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IMPORTANCE OF INSTITUTIONS IN TERMS OF COMPETITIVENESS IMPROVEMENT AND ECONOMIC SUCCESS[1]

Značaj institucija za unapređenje konkurentnosti i ekonomske uspešnosti

Abstract

In view of the fact that competition constitutes one of the key postulates of the economic prosperity of both the national economy and its economic entities, this paper brings to attention the need for its continuous improvement. Improvement of competitiveness of a national economy is the most reliable way to achieve economic growth and development, and thus improve the prosperity of the citizens. In this regard, the paper discusses different theoretical approaches to this important economic problem and analyzes the key factors of economic competitiveness. In accordance with the subject of this research, the emphasis is given to the importance of institutions, since they are crucial for creating a competitive business environment and improving competitiveness and economic success. The research implies that it is necessary to determine the level of competitiveness, as well as the state of basic economic institutions, in order to identify both strengths and weaknesses of the national economy as preconditions for the creation and implementation of relevant competitiveness and economic success improvement policies. Such approach is particularly important for overcoming devastating economic conditions in Serbia, which have been present for many years. The paper stresses the importance of the enforcement of contracts and property rights, judicial independence, quality and professionalism of public administration, as key institutions in Serbia's economy which must be consistently regulated in order to be able to contribute to improving the national economy competitiveness. Furthermore, it is pointed out that the institutions, by creating a favorable environment for successful development of economic activities, represent a very important factor in improving the competitiveness of the national economy, and hence provide a solid basis for the long-term growth and development.

Key words: *institutional environment, competitiveness of the national economy, business environment, economic prosperity*

Sažetak

Polazeći od činjenice da konkurentnost predstavlja jednu od ključnih pretpostavki ekonomskog prosperiteta kako nacionalne ekonomije, tako i njenih ekonomskih subjekata, u radu se ukazuje na neophodnost njenog kontinuiranog unapređivanja. To iz razloga što je unapređivanje konkurentnosti nacionalne ekonomije najpouzdaniji način za ostvarivanje ekonomskog rasta i razvoja, a posledično i za podizanje blagostanja građana. Imajući u vidu navedene konstatacije, u radu se razmatraju različiti teorijski pristupi ovom bitnom ekonomskom problemu i analiziraju se ključni faktori konkurentnosti ekonomije. Shodno predmetu istraživanja, naglasak je na značaju institucija, kojim se stvara konkurentski poslovni ambijent, i njihovom uticaju na unapređivanje konkurentnosti i ekonomske uspešnosti. Samo istraživanje podrazumeva potrebu utvrđivanja nivoa konkurentnosti, kao i stanja bazičnih ekonomskih institucija, kako bi se utvrdile prednosti, a istovremeno, identifikovale slabe strane nacionalne ekonomije, kao uslova za kreiranje i sprovođenje politike unapređivanja konkurentnosti i ekonomske uspešnosti. Navedeni pristup je od posebnog značaja za prevazilaženje višegodišnjeg deprimirajućeg stanja u privredi Srbije. U radu se ukazuje na važnost zaštite vlasničkih prava, ugovornih odnosa, nezavisnosti sudstva, kvaliteta i profesionalizacije javne uprave, kao ključnih institucija u privredi Srbije koje je neophodno konzistentno urediti kako bi mogle da doprinesu unapređivanju konkurentnosti nacionalne ekonomije. Pokazuje se da institucije, oblikovanjem ambijenta stimulativnog za uspešno odvijanje ekonomskih aktivnosti, predstavljaju veoma bitan faktor unapređenja konkurentnosti nacionalne ekonomije, čime se njen rast i razvoj postavlja na dugoročno stabilne osnove.

Ključne reči: *institucionalno okruženje, konkurentnost nacionalne ekonomije, poslovni ambijent, ekonomski prosperitet*

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Introduction

In order to define and successfully implement strategic development goals and objectives of the national economy, it is necessary to create key preconditions for developing consistent and comprehensive national competitiveness improvement strategy along with other relevant growth and development factors. This implies the need to direct the role and responsibility of the state, among other things, towards creating such a business environment that would be favorable for economic actors and enable achieving greater effectiveness and efficiency, without which there is no possibility of raising the level of economic prosperity of the society, as well as the individuals. In view of the fact that competitiveness represents one of the key prerequisites for economic progress, its continuous improvement represents one of the most important goals of any national economy and its economic actors. This implies the existence of a developed and consistent institutional environment, as well as other relevant factors. Accordingly, the emphasis is on creating institutional conditions to improve competitiveness at all levels – both macroeconomic and microeconomic ones, which is a requirement for greater economic success. The importance of proper institutional arrangement and the competitiveness of the national economy is reflected in the fact that the basis for the strategic competitive advantages of modern enterprises and the economic prosperity of the country are defined, created and directed in the national economic environment.

There are numerous efforts in the economic literature to explain both economic success and economic failure of particular countries and, therefore, offer an answer to the question why some economies are more successful than others. One possible approach in formulating answers to the above-mentioned question is the analysis of the country's competitiveness. Competitiveness is expressed by means of different indicators, such as the export volume, the share in the world market and the level of Gross Domestic Product (GDP). However, most commonly, competitiveness is manifested in the growth of labor productivity, which ensures long-term sustainable economic growth and increases the well-being of the population, which again, embodies the ultimate goal of the economic policy of each country.

This paper points to the importance of institutions as a determining factor related to improving competitiveness and economic success of the national economy, which is also the *subject of the presented research*. The emphasis is on the fact that the transition economies need to develop adequate and quality institutional environment that would allow dynamic economic growth and development, as well as the improvement of the well-being of the citizens. Thus, the *aim of this paper* is to highlight the importance of conducting thorough and sound reforms, which should result in establishing a favorable business environment that most directly affects the improvement of competitiveness factors, as well as to point to certain weaknesses in the process of establishing appropriate institutions that have appeared in the transition process thus far. The initial *hypothesis* in this paper states that the business conditions decisively determine the level of competitiveness and economic success of a country's economy, which makes it necessary for the particular country to establish an institutional environment that would be favorable for economic actors. Consequently, better and more efficient institutional environment enables creation of a favorable business environment, which decisively influences the improvement of competitiveness and economic success of the national economy.

This paper, in addition to an introduction and a conclusion, is organized in three sections. The first section takes into consideration different approaches to the aforementioned important economic issues, points to the importance of competitiveness of the national economy and its economic actors and analyzes the key competitiveness factors. The emphasis is placed on the role and importance of institutions in creating competitive environment and improving competitiveness and economic success. The second section points to the methods of determining the level the national economic competitiveness, with an emphasis on the economy of Serbia. The key institutional arrangements that are crucial for improving the competitiveness are analyzed in the third section of the paper.

Competitiveness and its key factors

There is no generally accepted single definition of national (economic) competitiveness due to the complexity and diversity of factors by which it is conditioned. In accordance with the specific objectives of this research, the author has chosen to define competitiveness as a set of institutions, policies and factors that determine the size of the national economy output and productivity level per capita. Moreover, productivity is also defined by the sustainable level of economic well-being that is created in a national economy. This means that the level of income, i.e. the level of economic well-being of the citizens of a country, is determined by the level of the country's competitiveness. It is important to bear in mind that the level of national competitiveness is influenced by numerous factors, both direct and indirect ones, including the institutional environment. However, the competitiveness of enterprises as drivers of economic activity and creators of new values is crucial.

The need for continuous research in the field of creating and implementing competitiveness improvement policies and their relevant aspects is indisputable due to their relevance to the national economy and its economic agents. However, it is necessary to point out that the competitiveness as a crucial factor for stimulating economic dynamics, i.e. growth and development, is also followed by certain contradictions. For example, the competition policy, as one of the most important instruments for strengthening competitive environment, is often accompanied by conflicting attitudes. According to many views, competition policy is essential because it is the way to establish uniform competitive conditions, which are, at the same time, an important factor for stimulating new investments. However, there are positions which consider that competition policy offers additional advantages to certain market players compared to their competitors, which affects the lack of interest in increasing the level of production efficiency [1].

At the same time, the adequate concept of economic policy which is aimed at strengthening the competitiveness involves a set of activities aimed at the creation of institutions and their restructuring, in order to establish appropriate policies that would be motivating for economic actors. After all, without adequate support from, on the one hand economic policy and its instruments, and institutional environment on the other hand, it is impossible to achieve the sustainability of innovation-based economic growth. In this way, the active participation of the state and its effect on the way the resources are used is attained, which affects the level of economic success. Therefore, the aim of competition policy is to create conditions for achieving sustainable economic growth and development and improvement of the well-being of the general population.

The basic method of competition policy is the establishment of equal conditions of competition, which supports the creation of adequate investment and innovation incentives in various forms (production, technological, organizational, etc.). Competition policy is the policy that is aimed at supporting and/or creating a competitive market conditions through setting up certain rules and guaranteeing their enforcement, as well as prohibiting certain forms of behavior in the market. In this sense, competition can be considered as a market situation where a single economic entity is not able to significantly influence the general conditions of carrying out transactions in any market segment.

Competitiveness analysis is a synthesis of microeconomic and macroeconomic aspects. In this context, it should be emphasized that macroeconomic factors play a significant role in explaining the growth of competitiveness given the fact that companies create value in accordance with their capability to produce competitive goods and services by applying efficient methods. The position that the low inflation rate, exchange rate stability, balanced public finances and high levels of reserves represent an essential prerequisite for sustainable economic growth and development as indicators of macroeconomic stability is still a subject of discussion. However, macroeconomic stability by itself is not sufficient to ensure economic growth – it only contributes to the more efficient realization of product creation process which belongs to the microeconomic level. This means that the traditional analysis, which uses the concept of competitiveness to explain the economic growth, should be complemented by researching microeconomic environment. As pointed out by *Djuricin* [3], there are no isolated macroeconomic policies or major moves at the microeconomic level that can improve competitiveness. Only synchronized improvements in various areas lead to an increase in competition, which is a long lasting process.

The term competitiveness is widely used in economics and refers to the products or companies, as well as the industries and even countries. In addition, there is no clear definition of what is meant by the term competitiveness, and according to *Krugman* [5] in case of competitiveness of a country there are some doubts referring to the adequacy of the usage of this term.

The country's competitiveness implies the ability of that country to create and maintain such environment that will be favorable for a more intensive value creation in companies and greater well-being of the population. In other words, the state does not create a new value; rather it helps economic actors to create it. In this sense, the long-term goal of the state should be to create favorable conditions for business operations and to provide support over time, thus creating conditions for strengthening competition between economic agents and hence their competitiveness, as well as the competitiveness of the economy as a whole. *The Global Competitiveness Report* defines competitiveness by taking into account several aspects. In its edition from 1996 the competition is defined as the ability of the state to achieve continuous high growth rates of GDP *per capita*, while ten years later, in 2006 edition of the same report, the country's competitiveness is said to be a set of factors, policies and institutions which determine the level of its productivity. OECD countries indicate in their reports that competition can be seen as the degree to which a country can, under free and fair market conditions, produce goods and services in accordance with the international competitiveness criteria, which will affect the strengthening and growth of the real incomes of its people over the long-term period. According to *Porter* [13], competitiveness is determined by the country's level of productivity and resource usage – such as natural, human, or capital resources, which makes it the key factor for determining the economic well-being of the country and its citizens. The ultimate goal of increasing the country's competitiveness is the growth of its economic prosperity, i.e. the well-being of its citizens.

Competitiveness, as a dynamic process, is manifested in the improvement of products and technologies, creation of new markets, finding new sources of resources, setting up new types of organization and etc. This, as a rule, requires investments. The main incentive for investments can be found in the capacity to achieve economic gain. At the same time, it is necessary to look at two possible situations – the situation where the access to resources is provided, however, there are no adequate incentives for investment and the situation where there are incentives for investments but the resources are not available. The first situation is characteristic of the economies with abundant resource potential, but also weak institutions where decisions on how to allocate resources depend on the mutual relations of certain influential groups. Another situation is inherent in economies with low resource potential, regardless of the quality of their institutions. In other words, there is no mutual compatibility between resource potential and the quality of institutions. In this respect there are four possible options regarding the resource potential and the quality of institutions, as illustrated in Table 1.

Table 1: The combination of the resource potential and the quality of institutions

Resource potential	Quality of institutions	
	High	Low
High	1.1	1.2
Low	2.1	2.2

Based on the above given possible combinations of the resource potential and the quality of institutions, it can be concluded that the combination 1.2 which is characterized by low quality of institutions and high resource potential and the combination 2.1 which reflects high quality of institutions and low resource potential, pose a threat to the efficiency of economic activity. Therefore, the main objective should be to implement appropriate improvements regarding both observed factors and thus position oneself in the field 1.1 featuring high resource potential and high quality of institutions, which is a precondition for improving both the level of competitiveness and overall economic performance.

Porter [13] distinguishes three types of factors that affect competitiveness:

- Basic factors,
- Factors of macroeconomic environment, and
- Factors of microeconomic competitiveness.

According to *Porter* basic factors are natural resources, geographical location and historical heritage. These factors are exogenous and they represent a framework within which the country's competitiveness is being developed. Macroeconomic environment to a large extent determines the quality of the country's performances, as well as its competitiveness. A stable macroeconomic environment and realistic economic policy motivate investment activities which make necessary condition for economic growth. Microeconomic competitiveness is determined by the quality of the microeconomic business environment, the degree to which clusters are developed, the degree of management complexity and efficiency. These are the decisive factors affecting the quality of business strategy and principles of companies' operations and management, which is crucial for the competitiveness of individual companies. This fact is of vital importance since the very competitiveness of a country depends on the competitiveness of its companies. As for the transition economies, microeconomic competitiveness is an important limiting factor to macroeconomic competitiveness. Due to retaining a high degree of state ownership, protectionism in favor of state-owned enterprises is present, which results in a low level of competition. In an environment where there is insufficient protection of the investors' rights, the private sector cannot be properly developed which is necessary for the successful functioning of a market economy and strengthening of competitiveness.

As for the static and dynamic components, productivity represents the decisive factor that affects competitiveness, therefore both the country as a whole and its companies try to initiate and support its growth. Companies see an increase in productivity as a reliable basis for earning higher profits and as for the country – it expresses its ability to maintain a high level of income and satisfactory return on investment. Therefore, in the economic and social development strategies of each country the emphasis is placed on the competitiveness improvement policy. The importance and relevance of this particular orientation is imposed by years of unfavorable state of the economy, which is even worsened by the global economic crisis, since it is impossible to successfully overcome the consequences of a deep recession without improving competitiveness.

In the conditions of the increasing internationalization of economic flows, where the integration processes take on qualitatively different contexts, policy makers are faced with increasingly complex tasks and goals. On the one hand, there is the question how to improve the competitive position of the national economy and on the other hand the most effective way must be found in order to make the best of the international distribution of cash and goods flows which are becoming more and more liberal. The task is even more complicated because due to the impact of globalization, competition is constantly being modified and assumes new forms.

The quality of the institutional environment, as a significant factor in developing competitiveness improvement policies, is of particular importance in shaping the adaptive efficiency of the economy. In addition, competition can be understood as the adaptiveness of the national economy, i.e. its ability to outline necessary structural changes and adapt to them. Competitiveness can also be seen as the country's ability to create and maintain a favorable business environment where companies can continuously create value and the well-being of citizens can be improved. The different combinations of institutional arrangements which regulate key aspects of the economy and society such as property rights, elimination of market failures, macroeconomic stability, social stability and management of social conflicts, ensure achieving a high degree of adaptive efficiency [8] which *North* [10] considers as the key to achieving a long-term growth. Allocative efficiency based on the standard neoclassical Pareto principle is a static concept which includes a certain group of institutions. Adaptive efficiency is associated with the types of rules that govern the ways in which the economy develops over time. Hence, the adaptive efficiency is closely related to the willingness of a society to perceive the significance of knowledge, to encourage innovation, to decide on the risks and take creative activities of all kinds. In all these processes the entire institutional structure plays a key role and decisively determines the willingness of the society to encourage entrepreneurship, innovation and other activities that are considered adaptively efficient. Therefore, it can be concluded that a flexible institutional matrix is a condition of a proper functioning of an economy. The distinctive characteristics of successful economic systems are flexible institutional structures that are able to adapt to change, which is important because the adaptive efficiency is closely related to the informal norms of the society. This reflects the role and importance of effective rules which are designed to successfully eliminate failed organizational structures and support successful activities. Such institutional structure has a beneficial effect on improving the competitiveness of the economy, which is a prerequisite for its dynamic efficiency and achieving a stable and long-term sustainable growth.

Economic conditions are crucial for competitiveness of the national economy, as well as its competitive market. Only those countries that established most favorable conditions for investment capital can count on making a profit, i.e. the increase of the economic prosperity. This represents such institutional environment where business conditions are the same for all economic actors, and where all economic actors are protected from any form of potential expropriation of property or income. Therefore, it is necessary that the state implements deregulation as to reduce the number of unnecessary restrictions and regulations, but this process must not be mistaken for the establishment of uncontrolled liberal regime. On the contrary, it is necessary to continuously invest efforts in finding reasonable balance between liberalization and regulation. As pointed out by *Stiglitz* [16], the state should have a role not only in saving the economy when markets fail, but also in regulating the market in order to eliminate certain types of market failures. Economies necessitate balance between the role of the market and the role of the state – including a significant contribution of non-market and non-governmental institutions.

Issues concerning the role of government in regulating economic relations once more have an important place in the debate about the many contradictions related to modern economics, especially those associated with the process of globalization, on the one hand, and the causes and effects of the global economic crisis on the other hand. By analyzing relevant aspects of mutual relations between the state and the market, as one of the recent economic issues, we arrive at a certain paradox. Namely, free competition led to the strengthening of the economic agents and the monopolization of the market as a result of the inherent property of capital to constantly strive towards consolidation, which imposes the need to strengthen the role of the state in the economy. This created conditions to increase the role of the state in the economy, since, over time, state emerges as an institution and an instrument of entrepreneurship as a guarantor of transactions, as well as a provider of various privileges to large companies. It can be said that there is nothing controversial about the fact that the state articulates its interests in economy, defines development priorities and implements a strategy to increase the competitiveness of the national economy. By supporting the foreign/international economic activities, as well as the regulation of the domestic market, the state encourages the strengthening of the competitiveness of the national economy, which can only be achieved through active participation in international competition while simultaneously tightening the competition in the domestic market.

With regards to the national economy, every country opts for maximizing the level of economic prosperity as its primary objective. However, high level of economic prosperity of a country does not necessarily mean a high level of competitiveness of its economy. Thus, the following question arises: what are the parameters based on which we can determine whether one country is in a better competitive position than some other country? In searching for the answer to this question, we begin with the most basic indicators of economic growth and development. Basic indicators which are commonly used to expresses the level of competitiveness of the national economy are productivity growth and real per capita income growth rate, together with the basic indicators of international trade: export structure, share in world exports and export growth.

As for transition economies, an essential requirement for the penetration of their companies in the domestic and foreign markets are the qualitative reforms which should enable the establishment of a favorable business environment, which will directly contribute to the improvement of competitiveness. At the same time, an analysis of the competitive advantages of a particular national economy can contribute to the acceleration of reforms in these countries, because they contain the elements based on which the real position of each national economy in the international division of labor can be assessed. In this way an institutional environment that will be favorable for greater economic success and that would improve the competitiveness of the national economy would be more successfully created. Creating such a business environment is the responsibility of the state, which should contribute to its development, especially in terms of full legal protection of property rights and enforcement of contracts as key institutions necessary for the development of a market economy. This will also set up the rules which will regulate free economic activities.

Factors that determine the level of competitiveness – the case of Serbian economy

Competition provides opportunities for more successful activation of a number of factors and more efficient use of resources due to the effect of market incentives. However, these are often poorly utilized due to the absence of a competitive environment. Efficient functioning of the mechanisms that contribute to creating and fostering a favorable competitive environment at the same time contribute to creating a favorable climate in terms of competitive goods production. Therefore, the improvement of competitiveness as one of the key strategic tasks of each country is given significant attention, and in order to test and improve the competitiveness of the national economy the relevant specialized bodies are formed.

The level of the national economy competitiveness, as well as the competitiveness of its enterprises, reflect the ability of that particular country to produce goods that can meet the needs of the world market in conditions of free competition. This increases the level of well-being of the population and opens the opportunities to realize a long-term sustainable growth and development strategy. At the same time, without achieving stable competitive advantages, which are linked to innovation and human capital, it is practically impossible to increase the competitiveness of the national economy and ensure high growth rates [4].

In order to determine the level of the national economy competitiveness, it is necessary to perform the comparison with the competitiveness levels of different countries, based on the set of relevant parameters. In this way, apart from assessing the current position of the country compared to other countries, strengths and weaknesses of the national economy are determined, as well as the efficiency of the national economic policy implemented in order to strengthen the country's position regarding the international economy.

Country's competitiveness, as well as its ability to create, maintain and develop competitive advantages in conditions of the dynamic international competition, is primarily determined by the level of innovation. Based on these properties, competitiveness can be explained as the country's ability to continuously generate more wealth at international markets than its competitors. Such macro-competitiveness is manifested as the country's ability to independently develop itself in political terms and successfully compete with other countries.

Furthermore, competitiveness of a country can be viewed from two different perspectives: external/foreign competitiveness which indicates the country's position in the world and internal competitiveness as an indicator of the willingness of local companies to develop their operations in the domestic market and compete with other domestic and imported goods. Foreign and domestic competitiveness are closely linked and largely depend on the nature of the state regulation measures in the field of macroeconomic processes. In this sense, the task of the state is to provide adequate political, institutional, infrastructural and other support to its companies in order to make it possible for them to participate in the competition in the international markets on more equal terms. It should be noted that competition in terms of a closed national market is ephemeral and does not contribute to the economic prosperity. The importance of this approach is supported by the fact that the competitiveness of the national economy is determined, on the one hand, by the ability of the economic institutions to establish favorable environment and by the ability of firms and industries to take advantage of such environment to create and foster sustainable competitive advantage on the other hand. The essence of national economy competitiveness implies an appropriate level of competitiveness of domestic enterprises and their products. Drivers of competitiveness are primarily companies and industries, as only they can accomplish it. State appears primarily as a subject who is responsible for creating an institutional environment as a condition for the establishment of competitive environment.

The economy of Serbia is characterized by a low level of national competitiveness. According to a number of indicators of institutional, investment, infrastructure, innovation capacity and the quality of human and physical capital, the country lags significantly behind the developed countries. Therefore, building up of the high-quality and efficient institutions, which will contribute to encouraging the development of the innovation potentials, based on relying on human capital and attracting foreign technologies is one of the ways to solve the problem of macroeconomic dynamics sustainability. At the same time, it is necessary to adopt comprehensive and consistent national economy competitiveness strategy in order to encourage positive trends, especially in the field of technological and structural changes. In this way, both the economy and the economic actors would be more successfully included in international economic trends and they would more easily adapt to the dynamic changes related to the international competitiveness of the country and trends related to competitive advantages [2]. As a result of these changes, modern economy is dominated by "intensive" factors of international competitiveness – knowledge, human capital, information technology, flexible production and new forms of governance [9].

When it comes to the institutions which support effective competitive environment it is necessary to point out that their formation is not the result of spontaneous evolutionary selection of quality institutions, but the product of purposeful activities of the state. Qualitative ratings of the economic policy results and institutional infrastructure, which are relevant for the formation of a competitive environment, are given by various international ranking bodies and agencies. One of the most common and widely accepted rankings is the international rankings of competitiveness published by the World Economic Forum in the yearly report called *The Global Competitiveness Report* (GCR). The mentioned *Report* ranks countries based on the Global Competitiveness Index (GCI) which represents a synthesis of microeconomic and macroeconomic indicators of national competitiveness. In terms of improving the level of competitiveness, these indicators make the realistic basis for taking appropriate corrective actions in the sphere of the economic system and economic policy. Data on the GCI values and state of public institutions in Serbia for the period 2007-2012 are given in Table 2.

Data on the GCI values and indicators of the quality and efficiency of the institutional framework in Serbia in the period 2007-2012 show that the domestic economy shows continuous decline in terms of competitiveness and the quality and efficiency of institutions and thus has the poorest scores compared to neighboring countries. These data confirm the existence of a positive correlation between the level of economic competitiveness and the quality and efficiency of institutions, which confirms the position that inadequate institutions and policies result in unsatisfactory growth rates which are way below the country's potential.

Table 2: Indicators related to global competitiveness index and institutions of Serbia in the period 2007-2012

	Global Competitiveness Index		Public institutions	
Year	Rank	Score	Rank	Score
2007	91	3.78	99	3.37
2008	85	3.90	108	3.40
2009	93	3.77	110	3.24
2010	96	3.80	120	3.20
2011	95	3.88	121	3.15
2012	95	3.87	130	3.16

Source: The Global Competitiveness Report (editions 2008-2012)

As far as the indicators of the state of institutions are concerned, the emphasis is on the fundamental building blocks of a competitive environment – property rights, especially intellectual property protection, judicial independence and efficiency of legal framework in settling disputes, burden of government regulation, organized crime, protection of minority shareholders' interests – whose scores and rankings illustrate the state of Serbian institutions in the period 2008-2012 (see Table 3).

The analysis of subindexes relevant for assessing the quality and effectiveness of the institutional framework in Serbia shows that the unfavorable situation is particularly evident regarding the definition and protection of property rights (intellectual property rights in particular), burden of government regulation, existence of organized crime and protection of minority shareholders' interests. Unfortunately, remaining subindexes did not receive much more favorable scores. Evidently these are the key economic institutions that represent a decisive stimulating factor for economic actors and which directly determine their (un)willingness to initiate and realize economic activities, as well as their level of productivity that in turn determines their level of competitiveness. The correlation between quality and efficiency of institutions on the one hand and the level of competitiveness and economic performance on the other hand, is a confirmation of the hypothesis that better and more efficient institutional environment decisively affects the improvement of competitiveness and economic performance of the national economy.

In accordance with the above stated facts, one of the key priorities that Serbia faces is strengthening of institutions as key competitiveness and development factors which provide the increase in resource quantity and level of technology, and on this basis produce increase in volume and quality of products and services. The insufficiently built and ineffective legal and institutional framework in Serbia represents a major development constraint. The competitiveness should be improved by encouraging entrepreneurship and innovation in companies, raising the level of knowledge, rapid technological development and enhancing economic and technical possibilities. At the same time, it is necessary to improve the general competitiveness factors such as macroeconomic stability, the quality of the rule of law and economic policy and the quality of legislation that regulate business environment, which implies implementing radical reforms without any further delay. Namely, the set of national competitiveness factors can be improved by implementing a series of reforms in various areas that affect long-term productivity which is a key factor that determines economic growth and economic development. This is necessary since increasing competitiveness represents the surest way to form a stable and sustainable basis for economic development of this country.

Improvement of the existing level of competitiveness should be based on defining the export specialization of the country, the establishment of effective institutions, encouragement of investments, infrastructure and innovation development, reliance on human capital and long-term solutions for macroeconomic dynamics issues. The development based on the activation of innovation activities, human capital development and improvement of the institutional environment, would contribute to establishing appropriate economic structure that would

Table 3: State of Serbian institutions in the period 2008-2012

Indicator	2008		2009		2010		2011		2012	
	Rank	Score	Rank	Score	Rank	Score	Rank	Score	Rank	Score
Property rights	108	3.6	111	3.4	122	3.2	126	3.1	130	3.1
Intellectual property protection	105	2.8	101	2.8	111	2.6	107	2.7	116	2.8
Judicial independence	106	3.0	110	2.8	124	2.5	128	2.4	129	2.4
Burden of government regulation	132	1.9	129	2.2	131	2.2	134	2.3	136	2.4
Efficiency of legal framework in settling disputes									138	2.5
Transparency of government policymaking	82	3.9	86	4.0	97	4.0	102	3.9	111	3.8
Organized crime	97	4.5	109	4.2	111	4.3	107	4.3	118	4.1
Protection of minority shareholders' interests									143	2.6
Strength of investor protection									65	5.3

Source: The Global Competitiveness Report (editions 2008-2012) in turn enable efficient adaptation to external conditions. Therefore, improving the competitiveness of a country's economy includes the successful resolution of the complex long-term tasks. A country can only count on penetration to the world market if the reduction of production costs, increase in labor productivity and efficiency of foreign trade activities are achieved both in traditional and in relatively successful export industries. The transition economies, where radical system transformations are implemented, can increase competitiveness, primarily by overcoming instability and by effective implementation of the restructuring of their economies, as well as raising the qualitative level of economic dynamics.

Institutional factors that determine competitiveness and economic success improvement

In search of the key factors of a new quality of economic growth, considerable attention is paid to researching the methods to raise the level of economic competitiveness and improve the level of economic success. In this context, it should be noted that the continued development of market institutions is of critical importance for the formation of a competitive environment, as a condition of greater competitiveness. Regarding the Republic of Serbia, the basic concepts of its successful long-term socio-economic development should be based on the project of reforming the economy whose content should consist of four interrelated pillars, which can be called "4 I(s)"– institutions, infrastructure, investment and innovation. The quality of economic growth is determined by mutual relationship of basic conditions: the level of development of the market economy institutions, resource limits to growth, and quality and innovative potential of human capital which is ready for challenges brought about by the post-industrial development.

The institutional structure of the economy is the result of the efforts of the state to establish an institutional economic system, as well as a spontaneous evolutionary selection of the most efficient institutions. The experiences of developed market economies show that it takes time to forma institutions which are in line with the prevailing coordination methods. In terms of developed and consistent market institutions, the use of direct and indirect methods of implementing necessary economic policies would not pose significant limitations to the national economy nor a risk of possible distortions of institutional-economic system. The regulation of the competitive environment includes the following:

- Establishment of basic competitive environment institutions and development of competition;
- Safeguarding of the competitive environment from the inner self-destruction under the influence of pure market mechanisms, which is primarily in the competence of the state anti-monopoly economic policy.

Quality and effective institutions are necessary in every system, since the underdeveloped institutions create fertile ground for promoting regulatory discretion in implementing economic policy instead of promoting appropriate rules, which leads to the problem of competence and genuine political motives of economic policy makers [15]. Underdeveloped and dysfunctional institutional infrastructure is suitable for manifesting opportunism and of corruption at all levels, rather than creating a favorable environment for competitiveness improvement.

Undoubtedly, political obstacles are often present when it comes to initiating and implementing such institutional engineering that would result in a business environment suitable for improving competitive relations. *North* [10], in his writings, suggests that the creation of a stable political system is one of the key implications of institutional changes implementation, since the rules of the economic game are defined within the political system and the political community. Concurrently, as indicated by *Madžar* [7], it is necessary to bear in mind that the society is neither homogeneous nor compact, but rather divided into different interest groups with different levels of social power. Therefore, since different groups see an opportunity to exercise their special interests whenever certain change appears, there are many obstacles to reach an agreement with respect to desired system changes thus hindering their pace and making them eventually fail. In view of the aforementioned facts, an unambiguous and straightforward political commitment is required, as well as the political stability, in order to initiate and implement necessary institutional changes that would result in the business environment that would encourage improvement of both competitiveness and economic success.

Considering the socio-economic reality of Serbia, it is necessary that the set of institutional reforms becomes one of the main directions of the new economic strategy. This implies the need to transform basic institutional conditions of economic activities in the country such as the system of court proceedings and legal guarantees for contract enforcement, the mechanism to enforce court decisions, the system regulating the relations between companies and administrative authorities – especially those authorities regulating economic activity, the tax system, the definition of the boundaries and shared responsibility for the functioning of the public sector, the status and the framework of activities of state monopolies, status of financial sector entities, status of economic entities and etc. In all these areas there are many unresolved critical issues which cannot be ignored in the process of creating the conditions for dynamic economic growth and the successful modernization of the country.

Institutions, which include specific perceptions of individuals regarding economic activities, and are established in accordance with national and cultural characteristics of the country, make a special structure that is the basis of economic relations in a society. The essence of this system is the institution of property rights whose state determines the character of all other institutions. The institutional structure represents the capital stock of institutions that perform specific functions and ensure the efficiency of interactions between economic agents. The response of macroeconomic variables to the macroeconomic decisions that affect the economic environment in general depends on existing institutions [12]. Hence the conclusion that the low efficiency of the current market reforms is caused primarily by poorly designed institutional transformations whose complexity has been underestimated, as well as the decisions to simply import institutions instead of creating them [6]. The expectations that the formal introduction of market mechanisms and democratic institutions would establish true market-oriented economic relations and therefore adequate competitive environment proved wrong. Quite the opposite, the inefficient institutions were formed which suited the needs of certain business structures and corrupt officials. This resulted in creation of a network of corruption. Due to the enormous influence and sustainability of inefficient institutions, a system of institutional traps (inefficient, however stable institutions) emerged, which eliminated any opportunity for implementing effective measures to prevent infestation of corruption. The result is a low level of the domestic economy efficiency and the absence of any tendency towards economic growth.

Many of the economy's weaknesses are a product of the privatization concept, which was carried out on the "privatization-just-for-the-sake-of-privatization" basis. The privatization process was launched with the idea that economic resources would fall into the hands of those process owners who will be able to apply appropriate business principles where the property would be used in the best possible way. However, these expectations proved wrong in practice, which is also evidenced by numerous unsuccessful and annulled privatizations. It turned out that it was not enough just to brake off with the centrally planned economy. In order to be successful this concept should have been replaced with a new one – the efficient market economy, but this did not happen. Simply put, the privatization process has not led to the establishment of efficient owners, who, guided by the basic economic development logic, should have improved operations of the state owned enterprises which were taken over. There was no strategy for the development of such environment which would endorse competition among different economic agents, therefore in such circumstances it is not possible to speak about an efficient and competitive national economy.

In order to establish an institutional environment that will ensure control and authority in terms of reasonable use of property rights, it is necessary to implement comprehensive and consistent institutional changes at all levels of the economy and the society in order to achieve their complementarity. In political terms, in order to establish appropriate property rights structure that would support functioning of the market economy, it is necessary to establish an institutional system based on the rule of law. Concerning the microeconomic level it is necessary to create such institutional environment that would be stimulating for:

- Economic actors which would contribute to increasing economic growth due to their economic success;
- Creating conditions for developing competitiveness;
- Restructuring and modernization of companies;
- Growth of budget revenues and reduced pressures on the budget;
- Reduction of transaction costs concerning the transactions between economic entities.

It is necessary that the economic institutions, at the microeconomic level, provide better management quality and more efficient production, expand the investment base for self-financing and increase the adaptability of the economic entities in relation to the market innovation.

It was assumed that competition and competitive environment would be established simultaneously with the beginning of the transition process due to introducing market mechanisms and democratic institutions; thus, the policy of "imported institutions" that focused on the best models characteristic of the most developed countries was largely implemented. Because of this misconception, the economy experienced serious problems relating to the acceptance and survival of such institutions. It became clear that reforms could not simply come down to the adoption of a package of normative acts, without adequate analysis of their adaptation to the existing conditions regulating current business practices. Limiting reforms only to the formation of the formal legislative institutions has resulted in their systematic neglect ion or opportunistic use by the economic agents. It turned out that in an environment of uncomplimentary institutions and such institutional system that is not able to transcend the institutional vacuum, there is a rejection of the newly introduced formal rules that are inconsistent with the existing business practices.

In the sphere of economic policy and legislation, the activities should be focused primarily on creating the conditions for fair and effective competition, which means, above all, more efficient and more effective competition policy. At the same time, it is essential that all stakeholders provide equitable, open and competitive access to government procurement and other budgetary resources, as well as the resources provided by the credit and financial institutions. This is in the best interest of both economic entities and the state. In order to provide easier access to the market, it is necessary to carry out de-bureaucratization of the economy, which will result in the reduction of barriers to starting a business as well as eliminate the essential prerequisites for corruption. In order to reduce arbitrariness and tyranny of government officials, it is necessary to increase the quality of a professional civil service and local self-government services, as well as to clearly define the level of competence in order to reduce the sphere of activities where various forms of potential opportunistic behavior might appear. This is necessary because the efficiency and quality of governance has significant impact on the competitiveness of the national economy as well as the level of economic freedoms.

The strategic paradigm of establishing a competitive economy stands for ensuring the quality of the functioning of institutions, in order to facilitate mutual supportive relationships among businesses, governments, companies and citizens. This includes innovation in the design of system solutions concerning normative regulations, in order to make them suitable for the development of business activities. The full independence of the judiciary from the executive and legislative authorities should also be secured. Establishment of an enabling business environment is related to the radical reduction of administrative barriers, especially concerning those administrative procedures are necessary for starting and running a business, in order to prevent bureaucratic *rent seeking* in the form of bribery and corruption.

An effective instrument of the development of entrepreneurship environment involves, primarily, a set of rules and measures to protect property rights and facilitate economic freedoms as a necessary motivator for starting and running business operations. Full protection and provision of guarantees in terms of the inviolability of property rights and income earned from ownership, make an important motivating factor for the initiation and implementation of innovative activities and production of highly innovative goods, which is a decisive factor in raising the competitiveness level of companies and the economy as a whole.

The main objective of every modern state should be the establishment and fostering of the institutional environment of the economy in optimum conditions, which will motivate economic agents to improve their marketing activities through continuous innovative self-development, and, therefore realize their competitive advantages. In other words, the dominant task of the state is to create such economic environment where market actors will be motivated and empowered to create competitive advantages, as well as to realize them in market transactions. In this way, it is possible to achieve synchronization of companies' business interests and goals of economic and social development through evolution of the key principles and mechanisms of economic coordination.

The state has a responsibility to create and pass formal laws, as well as to guarantee their enforcement. Depending on the method the government chooses to implement this primary function of the state, such conditions will be created that will either contribute to increased efficiency, or represent an obstacle to the mentioned process. It must be kept in mind that in addition to formal law, laid down by the state, there are a number of informal rules, which are indicators of the quality and acceptability of these formal rules. The more things in common between the informal and formal rules, the better harmonization of formal laws and informal rules. In this way the economic agents that carry out their activities in a competitive environment would more easily accept and respect institutions. As part of a systematic approach, it is necessary to point out the fact that the quality of an environment is essentially determined by the quality of the worst fundamental institution. In fact, it takes a single inefficient institution (e.g. protection of property rights and enforcement of contracts) to reduce the level of efficiency of the competitive environment in general and to devaluate all efforts invested in increasing the quality of other structural institutions in particular competitive environment.

The state has a number of significant instruments at its disposal for the creation of markets and adequate competitive market environment; therefore it is of particular importance for establishing such institutional structures that would support the creation and implementation of the national economy competitive policy. This is especially important for those countries that necessitate radical structural changes, as is the case with Serbia. Underestimation of the active role of competition policy can lead not only to serious disturbances in the system that offers support to economic agents, but also to hindering the development of certain industries and the economy as a whole. Bearing in mind that the country's competitiveness is not achieved in all industries, but only in those that contribute to competitive advantages of the country, the main task of competition policy is the creation and protection of competitive mechanisms in the industries which are able to ensure more efficient use of limited resources. In this regard, it is important to note that although the realization of competition policy objectives can contribute to the realization of the industrial policy objectives, it can also disrupt them. Thus *Picot et al* [11] suggest that the intensive development of major infrastructure components (communication systems, information transfer, etc.) makes possible significant reduction of transaction costs related to the various forms of co-ordination of economic agents' activities. Investments in market research and collection of market information have a significant share in transaction costs. Hence, the state can take over a part of information activities and thus contribute to the reduction of transaction costs. At the same time, *Porter* [14], referring to the effects of the information revolution, stresses that dramatical reduction of the costs related to collection, processing and dissemination of information significantly improve the manners of doing business. In this regard, the successful implementation of competition policy creates the conditions for accelerating the development of the "new economy" industries, which represent a significant objective of industrial policies of many world countries. A number of countries, especially the most developed ones, have institutionalized their attitudes towards the issue of competitiveness by establishing appropriate government bodies whose task is to regularly report on the state of the economy's competitiveness and to promote competition policy. This information can be useful for Serbian policy makers and creators of the economic system.

Conclusion

Competitiveness of the national economy represents its ability to actively participate in international economic relations and, by using its advantages, strengthen its position in the international market and improve the growth of economic and social well-being. An active participation of economic agents (private and state-owned companies) along with the rational use of the available resources of the country and implementation of the effective and efficient macroeconomic policy is necessary for the improvement of the country's competitiveness. Macroeconomic, political, legal and social context of the economy represents a set of regulatory policies and institutions, which creates a common framework for business and government operations, as well as the activities carried out by individuals. The above-mentioned set of regulatory policies and institutions does not automatically create successful business operations by itself, but merely establishes the potential for economic success. In fact, the government and other public institutions do not create value. Value is created in the companies that depending on their technical, technological and organizational competences produce competitive goods and services.

The problem of determining the level of competitiveness of the national economy and the adequate methods for its improvement, has particularly attracted attention and gained importance since global financial and economic crisis and appearance of the significant changes that have occurred in the dynamics of the global economy and economic development of many countries, including those that have significant impact on the global economy. We are constantly looking for the ways to improve the level of competitiveness of the economy in order to be more efficient in terms of the changing environment within which global economy functions. All approaches to the current economic issues point to the crucial importance of the business environment where economic activities take place, which is a product of the institutional framework of the national economy. In fact, there is no doubt that the prosperity of the national economy is of paramount importance to improving competitiveness, which also requires a favorable business environment. The attractiveness of the business environment is even more important because it directly affects the efficient productivity of companies and hence, their competitiveness.

With reference to the above stated, the task of the state is to create an attractive business environment in its territory in order to motivate the companies as creators of value to initiate and organize those types of activities that will improve the level of productivity. Therefore, creation of a favorable business environment must be the primary goal of each country and depending how the government chooses to establish such environment the level of competitiveness and performance of the national economy will be determined. This paper confirms the hypothesis that high-quality and efficient institutions, by creating a favorable business environment, decisively influence the improvement of competitiveness and economic performance and success of the national economy.

Given the level of their economic development, majority of transition countries, as well as Serbia, opt for institutional environment and entrepreneurial potential as the key elements of competitiveness improvement. By creating stable and consistent institutions, the conditions for positive motivation of entrepreneurial activity, innovation, savings and investments will be established. It is therefore necessary to create institutional and systemic preconditions that will facilitate improvement of the competitive operations, both in domestic and international markets, which will by the force of their necessity, in an objective way verify the success of the business. Hence, the importance of the institutional environment for improving competitiveness and economic success becomes essential for all development phases and economic conditions and in that respect will also be the subject of future research.

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