INSTITUTIONAL ENVIRONMENT - BASIC REQUIREMENT OF ECONOMIC COMPETITIVENESS

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Abstract:
Research shows that institutions play a key role in facilitating private investment and that institutional quality is the most important factor that explains why capital does not flow from developed countries, where it has a lower return, to developing countries where it has a higher return
The importance of institutions is not restricted to the legal framework. Government attitudes toward markets and freedoms and the efficiency of its operations are also very important: excessive bureaucracy and red tape, overregulation, corruption, dishonesty in dealing with public contracts, lack of transparency and trustworthiness, or the political dependence of the judicial system impose significant economic costs to businesses and slow down the process of economic development.
The paper approaches thus a topic of present utmost interest, rising the interest of specialists, media and, last but not least, the interest of entrepreneurs, irrespective of their domain of activity.

Key words*: institutional environment, competitiveness, development*

JEL classification: O10, O43

1. Introduction

The institutional environment forms the framework within which individuals, firms, and governments interact to generate income and wealth in the economy.

Institutions come in a variety of dimensions and levels: economic, social, political, and corporate institutions; public and private institutions; and national and sub-national, subregional, regional and global. Notwithstanding their value, institutions are hard to grasp and have been defined in a variety of ways by different authors. Most notably, Douglas North (1990) defines institutions as the formal and informal rules governing human interactions. Unlike institutions, policies are choices made within a political and social structure - within a set of institutions. Institutions might also explain differential capital-labour ratios in terms of differences in cultural context and technological capacity.

The institutional framework has a strong bearing on competitiveness and growth. It plays a central role in the ways in which societies distribute the benefits and bear the costs of development strategies and policies, and it influences investment decisions and the organization of production.

In the broad sense, competitiveness means the capacity of a society to create and maintain the institutional economic and infrastructure conditions favouring the constitution, attracting and development of certain companies which produce merchandise and services of quality higher than that of its competitors, under the conditions of a most efficient use of available resources.

2. The Institutional Environment in Romania

In the context of the integration into the European Union, the issue of the increase of firms' competitiveness has become essential for Romania's economy also, which requires as a mandatory condition the elaboration and application of certain clear strategies, both at the level of firms, and of the Government's, with specific goals and actions. The problem now in Romania is finding the most efficient means enabling us to organically reintegrate, as society, into the western values, knowing that, in the global economy competition, Romania is not the leader in any category of products or services.

Institutions can affect capital flows directly by providing the enabling environment, good governance and sound financial institutions that encourage the flow of capital and facilitate long-term investments. Indirectly, institutions affect capital flows through their impact on other variables that affect capital flows, in particular their impact on economic growth and the business environment, including the quality of public infrastructure, policy environment, political stability, labour costs, exchange rates, and price and exchange rate stability.

Table 1

The Competitiveness Index: Institutions

Country	**Institutions**		**Basic requirements**	
	Rank	**Score**	**Rank**	**Score**
Sweden	1	6.12	1	5.98
Finland	2	5.96	2	5.97
Denmark	3	5.84	4	5.86
Luxembourg	4	5.73	6	5.81
Netherlands	5	5.54	5	5.82
Germany	6	5.5	3	5.89
Austria	7	5.42	7	5.67
United Kingdom	8	5.28	9	5.58
Ireland	9	5.14	14	5.18
France	10	5.04	8	5.67
Belgium	11	4.98	10	5.45
Cyprus	12	4.91	12	5.28
Estonia	13	4.91	11	5.38
Malta	14	4.83	16	5.08
Portugal	15	4.37	17	5.01
Slovenia	16	4.37	13	5.18
Spain	17	4.25	15	5.13
Poland	18	4.18	22	4.69
Lithuania	19	3.99	20	4.77
Czech Republic	20	3.86	18	4.91
Latvia	21	3.79	24	4.6
Hungary	22	3.76	23	4.65
Romania	**23**	**3.74**	**27**	**4.36**
Greece	24	3.67	25	4.49
Slovak Republic	25	3.6	21	4.77
Italy	26	3.58	19	4.84
Bulgaria	27	3.29	26	4.43

Source: Adapted from World Economic Forum, *The Global Competitiveness Report, 2010 – 2011*, p. 16-17.

Owners of land, corporate shares, and even intellectual property are unwilling to invest in the improvement and upkeep of their property if their rights as owners are insecure. Of equal importance, if property cannot be bought and sold with the confidence that the authorities will endorse the transaction, the market itself will fail to generate dynamic growth.

The importance of institutions and the mechanism through which institutions affect capital flows were not clear until recently. Empirical evidence suggests that institutional differences are a major source of the differences in economic performance across countries.

Although the economic literature has mainly focused on public institutions, private institutions are also an important element in the process of creation of wealth.

According to World Economic Forum, in terms of institutions, Romania ranks the 23^{th} place in the European Union, just ahead of Greece, Slovak Republic, Italy, Bulgaria, managing to get only 3.74 points from a maximum of 7 points (table 1).

The position of Romania is explained by the fact that, in analyzing the institutional environment should be considered and other important issues: excessive bureaucracy, corruption, bad faith in dealing with public contracts, lack of transparency and trust, or a political dependency system judiciary, etc. all require significant economic costs for businesses and slow the process of economic development.

From the perspective of the Lisbon Agenda, competitiveness refers to the capacity of a country to maintain, at least on a medium term, high rates both of the economic growth and of employment, all these having as a long-term result the increase of the population's wellbeing. From this perspective, competitiveness depends first of all on the institutional and economic capacity of a country to support the increase of productivity and innovation.

Under these circumstances, the issue of increasing firms' competitiveness has become essential for Romania's economy. Nevertheless, this also requires the elaboration and application of clear strategies, both at the level of companies and at the level of the government, with specific goals and actions.

Consequently, competitiveness is generated at the microeconomic level, the sustainable prosperity being created by firms, and thus the quality of the business environment is a fundamental factor, but it is supported and consolidated at the macroeconomic level, as competitiveness is expressed at the same time by the capacity of a country to maintain, at least on a medium term, high rates of both economic growth and employment, all these resulting in the long run in the increase of the population wellbeing. From this perspective, competitiveness depends, first of all, on a country's institutional and economic capacity to support the increase of productivity and innovation.

3. Conclusions

While macroeconomic stabilization policies are necessary for attracting steady and predictable flows of external finance, they will be more entrenched and sustainable if underpinned by a sound institutional environment.

The significant corporate scandals that have occurred over the past few years, and the present global financial crisis, have highlighted the relevance of accounting and reporting standards and transparency for preventing fraud and mismanagement, ensuring good governance, and maintaining investor and consumer confidence. An economy is well served by businesses that are run honestly, where managers abide by strong ethical practices in their dealings with the government, other firms, and the public. Private-sector transparency is indispensable to business, and can be brought about through the use of standards as well as auditing and accounting practices that ensure access to information in a timely manner.

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