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22 December 2019

Online at https://mpra.ub.uni-muenchen.de/97755/
MPRA Paper No. 97755, posted 31 Dec 2019 10:11 UTC

# The relationship between institutions and economic development

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## 1.Abstract

Development is a continuous process which increase choices available for human beings. However, there is a huge disparity throughout the world in relation to economic development. Differences in the institutions show a direct relationship with difference in the economic development. Established political and economic institutions affects the level of investments for human capital, physical capital and technology formation which decide the capacity of good and service production in a particular country. Through that, established institutions of a country influences directly on the level of development in a particular country.

This article discusses the institutions, evolution and types of institutions, relationship between institutions and markets, and functions of institutions for economic development. Further this article discusses the way that trust and anti-corruption affects the economic development and link between political power and institutions. Finally, some evidences to show the impacts of institutions on economic development are discussed.

**Key worlds:** development, institutions, political institutions, economic institutions, inclusive institutions, extractive institutions

## 2. Introduction

People in some countries are struggling to earn at least a Dollar per day and their children are suffering due to starvation and malnutrition. Epidemics like Malaria and Ebola are hitting badly to poor communities. On the other hand, people in some other countries enjoy a sophisticated life with good education, health, nutritious food and technological advancement. The reasons for this regional disparity might have various dimensions. According to the literature, this problem has been explained in different points of views such as geography, culture, market and institutions. The constitution, rules, policies, system, and procedures may be considered as institutions of a country.

It is important to highlight that, most of the countries with poor socio-economic performances carry a common set of characters such as high corruption, a low degree of democracy or dictatorship, property right problems and biases in law enforcement. On the other hand, developed countries perform good institutions which promote the socio-economic development. Many researchers argue that the institutions of the countries might play a major role in the regional disparity of economic development. Generally, the

Institutions of a country evolved for a long period of time and it shapes the prosperity of the country. The political power of the country chooses the political institutions and then political institutions decide the economic institutions. There is an interaction between political and economic institutions, and the relationship is dynamic. Some countries like United States, Australia, and Japan are the nice examples for the good institutions while less developed countries have comparatively bad political and economic institutions.

The objective of this essay is to discuss that what are the institutions and how it affects the economic performance of the countries. The concept of institutions, types, and functions of institutions, the relationship between institutions and economic development are discussed in this essay. Further, the essay discusses briefly the other concept such as geography hypothesis, cultural hypothesis and ignorance hypothesis in relevant to the regional disparity. The geographic and cultural hypotheses are less supported by the empirical evidence and this essay discusses some research findings on "relationship between institutions and economic development".

**3.Understanding of institutions**

The concept of institutions is broad and the term "institution" was defined in different ways. North, Fukuyama and Huntington, Helpman and Grief defined institutions in different ways (Fallon 2016). North (1990) defines that "Institutions are the rules of the game in a society or, more formally, are the humanly devised constraints that shape human interaction". The main features highlighted in this definition include "rules of the game", "humanly devised" and "shape human interactions". In the sports, rules of the game control players and if a player violates the rules, opponents has a right to be against him (North, 1990). In the same way, institutions can be understood as a set of rules for the members of the society that shape their behaviours. Institutions provide a set of constraints to the society and society members take decisions under the given set of constraints. The set of constraints was created by the human being or it evolved through the intervention of human being (North, 1990). The interactions among members of the society are shaped by these constraints.

Another definition says that "Institutions are the humanely devised constraints that structure political, economic and social interactions" (North, 1991). The second definition is narrower than the first and it is easier to understand. In both definitions, North mentioned a condition called "humanly devised constraints". According to North (1991), there are two types of constraints such as formal and informal. The informal constraints consist of "sanctions, taboos, customs, traditions and codes of conduct" (North 1991). "Constitutions, laws, property rights" are included in the formal constraints (North, 1991). However, Huntington (1965) defines institutions as "stable, valued recurring patterns of behaviour".

### 3.1. Evolution of institutions

Generally, institutions provide guidelines for members of the society to control their behaviour and simply it says what to do and what not to do (North 1990). In the real world, the institutions resulted from the process of evolution or creation (North 1990). As North (1991) describes, in the process of evolution of institutions, economic benefits for its members have been increased. It means that people selected the efficient combination of choices under the given set of constraints (institutions) in the way which increases economic benefit to the people. This process is dynamic and eventually, it leads people to a better economic position. Then, it is important to understand that there is a link between development of institutions and the economic development of a country.

### 3.2. Types and roles of institution

The development of the country depends highly on political and economic institutions of the country (Acemoglu & Robinson, 2012). The differences in institutions are determined by several factors as follows (Acemoglu & Robinson 2008).

1. Type of governing mechanisms such as democracy or dictatorship
2. Type of economic institution (property right, entry barriers, contracts available for private sector)
3. Decentralized or centralized democratic system (whether power has been divided among different group of the society or not?)

According to the functions, two main types of institutions such as political and economic institutions can be identified (Acemoglu & Robinson 2012).

#### 3.2.1. Economic Institutions

Economic institutions of the country are decided by the political institutions (Acemoglu & Robinson 2012). As Acemoglu (2010) describes, the role of the economic institutions involves

1. Protecting of property rights
2. Managing the entry barriers
3. Availability of contracts for private sector

The economic system in a democratic country like the United States or Australia is different from the economic institutions in a country with a dictatorship like North Korea. Therefore, the role of the economic institutions varies from country to country. The Economic institutions which resulted from a political system have a collective decision-making process which encourage the economic development and its can be considered as good economic institutions. In the developed countries like United States, entrepreneurs enjoy all the benefits from the good economic institutions (Acemoglu & Robinson 2012) including ensuring their property right, supportive policies for market entry, competitive based contracts for the private sector. The entrepreneurs from an underdeveloped country like Mexico which does not have the good economic institutions face many difficulties when they grow their businesses (Acemoglu & Robinson 2012). They struggle with property insecurity, barriers for market entry and biased contract offering. The good economic institutions provide people a conducive environment for saving, learning, inventing and investing (Acemoglu & Robinson 2012). Further, a country with good economic institutions experiences the financial system stability, low-interest rate and low inflation rate, consistent macroeconomic policies. This increases the investor confidence and as a result, higher investment, lower unemployment, higher income and advancement in socio-economic indicators can be reached. Further, the efficient allocation of resources can be observed in a country which has good economic institutions (Acemoglu, Johnson & Robinson 2004). Based on the way it contributes to the economic development, there are two types of economic institutions such as Inclusive and Extractive (Acemoglu & Robinson 2012).

***Inclusive economic institutions***

Inclusive economic institutions encourage all people to participate in economic activities by providing their production factors to the market or investing in business activities (Acemoglu & Robinson 2012). Individuals can supply their land or labour in an efficient manner and they will receive the rent or the salaries as rewards. Entrepreneurs can invest in the market and generate entrepreneurial profits. People will invest in Research and Development and generate novelties to the society. Protecting private properties, maintaining the law and order, and providing public service to encourage the private sector are essential parts of inclusive economic institutions (Acemoglu & Robinson 2012). The countries like the United States and South Korea practice the inclusive economic institutions and as a result of that, increase in productivity and higher economic prosperity have been obtained (Acemoglu & Robinson 2012).

***Extractive economic institution***

Extractive economic institutions are opposite to the inclusive economic institutions. As Acemoglu and Robinson (2012) describes, North Korea or Colonial Latin America practice extractive economic institutions. Both regions do not protect property rights of the majority of individuals and businesses are limited to the small segment of a society. An unbiased legal system cannot be seen in both countries. Majority of people in these countries suffer due to social injustice. Insecurity of private property causes the low-investment and finally it will lead for declining or stagnating the economic growth. The economic institutions of these countries do not focus the economic prosperity of the general public (Acemoglu & Robinson 2012).

### 3.2.2. Political institutions

Acemoglu and Robinson (2012) describe that political institutions decide the economic institutions of a country. A state is governed by the political institutions and therefore the political institutions of a country need the power and capacity to regulate the society (Acemoglu & Robinson 2012). The authoritarian power is concentrated on the political institutions and as a result of that, the economic development highly depends on the decisions of political elites in the country. Most of the economic interventions including growth, distribution of economic benefits, the openness of the economy, safety net programme, health, and education will be decided by the political system. The constitution of the country and the type of the political system can be considered as most important components of the political institution (Acemoglu & Robinson, 2012).

Political institutions can also be divided as extractive and inclusive political institutions. Extractive political institutions can be observed in the areas like North Korea and Colonial Latin America. They use political power for the benefits of a small group but not for the benefits of the majority of the society (Acemoglu & Robinson 2012). The inclusive political institutions choose the inclusive economic institutions and power will not be centralized (Acemoglu & Robinson 2012). The developed countries are generally governed by the inclusive political institutions which bounded to the high level of democracy. In such countries, people participate actively in the decision-making process and the decision-making power of political elites have been restricted by the strong political institutions. Most of the least developed countries do not have an advanced political system. The low level of democracy, problems in the election mechanism, high level of corruption, civil wars and political instability are linked to the underdevelopment. As shown in fig.1, most of the underdeveloped countries are coming under the alert and warning category of Fragile States Index (The Fund for Peace 2016). The Fragile State Index is based on 12 indicators relevant to social, economic, political and military pillars. The social indicators include Demographic Pressure, Refugee and IDPs, Group Grievance, Human flight and Brain Drain. It includes the economic indicators such as uneven economic development, poverty and economic decline. As political and military indicators, State legitimacy, Public Services, Human Rights and Rule of law, Security Apparatus, Factionalized elites and External Intervention are considered (The Fund for Peace, 2019).

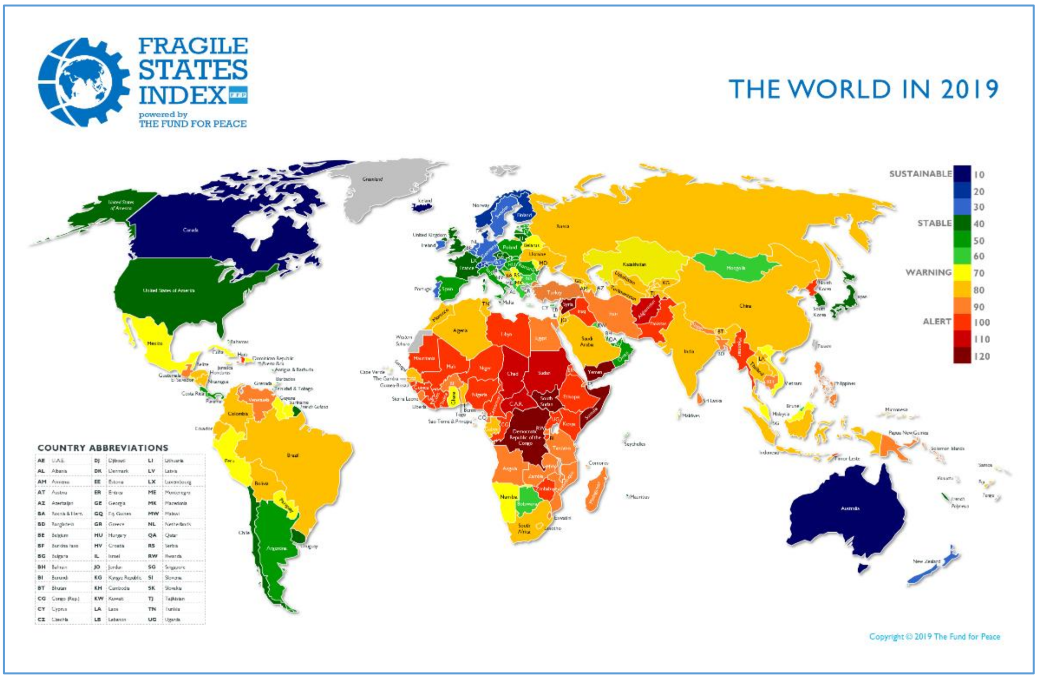


***Fig 1*: Distribution of country according to Fragile State Index, 2015**

(Source: Fund for Peace, 2019)

### 3.3. Institutions and Economic Development

By refereeing the Francis Fukuyama's book on "Origins of Political Order" which was published in 2011, Wikipedia mentions three principles to achieve a stable state as mentioned in fig.2, "Modern and Strong, Follows the Rule of Law and Accountability" (Wikipedia 2015). It is important to highlight that these three pillars are controlled by the political institutions. The political systems of most of the developing countries fail to strengthen these three pillars and final consequence is the under development.

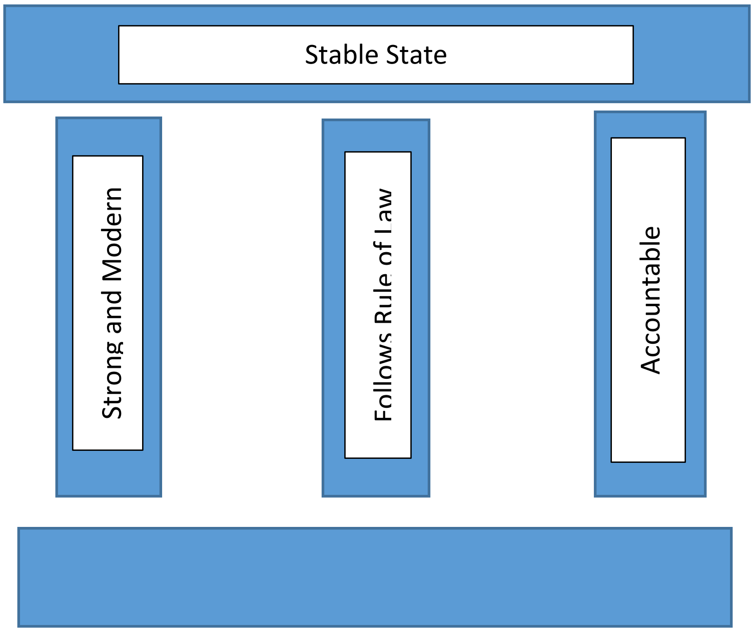


***Fig 2: Three pillars of the stable state according to Fukuyama***

(Source: Wikipedia 2015)

Modern State is a concept that a state needs to be organized with cultural and national homogenization. All members in the society including those who are in the government need to be subjected to the legal codes and process that has been publicly disclosed (Wikepedia, 2019). An accountable government is responsible to the public in relation to the all activities and the decisions which are taken by the government.

### 3.3.1. Institutions and Markets

If the political institution of the country can ensure the above three pillars, the country can create the good economic institutions and the inclusive economic institutions. The inclusive economic institutions will create the inclusive market and the market is fully bounded by the property right. If the economic institutions protect private property, it will increase the confidence of investors and get decisions on entering and improving the market (Acemoglu, Johnson & Robinson 2004).

### 3.3.2. Engines of prosperity

The inclusive markets, technology, and the education can be considered as engines of prosperity and they are created by the inclusive economic institutions. In the process of economic development, better choices will be available to people and they will choose the better options. The inclusive market facilitates people to select better choices and increase the productivity (Acemoglu & Robinson, 2012). The technology always improves the productivity and there is a clear link between education and technology (Acemoglu & Robinson 2012).

### 3.3.3. Functions of Institutions for economic development

The contribution of institutions for economic development is obvious and based on the functions, the modern institutions can be divided into four categories as follows (Rodrik & Subramanian 2003).

1. *Market creating institutes which promotes the market by ensuring property rights and promoting the private sector*
2. *Market regulating institutes which avoids market failures through the regulation processes.*
3. *Market stabilizing institutes which stabilize the macroeconomic conditions of the country*
4. *Market legitimizing institutes*

For the economic development, both economic growth and distribution are important. Institutions like pension schemes and other social policies can be considered as market legitimizing institutes.

## 4. Trust, Institutions, and Development

Trust is a very important concept in economic development which links the institutions. According to the Bradach and Eccles (1989), "Trust is a type of expectation that alleviates the fear that one's exchange partner will act opportunistically" (Bradach and Eccles 1989). In the society, trust has to be built among agent of the society and between agents and institutions of the society. As described by Nootboom (2006), trust can reduce the both risk and cost of the transactions because involving parties believe each other. Trust is important in both formal and informal setup and trust can be observed in two types such as "Institution Based Trust and Institutional Trust" (Nootboom 2006).

The social capital is another important concept which plays a significant role in the process of economic development. In broad based, the social capital includes many things that belong to the people and the community. Nootboom (2006) defines social capital as "contributing to goal achievement of actors on the basis of relationship". Trust is a part of social capital and by ensuring trust in the society, social capital can rise. Higher social capital contributes to increasing the market activities (Quddus, Goldsby & Farroque 2000). Both higher social capital and good institutions cause to promote the image of the country in locally and internationally. As a result of that, the local and the international investment flow to the market and create the economic development. Doing Business Index, Fragile State Index and Corruption Perception Index contribute to measuring some properties of social capital and institutions of a country. As shown in table 1, these indicators show a relationship with the level of investment in each country.

| Country | Rank in the list | | | FDI Inflow (US$ million) (2014) |
|---|---|---|---|---|
| | CPI (2015) | DBI (2016) | FSI (2015) | |
| Singapore | 8 | 1 | 159 | 67,523 |
| United States | 16 | 7 | 158 | 92,392 |
| Australia | 13 | 13 | 170 | 54,239 |
| Afghanistan | 117 | 177 | 8 | 54 |
| Somalia | 167 | NA | 2 | 106 |
| Sudan | 165 | 159 | 4 | 1,277 |

**Table 1. The relationship between FDI inflow and institutions and social capital related indicators**

(Source: Fragile State Index (2015), World Investment Report (2015), Doing Business Index 2016,)

<u>*Abbreviations:*</u>

*FDI:* Foreign Direct Investments

*CPI:* Corruption Perception Index

*DBI:* Doing Business Index

*FSI:* Fragile State Index

Investors assess the risks before doing the investment. As mentioned in above table 1, Singapore, Australia and United States perform very well in all 3 indicators and FDI inflows in those countries are very much higher than the FDI inflows in the countries such as Somalia, Sudan, and Afghanistan. Lower performances of all three indicators in Somalia, Sudan and Afghanistan imply the bad institutions and lower social capital of these countries. FDI inflow in the United States is more than 1700 times of FDI inflows in Afghanistan.

**5. Anti-Corruption and economic growth**

Corruption is happening all over the world and the level of corruption is different from country to country. The corruption is inversely related to economic growth and effects on the society directly and indirectly (Easterly 2002). Corruption occurs as a result of bad economic and political institutions and on the other hand corruptions make economic policies worse. High corruption leads to low investment, low business confidence, high inequality and social injustice, high unemployment rate, high gender inequality, high level of bribery, high risk of credit, insecurity of property right and many other factors. Low level of democracy of the country, financial system, and macroeconomic instability resulted due to the high corruption. Moreover, the high corruption causes market failure and eventually country's economy will decline or stagnate. The following table 2 compares several developed countries and less developed countries according to corruption and GDP per capita.

| Country | CPI Rank | GDP per capita (2014) (Current US$) | Life expectancy at Birth (2014) | HDI and Rank |
|---|---|---|---|---|
| Australia | 13 | 61,979.9 | 82.4 | 0.935 (2) |
| Japan | 18 | 36,194.4 | 83.5 | 0.891 (20) |
| United States | 16 | 54,629.5 | 79.1 | 0.915 (8) |
| Sudan | 165 | 1,875.8 | 63.5 | 0.479 (167) |
| Afghanistan | 166 | 633.6 | 60.4 | 0.465 (171) |
| Zimbabwe | 150 | 931.2 | 57.5 | 0.509 (155) |

**Table 2**: Corruption and Development Relationship
Sources: Transparency International 2016, World Bank 2016, UNDP 2015
**Abbreviation:** CPI: Corruption Perception Index

**Note**: Corruption Perceptions Index 2015 has compared 168 countries in the world and rank 1 is given for least corrupted country and rank 168 has given for the highest corrupted country.

Countries like Australia, Japan, and the United States which have lower corruption level show higher ranks in development indicators while highly corrupted countries show very lower levels of development. According to the table, it is obvious that corruption is negatively related to the development. Therefore, less developed countries need to eliminate the corruption and improve the institutions, if they want to achieve the higher level of development.

## 6.Understanding the regional disparity in the world

There is a huge disparity in economic development in the world. Most of the countries in some parts of the world like Africa, Asia, and Latin America suffered due to poverty, food insecurity, outbreaks of disease such as Malaria, Ebola and HIV/AIDS, low health and the education facilities, and less availability of many other economic infrastructures. Three major reasons such as institution, geography and culture can be considered for income inequality (Acemoglu, Johnson & Robinson 2004). Further, geography hypothesis, cultural hypothesis and ignorance hypothesis which describe the regional disparity in the economic development can be elaborated as below. However, the geography hypothesis, the cultural hypothesis, and the ignorance hypothesis are not widely accepted because of less supportive evidence.

### 6.1. Geography hypothesis and Cultural hypothesis

Wealth distribution pattern in the world is considered, most of the rich countries are located in the temperate region while most of the countries which are located in the tropical region are poor. The geography hypothesis explains the regional disparity in relation to the climate and disease distribution (Acemoglu & Robinson 2012). Another version of geography hypothesis argued that unproductive agriculture systems of the tropical countries lead people to be poor (Acemoglu & Robinson, 2012). As Acemoglu and Robinson, (2012) explains, this argument is correct to some extent because in general, the soil layer of the tropical countries is thin and its capacity for nutrient retention is low. Further, this soil is highly vulnerable to erosion with the heavy rains in the tropical countries. More than the low fertility in soil, the institutional problems such land ownership and low incentives for farmers contributed the low agriculture productivity in these countries (Acemoglu & Robinson, 2012). On the other hand, world inequality cannot be described only on the agricultural productivity because technology plays a major role in the development after the industrial revolution (Acemoglu & Robinson, 2012). Another extension of geography hypothesis was introduced by Jared Diamond and it explained that regional disparity as a result of animal and plant diversity in the regions (Acemoglu & Robinson 2012). The difference in plant and animal varieties in the different region made the difference in agriculture and animal husbandry, and it causes the technological differences among regions and as a result of that, the prosperity differences among nations have been generated (Acemoglu & Robinson 2012). The cultural hypothesis shows another angle of regional disparity and it explains that the economic success of the country depends on cultural reasons such as religion, belief, norms and values of the society (Acemoglu & Robinson 2012).

### 6.2. Ignorance Hypothesis

The ignorance hypothesis describes that the impacts of market failure causes to make rich and poor countries (Acemoglu & Robinson 2012). Rulers in rich countries make effective and efficient policy decisions and encourage the counties to achieve the free market condition. However, rulers in poor countries do not do so (Acemoglu & Robinson 2012). This market failure does not result only from ignorance of the leaders. The problems of institutions are also contributed to the market failure.

**7. Economic institutions and economic prosperity**

Acemoglu, Johnson & Robinson (2004) explains that there is a trade-off between economic efficiency and distribution (Acemoglu, Johnson & Robinson 2004). In the process of economic development, it is necessary to select the right combination of resource allocation to balance the gap between growth and distribution. The inefficient institution hinders the growth and development and the inefficient economic institutions arises due to following reasons (Acemoglu, Johnson & Robinson 2004).

1. Although political elites promised to protect property right, after investment was done, the commitment will be broken by political elites
2. Some economic institutions are important for political elites to protect their power. If economic institutions are efficient, they think that their power will erode and they will get economical disadvantages. In such case, the political elites do not build the efficient economic institutions
3. When inefficient economic institutions convert to efficient, some groups get worse off and such groups hinder the institution transformation

**8. Political power and introduction of economic institutions**

Mainly political power shows in two main forms as “de jure” political power and “de facto” political power (Acemoglu, Johnson & Robinson 2004). The “de jure” political power is the power that given to an individual or a group by a political institution (Acemoglu, Johnson & Robinson 2004). The “de facto political power” will be created by an individual or a group based on their actions (Acemoglu, Johnson & Robinson 2004). In reality, the political power is a combination of both “de jure” and “de facto” powers and it contributes to shaping the economic institutions. The economic institutions effect on the economic performance and future “de jure” political power through the process of resource allocation (Acemoglu, Johnson & Robinson 2004).

**9. Institutions and Innovations**

Without ensuring the property right, the country will not be able to improve the capital formation, land and real estate development and investment in Research and Development (Helpman, 2004). The Research and Development generate novelties and innovations contribute to economic development significantly. The political institution that is responsible for protecting the rule of law, enforcing contract laws and restricting the power of political leaders plays a major role regarding the securing the private properties (Helpman 2004). Helpman (2004) discussed the importance of efficiency in the court system to protect the property right. It is needed to take necessary intervention by the political institution to protect the independence and un-biases in the law enforcement. If people trust the legal system which protects private property, it will increase the investment and supply of production factors.

**10.Evidences for the relationship between institutions and economic performance**

10.1. According to the Acemoglu & Robinson (2012), with the Japan's defeat in the World War II, North part of the Korea was administrated by Russia and South part was administrated by the United States. With time being, the country was separated to two countries as South and North Koreas and the initial condition of these two countries were similar. South Korea leader, Syngman Rhee received the support from the United States and he established good institutions to achieve the growth and development. The South Korea practiced the market economy by protecting the property rights. The economic and political institutions of South Korea facilitated for innovation, investments, industrialization, technology transfer, exports, education, health and trade and as a result of that, South Korea became a leading country in the world (Acemoglu & Robinson 2012).

The North Korean leader Kim Il-Sung was a dictator and he implemented a central plan economic system with the support of Soviet Union. The North Korea did not practice sound policies for ensuring private property rights, implementation of free market system and level playing field for contracts awarding (Acemoglu & Robinson 2012). Today, people in North Korea suffer due to very low socio-economic standards as a result of incorrect choices that were taken in relation to the political and economic institutions (Acemoglu & Robinson 2012). Difference in the choice of institutions of the rulers in South Korea and North Korea has resulted a huge difference in these two countries in relation to the economic development.

10.2. New institutions were emerged in the European colonies in the North and South American countries after independence. Although new institutions in the United States were able to capture the development process, most of the Latin American countries were failed to do so. As a result, the United States got the benefits of the industrial revolution and received the economic prosperity. However, the leaders of the countries such as Mexico decided to export their natural resources to North America and Western Europe under their new institution set up. Therefore, Latin America could not success in the formation of the new institution and people became poor and poor (Acemoglu & Robinson 2012).

10.3. Econometric studied have proved that there is a significantly positive relationship between property right institutions and long-run economic growth. Moreover, property right institutions showed a positive relationship with investment, credits, and financial development also (Acemoglu & Johnson 2005).

10.4. Botswana received independence in 1966 and since then, the country practices an uninterrupted democracy. During the past period from the independence, the country was able to increase the per capita GDP from US$70 to US$ 15,825 in 2015 (Wikipedia 2016). Through the changing the extractive institutions which were introduced by the colonial rulers to the good institutions, Botswana was able to achieve economic success.

10.5. Acemoglu, Johnson & Robinson (2001) revealed that the colonial institutions affect the present institution of early European colonies and however it is not the only factor that has been determined the present institutions of these countries. According to the study, Europeans have set two extremes of institutions in their colonies. In Australia, New Zealand, and the United States, they practiced institutions which promote the investments and rule of law. In another set of countries like Congo, the extractive policies were set (Acemoglu, Johnson & Robinson 2001). The countries which established the good institutions were successful in economic development and the countries which established the bad institutions were not successful in economic development.

10.6**.** Acemoglu *et al.* (2002) observed a relationship between macroeconomic volatility and institutions in less developed countries over the post-war period. The macroeconomic instability resulted from bad institutions of these countries. The people who had power practiced the bad institutions for their benefits and maintain the power continuously.

Most of these evidences support that the regional disparity of economic development has a clear relationship with institutions. Some of them highlighted that some countries are poor due to extractive institutions that were practiced by the political elites.

## 11. Conclusion

Development is a continuous process which increases choices available for human beings. People will choose better combinations and it increases the quality of people's lives. However, there is a huge disparity among some countries and regions. The depth of this disparity is very high and experts involved to understand this problem through different approaches. Geography hypothesis, Cultural Hypothesis, ignorance hypothesis and institution approach were widely used to explain this regional disparity.

Institution hypothesis discusses how political and economic institutions effects on the economic development and how institutions cause the regional disparity. The political institution which includes the political system and constitution decide the economic institutions. Finally, both political and economic institutions jointly shape the economic development of the country. Generally, good institution encourages the development and bad institution results a declining or stagnation of the economy. In reality, most of the developed countries experience the good institution and developing countries in various parts of the world suffer due to the bad institutions.

Trust among involved parties reduces the transaction cost and associated risk. The social capital is a very broad concept and trust is an integral part of social capital. Higher social capital and good institutions can attract the investment through increasing investor confidence.

In conclusion, good political institutions form inclusive economic institutions and higher level of social capital which attract investments for the main factors of production in modern economy such as human capital, physical capital, and technology. Ability of firms and workers to increase of human and physical capital, and technology within a particular period of time (Acemoglu & Robinson 2008) causes to raise the level of goods and services production in a country. Excess productions are sold in the external market and generate income to import the goods and services which are inefficient to produce in the country. Further, good political institutions and inclusive economic institutions causes to ensure the distribution of economic benefits throughout the society. Improved level of income and choices will provide opportunity for people to purchase better combination of choices in goods and services and thereby improve the quality of life of the people and eventually the economic development happens.

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