

# Institution with Economics and Development

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**Abstract:** *The core elements of development, also known as the dynamics of a nation's development, are emphasized in two main concepts, namely: institution and economics. These are the two basic factors that affect the development of a country, which promotes or hinders the development of that country.*

**Key words:** *Institution, economics, development.*

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## I. Definition of institution

According to the World Economic Forum (WEF): "Institution can be understood as the factor creating an orderly framework for human relations, locating the enforcement mechanism and limitations among the parties involved; is the common will of the social community to establish the order, rules, constraints, norms, and common values shared by all".

A study conducted by Simon Anholt and Dung (2008) argues that institution consists of three elements: laws, state apparatus, and modes of national administration. The common institutional values of the developed countries of the Organization for Economic Co-operation and Development (OECD) are democracy, separation of powers, market economics, and international integration. These values are sustainable because dozens of socio-economic crises have erupted in these countries, yet not only did they not destroy those sustainable values but also made those common values more complete.

According to Douglass North (1993 Nobel Memorial Prize in Economic Sciences), institution refers to humanly devised constraints orienting human interactions. In other words, institution is "game rules in a society." If they do well, they will encourage people to act in a way that good results are yielded, and vice versa. These "game rules" include formal institutions (such as laws, property rights, government constitutions) and informal institutions (such as traditions, customs, and social codes of conduct). North argues that informal institutions are also vital as they influence the success or failure of formal institutions. For example, even though many effective laws are promulgated, without the law-abiding spirit, their effect will not be considerable.

Some Vietnamese researchers agree that the institution is a broad concept, which is comprehensively defined, sometimes vague and consists of formal or informal rules that shape human manners. The institution of a country or territory consists of formal and informal institutions. Formal institutions include constitutions, laws, especially property rights, laws on contractual freedom, freedom of competition, public authority, especially law enforcement institutions and other public power control procedures implemented by objective mechanisms. Informal institutions consist of innumerable unspoken rules, norms, and taboos that are observed in the relationship of groups of people. Thus, in a more general sense, institutions are the principles that define social relations, shape the behaviors of members in a society and regulate social functioning.<sup>2</sup>

## II. The relationship between institution and economics and development

Institutions provide an important framework for economic development. Unlike other aspects, the institution stands at the center operating the whole system of development and social transformation. Economic growth and institutional stability share an organic bond. On the one hand, institutional instability can reduce investment and economic growth. On the other hand, severe economic degradation can lead to instability and institutional collapse.

Development, economics and institution are deeply connected. Institution, however, is not the leading authority of the nation; yet unstable institutions may slow down development. Institutions are often mistaken for leadership at a macro level, especially in developing countries. These two concepts are different whether they can be enforced and mutually supportive. For example, institutions can enforce leadership through legislation and leadership can enforce institutions in the administration aspect. Institutions, economics and development play a critical role in shaping the development path of a country; unforeseen institutional challenges may be the main cause of unsuccessful policy reforms and can slow down development.

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<sup>2</sup>Pham Thi Tuy, *Institutions*, Political Theory Journal, May 2014

Development-researchingscholars do not point out real factors that can create development or even factors that can drive development progress. This may be due to the complexity of development. In fact, the development of a country should be combined with both institutional and economic aspects, i.e. two major factors influencing the development process. However, this can only happen in developed economies, in which systems are observed and respected.

### **III. Relationship between institution and development**

The relationship between institutions and development manifests itself in four areas: Institutional stability as a pathway to industrialization; Institutional development as a pathway to infrastructure development; Institutional stability as a pathway to proactive labor; and Institutional stability as a pathway to democracy and human rights.

#### **3.1 Institutional stability as a pathway to industrialization**

Yankee (1991) stated that the development of industrialization in the United States between 1859 and 1877 was attributed to a stable institutional environment. One can demonstrate this in the simplest sense that no one wants to invest their money where it is likely to be lost, which is a prerequisite for industrialization together with institutional stability<sup>3</sup>. Sullivan and Steven (2003) define industrialization as a period of economy and social change that transforms a group of people from an agricultural society into an industrial one. This is achieved by organizing an industrial economics on a stable institutional basis for manufacturing purposes<sup>4</sup>.

#### **3.2 Institutional development as a pathway to infrastructure development**

Wallman (2010) asserted that institution relates to why some countries remain poor and institutional instability is among the causes of such situation. He claimed that the infrastructure of the economy will only develop on the basis of a stable institution<sup>5</sup>. For example, when institutional instability continues, both in terms of ideology and conflict of laws, the growth of social and economic infrastructure will not be achieved. Governments need to do a lot to encourage development especially in relation to institutional stability to develop the infrastructure so that it can be achieved. The development of a nation's infrastructure is built and developed by both sectors: public and private ones. The public sector focuses on the construction and development of economic and social infrastructure, while the private sector only invests in infrastructure where it is safe. Both goals require institutional stability for investment activities. Thus, institutional stability is the basis for infrastructure development. On the other hand, institutional instability reduces the predictability of government policies for businesses and households, thus making it difficult to make optimistic plans for investment and consumption. It is therefore important to have a sufficiently secure institution to protect and develop the production infrastructure that can promote national growth and development.

#### **3.3 Institutional stability as a pathway to proactive labor, saving and investment**

For labor to become active and productive, they must be guided by institution and protected by constitution and laws. Institutional stability in the form of democracy is the foundation for a labor force to work diligently to save without fear of loss due to instability. On the other hand, unstable institutions may slow down labor and investment due to fear of toll or loss, and that fear destroys the need for savings and investment.

#### **3.4 Institutional stability as a pathway to democracy and human rights**

In addition to the growth in volume of goods and services, human rights and democracy contribute greatly to the development process that a particular country is undertaking. Development occurs only when citizens can clearly choose their leader according to a constitution that is observed and guides respectful choices that people can make on the principle of freedom and equality.

Preworski, Alvarez and Limongi (2000) argue that economic development itself does not create democracy but democracies can exist and flourish in affluent societies. By implication, Preworski et. al. argue that democracies merely work when there is economic growth. In a democratic society, development choices require people not to be constrained in decisions and opportunities, and these can only be provided by democracies<sup>6</sup>. In his book, "Democracy and Economic Development", Preworski (2000) stated that democracies

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<sup>3</sup>Yankee. L (1991), *The Origins of Central State Authority in America, (1859-1877)*

<sup>4</sup>Sullivan. A and Steven M.S (2003), *Economics: Principles in Action*. Upper Saddle River, New Jersey.

<sup>5</sup>Wallman (2010), *Living more with less. Political factors that affect development*.

<sup>6</sup>Preworski A, Cheibub. J. A & Limongi. F (2000), *Democracy and Development. Political Institution and Well-being in the World 1950-1990*. A part of a Cambridge research on Democratic Theory.

are really rare in poor countries and therefore have a long-term influence on the development of these countries. Dictatorship economies may also achieve some development criteria, but it should be noted that democracy is a prerequisite for modern-day development indicators<sup>7</sup>.

In addition, institutional stability also leads to the recognition and development of human rights. Virtue of people all over the globe needs to be recognized in many aspects of life. Respect for the essential attributes of life, such as culture, health, education, gender, religion, political opinion, etc., contributes to the diversity of individual contributions to the development of society. Thus, it can be claimed that institutional respect for human rights is a core strategy that determines whether growth and development will be achieved or not.

#### IV. Conclusion

Institutions, economics and development are factors that have a dialectic and interrelated relationship in a certain socio-economic form. Stability or instability of a factor can have a positive or negative impact on the other. The study of this field should be placed into a combination of historical relationships and contexts. This is also a significant responsibility of policymakers in building and perfecting the institutions that facilitate economic growth and national development.

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