

## INCLUSIVE INSTITUTIONS AND ENTREPRENEURSHIP

Prof. Dr. Miomir Jakšić<sup>1</sup>

Dr. Milica Jakšić<sup>2</sup>

### ABSTRACT

Good institutions are characterized with three attributes: 1. they establish and protect property rights; second, they restrict social elites which strive to expropriate income and property of others members of society; third, they provide equal chances for employment, social security and civil rights to all individuals. Good institutions contribute to political stability, successful macroeconomic policy and enhance initiatives. Key role of institutions is in securing stability and continuity.

Extractive institutions in two ways can negatively affect entrepreneurship and whole economic development:

- a) Increasing the opportunity cost, resulting in upward movement of Opportunity cost curve.
- b) Affecting Return to entrepreneurship resulting in leftward movement of Return to entrepreneurship curve.

**Keywords:** *institutionalism, inclusive institutions, political macroeconomy*

**JEL Classification:** *B22, P16, P48*

### 1. Growth and inclusive institutions

In recent two decades, due to contributions of Political macro economy, focus of macro economy turned away from narrow perspective based on market and privatisation (market fundamentalism) towards broader perspective based on institutions and values (institutionalism). "Human and physical capital are proximate causes of economic growth. Why do some countries have better technologies and more human capital?"<sup>3</sup>

Main thesis of one of leading proponents of Political macro economy, D. Acemoglu, is: "growth is much more likely under inclusive (economic and political) institutions than extractive institutions. Inclusive economic institutions: Secure property rights, law and order, markets and state support (public services and regulation) for markets; open to relatively free entry of new businesses; uphold contracts; access to education and opportunity for the great majority of citizens, i.e., create incentives for investment and innovation and a level playing But most societies throughout history and today ruled by Extractive economic institutions: they are designed by the politically powerful elites to extract resources from the rest of society."<sup>4</sup>

---

<sup>1</sup> University of Belgrade, Faculty of economics, Beograd, Serbia e-mail: [mjaksic@ekof.bg.ac.rs](mailto:mjaksic@ekof.bg.ac.rs)

<sup>2</sup> Modern Business School, Beograd, Serbia, e-mail: [mjaksic@mbs.edu.rs](mailto:mjaksic@mbs.edu.rs)

<sup>3</sup> Acemoglu, D., Political regimes, institutions and growth, June 2005, Tüsiad-koç university economic research forum.

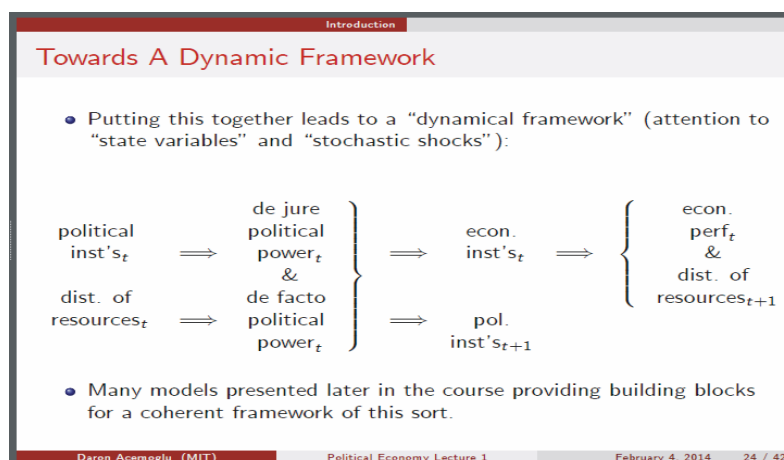
<sup>4</sup> Acemoglu, D., State Building: A Political Economy Perspective, Nemmers Lecture. Acemoglu, D., Robinson, J., Why Nations Fail, FBBVA Lecture, May 21, 2012.

Importance of institutions, culture and values lies in the fact that, contrary to previously dominant market fundamentalism, there exist correlation between GDP and democracy, but not oneway unilinear causation, either from side of GDP or democracy. "If institutions matter (so much) for economic performance, why do societies choose or end up with institutions that do not maximize economic growth or aggregate economic welfare."<sup>5</sup>

D. *Acemoglu* writes: "Institutions are the rules of the game in a society or, more formally, are the humanly devised constraints that shape human interaction. Institutions are humanly devised, set constraints, and shape incentives."<sup>6</sup>

These ideas can be presented schematically:

Figure 1



**Source:** Acemoglu, D., "14.773, Political economy of institutions and development, Lecture 1: Introduction and overview", pdf 9522, MIT, Feb. 4, 2014. <http://economics.mit.edu/faculty/acemoglu/courses>.

D. *Acemoglu* writes: "It may also be tempting to follow political scientists and sociologists and classify institutions into two groups (with the implicit understanding that most real world institutions will fall somewhere in between):

- Predatory ("bad") institutions: as institutions that do not encourage investment and economic development.
- Developmental ("good") institutions: as institutions that permit or encourage investment and growth.<sup>7</sup>

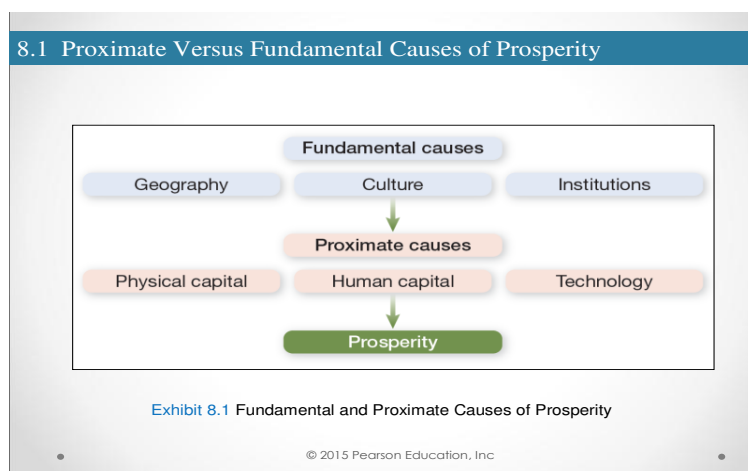
Distinction between bad and good institutions evolved in distinction between **extractive institutions** (bad institutions) and **inclusive institutions** (good institutions).

<sup>5</sup> Acemoglu, D., Modeling Inefficient Institutions, *Ekonomске ideje i praksa*, no. 12, march 2014., thematic issues Political macroeconomy and contribution of Daron Acemoglu.

<sup>6</sup> Acemoglu, D., "14.773, Political economy of institutions and development, Lecture 1: Introduction and overview", pdf 9522, MIT, February 4, 2014. <http://economics.mit.edu/faculty/acemoglu/courses>.

<sup>7</sup> Acemoglu, D., "Political Economy Lecture Notes", PE9524.pdf & <http://economics.mit.edu/faculty/acemoglu/courses>, p. 14.

Figure 2



**Source:** Acemoglu, Liabson, List Macroeconomics, Chapter 8, "Why Isn't the Whole World Developed?," Pearson, 2015, [www.pearsonhighered.com](http://www.pearsonhighered.com), Instructor resources.

## 2. Three growth hypotheses

Different destinies of particular countries and non-existence of warranted economic and social prosperity are explained by three hypotheses:

1. Geography hypothesis,
2. Culture hypothesis, and
3. Institutions hypothesis.

1. **Geography hypothesis** insists upon significance of physical geography, climate, and ecology. Geographical factors have significant role in determining the location and level of interactions of those ancient agricultural civilisations.<sup>8</sup> L. Putterman writes: "What and how big is the role of historical factors in explaining great differences on the level economic development between different countries and regions in the world today? The level of economic development and the growth rate since the end of the European colonial era has greatly depended on the average level of technology and political position of the area where the ancestors of today's inhabitants lived long before or immediately before the colonial era. The interplay between geography and human capital, broadly viewed as culture, norms and institutional capacities have a central role in explaining those differences."<sup>9</sup>

2. **Cultural hypothesis** point towards significance of cultural heritage, values and tradition. Guiso, Sapienza, and Zingales defined culture as "those customary beliefs and values that ethnic, religious, and social groups transmit fairly unchanged from generation to

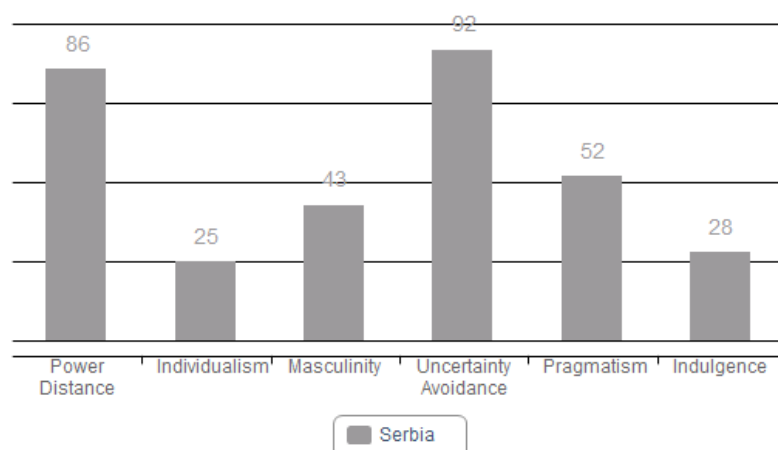
<sup>8</sup> Jakšić, M., "Geographical Deviation and historical development", *Ekonomске teme*, Niš, vol 53(3), 2015, pp.319-334.

<sup>9</sup> Putterman, Louis. "History and comparative development." *The New Palgrave Dictionary of Economics*. Online Edition. Eds. Steven N. Durlauf and Lawrence E. Blume. Palgrave Macmillan, 2014. The New Palgrave Dictionary of Economics Online. Palgrave Macmillan. 22 May 2014  
[http://www.dictionaryofeconomics.com/article?id=pde2014\\_G000223](http://www.dictionaryofeconomics.com/article?id=pde2014_G000223).

generation.”<sup>10</sup> Alesina, A., Giuliano, P. explains significance of culture as follows: "Recent research demonstrates that cultural variables determine many economic choices they even affect the speed of development and the wealth of nations. Culture and institutions are endogenous variables, determined, possibly, by geography, technology, epidemics, wars, and other historical shocks."<sup>11</sup>

For Cultural hypothesis we give example of Serbia. Power distance and Uncertainty avoidance are significantly high; Pragmatism and Masculinity rather high, while Individualism and Indulgence are low. This leads toward conclusion that Serbian society is highly influenced by traditional values and culture.<sup>12</sup>

Graphic 2



Source: <http://geert-hofstede.com/dimensions.html>, accessed 4.1.2015

3. **Institutional hypothesis** attributes the central role to institutions, which promote investment in human, physical capital and technology. Institutional hypothesis can be illustrated with significance of institutions for economic development via promoting or inhibiting entrepreneurship. "The institutions hypothesis claims that differences in institutions — how societies have organized themselves and shaped the incentives of individuals and businesses — are at the root of the differences in prosperity across the world. In other words, the institutions hypothesis is based on the notion that it is the way that humans themselves decide to organize their societies that determines whether or not they prosper."<sup>13</sup>

Next diagrams explain fundamental significance of institutional hypothesis for economic development.<sup>14</sup> Good (inclusive) institutions **positively** affect either Return to entrepreneurship or Opportunity cost, or both, whilst Bad (extractive) institutions **negatively** affect them.

<sup>10</sup> Guiso, L., Sapienza, P., and L. Zingales, 2006, "Does Culture Affect Economic Outcomes?", *Journal of Economic Perspectives*, 20(2): 23–48, according to Alesina, A., Giuliano, P. "Culture and Institutions", 1. September, 2014.

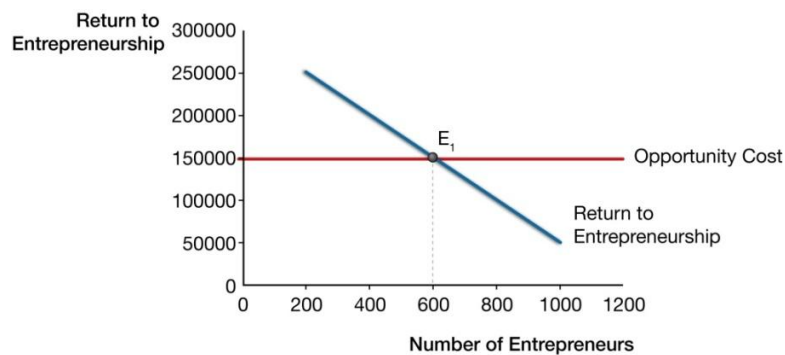
<sup>11</sup> Alesina, A., Giuliano, P. "Culture and Institutions", 1. September 2014. accessed 23.12.2014.

<sup>12</sup> Jaksic, M., Jaksic, M., "Proximate and Fundamental Factors of Growth: Culture and Institutions", *Economics and Economy*, vol. 1, no. 4, dec. 2014, pp. 7-22.

<sup>13</sup> Acemoglu, Liabson, List, *Macroeconomics*, Chapter 8, "Why Isn't the Whole World Developed?" Pearson, 2015., [www.pearsonhighered.com](http://www.pearsonhighered.com), Instructor resources.

<sup>14</sup> Acemoglu, Liabson, List, *Macroeconomics*, Chapter 8, "Why Isn't the Whole World Developed?" Pearson, 2015., [www.pearsonhighered.com](http://www.pearsonhighered.com), Instructor resources.

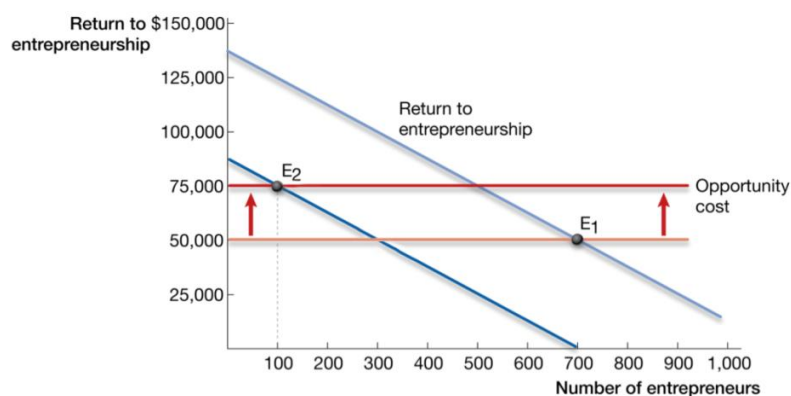
Graphic 3



**Source:** Acemoglu, Liabson, List, *Macroeconomics*, Chapter 8, "Why Isn't the Whole World Developed?" Pearson, 2015., [www.pearsonhighered.com](http://www.pearsonhighered.com), Instructor resources.

Extractive institutions in two ways can negatively affect entrepreneurship and whole economic development:

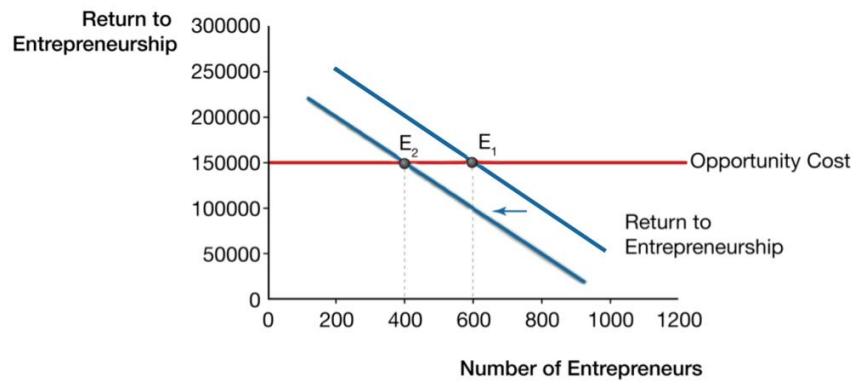
- a) Increasing the opportunity cost (e.g. licensing, administrative barriers) resulting in **upward movement** of Opportunity cost curve.



**Source:** Acemoglu, Liabson, List, *Macroeconomics*, Chapter 8, "Why Isn't the Whole World Developed?" Pearson, 2015., [www.pearsonhighered.com](http://www.pearsonhighered.com), Instructor resources.

- b) Affecting Return to entrepreneurship (e.g. barriers to entry, rent-seeking, insecure legal position) resulting in **leftward** movement of Return to entrepreneurship curve.

Graphic 4

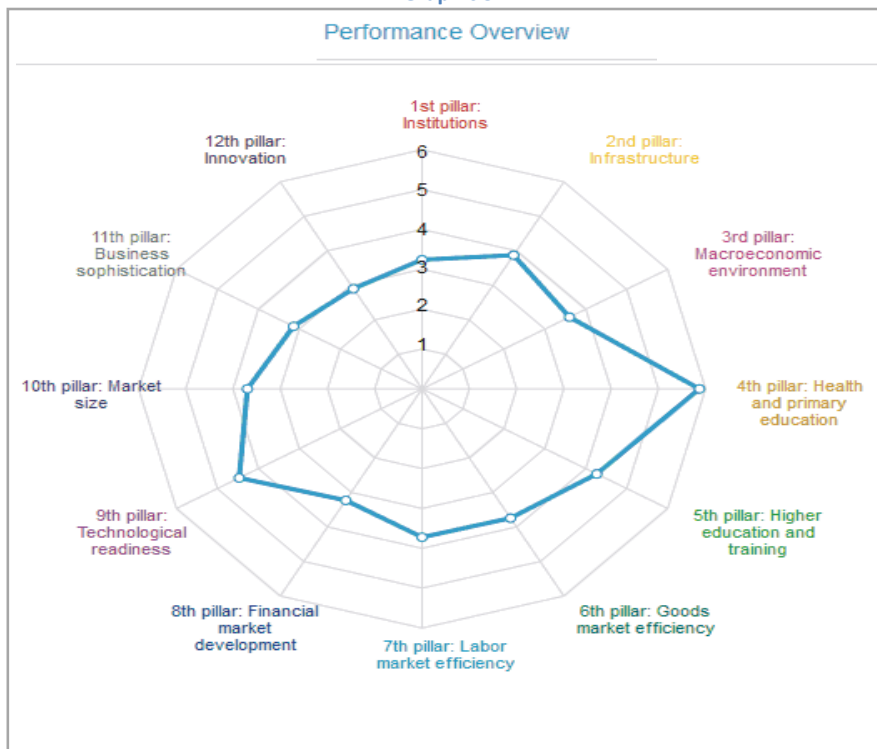


Source: Acemoglu, Liabson, List, Macroeconomics, Chapter 8, "Why Isn't the Whole World Developed?" Pearson, 2015., [www.pearsonhighered.com](http://www.pearsonhighered.com), Instructor resources.

### 3. Conclusion

World indicators, in the first place *World competitiveness index* and *Doing business list*, reflect rising significance of institutional infrastructure, more broadly than narrow focus on privatisation which for long time was in the core of Washington consensus. Here is the example for Serbia.

Graphic 5



Source: <http://reports.weforum.org/global-competitiveness-report-2015-2016/economies/#economy=SRB>.

Importance of institutions, culture and values lies in the fact that contrary to previously dominant market fundamentalism there exist correlation between GDP and democracy, but not oneway unilinear causation, either from side of GDP or democracy. Fundamental factors of growth (culture and governance) are of much more importance for economic growth and were greatly neglected during social and economic development of post-socialist countries.

## References

1. Acemoglu, D., Political regimes, institutions and growth, June 2005 Tüsiad-koç university economic research forum.
2. Acemoglu, D., Modeling Inefficient Institutions, *Ekonomске ideje i praksa*, no. 12, march 2014., thematic issues Political macroeconomy and contribution of Daron Acemoglu.
3. Acemoglu, D., "14.773, Political economy of institutions and development, Lecture 1: Introduction and overview", pdf 9522, MIT, February 4, 2014.  
<http://economics.mit.edu/faculty/acemoglu/courses>.
4. Acemoglu, D., "Political Economy Lecture Notes", PE9524.pdf, <http://economics.mit.edu/faculty/acemoglu/courses>.
5. Acemoglu, D., State Building: A Political Economy Perspective, Nemmers Lecture. Acemoglu, D., Robison, J., Why Nations Fail, FBBVA Lecture, May 21, 2012.
6. Acemoglu, Liabson, List, Macroeconomics, Chapter 8, "Why Isn't the Whole World Developed?," Pearson, 2015., [www.pearsonhighered.com](http://www.pearsonhighered.com), Instructor resources.
7. Alesina, A., Giuliano, P. "Culture and Institutions", 1. September, 2014., accessed 23.12.2014.
8. Guiso, L., Sapienza, P., and L. Zingales, 2006, "Does Culture Affect Economic Outcomes?," *Journal of Economic Perspectives*, 20(2): 23–48, according to Alesina, A., Giuliano, P. "Culture and Institutions", 1. September, 2014.
9. <http://reports.weforum.org/global-competitiveness-report-2015-2016/economies/#economy=SRB>.
10. Jakšić, M., "Geographical Deviation and historical development", *Ekonomске teme*, Niš, vol 53(3), 2015, pp.319-334.
11. Jaksic, M., Jaksic, M., "Proximate and Fundamental Factors of Growth: Culture and Institutions", *Economics and Economy*, vol. 1, no. 4, dec. 2014, pp. 7-22.,
12. Putterman, Louis. "History and comparative development." *The New Palgrave Dictionary of Economics*. Online Edition. Eds. Steven N. Durlauf and Lawrence E. Blume. Palgrave Macmillan, 2014. *The New Palgrave Dictionary of Economics Online*. Palgrave Macmillan. 22 May 2014 [http://www.dictionaryofeconomics.com/article?id=pde2014\\_G000223](http://www.dictionaryofeconomics.com/article?id=pde2014_G000223).