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# Institutional Foundations of Economic Growth: Evidence from the Capitalist–Communist Divergence during the Cold War Era

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**Abstract**

Drawing on evidence from the capitalist-communist divergence of the Cold War era the research paper extensively examines the institutional factors that shaped long-run economic growth, income inequality, and social welfare outcomes in post-communist nations. The research investigates three interconnected propositions: whether stronger pre-transition democratic institutions predict superior long-run economic performance; whether Soviet-era institutional persistence generates an "institutional path dependency trap" diminishing convergence with Western capitalist economies and lastly, whether hybrid configurations combining market capitalism with authoritarian state control produce systematically distinct growth-inequality trade-offs. The study adopts a mixed – methods approach combining quantitative comparative analysis of nine post-communist states using Polity IV scores and World Governance Indicators with theory-driven case studies grounded in institutional path dependency and institutional economics. The results indicate that the strength of democratic institutions at the time of transition play a crucial role in shaping long-term growth, inequality reduction, and human development outcomes. At the same time, persistent Soviet-era institutional features, including patronal networks and weak property rights, continue to limit effective market reforms. Hybrid regimes, which can achieve growth, tend to do so alongside higher levels of inequality compared to more fully liberalised systems.

**Keywords:** institutional economics; post-communist transition; path dependency; economic growth; Cold War divergence

## I. Introduction

This research paper outlines the stark differences between capitalist and communist societies because of ideology during the Cold War (1947–1991). The Cold War played a central role in defining the global economic order. Capitalist societies argued that private property and market-based economic drivers exceeded the efficiency of the bureaucratic systems found in communist states. In contrast, communist societies characterised economic growth as a deliberate ideology advanced by Western states to secure consent from the governed (Barry, 2018c).These ideological debates further influenced discussions among economists regarding the strengths and weaknesses of capitalist markets. This paper also explores how the perspectives of radical and institutional economists have been compared in the context of uncontrolled capitalism and persistent market dysfunction. It further examines how, in capitalist societies, economic policies emphasising free markets, deregulation, and aggressive labour reforms may have contributed to instability rather than sustained growth. In addition, the paper explains why post-communist nations failed to achieve equal economic prosperity compared to established market economies. Figure 1 illustrates the key institutional drivers that contributed to the rise of capitalism (Upchurch, 2012).

Historical evidence suggests that, despite Marxist ambitions to reshape economic organisation, communist regimes struggled to outperform capitalist systems across key economic indicators (Kemp, 2016). This study also investigates the institutional foundations of economic growth by examining the capitalist-communist divergence during the Cold War era. The primary research question (RQ1) assesses how pre-transition institutional strength in nine post-communist countries influenced post-transition economic growth, inequality, and welfare outcomes. Specifically, it groups countries by institutional quality, compares group averages, and visualizes patterns through charts and correlations. Complementary research questions (RQ2 and RQ3) explore causal mechanisms and

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contextual factors via qualitative case studies, providing a comprehensive framework to explain divergent growth trajectories.

Section 2 reviews literature; Section 3 outlines research questions and hypotheses; Section 4 describes methodology grouping countries by institutional metrics and through qualitative case studies Section 5 presents results and discussion; Section 6 concludes the research paper.


**Figure 1. Rise Of Capitalism: Key Institutional Drivers**

## II. Literature Review

This research paper evaluates how rules, norms, and the efficiency of institutional structures have become pivotal for economic growth and are more critical to prosperity than capital or technology. The study includes a novel index of 27 post-communist nations, assessing how effectively company policies and government rules align (Markus & Mendelski, 2013). Building on this institutional perspective, further research shifts focus on the political conditions that shape these frameworks. Political stability plays a key role for countries transitioning from communism to capitalism. countries trajectories are significantly dependent on abrupt or gradual evolutionary shifts. By analysing data from 87 countries the study proves that an efficient institutional framework is vital for long-term financial and political success. (Tamilina & Tamilina, 2017). Moving away from the role political stability, while authors like Acemoglu and Robinson emphasise local institutions as the primary drivers of national prosperity, Grinberg (2018) argues that state development is better understood as a reflection of global economic dynamics and position. For example, the geopolitical threat of communist encouraged Western elites to introduce redistributive policies to maintain social stability and avoid unrest. This period saw a focus on industrial growth and labour protection which reduced poverty ("The Three Options: An Introduction," 2020).

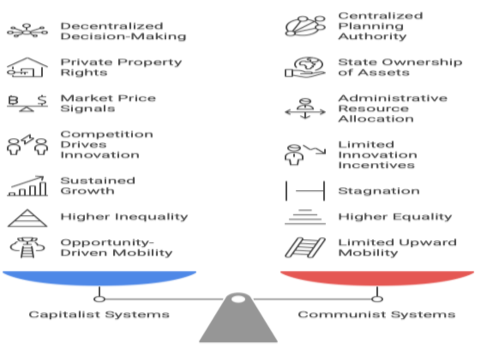


**Figure 2. Institutional Divergence and Economic Outcomes: Capitalist vs Communist Systems during the Cold War**

The study emphasises the efficiency of market-based systems and private property over centrally planned economies and critiques the bureaucratic rigidity in communist systems which often led to resource misallocation. Paternalism and informality played a big role in shaping communist societies such has China and Eurasia (Magyar & Madlovics, 2020). Figure 2 highlights the differences in ideologies in capitalist and communist systems which led to different economic outcomes and institutional divergence.

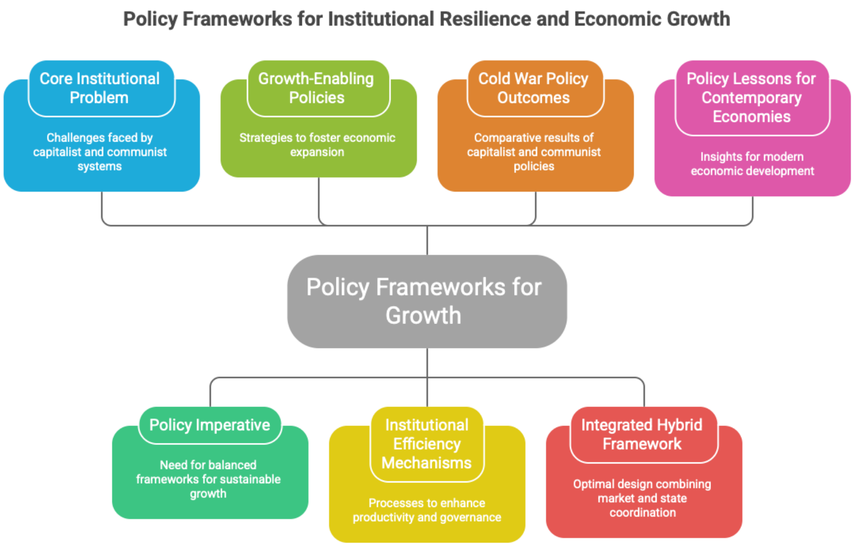


**Figure 3. Policy Frameworks for Institutional Resilience and Economic Growth**

Despite these stark systemic differences, the CESEE region experienced significant industrial growth and capital accumulation. This expansion was driven by structural modernization and high investment. Overall, the study analyses how modern income trends were shaped by the institutional and productivity drivers unique to each governing philosophy (Marcus et al., 2020).

**Table I. Extensive Literature Review for Institutional Foundations for economic growth**

| Sr.No | Methodology | Key findings | Limitations | Implications in cold war context |
|---|---|---|---|---|
| 1 | Institutional evolution under Cold War geopolitical competition | Cold War institutions reoriented Soviet economic policy frameworks | Elite-centric archival focus underrepresents societal responses | Superpower rivalry reshaped planning, legitimacy, developmental priorities |
| 2 | Comparative capitalism driven by institutional diversity and complementarity | Institutional complementarities structure diverse capitalist performance outcomes | Limited integration of sociological embeddedness within NIE frameworks | Systemic bifurcation reinforced institutional diversity over convergence |
| 3 | Informal patronalism shapes regime evolution in post- | Patronal networks structure post-communist | Complex typologies risk overgeneralization across | Communist legacies persist through informal power |

| | | | | |
|---|---|---|---|---|
| | communist societies | regimes beyond formal institutions | heterogeneous national contexts | consolidation mechanisms |
| 4 | Structural power sustains global inequality under modern globalization | Global inequality structured by persistent North-South economic hierarchy | Broad bloc analysis may oversimplify diverse national trajectories | Cold War reinforced global inequality and shaped economic discourse |
| 5 | Path dependence and institutional evolution drive divergent capitalist models | Open economic model rooted in British colonialism and Anglo-Chinese collaboration | Focus on two city-states limits broader generalisation to other colonies | Post-war divergence shaped by political contestation, not ideology alone |
| 6 | Perception vs reality misinterpretation of expert analysis created the illusion of failure | Western economists and CIA did recognize Soviet slowdown early; not a complete intelligence failure | Focus on economic assessments; less emphasis on political and social collapse factors | Economic weakness shaped superpower strategy but was misunderstood in public discourse |

After conducting an extensive literature review on the to Institutional Foundations of Economic Growth: Evidence from the Capitalist–Communist Divergence During the Cold War Era the study formulates research questions, objectives, and hypotheses which can be tested and proved using the Case study model. These are aligned with the research title, "Institutional Foundations of Economic Growth: Evidence from the Capitalist–Communist Divergence During the Cold War Era".

Research Question

**RQ 1: How does post-communist nations with stronger pre-transition democratic institutions exhibit higher long-run economic growth, lower income inequality, and better social welfare outcomes than those with weaker institutional foundations?**

**Hypothesis**

**$H_1$:** Post-communist states that had stronger pre-transition institutional quality measured by rule of law, property rights protection, and bureaucratic capacity demonstrate significantly higher GDP per capita growth, lower Gini coefficients, and better Human Development Index scores in the 1991–2020 period compared to states with weaker institutional foundations, even after controlling for natural resource endowments and geographic factors.

**RQ 2: Does institutional persistence from the Soviet era measured through continued state capture, patronal networks, and weak property rights create a 'institutional path dependency trap' that suppresses convergence with Western capitalist economies?**

**Hypothesis**

**$H_2$:** Post-communist nations exhibiting higher levels of institutional persistence operationalised as continued state ownership of key industries, low judicial independence scores, and high levels of political patronage experience significantly slower β-convergence toward Western European income levels compared to nations that underwent rapid institutional discontinuity, suggesting the existence of a self-reinforcing institutional path dependency trap.

**RQ 3: How hybrid institutional configurations combining elements of market capitalism with authoritarian state control do produce systematically different growth-inequality trade-offs compared to fully liberalized capitalist systems?**

**Hypothesis**

**$H_3$:** Hybrid institutional configurations in post-communist transformations characterised by partial privatisation, selective rule of law, and maintained state intervention in strategic sectors generate higher short-run GDP growth but significantly worse distributional outcomes (higher Gini, lower bottom-quintile income share) than fully liberalised capitalist institutions, with this inequality penalty amplified in nations carrying colonial extraction legacies, suggesting that hybrid capitalism reproduces colonial-era distributional patterns through new institutional mechanisms.

## III. Research Methodology

This study follows a post-positivist approach, recognising that although institutional quality plays an important role in shaping economic outcomes, such relationships cannot be measured with complete precision using available data. The research adopts a deductive framework, starting from the theoretical expectation that countries with stronger institutional foundations at the time of transition are likely to experience better economic performance in the years that follow. To address the first research question, a quantitative comparative design is used, focusing on a sample of nine post-communist countries selected to reflect variation in institutional strength. Institutional quality is measured using Polity IV scores along with supporting governance indicators. For the second and third research questions, a case study approach is incorporated to examine specific national experiences in greater depth and to better understand the mechanisms linking institutions to economic and welfare outcomes. The analysis covers the period from 1995 to 2020, allowing for a consistent 25-year post-transition comparison across countries. Key variables include GDP growth, income inequality measured by the Gini coefficient, and human development measured by the HDI. Countries are grouped based on their institutional strength at the point of transition, and differences across these groups are analysed using descriptive statistics, graphical methods, and correlation. All data used in the study are drawn from publicly available sources, including the World Bank, UNDP, and Polity IV dataset, making this secondary data analysis.

This research paper is divided into 9 post-communist nations into three groups:

- Group 1: strong pre-transition institutions like **Poland, Czech Republic and Hungary.** *These had* relatively more exposure to democratic traditions, stronger civil society*, and* more independent legal systems before communism ended

- Group 2: moderate pre-transition institutions like **Slovakia, Croatia and Bulgaria.** These had partial democratic elements but significant authoritarian legacy

- Group 3: weak pre-transition institutions like **Russia , Ukraine and Belarus**. These had deeply entrenched Soviet control with very little democratic infrastructure before transition.

We have grouped the countries In my research paper by using the Polity IV score for each country in the 1988-1990 period. Countries with polity score above +3 = group 1. Between -2 and +3 = group 2 and below -2 = group 3 . We have excluded countries Cuba and north Korea due to insufficient publicly available data. We have also excluded East Germany as it reunified with West Germany, making it a unique outlier.

**Variables**

We mease the independent variable which is Pre-Transition Institutional Quality (PTIQ). It refers to the strength, effectiveness, and credibility of a country's formal and informal institutions before transitioning from a centrally

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planned (communist) system to a market-based (capitalist) economy. We measure the PTIQ by using the polity IV score averaged for 1995-2020. These are the dependent variables; Economic Growth, Social Welfare and income in-equalities. Economic growth means an increase in a country's production of goods and services over time. We will measure how fast each country's economy grew after transition. To measure economic growth, we will use average annual GDP per Capita growth rate from 1995– 2020.

**Income inequality** is the unequal distribution of income among people, and it measures the gap between rich and poor and how evenly income is shared in an economy. To measure income inequality, we will use **Average Gini Coefficient** from 1995 to 2020. The scale which we will be using is 0 = perfectly equal; 100 = perfectly unequal.

**Social welfare** refers to the overall well-being of people in a society, and it measures the quality of life, including income, health, education, and equality. To measure social welfare, we will use **Average Human Development Index (HDI)** from 1995 to 2020. The scale which we will be using is 0 to 1 (higher = better). Table II summarizes the independent and dependent variables used in this study, along with their measures, sources, and scales.

**Table II: Summary Variable Table**

| Variable | Role | Measure | Source | Scale |
|---|---|---|---|---|
| Polity2 Score (1988–90) | Independent | Democracy scores pre-transition | Polity IV | −10 to +10 |
| GDP per capita growth | Dependent 1 | Avg. annual % growth 1995–2020 | World Bank WDI | % |
| Gini Coefficient | Dependent 2 | Avg. inequality score 1995–2020 | World Bank | 0–100 |
| HDI Score | Dependent 3 | Avg. welfare score 1995–2020 | UNDP | 0–1 |

Table III presents the complete master dataset for all nine countries, including their group classification and scores on each variable.

**Table III: Final Master Data Set Containing Independent and Dependent Variables**

| COUNTRY | GROUP | POLITY IV SCORE (1988-2020 | Avg GDP Growth | Avg Gini | Avg HDI |
|---|---|---|---|---|---|
| **POLAND** | 1 | 9 | 4.10% | 31 | **0.84** |
| **CZECH REPUBLIC** | 1 | 10 | 2.60% | 25 | 0.88 |
| **HUNGARY** | 1 | 9 | 2.40% | 29 | 0.84 |
| **SLOVAKIA** | 2 | 9 | 3.80% | 26 | 0.85 |
| **CROATIA** | 2 | 8 | 2.20% | 30 | 0.83 |
| **BULGARIA** | 2 | 8 | 3.10% | 28 | 0.8 |

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| | | | | | |
|---|---|---|---|---|---|
| **RUSSIA** | 3 | 4 | 2.50% | 37 | 0.8 |
| **UKRAINE** | 3 | 6 | 1.70% | 26 | 0.75 |
| **BELARUS** | 3 | -6 | 3.40% | 27 | 0.81 |

Table IV reports the group-wise averages of the dependent variables, shown below.

**Table IV: Average Of Dependent Variables of Each Group**

| OUTCOME | GROUP 1 MEAN | GROUP 2 MEAN | GROUP 3 MEAN |
|---|---|---|---|
| GDP GROWTH (%) | 3.03% | 3.03% | 2.53% |
| GINI COEFFICIENT | 28.33 | 28 | 30 |
| HDI SCORE | 0.85 | 0.83 | 0.79 |

Table V reports the corresponding group-wise medians of the dependent variables.

**TABLE V: Median of Dependent Variables of Each Group**

| OUTCOME | GROUP 1 MEDIAN | GROUP 2 MEDIAN | GROUP 3 MEDIAN |
|---|---|---|---|
| GDP GROWTH (%) | 2.60% | 3.10% | 2.5 |
| GINI COEFFICIENT | 29 | 28 | 27 |
| HDI SCORE | 0.84 | 0.83 | 0.8 |

Tables VI and VII present further descriptive statistics and visualisations of the relationship between PTIQ and the study's dependent variables, beginning with the standard deviation of each group in Table VI.

**Table VI: Standard Deviation of Dependent Variables of Each Group**

| OUTCOME | GROUP 1 STD | GROUP 2 STD | GROUP 3 STD |
|---|---|---|---|
| GDP Growth (%) | 0.77 | 0.8 | 0.69 |
| Gini Coefficient | 3.06 | 1.63 | 497.00% |
| HDI Score | 0.02 | 0.02 | 4 |

**Table VII: Min-Max of Dependent Variables of Each Group**

| OUTCOME | GROUP 1 MIN-MAX | GROUP 2 MIN-MAX | GROUP 3 MIN-MAX |
|---|---|---|---|
| GDP Growth (%) | 2.4%-4.1% | 2.2%-3.8% | 1.7%-3.4% |
| Gini Coefficient | 25-31 | 26-30 | 26-37 |
| HDI Score | 0.84-0.88 | 0.80-0.85 | 0.73-0.81 |

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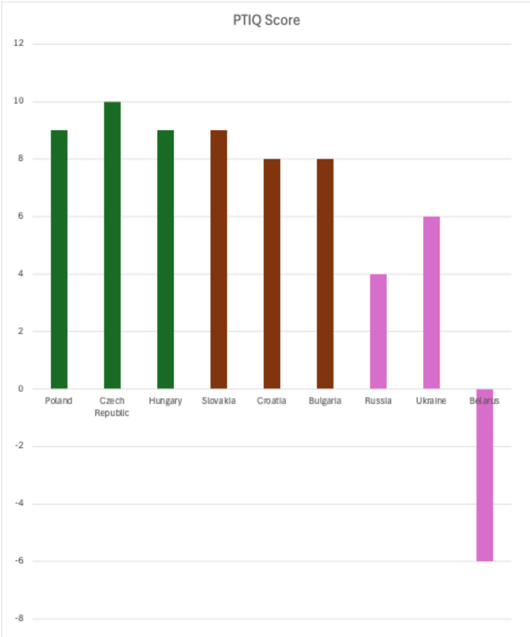


**Figure 5: Bar Chart: PTIQ Scores for all 9 Countries**

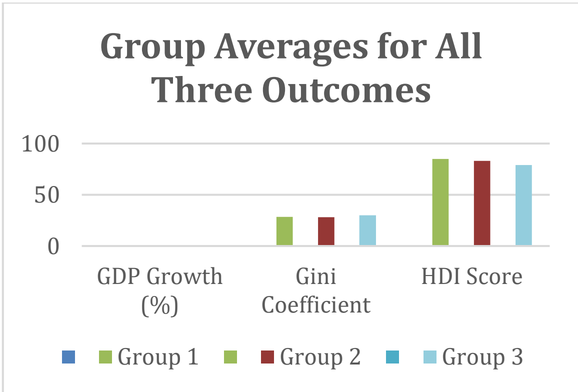


**Figure 6 : Grouped Bar Chart**

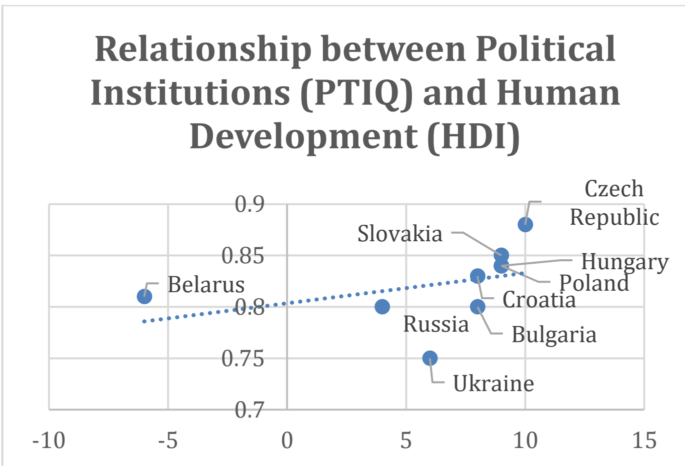


**Figure 7: PTIQ vs. GDP Growth**

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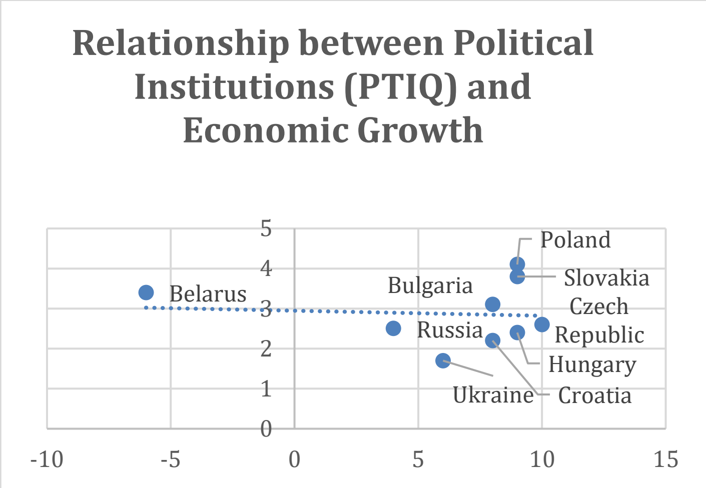


**Figure 8 : Relationship Between PTIQ And Gini**

**RQ 2: Does institutional persistence from the Soviet era measured through continued state capture, patronal networks, and weak property rights create a 'institutional path dependency trap' that suppresses convergence with Western capitalist economies?**

This research paper examines how historical systems of governance continue to influence the modern prosperity of nations that were once part of the eastern Block. By analysing the economic divergence between Western capitalist systems and former communist states the author investigates why certain countries face persistent challenges in modernising their financial structures. The end of the cold War is treated as a critical juncture to examine how embedded institutional habits resist change. Ultimately, the paper seeks to determine if the structural components of soviet era planning still act as a barrier to current growth and global integration. Overall, the analysis underscores the ever-long impact of political institutions on long-term economic outcomes. This research paper further goes on to investigate how historical institutional structures continue to constrain economic progress in former soviet nations with a specific emphasis on Ukraine. It draws on the concept of path dependency suggesting that entrenched structures like state capture and oligarchic influence, prevent these former soviet nations to align themselves with modern capitalist economies. By utilising computational modelling and institutional theory, the study seeks to understand why property rights remain weak and competitive markets underdeveloped. Ultimately, the study seeks to understand the persistent economic problems that stem from the historical divide between communist and capitalist institutions. This analysis provides a comprehensive look at the systemic and institutional barriers that stall growth in post – soviet transitions. (*Ukrainian-style Oligarchic Economies: How Concentrated Power Undermines Value Added in Production Chains*, n.d.) Understanding the concept of institutional path dependency is essential for analysing post-communist economic trajectories. Institutions that formed under the Soviet Union did not completely disband during the transition phase rather they adapted to new political and economic conditions. This persistence reflects both structural inertia and strategic adaptation adopted by the elites who benefitted from existing arrangements. As a result, modern institutions often retain features of centralised control, informal governance and a weak legal system. An important way in which institutional persistence is maintained is state capture. In this context, economic elites hold excessive influence in policy formation, influencing regulations, privatization policies and consolidate their economic power in ways that reinforce their own economic dominance. These processes are closely associated to patronal networks, which emerged from soviet administrative structures into systems of political and economic exchange driven by personal loyalty and exchange relationships. Such networks substitute for formal institutions, weakening institutional accountability.

Ukraine exemplifies the continuation of oligarchic economic structures originating from Soviet era industrial organization. During the economic transformation phase, the privatization of state-owned enterprises enabled a small group of actors to centralise power over key sectors of the economy. These oligarchs established integrated supply-chain structures encompassing resource extraction, manufacturing, and distribution. This structure enables oligarchic groups to dominate full production chains, including coal mining, steel production, energy generation, and transport infrastructure. While vertical integration can, under certain conditions, improve productivity, in the Ukraine context it has been used primarily as a tool for market foreclosure. By limiting entry to critical inputs and infrastructure, oligarchs effectively suppress competition and maintain concentrated market dominance over key industries. To extend beyond descriptive analysis, this study employs an agent-based modelling framework to model the functioning of an elite-controlled economic system. These findings imply that the impact of reform policies is determined by their alignment with the structure of the economy. Broad or standard policies approaches are unlikely to be successful because they fail to address the specific mechanisms of elite control. Instead, focused interventions targeting strategic points within the production network are necessary to improve economic performance. (Robinson, 2019). However, in many other post-communist environments, the persistence of centralized elite dominance has obstructed reform processes. The level of social stratification and institutional capacity plays a key role in determining the effectiveness of democratic and legal systems. Where the state lacks the enforcement capacity to enforce laws and regulations, formal institutions remain weak, and informal networks continue to dominate economic activity. Even when limited reforms are introduced economies with deeply embedded elite control often converge towards low-growth equilibria as the existing power structures adapt to weak the efforts made by reforms. Thus, if reform is to be impactful, they must be implemented in specific areas within production networks where oligarchic control is limited. This requires strengthening property rights, ensuring judicial independence and shifting state capacity from coercive control to infrastructural facilitation of economic activity. The key policy mechanisms are summarized in Figure 9 below.

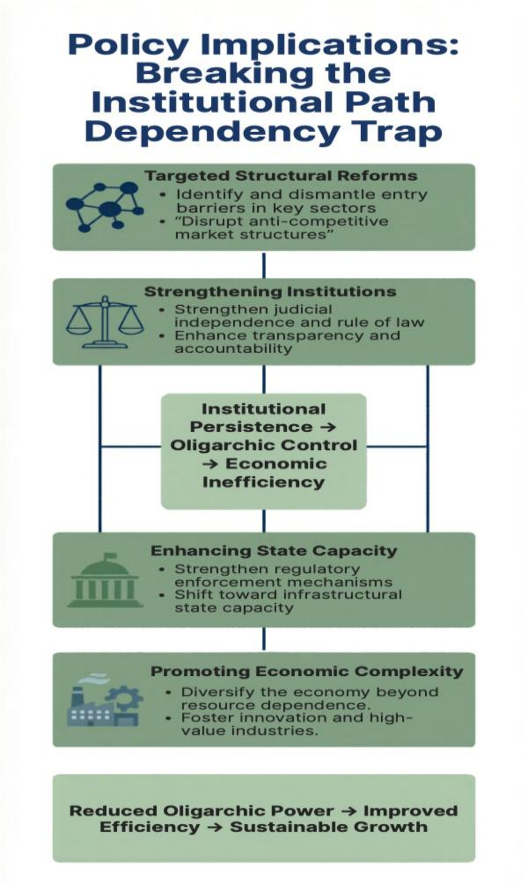


**Figure 9; Policy implications: breaking the institutional Path dependency Trap**

**RQ 3: How hybrid institutional configurations combining elements of market capitalism with authoritarian state control do produce systematically different growth-inequality trade-offs compared to fully liberalized capitalist systems?**

**Hybrid Institutional Configurations and the Growth–Inequality Trade-off: Evidence from State–Market Economies in the Post–Cold War Era**

Most economists divide the world between capitalist and communist systems. However, developments in post-Cold War era have exposed this dual framework as many economies have transitioned into hybrid institutional configurations which combine market-oriented mechanisms with varying degrees of state control. The studies focus lies whether hybrid institutional configurations consistently produce distinct growth-distribution dynamics compared to fully liberalised capitalist economies. The analysis dives deep into how institutional complementarities between state control and market coordination play a major role in influencing economic performance and distributive outcomes. The study focuses on East and southeast Asian development along with post-socialist transition economies, thereby reflecting the diversity of hybrid institutional arrangements (Feldmann, 2018). Recent scholarships have demonstrated that conventional economic models often represented systems between capitalist and communist systems which do not fully reflect the institutional diversity observed in contemporary economies. Moreover, hybrid systems have shown to develop through the coexistence of market mechanisms with strong centralised state control.

The extension of the varieties of capitalism (VoC) framework help explain how hybrid systems function institutionally. There are three ways in which institutions can be organised; some focus on how firms communicate with each other, governance – centred institutions focus on organised frameworks such as financial systems and labour relations while others like state centred approaches highlight the role of government in shaping economic outcomes. In a Hybrid system these layers interact in complex ways and reinforce each other which is why end up looking so different from pure market economies. A critical insight from this information is that state power does not necessarily kill markets, it can help to facilitate coordination, lower uncertainty and promote long-term investment. However, there is a trade off- the same power that stabilizes the economy can also be used to benefit connected elites. When the state controls resources and opportunities, it can hand them out selective individuals which creates in-equality. In east and Southeast Asia, strong bureaucratic institutions and centralized governance have facilitated investment strategies, export -orientated growth and technological advancements. On the other hand, post-socialist economies have exhibited more fragmented forms of hybridity wherein limited institutional strength and competing elite interests have reduced the effectiveness of intervention by state. The unique relationship between hybrid institutional systems and economic outcomes can be understood through three main mechanisms; first hybrid systems can boost economic growth, at least early on. When the state allocates key resources towards strategic sectors like steel, semiconductors, infrastructure it solves a problem that markets can't: getting money into complex areas like infrastructure and industrial development which take years to pay off. This matters most when a country is just starting to develop and doesn't yet have functioning banks or stock markets Second When the state controls resources it often rewards people with connections. This creates in-equality. Elites get first access to contracts, loans and opportunities – not because their efficient but because they know the right individuals. The economy grows overall, but the concentration of money and power remains with the elites which creates a huge gap between the rich and poor. The rich keep getting richer and the poor get poorer Third, not all laws are applied equally by the state. Some firms, typically those associated with government enjoy strong protection of their assets and contractions while others operate under uncertainty which limited competition and innovation. An economy divided between winners and losers rather than a level playing field results from strong sectors prospering while everyone else suffers

East Asia demonstrates what is feasible. Even though countries like Singapore and South Korea did grow quickly they never created extreme inequality. How? They invested heavily in education, made sure people had access to job opportunities, and they used taxes and social spendings on reducing the gap between the rich and poor. These countries were strategic about their growth and development. On the other hand, post socialist countries took a different path. When countries like Russia, Ukraine tried hybrid capitalism, they mixed markets with authoritarianism However, they excluded institutional control, so when markets opened the elites took control over everything as the rules and regulations were weak. Growth happened in pockets, but inequality exploded. So, what happened? Instead of a creating a functioning hybrid system they facilitated the emergence of "alternative institutions" that disrupted markets and governance systems. Elites used their power to bend rules in their Favor, which destroyed any chance of equal competition or fair treatment under law. Growth happened in some areas other areas it stagnated. Overall, it created a lot of inequality between the rich and poor and ordinary people saw little to no benefit. While this can generate rapid growth, specifically in sectors prioritized by the state, it also raises concerns about sustainability and inclusiveness. Inequality in such systems is often structurally ingrained, reflecting both institutional design and political constraints. The analysis reveals that hybrid institutional configurations produce **clearly distinct growth–inequality trade-offs** compared to fully liberalized capitalist systems. In liberal market economies, growth is typically driven by decentralized processes and competitive markets, with inequality arising because of differential productivity and market outcomes. In hybrid systems, however, growth is often more centralized and state-led, leading to potentially higher initial growth rates. However, inequality is shaped less by market forces and more by access to institutions, political connections, and state policies. This results in a different trade-off pattern, where growth can be achieved alongside either moderate or high inequality depending on the nature of state intervention and institutional quality. This analysis confirms $H_3$ hybrid institutional configurations produce systematically distinct growth-inequality trade-offs, with outcomes determined less by the presence of markets than by the quality of institutions governing them.

## IV. Results And Discussion

The findings of the two studies highlight the central role of institutions in shaping economic systems across different contexts. One study demonstrates that institutional transformations during the Cold War significantly reoriented Soviet economic policy frameworks, as evolving structures and external pressures significantly influenced the direction of economic decision-making and reform trajectories (David lane , 2000). The other study emphasises that institutional complementarities wherein different institutional arrangements reinforce each other plays a critical role in producing diverse performance outcomes across capitalist economies, explaining variations in growth and efficiency despite similar market foundations (Peter A. Hall and Daniel W. Gingerich 2004). Together, these findings suggest that economic outcomes are not determined by isolated policies, but by the broader configuration and interaction of institutions over time I compared nine post-communist countries, grouped by their Polity IV scores at transition, and found three distinct patterns. First, over the period 1991-2020, countries which started with stronger democratic institutions such as Poland, the Czech Republic and Hungary grew faster than countries that started with weak democratic institutions like Russia, Ukraine and Belarus. That means that what a country inherited at transition matters for decades to come. Second, inequality followed a similar pattern. Stronger institutions meant falling inequality, like Western Europe. Weaker institutions meant inequality stayed flat or rose, locked in by old Soviet structures. Third, overall quality of life measured by health, education, and living standards correlated with institutional strength. But it wasn't just because GDP grew. Stronger institutions worked through multiple channels: better schools, functioning courts, safer investments, and fairer access to opportunity.

These findings both support and build upon existing literature. While Acemoglu et al. (2001) and North (1990) highlight the long-term importance of institutional origins, this study shows that the speed and quality of institutional change at the transition stage also play an independent role in shaping outcomes. In contrast to Roland's (2000) sequencing framework, which prioritises economic liberalisation, the evidence here suggests that democratic institutional strength is necessary for sustained growth, supporting an "institutions-first" approach. The three-tier Institutional Quality–Growth Nexus framework introduced in this study provides a clear way of understanding these relationships. Tier 1 includes institutional foundations such as democratic quality, governance capacity, and property rights protection. These do not directly produce outcomes but instead influence Tier 2 processes, including the investment environment, market functioning, and returns to human capital. These intermediate processes then lead to Tier 3 outcomes such as long-term growth, reduced inequality, improved welfare, and convergence with advanced economies. This structure shows that institutional effects are indirect and operate through multiple stages. As a result, policies that focus only on final outcomes, such as increasing foreign investment or expanding welfare programmes may have limited impact if institutional weaknesses are not addressed. In contrast, prioritising institutional reforms, especially in areas like judicial independence, anti-corruption measures, and property rights enforcement, is more likely to generate sustained development benefits. For international development agencies and bilateral donors, this suggests a shift in approach. Greater emphasis should be placed on institutional indicators such as Polity IV scores and governance metrics, while economic and welfare outcomes should be viewed as longer-term results rather than immediate targets.

At the same time, some limitations need to be acknowledged. The reliance on governance and archival data, which often focus on elite-level institutions, may overlook informal societal dynamics that influence how institutions function. The sample of nine countries, although selected to reflect institutional variation, cannot fully represent the diversity of post-communist experiences, so caution is needed when applying these findings to other regions such as Sub-Saharan Africa or Latin America. In addition, the framework mainly focuses on economic and welfare outcomes, while factors like political stability and social cohesion which may interact with institutional quality are not explored in depth.

## V. Conclusion And Future Scope

This study sought to investigate whether the quality of democratic institutions before transition shapes the long-run economic trajectories of post-communist nations. The findings provide a clear but nuanced confirmation of this relationship. Based on a quantitative comparative analysis of nine post-communist states, the results show that Polity IV scores at the moment of transition are strong and consistent predictors of later GDP per capita growth, income equality, and broader social welfare outcomes. This supports the central proposition of the institutional quality–growth nexus framework developed in this study.The central theoretical contribution of this research is the development of a three-tier policy architecture. This framework breaks the institutional quality–growth relationship into three connected layers: inputs, mediating mechanisms, and outcomes. It moves beyond the widely accepted idea that "institutions matter," established by North (1990) and Acemoglu et al. (2001). Instead, it offers a more practical explanation of which institutional factors matter most, how they operate, and which welfare outcomes they influence. The framework also has clear implications for reform sequencing in transition economies. It suggests that Tier 1 investments in democratic governance, judicial effectiveness, and property rights protection are essential. These create better investment conditions and improve human capital returns, which then drive long-term convergence.

Future research can extend this framework by incorporating patronal network dynamics and hybrid capitalist configurations, building a more complete theory of institutional divergence in transition economies. Methodologically, combining qualitative case studies with the current quantitative approach would strengthen causal understanding and better capture the informal and embedded dimensions of institutional change not fully addressed here.

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