CONFERENCE PROCEEDINGS
OF THE INTERNATIONAL SCIENTIFIC CONFERENCE

TOWARDS A BETTER FUTURE

DEMOCRACY, EU INTEGRATION AND CRIMINAL JUSTICE

Volume II

FACULTY OF LAW,
UNIVERSITY "ST. KLIMENT OHRIDSKI"– BITOLA,
REPUBLIC OF NORTH MACEDONIA

International Scientific Conference

“Towards a Better Future: Democracy, EU Integration and Criminal Justice”

Conference Proceedings, Volume II

Faculty of Law - Kicevo, University “St. Kliment Ohridski” - Bitola

Bitola, 2019

CIP - Каталогизација во публикација
Национална и универзитетска библиотека "Св. Климент Охридски", Скопје

34(082)
32(082)

INTERNATIONAL scientific conference (2019 ; Bitola)
Towards a better future : democracy, EU integration and criminal justice : conference proceedings / International scientific conference, Bitola, Bitola, 10-12 May, 2019 ; [editors Goran Ilik, Angelina Stanojoska]. - Bitola : "St. Kliment Ohridski" University, Faculty of law - Kicevo, 2019. - 2 св. (372, 362 стр.) : илустр. ; 25 см

Фусноти кон текстот. - Библиографија кон трудовите

ISBN 978-608-4670-04-9 (V. 1)
ISBN 978-608-4670-05-6 (V. 2)

а) Право - Зборници б) Политички науки - Зборници
COBISS.MK-ID 110330634

International Scientific Conference

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Bitola, 10 – 12 May, 2019

Conference Proceedings

Volume II

Publisher
Faculty of Law - Kicevo, University “St. Kliment Ohridski” - Bitola
Center for Scientific Research at the Faculty of Law - Kicevo

For the Publisher
Prof. Dr.sc Goran Ilik, Dean of the Faculty of Law – Kicevo

Address of the Publisher
Rudnicka BB
6250 Kicevo, Republic of North Macedonia
+ 389 45 220 267
http://pfk.uklo.edu.mk

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Review Scientific Article
UDK 35.07:341.217(4-627EU)

GOOD GOVERNANCE AND INSTITUTION BUILDING AS A CONDITION OF EU INTEGRATION AND ECONOMIC GROWTH

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Abstract
Institutions represent rules of behavior in a particular society, the limitations that a person has designed to shape interactions between people. Inclusive institutions promote the rule of law, maximize efficiency and social well-being and contribute to the achievement of higher rates of economic growth and represent key economic freedoms. Inclusive institutions provide security of private property, an impartial legal system and public services that provide equality in exchange and contracting, as well as citizens' participation in economic activities. Residents of countries with such type of institutions have access to political institutions, which gives them the opportunity to participate in the democratic process, to elect representatives of the authorities, change them, etc. Extractive institutions, as opposite to inclusive institutions, allow access to political power only to a privileged circle of people. The aim of this institutions is to subtract income and wealth from one social subgroup in favor of the other. The emergence, development and establishment of inclusive institutions is not a short process and it also implies the fulfillment of certain political prerequisites such as: the representation of parliamentary tradition and therefore political culture, compliance with laws and regulations, respecting private property rights, respecting state property rights, strong public opinion etc. Greater representation of inclusive institutions will certainly contribute to EU integration.

Keywords: *inclusive institutions, extractive institutions, integrations, governance, rule of low, growth*

INTRODUCTION

One definition that comprehensively determines the notion of institutions and thus is generally accepted is the one that indicates that the institutions are the rules of behavior in a particular society and the restrictions that a person has designed to shape interactions between people. The aforementioned definition of institutions shows us that the institutions are connections and rules of behavior in the mutual interactions of people. Each individual is familiar with potential benefits that he can achieve if he respects certain "rules of the game", but is also aware of the potential sanctions and costs incurred by non-compliance with the rules. In the recent years,

the use of the term "institution" has been widespread in the social sciences and reflects the growth of the institutional economy (North 1990, 13). This term is also used in other disciplines such as law, philosophy, sociology, politics, geography.
As North points out, institutions are based on formal but also informal behavior rules, as well as mechanisms that allow their implementation. The existence of institutions cannot guarantee us with certainty that each individual will behave in a socially acceptable and desirable way, but the existence of institutions will certainly increase the likelihood of compliance with the rules and regulations. Every individual who violates the rules of behavior must bear certain costs (North 1990, 14-16).
Geoffrey Hodgson points out that all activities in society are based on a specific institutional framework and all social interactions are under the concept of institutions. Also, institutions can be defined as a set of rules and norms that determine patterns of behavior of economic actors in a society (Hodgson 2006, 1-3).
Boland and Newman also deal with the problem of defining institutions, but within neoclassical theory. Institutions represent a certain kind of constraint that can be transparently given or tacitly defined to determine equilibrium positions in a social community (Boland and Newman 1979, 72-74). As authors point out, if one takes into account the aspect of economic policy, institutions can be defined as dynamic, active instruments by which it is possible to postpone or inhibit the occurrence of a particular change, or, on the other hand, to accelerate the development of the change. In this way, the authors point to the dynamic and static nature of institutions which on the one hand can guarantee economic stability, while on the other hand can be the drivers of economic change and thus become a source of economic instability.
North considers that institutions are never static and he pays special attention to formal and informal institutions when defining institutions. According to Raiser, informal institutions can be seen as a set of rules and norms imposed by society and moral values that affect individuals and organizations (or even force them) to strive to achieve their goals (Raiser 1997). The author points out that efficient informal institutions significantly influence economic development by reducing transaction costs and fostering state efficiency.

INSTITUTIONS, RULE OF LAW AND EU INTEGRATIONS

As Fukuyama points out, state building is precisely based on strengthening existing and creating completely new state institutions (Fukuyama 2004, 7). Institutions are precisely those that determine how stable and economically developed countries are and constitute a key development variable. Stability of institutions can actually be viewed as an indicator of the maturity of a society. Institutions are very important not only for the countries in transition, but they are also the preconditions for the development of an economy. The representation of weak institutions in one economy is reflected in the following statements (Šuković 2002, 26):

- The existence of a weak state, unable to enforce laws, collect taxes, oppose pressures from interest groups, etc.,
- Lack of political leadership and credible implementation of political reforms,

- Poor local self-government and poorly defined relations between central and local authorities,
- Widespread corruption resulting from excessive bureaucratic interventions and excessive regulation,
- Inconsistent and weak public procurement procedure based on administrative orders and only partially on market offers (Jovanović 2002, 247-249),
- Poor supervisory and regulatory procedures for the financial sector, etc.

EU Membership requires that the candidate country has achieved stability of institutions guaranteeing democracy, the rule of law, human rights and respect for and protection of minorities, the existence of a functioning market economy as well as the capacity to cope with competitive pressure and market forces within the Union. Membership presupposes the candidate's ability to take on the obligations of membership including adherence to the aims of political, economic and monetary union (European Council 1993).

Serbia, as a new state is expected to prove during the accession process that it is able to apply the legal heritage of the EU in its territory from the date of accession in the same way as the old member states. Serbia must prove all this during the accession period. Therefore, the harmonization of domestic legislation in that period and the construction of institutions that must be able to apply law, as well as the presence of courts overseeing the entire system, are of key importance. We can conclude that the ability to apply EU law in the territory of the Republic of Serbia is a condition for membership, not its consequence (European Commission 2018).

Judicial reform encompasses the necessity of becoming independent, impartial, efficient, responsible and professional. The fight against corruption includes several aspects, including preventive action, repression in terms of prosecuting corruption offenses and an institutional framework, which must be set up to ensure effective resolution of this issue (Međak 2016, 80-81). In order to fulfill the conditions in this chapter (Chapter 23: Judiciary and Fundamental Rights), Serbia needs to implement numerous reforms and activities that have a direct impact on the daily life of citizens. Establishing a reliable judicial system, in which citizens will be able to protect their rights and receive final judgments within the optimum period, is the basic benefit of all activities undertaken in the field of judicial reform. In addition, with an efficient justice system and an effective fight against corruption, Serbia becomes a reliable country with a stable legal system and in this way becomes attractive for investment (Subotić 2016, 7-8).

In support of the foregoing, the conclusion is also that the violation of private property and contractual rights, or their expropriation, inevitably leads to the reduction of the actual and expected returns, which leads to a weakening of incentives for the owners of the production factors to invest them. For what reason, any investor who rationally behaves will invest his own production factors if there is a great danger of expropriation of the yield of this investment. The greater likelihood of a violation of private property rights leads to less probability of investing, which leads to a reduction in the investment rate, which undermines the economic growth rate (Begović 2011, 176).

If we observe the EU requirements that are mentioned above, it is important to note that the representation of the rule of law institutions is important for EU accession. Two very important types of institutions are highlighted: inclusive and extractive institutions. Inclusive institutions contribute to economic activity, productivity growth and, economic progress. Such institutions provide security of private property, an impartial legal system and public services that enable equity in the exchange and contracting policy, as well as citizens' participation in economic activities (Acemoglu 2009, 58-63). We can conclude that greater representation of this type of institution contributes to EU integration, as well as the achievement of higher rates of economic growth.

The basic characteristic of inclusive institutions is that they function on the principles of the rule of law, which implies that laws are applied equally to all citizens. The value of the principle of the rule of law is reflected not only in equality before the law but also in providing opportunities for wider involvement in political processes. In this way, established, inclusive political institutions support inclusive economic institutions that speak of their interconnectedness (Jakšić and Jakšić 2018, 5-10).

Inclusive institutions create inclusive markets, allow individuals to get educated and choose their own profession with complete freedom. They encourage companies to create innovations and invest in state-of-the-art technology. Residents of countries with such type of institutions have access to political institutions, which gives them the opportunity to participate in the democratic process, to elect representatives of the authorities, change them, etc. It should also be emphasized that the security of property rights, legal regulations, public services and the freedom of contracting and exchanging depend primarily on a government that is firmly linked to economic institutions (Acemoglu and Robinson 2012, 87-88).

Extractive institutions are the opposite of inclusive institutions. They aim to seize income and wealth from one social subgroup in favor of the other. These institutions extract wealth from the majority of citizens and redistribute it to the minority by which they received such a name. Such institutions do not have incentives for savings, investments, innovations (Vanino and Lee 2018, 10-13). Extractive institutions allow access to political power only to a privileged circle of people, while inclusive institutions provide a chance for more people to participate in political life or economic process and have access to political power and economic wealth. The classic examples of extractive institutions are high tax rates[108], high fees for starting a business, banning imports or exports, and so on. Extractive institutions enable acquiring big profits and wealth through gaining of power, the appropriation of others' property and the establishment of monopolies (Acemoglu and Robinson 2012, 89-92).

The presence of inclusive institutions in one country facilitates EU accession. The chapter on competition (Chapter 8: Competition) is one of the most demanding and complicated chapters and consists of three parts: competition policy in the narrow

[108] The rate of income tax for citizens which moves within the limits of normal will affect that citizens regularly settle this obligation. However, that rate is extremely high, the only thing we can expect is the avoidance of tax payments by citizens (tax evasion), the rise in the gray economy, a significant decline in the employment rate.

sense (the fight against monopoly and concentration), state aid control policy and liberalization of certain sectors of the economy. These areas include rules and procedures for combating the monopolistic behavior of the companies (such as limiting agreements between companies and abuse of a dominant position), rules for examining the merger of enterprises and rules for preventing the granting of state aid that distorts or may impair competition in the internal market (Međak 2016, 51-53).

The emergence, development, and establishment of inclusive institutions is not a short process and it also implies the fulfillment of certain political prerequisites such as the representation of parliamentary tradition and therefore political culture, compliance with laws and regulations, respecting private property, respecting state property, strong public opinion, etc. One state can certainly not achieve economic progress if the backward industry is not exposed to competition, the economy is subsidized, companies and banks that achieve poor business results are not closed, protection of the property is not represented, the free flow of labor is prevented, innovation and creativity are not encouraged, resources are not in the hands of those who are the most capable, the functioning of market laws according to which should survive only competitive and successful enterprises for whose products there is a demand, is not possible (Acemoglu and Robinson 2010, 17-25).

EU Membership requires that the candidate country present an industry development policy and a restructuring strategy in order to assess whether their industrial policies are in line with EU principles, especially in terms of privatization and restructuring. For example, all state-owned companies in Serbia will have to go through the adjustment process, which implies structural and organizational changes in these companies and their preparation for independent and competitive participation in a market game. Industrial policy is closely linked to competition policy (including state aid). EU industrial policy has the authority to control and limit subsidies and other forms of state aid, both at national and EU level. (Međak 2016, 75).

INSTITUTIONS IN SERBIA

If we look at Serbia during the nineties of the twentieth century, we can see that institutions that promoted the rule of law were not represented. On the contrary, wealth was concentrated in the hands of a small number of members of the political and economic elite. Processes of privatization and restructuring of enterprises have run slowly and have been burdened with many problems and unresolved issues. There were very complicated bureaucratic procedures for starting a business, loss-making companies continued to operate with state subsidies, there was no competition, and consequently, the generation of monopolistic and oligopolistic structures could not be prevented. In addition, no legal regulations were adopted which would define bankruptcy, competition, privatization, investment funds, etc. (Grujić and Uzelac 2011, 115-119).

The numerous studies conducted by the World Bank, the World Economic Forum, and many foundations are focused on measuring the quality of institutions in countries around the world. The aim of the conducted research is to create certain indicators on the basis of which one can draw conclusions about how much an economy is stable, whether the rule of law is represented, whether society is corrupt, how efficient the judiciary is, what are the limitations of government intervention and power, whether the labor market is free, etc.

Table 1. The ranking of the institutional indicators of Serbia

Institutions	Value	Rank/140
Organized crime 1-7 (best)	4.1	104
Homicide rate /100,000 pop.	1.4	46
Terrorism incidence 0 (very high) -100 (no incidence)	99.9	55
Reliability of police services 1-7 (best)	4.1	89
Social capital 0-100 (high)	n/a	n/a
Budget transparency 0-100 (best)	61.5	49
Judicial independence 1-7 (best)	3.0	107
Efficiency of legal framework in challenging regulations 1-7 (best)	2.9	98
Freedom of the press 0-100 (worst)	29.6	63
Burden of government regulation 1-7 (best)	2.8	113
Efficiency of legal framework in settling disputes 1-7 (best)	2.9	108
E-Participation Index 0-1 (best)	0.81	47
Future orientation of government 1-7 (best)	3.5	81
Incidence of corruption 0-100 (best)	41.0	66
Property rights 1-7 (best)	3.7	115
Intellectual property protection 1-7 (best)	3.6	100
Quality of land administration 0-30 (best)	18.0	52
Strength of auditing and reporting standards 1-7 (best)	4.0	108
Conflict of interest regulation 0-10 (best)	5.0	95
Shareholder governance 0-10 (best)	6.3	45

If we analyze the World Economic Forum data presented in The Global Competitiveness Report 2018, institutions present the first pillar of competitiveness of a total of twelve. The ranking of the twenty institutional indicators of Serbia is presented in Table 1. By analyzing the presented data from this table, it is observed that Serbia ranks 115th out of 140 countries in property rights. This is also the lowest ranked institutional indicator. This is followed by the burden of government regulation with rank 113, then the efficiency of legal framework in settling disputes and the strength of auditing and reporting standards with rank 108 (Schwab 2018).

The 2018 Investment Climate Statement also provides information on property rights in Serbia. It states that Serbia has an adequate body of laws for the protection of property rights, but the procedure of enforcing property rights through the judicial system can run very slow. There are many factors that can complicate the issue of property rights such as requests for restitution, unlicensed and illegal construction, limitation of property rights to rights of use, outright title fraud, and other issues. Investors are cautioned to investigate thoroughly all property title issues on land intended for investment projects (Bureau of Economic and Business Affairs 2018).

According to the Heritage Foundation, the Economic Freedom Index for Serbia is 62.5. According to the value of this index, Serbia is ranked 80th out of 186 countries. The Economic Freedom Index increased by 3.6 percentage points over the previous year. Serbia has advanced 19 places in comparison to the previous year on the Heritage List of Economic Freedom. Serbia is still recovering from years of international economic sanctions and damage from civil war and still making the transition from statism to a market economy. Inflation is under control, and the budget has stabilized. Many large state-owned enterprises in the electricity, communication and natural gas sectors should be reformed. Deeper institutional reforms are also needed to tackle bureaucracy, reduce corruption, and strengthen a judicial system that is vulnerable to political interference (The Heritage Foundation 2018).

CONCLUSION

Based on the previously announced information on the quality of institutions, Serbia should build inclusive institutions that will lead to economic progress and accelerate the EU integration process. The presence of inefficient institutions that do not promote the rule of law reflects the period of the nineties and the beginning of the twenty-first century when a lot of privatization processes failed. Unsuccessful transition and systemic corruption are the main features of a given period. In such circumstances, inadequate institutional infrastructure could not ensure a successful change of the economic system.

During 2018, Serbia maintained macroeconomic stability. The process of fiscal consolidation continued with the faster growth of gross domestic product relative to initial forecasts, but the economic growth strategy based on investment and exports has not yet been fully realized. Therefore, the situation regarding the quality of institutions in Serbia has improved in recent times, but constant work on their improvement is necessary. Some of the important challenges for Serbia are the inefficiency of the judiciary, high corruption, large state-owned loss-making enterprises, informal economy. All these challenges adversely affect economic growth.

EU membership is the foremost strategic foreign policy priority of the Republic of Serbia. Values promoted by EU member states are recognized as values that Serbia wants to further nurture, and the accession process is an opportunity for reforms and strengthening of European standards. In addition, the European Union is the most important trade and investment partner of Serbia and thus one of the most important factors of economic stability of the country.

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