionism is considered to be not only necessary, but oftentimes even virtuous in order to overcome market failures. Let us not be deceived: while pure economics departments continue to preach free markets, the Trump Administration of the USA in 2016 to 2020 has clearly taken a stance against free markets and of the multi-lateral trading régime, from TTIP to NAFTA for that matter. Protectionism is back in vogue, and so is the extra-territorial use of trade sanctions to promote political targets, from punishing Iran to contain Chinese expansion in various walks

[12] XU,CH./2011/: The fundamental institutions of China's reform and development. *Journal of Economic Literature,* vol.49.no.4.,pp 1076-1151.
[13] SHILLER,R./2019/:*Narrative Economics: How Stories Go Viral and Drive Major Economic Events.* Princeton, N.J. : Princeton University Press.

of life, from the university business to banking and information technology firms. The Republican administration is a far cry from being a supporter of free markets, domestically or abroad.

Let us note in concluding this section: *being statist and being in favor of institution-building are two distinct cups of tea.* Someone with a German ordo-liberal conviction may well be in favor of strong – and accountable – institutions and against petty interventionism and discretionary policies. And in contrast: Post-Keynesians or Structuralists may be in favor of state decisions over major investment projects, over macro-economic magnitudes, without necessarily emphasizing the role of institutions. If one takes Singapore from among the successful catching up countries, we see very little of transparent, rule of law guided institutions, but very strong central direction of affairs. Japan with its super-Keynesian policies is not a prime case for efficient institutions. Thus, it can easily be, that more statism goes hand in hand with weakened institutions – an outcome we shall return later.

Institutions as Impediment to Change

This insight counts among the better known ones in one part of the literature, and also among the most forgotten ones in the meantime- in a different literature. Coming from a post-communist country one cannot but think about the *opus magnum* of János Kornai/1992/[14], which counts among the most cited monographs on the field, despite its bulky volume. In this work – building on his previous empirical investigations as well as synthetizing previously available knowledge on diverse country experiences – he demonstrates with exceptional rigor the decisive role of institutional arrangements in bringing down the once invincible Soviet Empire. Looking from the theoretical perspective it is worth mentioning, that this reading runs counter to two equally wide-spread –though much less substantiated – explanations of the collapse in 1989-91. One blames the –unquestionable – errors and omissions, at the end of the day of lack of comprehensiveness in the Gorbachev line of *perestroika,* which aimed at saving the régime through incremental changes in policies and also to some extent in institutions[15]. While it has not gone as far as contemporary Chinese reforms –let alone later changes – the logic and mindset was by and large the same: to combine one party rule with partial marketization. Let us note: with the benefit of hindsight it is clear, that the idea per se had not been abortive, as it has been working in China and also in Vietnam in the following thirty years or so. The second competing interpretation blames the West for not having provided more forthcoming an international environment for Soviet and later Russian reformers.[16]

[14] KORNAI,J./1992/: *The Socialist System: the Political Economy of Communism.*Oxford: Clarendon Press.
[15] ASLUND,A./1991/: *Gorbachev's Struggle for Economic Reform.*London: Rances Pinter Publishers.
[16] SAKWA,R./2019/: *Russia's Futures.*London: Polity Press.

Similar stories are being told about the reasons for stagnation in Sub-Saharan Africa and Latin America, which we shall not enter into. This broader narrative is masterfully summarized in the best-selling book by Daron Acemoglu and James A. Robinson/2012/[17]. In their view it is the inclusiveness versus the predatory nature of institutions which is decisive, and those institutions are to a large degree derivatives of their colonial origins. This interpretation prevails today, though has also invited sweeping criticisms both from economic historians and economic theorists. The first group tended to finger-point to the perceived or real shortcomings of the bits and pieces of descriptive parts of the book. The second group tended to question if institutions on their own, without help from policies and the global environment, can be proven to be the only mover of changes, especially if and when this claim is to be substantiated in an econometrically sound manner. While it would take a separate review article to analyze the claims and counter-claims, our purpose was to show that this narrative has developed into a reigning one for the second decade of the current millennium, irrespective of its potential incoherence or imprecision.

A third major narrative where institutions play a pre-eminent role has been the revival of *the middle income trap literature,* observing its syndromes in the 2000s.[18] This term is a modification of the broader concept of institutional trap as a form of lock-in phenomena, discussed in the broader theoretical literature.[19] First diagnosed by the now forgotten Nobel winner Simon Kuznets, countries with high rates of growth often enter into a period of low growth, even stagnation, owing to their institutional configuration, which hinders or preclude reforms, even if those are cognized by decision-makers. First diagnosed on Russia and the United States, the concept has become extended and widely used for explaining slowdown in countries which do not yet enter the stage of Japanese sclerosis, still lose out of their previous dynamics without any good reason or trivial explanation as war or revolutionary breakup.

True, a significant body of literature claims- including the neoclassicals- that mature economies grow slower or nothing due to their structural and technological characteristics[20]. In this case there is nothing

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[17] ACEMOGLU,D- ROBINSON,J.A./2012/: *Why nations Fail: the Origins of Power, Prosperity and Poverty.* New York: Crown Publishers.

[18] EICHENGREEN,B. – PARK,D.-H. – SHIN,K.-H./2014/: Growth slowdowns redux: new evidence on the middle income trap. *Japan and the World Economy,* vol.32.no.1.pp65-84, update and summary of ensuing debate in:KANG,N- PAUS,E./2019/: The political economy of middle income trap: the challenges advancing innovation capabilities in Latin America, Asia and Beyond. *Journal of Development Studies,* vol.55.pp 1-6/published online on 22 April/.

[19] POLTEROVICH,V./2019/: Institutional Trap. In: *The New Palgrave- a Dictionary of Economics-3d, online edition.*Cham: Springer International, online edition, last retrieved on 12 November, 2019.

[20] Cf recently with much influence in GORDON,R.J./2016/: *The Rise and Fall of American Growth.*princeton,N.J. : Princeton University Press.

to be explained. Radicalizing the pessimistic view of Gordon cited above, Vollrath/2020/[21] openly proposes that stagnant output is a feature of high level of development, or as he puts it, when the economy if 'fully grown'.

The trouble with this claim is that in real world scenarios we have equal amount of cases, like Luxemburg and Singapore, with no signs of slowdown, as compared to Japan and the UK, where slowdown seems to be a secular trend. Thus we need to attempt at alternative interpretations, not based on a single case observation and generalization thereof. In a comparative perspective stagnation is not to be equaled to normalcy, once a certain level of maturity is attained. Let us add: the examples analyzed in the *New Palgrave* entry cited above account for countries which would equal to medium level of development as of today, or middle income countries to use the term our sources do.

The concept of the middle income trap describes a widely observed phenomenon that has long been intriguing students of catching up and development. Namely that *good policies and good institutions seem to be eroding in the sense of getting less and less efficient with the time passing.* As a result registered rates of growth, but also efficiency of allocation, innovation and growth of employment/inclusiveness of the economy deteriorate. This may not automatically lead to the first becoming the last, but it often does mean that growth ebbs out before catching up would have been complete.

Some observers, such as the by now largely forgotten Mancur Olson/2000[22]/highlight the impact of vested interest politics and the ensuing *ossification of social and economic structures* that create impediments to continuous adjustment and change, conveniently postulated by mainstream/neoclassical accounts of growth and development. The concept of middle income trap goes a step further in specifying the causes and relates the *recurring delays in implementing already accepted structural reforms to specific political and communications channels*. These include the issue of visibility as well as the long established rule of the short run. The latter means that measures with no immediate popularity gains, such as investment in human infrastructure, or improving legal and institutional arrangements that bear fruit only in the long run, and mostly not for the government introducing them, will be pushed to the background as useless or not being really urgent. What seems to be an innocent delay today becomes a major blunder in the medium to long run, long before "we are all dead" as Keynes quibbled. These factors are magnified by the

[21] VOLLRATH,D./2020/: *Fully Grown.* Chicago/Ill.: University of Chicago Press.

[22] OLSON,M./2000/: *Power and Prosperity: Outgrowing Communist and Capitalist Dictatorships.* New York: Basic Books.

internet age and the advent of post-truth politics and the rule of the social media, where *validation of claims is usually lacking.*

This insight has been supported in many ways by the emerging new theories of growth and development, all stressing the relevance of issues like rule of law, trust, transparency and accountability, security of civic and property rights, that is the usual list of commandments for sound economic policies offered by various schools of thought.

While the Olsonian view focuses on institutional and social rigidities, as the final mover, the middle income trap approach highlights *the role of policies and incremental action as well as non-action* in bringing about unintended consequences that dominate the intended ones.

It seems that the middle income trap view is more encompassing as long as it covers *dictatorial and democratic regimes alike.* In the case of the former the most recent and perhaps most relevant in the global perspective is the reversal of Chinese reforms under the Xi Presidency, particularly since 2012/Lardy, N, 2019/.[23] But the more traditional cases, as those in the European Union, with reforms preached but not practiced in several peripheral countries, from Portugal to Poland may be cases in point.

All in all, the middle income trap – similarly to the resource curse and many other ills in development – may well be overcome. *There are remedies offered by economic theory, and there are successful cases* of breaking out developmental, institutional or political deadlock. What we do not have is perhaps the naïve enthusiasm and belief of three decades ago in the quasi inevitability of the triumph of democratic and market oriented solutions. At the end of the day, the big surprise in the decade which followed the Great Recession was precisely the lasting presence of state interventionism in its various forms and also in its condoning by a very large part of theories and of the public alike. Put it differently: while knowledge of how to handle what we would still describe as economic illnesses is solid and is also available/not least owing to open access and the internet/, *the willingness to apply proper medication is not necessarily there.* Anti- vaccination movements do abound, in advanced and emerging economies alike.

Can Institutions Become Hollowed?

In the third section we reflect upon a relatively new development. While certainly, at one level of abstraction “there is nothing new under the Sun”, but the institutionalist interpretation tended to be the

[23] LARDY,N./2019/: *The State Strikes Back: the End of Economic reform in China?*Washington,D.C.: Peterson Institute for International Economics Press.

mainstream view, if not in the theoretical economics departments, but definitely in development studies. The latter is reflected in the fact which is easy to check, that most influential fora on development are by no means pure economics journals. They tend to be rather multi-disciplinary outlets, with contributions including as diverse fields as sociology or infectology, plantation studies and demographics.

Development studies tended to be holistic in their diagnoses and therapy alike, from Gunnar Myrdal to Amartya Sen and more recently the Banerjee-Duflo-Kremer trio of Nobel winners of 2019. What we are concerned at this stage not the broader methodological issue which is at the center of debates in the economics profession over the need for co-operation with sister disciplines or the redundancy of inter-disciplinary approaches. Our claim is that owing to their broader focus development studies have long discovered what has become a fashionable topic for the mainstream of international political economy by the current decade, namely the hollowing of institutions.

In short, it counted among the platitudes in development studies to claim that institutional transfers may though work, but in reality it is quite rarely the case. Furthermore there is a tendency for the drift between developmental poetry and reality to be deeper than customarily acknowledged/Bird, G.et al,2012/.[24] This insight, supported by libraries of writings on the failed experiences in transplanting elsewhere successful arrangements in emerging and post-communist environments, has been running counter to development thinking of the current millennium, which has changed emphasis. If in the preceding decade the creed was by and large the Washington Consensus in its first, second and third editions, the post-crisis era tended to be a period of revival regulation school and of highlighting institutional pre-conditions for successful adjustments.

The big turn against this latter tide has been made in the post-2010 period, with Central and Eastern Europe in its bulk turning against the previous tide of marketization and democratization. It has been a subject of insightful and colorful debate if this turn added up to the emergence of classical mafia-states/Magyar,B.ed.,2019/[25], or rather what we observed was a milder, local version of a global trend of the state re-claiming its lost territories in economic development, both in terms of ownership and micro-management of the cycle/Szanyi,ed.2020/[26].

[24] BIRD,G – MANDILARAS,A.-POPPER,H./2012/: Is there a Beijing Consensus on international macroeconomic policy? *World Development,* vol.40.no.10.pp 1933-43.
[25] MAGYAR,B.ed./2019/: *Stubborn Structures.*Budapest-New York: CEU Press.
[26] SZANYI,M.ed./2020/: *Searching for the Best Master.* Budapest-New York: CEU Press.

Without re-iterating the literature cited in these extensive empirical volumes and our own reading of Hungarian reversals/Csaba, 2019/[27] let us posit the major puzzle. In Hungary- but also in Poland and to a much stronger degree in Russia and Ukraine – formal institutions of the market economy and of pluralist democracy have remained in their place. However, *their functioning has been modified, to the point of crippling,* by way of arbitrary appointments and by way of eroding the systems of checks and balances. For instance, by appointing individuals unconditionally loyal not only to the Party, but to the supreme leader's person to key positions, as the Governor of the central bank, the High Prosecutor, or heads of secret services and the public media/while undermining and closing down critical media and independent institutions, or turning them subordinates to the ruling party/ the name of the game changed. Formally speaking there continues to be a system of checks and balances, but if the State Audit Office tends to be regularly more optimistic than the Treasury on macro-economic trends, while is diligent in persecuting opposition parties, the entire division of labor among the players undergoes a change.

To take the Polish example: if members of the Constitutional Court are nominated *en masse* and without broader inter-party consensus exclusively and single-handedly by the governing party only, and the Supreme Court is cleansed from judges openly critical of the government, *the balance between legislative and executive obviously changes in favor of the latter, without any formal systemic change*. Similar changes in a much more radical manner are documented in the collections cited above for Ukraine and Russia, as amply documented in the volume/Magyar, B.ed.,2019/ cited above.

Yet another under-explored subject in this respect has been *the changing role of business-government relationship.* Central and eastern Europe never experienced a power vacuum, and the claim of neoliberal excesses and giving up state regulation has often been voiced, but never convincingly substantiated by factual material.[28] The state has never "withered away", it has remained decisive as an employer, owner, regulator and re-distributor in each and every country, including the most liberal Baltic States. For instance these countries have joined the Euro-zone, while the Central Europeans- save Slovakia and Slovenia- have not and perhaps also will not. Joining the EMU has always been a strategic decision, staying out too. Joining in requires orchestration, meeting fiscal and monetary targets, keeping 'all options open' too. In sum, neoliberalism might well have been preached, but never practiced on the ground.

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[27] CSABA,L./2019/: Unorthodoxy in Hungary: an illiberal success story? *Post-Communist Economies*/open access, published on 13 August on T+F Online/.
[28] For a recent ideological re-statement of this old claim from the early 1990s cf APPEL,H.- ORENSTEIN,M./2018/: *From Triumph to Crisis: Neoliberal Economic Reform in Postcommunist Countries.*Cambridge/UK and New York: Cambridge University Press.

We do not assert, that staying out of EMU were an act of statism or illiberalism. If one takes Denmark or Sweden, we may observe two countries with tough economic policies, much in line with what critics would term 'neoliberal' in France, Italy, Spain or even Germany, including the famous flexicurity arrangements, compelling workers for re-training in exchange for lavish unemployment benefits. Our claim is that the legal obligation to join EMU, taken up at the 2004 accession, have never materialized. And the explanation lays well beyond the customary technical explanations provided by central bankers in each of the countries concerned.

Non-membership in the EMU complements a series of other 'mishaps', pertaining to security of property, equal treatment of foreign and local enterprises, or ensuring competition as level playing field in all markets stipulated by EU law. In general, rule of law, implying even-handed and impartial administration of justice has been pushed to the background in favor of open favoritism, and far not only in agriculture. Banking, media, energy sector, even sports as an important economic activity/building stadiums, organizing global sport events etc/ all show signs of preferential treatment of those 'truly close to us', i.e of power centers.

The fundamental difficulty in interpreting what we observe is exactly the lack of formalization, or *the increasing drift between form and substance*. To give but a few examples: if out of 1200 initiatives of the opposition not a single one is adopted in the legislation, it does not abolish the parliamentary nature of government. However, it would be hard to pair it to the US practice of say, the 1950 to 2000 period, when bipartisan arrangements and solutions were not the exception, but the rule. Likewise if EU funds are allocated by a procedure in which the best bidder is chosen out of one, this may formally be law-abiding, but in substance it is a mockery of what this instrument is meant for. Likewise if public media lacks pluralism and becomes a mouthpiece of power much to the same degree as it used to be under one party rule, media pluralism becomes gradually extinct even without full nationalization. In short, *style becomes substance,* and a formally liberal market order is transformed into a highly coordinated one, without changing the law but modifying its implementation. Documenting these changes and proving claims against contesting, self-justifying propaganda is anything but a trivial task for analysts. By the same token the dividing line between 'hard facts and soft interpretations' fancied in American social science becomes porous at least.

In all, one of the new developments of the current decade is the *changing interface of formal and informal institutions.* The phenomenon per se is nothing new in development studies. What is new is the re-emergence of this issue in advanced countries like the USA under Trump or the Czech Republic under

Andrej Babis. In short, the hollowing may render institutions marginal rather than focal points in setting the features of the system as it works on the ground.

An Overview: What Makes Institutions Relevant for Change?

This section aims at incorporating the insights from the previous three into a broader theoretical framework and relate these to the new trends in thinking in global economics and international political economy. Perhaps one of the more perplexing trends has been the *de-emphasis of traditionally pre-eminent material factors and the appreciation of intellectual and emotional ones*, that is highlighting the role played by typically non-material factors in explaining outcomes and also in shaping the normative view.

We may refer first and foremost to the literature on financial crisis and crisis management, where both bankers and regulators tend to highlight the focal role of moral standards and accepted models of individual and collective behavior. To cut a long story short we may refer to the fall 2019 'long read' series in the *Financial Times* on the imminent need to re-think capitalism in its present shape. Contributions voiced the requirement to find purpose over and above incessant increases in the consolidated asset value of firms, the inevitability to adopt broader objectives than shareholder value maximization, the urgency of remedying wealth polarization and slowdown or even stagnation in social mobility, as well as the need to include environmental sustainability concerns among the objectives of the firms, including the parameters deciding over bonuses of management. The above listed issues, which we present as a selection of topics only, would have qualified as empty moralizing in the period between 1990 and 2010 not only in the media, but in most of management, finance and economics departments of good universities and business schools.

A keynote is not the place to come up with a new vision of the discipline. But our *tour d'horizon* may allow to reflect on some of those new developments, which may result in *an incremental but fundamental renewal of thinking about the economy*.

First, the very fact that institutions and their role have become so pre-eminent in global economic scholarship is a sign of a gradual re-assessment inside the profession of what matters in terms of explanatory power. The literature we surveyed may have been considered to be marginal at certain points of time, especially at the level of both public policies and corporate management. This is no longer the case. We have cited the recent book by Robert Shiller above, but it would be hard to find any major analysts, regulator or policy-maker who would not invoke in his or her analysis among the root causes of crisis and among the milestones of avenues for betterment the need to restore conservative and often not quantifiable values of solidity.

As a consequence- *second of all* -, in terms of management practices, one of the most intricate consideration is how to define and even more how to enforce such broad and non-parametric items like solid behavior, trustworthiness, responsibility for stakeholders and the broad- natural and social – environment. In terms of German ordo-liberalism we are back to square one: a free market *pre-supposes a set of values* to which players are explicitly committed, by law and internal convictions/set of values alike.

Third, we may refer to a re-emerging trend in economic thought, which underscores the *role of public discourse* in shaping values and setting standards for socially appreciated forms and ways of success. Perhaps Deirdre N.McCloskey/2006-2016/[29] of Chicago has gone the farthest in advancing this claim in her historical and logical explanation of capitalism and its innovativeness and ability to change and also generate shared prosperity against tendencies to monopolization of power and wealth. Under this angle the rule of social media and generally the flow of uncontrolled and uncheckable pieces of information/to the point of deliberate manipulation/ pose major and direct challenges to democracy and market economy, both built upon open exchanges and deliberation based on rational assessment of pros and cons. What becomes crystal clear supports our previous knowledge: *institutions do not act on their own,* as 'independent variables' in an equation. They exert their impact in the context created by societal values, that include discourses over what is and is not acceptable and commendable. Therefore the same arrangement may work in one place and totally fail in another one.

Fourth, as has traditionally been emphasized by Douglass North/2005/, all institutions matter as much as they *are enforced on the ground.* As we have seen, institutions may be completely transfigured by way of a changed interpretation. To bring but one example: while Russia under Yeltsin counted for many as a normal country at a medium level of development with an overgrown military, under Putin few would share this conviction outside the official academics in Moscow. And this despite the fact that the constitution, land law, civil law and many others are either the same as in the 1990s, or have been technically updated to conform to global standards. It is the implementation which changed.

Fifth, one more traditional debate, that of *sequencing* has gained new policy relevance for the contemporary world. Should institution building precede or conclude systemic transformation? Those

[29] McCloskey,D./2006-2016/: *The Bourgoise Era, vol.I-III.*Chicago/Ill.: University of Chicago Press.

believing in social engineering would opt for the first, those adhering to trial and error for the second option. Russia usually counts as a case for the first, China as the second, thus the issue seem to have been settled for some time. But it seems to be open again by now, with the marked and irreversible decline in the economic performance of mainland China.

In short, conventional wisdom went as follows in 19990-2010. Trial and error is superior to social engineering. The People's Republic of China with its profoundly a-theoretical, experimental approach is a showcase for success. By contrast, Russia shows that plans designed on computer remain dreams once experience disproves them, or if they turn out to be too abstract o be heeded.

In the current decade Russian economic performance deteriorated, not least owning to the stagnation of oil prices on global markets. The country has though recovered from the recession of 2015-16, but GDP growth remained sluggish, below two per cent p.a. in the subsequent periods. Retail sales peaked in 2010 and never re-gained that level in the following decade. The economic base for the revival of Russian great power interests, as illustrated by the annexation of the Crimea in 2014 and the involvement in helping to victory Syrian president Bashir Assad in 2019 render the Russian experience contentious. Chinese slowdown, on the other hand, points toward the limitations to institution-less evolution.

If we are to consider true success stories, from Estonia to Israel and Ireland we do see a considerable degree of *social engineering, perhaps in reverse.* This term tended to be retained for move towards more state managed options in the economy. In the above listed cases the move of the shuttle is though opposite, still it would be hard to deny: most of the changes were man made, or at least initiated by human action. Is not deregulation or fiscal balancing not a form of social engineering?

In all of the above cases our broader approach seems to have been substantiated. Particularly if we take the Baltics and Ireland social consensus is shown to play a formative role in laying the groundwork for sustaining solid policies/Győrffy, 2018,pp79-112/[30]. By contrast, derailments in countries like Cyprus, Portugal and Spain have been shown/i.a in op.cit, pp 113-146/ to be rooted in lacking social support for sensible economic policies and the actors aiming at implementation of these, lacking trust, and the ensuing weak functioning of available institutions, no matter how nicely elaborate the latter might have been.

[30] GYŐRFFY,D./2018/: *Trust and Crisis-Management in the European Union.* London: Palgrave.

We are, to a large degree, moving in darkness in our quest for the determinants for social trust and efficient institutions. This is an issue for political science, social psychology and international relations, sociology and media studies to study and come up with *propositions more subtle than the usual suspects,* as 'credibility of government' and 'coherence in institutional setup', long in use in the literature on structural adjustment.

Conclusion

We have not promised to solve the one million dollar quiz question at the very outset. Thus we are somewhat relieved. Mission accomplished in the sense that we produced an overview of the competing approaches to institutions and their role in producing change for the better and for the majority, as is usual in the policy relevant literature. We have shown some lines of reasoning to be more convincing, more robust than others. Still, *most of the big questions remain open* and require further study, both empirically grounded and theoretically oriented.

One of the most intriguing issues that we dodged may be the definition: what counts as an institution? We have much less trouble with the formal ones and more with the informal ones. How far should we include habits, customs, perceptions and beliefs especially in our new IT dominated world, where the borderline between perceived and real, virtual and material is about to disappear, or become permeable at least? *How can we test if certain claims hold true or not, especially on the role of non-material factors* and other items, usually outside the scope of economic analysis? In short, there is a lot to be reflected about in more than one plane of research.

If we are to wrap up what is to be taken home from this particular overview of the evolution of global thinking on the role of institutions in fostering change for the better/meaning well-being for as many people as possible/ we may come to a somewhat agnostic finding. Institutions do matter, as the limitation of institution-less pragmatic evolution – in China – and of weak institutions – as in Russia, Latin America and Sub-Saharan Africa – indicate. There is no sustaining progress in human conditions without good quality institutions/quality not being standardized, nor subject to quantitative indicators, to the regret of much of the profession/. On the other hand, or review of the potential and actual hollowing of institutions caution against believing they are everything. *Institutions as outcomes of human action do not act in empty space*[31]: they are surrounded by values, discourses, policies, collective action, natural and social

[31] This insight was elaborated first and in a most profound manner by the now forgotten classic of Ludwig von MISES/1949/2012/: *Human Action. A Treatise on Economics.*Mansfield Center, CT: Martino Publishing,pp 143-200.

environment which may be favorable or harmful to their functioning, and not least complemented or contradicted by policies employing them.

Thus we are well advised to pay due attention to the nature, coherence, inclusiveness and the overall quality of institutions if we are to see economic betterment in service of the vast majority of people. On the other hand we should avoid the naïve belief in the omnipotence of good quality institutions, as if they were to save the strenuous efforts of trials and errors in the process of economic change.

So what may be generalized for broad economic theory? If we are not entirely wrong in interpreting the global economic literature, the finding is an old/new task. Namely *to integrate institutional factors in the series of explanatory variables* of economic change, and that in a manner consistent with facts and fundamentals of institutionalism alike.