

QO‘QON UNIVERSITETI XABARNOMASI

ILMIY-ELEKTRON JURNALI
1-SON

**KOKAND UNIVERSITY
HERALD**


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**QO‘QON
UNIVERSITETI
XABARNOMASI
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UNIVERSITY
HERALD
VOLUME 1**

**ВЕСТНИК
КОКАНДСКОГО
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1/2023

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FACTORS AND VECTOR OF THE DEVELOPMENT OF INSTITUTIONS IN THE SME SECTOR OF THE NATIONAL ECONOMY

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ANNOTATION

One of the main policies of the Government of the Republic of Uzbekistan is to stimulate the development of the small business sector. Despite the improving business environment, there are problems affecting the national entrepreneurial sector. The aim of the study is to analyze the factors and directions of development of institutions related to small business, to identify patterns and predict their transformation. The paper uses the methodology of the theory of institutional change to describe, explain and recommend changes in the system of small business institutions.

Introduction. The active development of the small business sector of the national economy of the Republic of Uzbekistan represents a vector of modern economic policy pursued by President Mirziyoyev. Small and medium enterprises (SMEs) play an important role in most countries of the world, especially in developing countries. SMEs constitute the majority of enterprises worldwide and make an important contribution to job creation and global economic development. According to the World Bank, they represent about 90% of enterprises and over 50% of jobs worldwide. Formal SMEs contribute up to 40% of national income (GDP) in emerging economies. These figures are much higher if informal SMEs are included¹.

An important factor for assessing the "health" of a country's economy is the effective functioning of small businesses, which is an indicator of its flexibility, its ability to adapt to the constantly changing economic situation.

As of 1 January 2023, the number of operating small businesses and microfirms was 523,600, an increase of 60,800, or 13.1 per cent, over the previous year. The number of small businesses per 1,000 population was 17.9 units. In 2022, the number of active small businesses per 1,000 inhabitants was 17.9, an increase of 1.4 compared to 2021. The share of small businesses in GDP for 2022 was 51.8 per cent². One of the reasons for the relatively low development indicators of this sector, in our opinion, is the persistence of institutional barriers.

Let us consider the problems of the institutional environment of the entrepreneurial sector.

Literature review. Degree of study of the problem Analysis of the category "institutional environment", "institution", forms of its development and influence on economic processes on a macroeconomic scale is presented in the works of scientists of institutional and neo-institutional direction: T. Veblen, J. Commons, D. North, J. Hodgson, and others. Russian scientists are also engaged in the study of both theoretical issues of institutional analysis and problems of development of the institutional structure of the Russian economy. Among them are the works of A. Auzan, E. Balatsky, V. Zotov, O. Inshakov, G. Kleiner, Y. Kuzminov, R. Nureyev, A. Oleinik, V. Presnyakov, V. Polterovich, V. Radaev, V. Rosental, V. Tambovtsev, A. Shastitko, E. Yasin and others.

Research methodology. The theoretical and methodological basis of the study is a systematic approach to the study of socio-economic phenomena and processes, the key provisions of the works of domestic and foreign scientists in the field of entrepreneurial activity, regulation of the economy, entrepreneurship support.

Research results and discussion. Within the framework of institutionalism there exists a theory of institutional changes, which focuses on describing, explaining and forecasting changes in institutions, as well as on developing scientific and practical recommendations as regards the desired (required or necessary) transformations therein. The scientific apparatus of this theory can also be used to investigate the nature and nature of changes in the system of small business institutions.

According to this theory, the changes taking place in institutions mean the process of modifying the rules and enforcement mechanism in order to reduce the value of transaction costs.

All the structural elements of an institution are subject to change, which are:

- a) the rules for the economic agent (A) who has to follow the rule;
- b) the rules for the guarantor (G), who must ensure that they are followed and apply sanctions if they are not, according to Figure 1.

From this figure it follows that changes in institutions take place in relation to:

- 1) the algorithm for implementing the rules I1;
- 2) the contingent of agents - A to which rule I1 applies;
- 3) either rules I2;
- 4) or the contingent of guarantors -G.

If we take, for example, the rules of transportation of goods through customs posts as institution (I), then the first variant of changes concerns the procedure of document processing by entrepreneurs (A). An example of the second option of change would be to impose different requirements on entrepreneurs that would lead to a change in their composition. A third option is to expand or reduce the functional responsibilities of customs administration staff (G), and a fourth option is to transfer authority for certain procedures (customs transport control or declaration clearance) to another auxiliary body.

¹ <https://www.worldbank.org/en/topic/sme/finance>

² Data from the Statistical Agency under the President of Uzbekistan <https://stat.uz/ru/default/ezhekvartal-nye-doklady/21517-2022#tab-4>

In some specific cases, the legislature may abolish an institution or replace it with another. However, changes to institutions are not always accompanied by positive effects, but this will be discussed later.

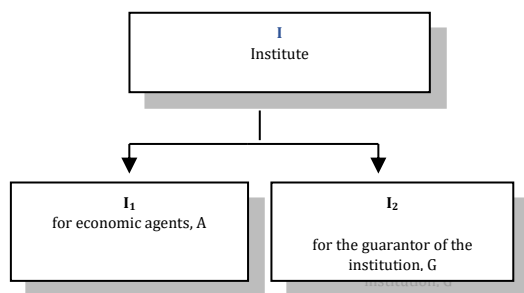


Figure 1. Structure of the institution (rules)

The theory of institutional change contains various concepts that explain factors in the development of institutions. Thus, according to the concept of H. Demsetz³ (Demsetz, H. 1967) the development of institutions is influenced by changes in the relative prices of economic resources, and the North, D. C., & Thomas, R. P., 1977) concept is influenced by demographic pressure⁴. The authors of both concepts believe that the inefficient use of resources forms the demand for new institutions necessary to use the opportunities provided by these changes. At the same time, the state and social groups play a passive role, do not participate in the process of creating institutions, but only accept them. An important prerequisite for this change, however, is increased efficiency, which contributes to the creation of value.

In-depth research in the field of institutional change has shown that the above-mentioned concepts contain a number of points requiring clarification. In particular, scientists have questioned the fact that changes in institutions automatically follow changes in economic conditions. North's concept (North, D. C., 1990), published in the 1990s, managed to dispel these doubts, and also became a seminal work for new developments in this area⁵.

D. North, examining the processes on political markets, found that political actors (entrepreneurs) have their own interest in institutional change. They are the main organizers of new institutional agreements aimed at reducing uncertainty and creating a basis for finding a compromise in the conflict of interests. In our opinion, D. North came to this formulation of the issue under the influence of evolutionary theory of J. Schumpeter. After all, in the theory of economic development the entrepreneur is given a central place as a disruptor of equilibrium, a catalyst of change and a source of innovation. Consequently, by combining new factors of production, the entrepreneur initiates changes in both relative (institutional arrangements) and absolute property rights (institutional environment). In doing so, the mechanism of institutional change is triggered by combining the action of external change and internal knowledge accumulation. D. North wrote about this as follows: "Factors (sources) of change are opportunities as perceived by entrepreneurs. They are derived from changes in the external environment, as well as from the accumulation of experience and knowledge and the integration of these factors in the mental constructions of the actor"⁶.

Based on D. North's approaches, an algorithm of institutional development was constructed, which looks according to Fig. 2. where:

- ▣ change in knowledge leads to new technologies;
- ▣ new technologies change relative price levels for resources;
- ▣ new price levels create incentives for owners of potentially increasing resource values to transform their ownership of resources;

▣ new price levels, in turn, lead to the emergence of rules to maximise the value of the use of such rights;

▣ at the same time, non-zero transaction costs on the political market prevent all potentially possible institutional changes from being realised and useful for value creation⁷.

As we see it, this algorithm shows the relationship between technological and institutional changes, which confirms our conclusion about the influence of J. Schumpeter's ideas on the formation of D. North's concept.

According to the concept of induced innovation by V. Ratten, V., 2019⁸ and Solis-Navarrete, J. A., 2021⁹, exogenous factors form the demand for institutional change, but political actors (entrepreneurs) suggest such changes in institutions that will provide them with a certain income¹⁰.

In our view, this concept indicates that, first, each institutional environment corresponds to a different distribution of political and economic power among economic agents and, second, political actors with more power seek to develop and consolidate such institutions that will allow them to improve the efficiency of economic activity in individual markets.

The author of the theory of the distributive nature of institutions G. Laibkep¹¹ is convinced that institutional changes cause shifts in the distribution of wealth and political power, so stakeholders develop distributive mechanisms to indicate the recipients of benefits from changes in institutions over time¹². The theory of G. Laibkep was developed in the works of M. Olson, who supports the view of the existence of special interest groups, but argues that groups should be distinguished by the degree of their capacity - into small and large. We believe that the latter is due to the fact that large groups are ineffective in achieving a common goal because of the "stowaway" effect. According to J. Knight, the "stowaway" effect consists in the fact that a rational agent will not take part in the political process, because in case of its successful completion he will get a part of the overall benefit without any costs. Small groups are more efficient because of the commonality of interests (homogeneity of preferences) of the group members and low costs of making collective decisions (voting costs).

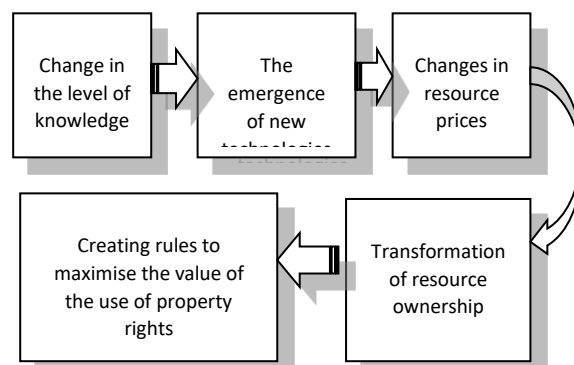


Figure 2. D. North's Algorithm of Institutional Development

B. Arthur identified two groups of factors that determine the direction of institutional change: increasing returns and transaction costs, which V. Polterovich added three more factors

- a) Transaction costs, i.e. the cost of switching from one norm to another;
- b) transition rents, i.e. the income that arises in the private sector as a result of the movement towards equilibrium after liberalisation of reforms;
- c) macroeconomic policy, i.e. government management can lead to significant changes in the institutional structure.

³ Demsetz, H. (1967). Towards a theory of property rights, American Economic Journal, 347-359. Ownership, control and the firm, 57(2), 347-359.

⁴ North, D. C., & Thomas, R. P. (1977). The first economic revolution. The Economic History Review, 30(2), 229-241.

⁵ North, D. C. (1990). Institutions, institutional change and economic performance. Cambridge university press.

⁶ North, D. (1997). Institutional change: a framework for analysis. Voprosy ekonomiki, 3(6), 7.

⁷ Institutional Economics: The New Institutional Economic Theory: / Ed. by A.A. Auzan. - MOSCOW: INFRA - M., 2005. -416 c.

⁸ Ratten, V., Ramirez-Pasillas, M., & Lundberg, H. (2019). Managing sustainable innovation. In Managing sustainable innovation (pp. 1-10). Routledge.

⁹ Solis-Navarrete, J. A., Bucio-Mendoza, S., & Paneque-Gálvez, J. (2021). What is not social innovation. Technological Forecasting and Social Change, 173, 121190. 11.

¹⁰ Auzan, A. (Ed.). (2021). Institutional economics. New institutional economic theory. Litres.

¹¹ Zykov, S. V., & Dayneko, D. V. (2022). Theoretical Aspects of Innovation Development and Institutional Transformations in the Forest Industry. In Forest Industry of Russia (pp. 1-15). Springer, Singapore.

¹² Tambovtsev, V. (2021). Theories of Institutional Change. Textbook. Litres.

The merit of V. Polterovich is that he showed the relationship between the theory of reforms and institutional change. In general, these concepts complement the work of D. North and allow a more complete explanation of the observed changes in institutions.

At the present stage, scholars from post-Soviet countries are proposing new concepts of institutional development. In particular, G. Kleiner proposes to divide the factors affecting the institutional process into three groups according to the level at which they emerge:

micro-level (the actions of social actors in creating and embedding norms);

The meso-level (the formation and change of 'interaction fields or arenas' - local spheres where institutions are born or established);

The macro-level (the interaction of institutions themselves).

According to the scholar, factors at all three levels are participants in institutional genesis, but in different roles and at different stages of the life cycle of an institution.

In his concept, institutional change is represented as a two-level process. At the highest level, which involves both conscious mental processes and the personal and collective unconscious, information impulses are formed as a result of certain kinds of events, reflecting the need of a significant part of society for a certain institution. These impulses trigger processes of searching for a corresponding prototype in the space of basic proto-institutions. The search is performed by adapters and initiators - a kind of institutional scouts or leaders of society - individuals or collectives whose voice will be heard by a given part of society. If such a prototype is not found, a certain combination of proto-norms is formed under the influence of the expressed need, which can be conventionally called "crossing over". This leads to the formation of "new" proto-norms and their nominal and actual carriers, which become institutions or disappear from social practice as a result of the rooting process. Actors (individuals) are participants in the process of embeddedness and "arenas" of interaction are the venues of these processes.

In our view, this concept differs from the previous concepts by the fact that G. Kleiner operates with such a concept as "event", which, in his view, is a kind of trigger of institutional dynamics.

In turn, the concept of institutional architectonics put forward by Ukrainian scientists uses such categories as institutional evolution, institutional dynamics, and institutional pit to explain institutional changes. In the most general terms, institutional architectonics is the structure of institutions, formed from the interconnections of the way of thinking and action of people, rules, norms, stereotypes, traditions, institutions and other social formations in their correlation with the essence and general aesthetic plan of building a social system. The object of institutional architectonics is the structure of institutions, viewed and evaluated from the viewpoint of their correspondence with the essence characteristics of society and its general aesthetic plan. Advocates of institutional architectonics believe that if an institutional structure is built up based on basic institutions, gradually increasing and complicating its architectonics and modifying the framework itself, then we are dealing with institutional evolution. A classic example of institutional evolution is the institutional transformation of China, which, relying both on its millennial traditions and on Marxist ideology, gradually builds a new institutional structure, adequate to the requirements of the time. By rigidly holding on to the institutional core, the Chinese leadership has allowed sufficient dynamic changes that are within institutional elasticity to exclude breaks in the institutional structure.

We agree with their view that institutional change should be pursued with appropriate rules to modify existing rules. The authors of this concept believe that market institutions are formed gradually in the process of market transformation, but this process will be more successful if they are based on the institutions of transformation, that is, on certain rules and norms of institutional change, which form the mechanism of transformation. In a transitional economy, this problem manifests itself, in particular, as a correlation between transformation of institutions and transformation institutions. The process of formation of rules, norms, procedures of institutional changes is a system of basic institutions of institutional dynamics.

An institutional hole is formed in the institutional environment, where the need for institutional change is present at the same time and the mechanisms of such change are absent.

The role of a disruptive force (factor) is played by the accumulated knowledge and experience that expand the worldview of the economic agent (entrepreneur). The new system of views of the entrepreneur also refers to the perceived relative costs of economic activity, the subsequent revision of which leads to violations in the system of relative prices and shifts in the comparative bargaining power of the parties, and changes in the latter, in turn, lead to a breach of institutional equilibrium.

According to D. North's methodological approach, institutional equilibrium is a situation where, given the balance of power of the players (firms) and a given set of contractual relations that form economic exchange, none of the players thinks it beneficial to spend resources on changing agreements. A breach of this equilibrium implies an incentive to change the contractual terms and conditions. Renegotiation of contract terms in order to obtain some potential gain from the exchange is understood as incremental (continuous) institutional change. Since knowledge and experience are always improving, there is a constant dynamic process of institutional development in society.

The process of decentralised choice of institutional forms of transaction (contractual rules) takes place on institutional markets. The concept of an institutional market was first introduced in 1994 by S. Pejovich, who wrote: "The market of institutions is a process which allows individuals to choose the rules of the game in their community. Through their voluntary interactions, individuals evaluate existing rules and determine and test the suitability of new rules. The most important function of this competitive market is to encourage institutional innovation and forms of adaptive behaviour".

Changes in relative property rights create the preconditions for a revision of absolute property rights (institutional environment) in political markets. The political market is the place where explicit institutional transactions (transactions) take place. This market encompasses a set of actors, organisations and procedures that shape and change the institutional environment. The subject of explicit institutional transactions are formal rules, coordinating the economic behavior of market actors. The outcome of transactions are institutional innovations, i.e. innovations implemented in formal rules without reference to future transactions for their implementation. In other words, these are various additions, changes made to existing regulations, adoption of new laws, regulations.

It should be noted that informal rules, due to their origin and scope of application, are rarely the subject of institutional transactions on political markets. The formalisation of an informal institution is a rare case. This process reflects the essence of the evolutionary variant of institutional development, when the norm underlying informal institutions acquires the force of law.

The literature describes two directions of institutional change: spontaneous and purposeful. Spontaneous change emerges and spreads without anyone's prior intent or plan. An example of spontaneous change is the transformation in contractual arrangements during the non-payment crisis. These are institutional forms of deal-making on the terms of advance payment for the value of goods supplied and barter exchange of goods and services. The first form was chosen by entrepreneurs to make the contract terms binding, while the other was chosen as one of the possible ways to stabilise prices. In the 1990s, these institutional innovations played a prominent role in economic development and became major components of the institutional environment of the time.

Purposeful (deliberate) change (or institutional design) emerges and spreads more or less according to some deliberate plan. The process of disintegration of central planning and the ensuing effort to create a new institutional structure with considerable assumptions can be described as an example of deliberate change. At the same time, this process is considered a prime example of discrete (revolutionary) changes, the essence of which is a radical change of formal rules. The

initiator of radical changes is the state and/or organised groups (the institutional entrepreneur).

Based on the above, we believe that the role of entrepreneurs and the state as the driving force initiating institutional changes in the small business sphere is played by entrepreneurs and the state. The existing institutional structure does not always provide a balance of interests of all participants in the economic process. By fulfilling their main purpose of improving the efficiency of production, the institutions cause redistribution of income, economic opportunities and economic advantage in society. As a consequence, the current institutional environment of small business can be a "positive good" for some entrepreneurs and a "negative good" for others. Dissatisfaction with the level of income, narrowing of opportunities, deprivation of advantages, in a word, lost potential benefits force outsider entrepreneurs to form special groups which lobby their interests on the political market. In other words, they express a demand for certain institutions. This shows that there is an ongoing process of struggle in the economic system for the expansion of economic freedom through the construction of an adequate system of property rights. The described actions of entrepreneurs are characterised by purposefulness. However, in everyday life their activities are accompanied by a spontaneous process of formation of informal rules of conduct (business customs, entrepreneurial ethics).

It is possible that an institutional framework that does not create incentives for entrepreneurial activity may lead to an economic crisis. In such cases, the institutional framework acts as the cause of inefficient functioning of the national economy, and the state initiates a restructuring of the institutional framework in order to change the focus of incentives.

In the theory of institutional change, we are particularly interested in the concept of V. Tambovtsev, which explains the mechanism of institutional change through the microeconomic model of the institutional market under perfect competition [20]. Its author believes that the market of institutions (institutional market) has the elements of a classical market: demand, supply, price and competition. Although the market of institutions cannot be seen, it is assumed that its mechanism accompanies all the actions of an individual in the process of preparing a transaction. The role of a commodity in the institutional market is played by an institution, which belongs to the category of 'durable goods'. Otherwise, they are called capital assets, capable of generating income over a long period of time.

Our previous theoretical studies have shown that the economic system generates demand for institutions necessary for entrepreneurs to facilitate the process of exchange and reduce transaction costs. V. Tambovtsev measures the amount of demand (QdI) for a particular rule by "the number of times economic agents turn to it when they engage in transactions relevant to that rule at some price of its use". He also believes that an individual's choice of one rule or another is conditioned not only by current economic benefits, but also by a wider range of circumstances, such as traditional religious or ideological constraints, etc.

A. Rounov, on the other hand, distinguishes between economic and organisational factors in the demand for institutions. Economic factors, he says, include changes in the relative prices of assets in different sectors of the economy due to the opening (or disappearance) of previous markets, decline in the product cycle; changes in the value of individual factors of production; new technological and innovative opportunities, which are difficult or unprofitable to implement within the existing system of rules. Organisational factors, on the other hand, include: changes in mental behaviour and ideology; changes in the mechanisms of the guarantors of the former system of property rights. In addition, he believes that, in general, the demand for institutions can be divided into two groups: the demand for the existing structure of property rights and the demand for new rules.

The specificity of the supply of institutions is also due to the fact that institutional innovations are not patented in the market and there is no ownership of them, so the right to imitate them is free of charge. Moreover, in some situations developed countries are often prepared to pay for the cost of transplantation (the process of borrowing

institutions developed in a different institutional environment), sometimes even competing for the right to grow their institutional product on new soil.

As for institutional transactions, their peculiarity lies in the fact that an institution is not sold or acquired in the literal sense as goods and/or services. The process of 'acquiring' institutions boils down to:

☒ obtaining, in one way or another, information about the content of the rule, the algorithm for its implementation and the consequences of actions under the rule;

☒ searching for a counterpart capable of and agreeing to interact with an individual according to the relevant rules;

☒ making an explicit or implicit institutional transaction with him;

☒ ensuring the guarantor's consent and willingness to impose sanctions in case of its violation.

The ultimate acquisition of an institution turns it into a good. Depending on the interest group, three types of good are distinguished: public, club, private. Public action is able to provide institutional innovation as a public good. Small groups are effective in the production of club goods, and private goods are created and controlled by the entrepreneur himself. A. Shastitko believes that the information provided by institutions allows them to be considered a public good.

According to G. Kleiner, it is not quite correct to talk about the demand for institutions. The concept of demand for a good as the aggregate willingness of agents to offer some values in exchange for the use of this good requires a certain level of specificity in characterizing both the good itself and the values exchanged. "If we are talking about some vague and indefinite good, such, say, as 'order', then the values exchanged for it also lose homogeneity and we cannot speak of their additivity". Accordingly, the concept of demand loses its correctness.

In addition, he notes that considering institutions as peculiar trust goods does not remove the problem because the formation of an institution is not the product of purposeful activity, but the result of unplanned evolution. In this sense, an institution can be the product of neither "institutional production" nor "institutional production" and, therefore, cannot be regarded as a commodity, a service or other market "good".

And yet, in the model we are considering, price is considered an inherent element. In the case of institutions, the price of their acquisition (use) is expressed in the mechanism for making choices, comparing the benefits and costs of such choices. According to V. Tambovtsev, this "price" is quantified within the framework of a two-point scale:

☒ cost-benefit ratio is acceptable;

☒ the cost-benefit ratio is unacceptable.

If an institution is 'purchased' by economic agents, the sellers of the institutions do not make a pure profit. That is why V. Tambovtsev suggests that the above-mentioned costs to be borne by economic agents should be regarded as the income of sellers.

Equilibrium on a given market occurs if both parties agree to carry out a commodity transaction in a mutually beneficial institutional form with a satisfactory level of transaction costs. In reality, there are disequilibrium states in the market caused by a deficit (or surplus) of institutional forms (rules).

Conclusion

We believe that the market for institutions can experience a deficit of rules when the demand for institutions exceeds their supply ($Q^d_i > Q^s_i$). In real life, such a situation occurred in the post-Soviet space after discrete institutional changes. As a result, an institutional vacuum was formed in the economic system, which was quickly filled by modified informal rules, transplant institutions. The predominance of informal relations over formal ones, and the inadequacy of transplant institutions in real life, were accompanied by a rise in legal nihilism (people's distrust of the law in general).

At the other extreme, there is an excess of institutions in a given market, which is evidence of excessive bureaucratisation and increased administrative pressure that stifle entrepreneurial activity and force operating firms to turn to an alternative institutional environment, expanding the scope of the shadow economy. In these circumstances, the inclusion of mechanisms for de-bureaucratisation and deregulation

of the economy is seen as one way of moving towards equilibrium. In addition, the diversity of institutions includes a mechanism for competition between them. The sign of a winning institution is its systematic use, and the sign of a losing institution is its disappearance. The situation of institutional equilibrium has already been described, but we must bear in mind that it lasts for a short time and leads to a

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