Will Bartlett, Nevenka Cuckovic and Kresimir Jurlin
A comparative perspective on institutional quality in countries at different stages of European integration

Article (Accepted version)
(Refereed)

TITLE: A COMPARATIVE PERSPECTIVE ON INSTITUTIONAL QUALITY IN THE EUROPEAN NEIGHBOURHOOD

This paper is for the Special Issue on "The economic perspectives of the European Neighbourhood Policy"

Authors:

NEVENKA ČUČKOVIĆ, Research Advisor, Institute for Development and international Relations, Department for International Economic and Political Relations

KREŠIMIR JURLIN, Institute for Development and international Relations, Department for International Economic and Political Relations

WILL BARTLETT, European Institute, London School of Economics and Political Science (email: w.j.bartlett@lse.ac.uk)

A COMPARATIVE PERSPECTIVE ON INSTITUTIONAL QUALITY IN THE EUROPEAN NEIGHBOURHOOD

Abstract

The paper investigates institutional quality in countries of the European Neighbourhood Policy (ENP), accession and candidate countries (ACC) and new member states (NMS) of the European Union. Several conclusions emerge. Firstly, ENP countries show less institutional convergence than candidate countries. Secondly, corruption is perceived as greater in ENP countries than elsewhere. Thirdly, ENP lags in democratic consolidation especially with respect to political and civil liberties. We construct an index of institutional quality in the public sector to track changes over time between the three regions. This reveals improvements in ENP in institutions supporting R&D and the use of ICT, while institutional progress to support education and innovation has fallen behind the EU average. We conclude that the EU has not yet played an important role as a "transformative power" and that the process of institutional reform in ENP is incomplete due to an absence of a clear European perspective.

1 INTRODUCTION

Since the beginning of the 1990s and the transformation of the former socialist countries, interest in the quality of institutions as a determinant of economic growth has increased considerably. The idea that good economic institutions in both the public and the private sectors have a distinctive role to play in supporting economic development is now widely acknowledged (Acemoglu and Robinson, 2012; Rodrik, 2008). It is often argued that well-designed institutions can trigger economic growth and act as important growth accelerators (Housemann, Prichett and Rodrik, 2004). A positive link between the quality of institutions and economic growth has been widely explored and empirically tested.[1]

Increasingly, investors take the quality of institutions into account as an important factor for doing business and in assessing the overall risk of future business operations. This is because the institutional framework creates both incentives and disincentives for economic transactions and business decisions. Firms are generally keen to invest in countries where property rights are protected, which have a developed legal framework and enforce the rule of law, and whose public services avoid burdensome bureaucracy, redundant regulation and corruption. It is also important that government policies are transparent, that the judiciary does not hinder business and that there is strong protection against crime and fraud. Institutional failures, on the other hand, significantly raise transaction costs for firms if public institutions fail adequately to enforce property rights, fail to protect business contracts or fail to ensure an adequate level of information to all market agents. Underlying rules of conduct, both formal and informal, of citizens and enterprises, together with instruments to control corruption, are also important and mirror the capacity of society to effectively

enforce regulations and contracts (Budak, 2006; Budak and Sumpor, 2009). In this paper, we take all these elements into account in measuring the quality of the institutional framework.

Political institutions affect the choice and shape of economic institutions both directly and indirectly, although the relation between institutions, governance and economic growth is complex (Acemoglu et al. 2004). A central hypothesis in exploring the impact of the quality of political institutions on economic development is that a strong and stable set of economic institutions which create incentives for economic development could only be achieved if they rely on political institutions which guarantee political and civil freedoms and the rule of law (Acemoglu and Robinson, 2012). A distribution and limitation of political power, accompanied by political inclusiveness also determines economic success or failure and a "combination of inclusive political and economic institutions shapes the incentives needed for societies to prosper" (Acemoglu et al, 2004). This is a point of departure of our analysis.

Although it is difficult to determine which political institutions and governance contracts matter most for economic outcomes, the institutional and governance structures are important for understanding the path of economic growth and why some countries have been more successful than others in building pro-market institutions. (Beck and Laeven, 2005). The transition countries have had different degrees of success, but the gap in development levels suggests that those countries that are better integrated into the EU demonstrate better long-term economic performance and governance capacities and that the quality of the institutional framework could provide some answers why this is so. We argue that having transparent, stable and well-functioning political and economic institutions has a positive impact on economic development and the integration prospects of the ENP countries. The conceptual framework for the analysis of the quality of ENP

institutions reflects the analysis of Monastiriotis and Borrell (2012), Ascani et al. (2012) and Wesselink and Boschma (2012)[2].

In this paper we examine the quality of institutions as measured by governance indicators and assess the degree of harmonization with the EU in two ENP countries, Ukraine and Moldova, which have both stated their political aspirations to integrate with the EU and have started to work towards institutional arrangements to achieve that goal. Public governance institutions affect the conditions in which economic agents, entrepreneurs and citizens interact, especially with regard to: a) the stability of political institutions and accountability of the government; b) voice in government policy-making; c) extensiveness of corruption and state capture) quality of entrepreneurial infrastructure and business environment, and e) quality of public services (education, quality of research and development system, innovation system). Among their effects, we distinguish between those that affect all citizens, such as the stability of political institutions, the accountability of government and the level of corruption and those that affect entrepreneurs and investors, such as the business environment and the quality of public services. The analysis that follows identifies the trends of convergence and divergence in the quality of governance indicators for the selected countries. The analysis also explores whether the pressure of Europeanization has provided an incentive to develop structures and institutions compatible with the other EU member states. For accession and candidate countries, the EU membership negotiations have also been an important external influence on national policies, institutions and governance structures, while the EU neighbourhood countries have been able to acquaint themselves with the conditionality and procedures for the accession.

In the next section we explore the quality of public governance focusing on political stability, government accountability, and perceptions of corruption drawing a several international databases that provide information about these aspects of governance. In section 3 we explore relevant indicators on the quality of public services, focusing on services that are relevant for growth and recovery from the economic crisis including education, innovation, R&D and the use of ICT. In section four we set out our conclusions and implications of the analysis for policy in the ENP region.

2 QUALITY OF PUBLIC GOVERNANCE – DEFINITIONS AND METHODOLOGY

Governance can be defined as "the traditions and institutions by which the authority in a country is exercised" (Kaufman et al., 2010: 4). Effective governance leads to political stability, and involves government accountability, protection of civil liberties and the control of corruption. We make use of governance indicators measured by the Worldwide Governance Indicators (WGI) of the World Bank's "Governance Matters" database (Kaufmann, et al., 2010). Our analysis will also use data from other available international sources including Freedom House, Transparency International, UNESCO and World Economic Forum (WEF).

The institutions of public governance (both formal and informal) including their negative manifestations such as corruption and state capture shape the business environment in many transition countries, especially in the ENP region. The quality of political and institutional governance has an important effect on economic performance and growth because the choice of institutions reflects the distribution of political power and economic resources (Acemoglu et al 2004; Kaufman et al., 2010). Also, interest groups and ruling elites

may succeed through rent-seeking in creating institutions that are favourable to themselves rather than to the wider society (Bartlett and Prica, 2012).

Political and administrative corruption has been shown to be a major obstacle for doing business (Griffits et al., 2009; Grodeland and Aasland, 2011;Dreher and Gassebner, 2007). We therefore examine the quality of institutions that have been set up to combat corruption. Also, the analysis explores the "governance gap" between the selected countries and the EU, and assesses the effectiveness of institutions that aim to bridge this gap.

Our analysis of the quality of governance involves an examination of indicators at two levels:

a) Political institutions that regulate the system of governance (political stability, government accountability, control of corruption and protection of civil liberties)

b) Public sector institutions that regulate and develop the factors of production factors (indicators on education, R&D, innovations, and infrastructure)

The focus of the study is on the analysis of quantifiable indices that measure qualitative variables. In measuring the quality of public sector institutions we construct a synthetic indicator, which we call the Public Sector Institutional Quality Index. We identify trends in convergence or divergence of the selected countries by changes in the coefficient of variation of the index over the period 2004 to 2011.

2.1   The quality of political and institutional governance

In this section we analyse the quality of the institutions of governance using indicators of political stability, government accountability, success in the control of corruption, protection of civil liberties and governance effectiveness. We compare indicators for two EU neighbours (Ukraine and Moldova), two candidate states (Croatia[3] and Macedonia), and two EU member

states (Bulgaria and Romania) in order to identify the differences in the quality of governance between regions that stand in different relationships to the EU, a dominant agent in constructing the institutions of public governance in Europe. Our empirical analysis is based upon the World Governance Indicators (WGI) dataset 2004-2010,[4] which provides percentile ranks of various indicators of public governance in ranging from 0 (lowest) to 100 (highest) for each country. The higher the percentile rank that a country scores, the better its governance institutions function and perform. In comparing the ENP countries progress in implementing institutions of public governance we compare countries from other regions at different stages of adoption of EU norms and institutions. In Figures 1-3 we compare the performance in terms of the quality of governance institutions between the three groups of countries from the ENP region the accession and candidate country region and the new member state region.

Figure 1 about here

The data in Figure 1 show that political stability has improved fairly consistently in the NMS between 2004 and 2010, and since 2005 in the ACC countries since shortly after their acceptance as candidate countries[5]. In contrast the ENP countries have had a more volatile experience in building institutions providing political ability, with a sharp reversal from 2007 to 2009 and despite some improvement in 2010 the indicator scores have increased only marginally over the whole period from 2004-2010.

In 2004, the "Orange Revolution" in Ukraine created high expectations with regard to building a fully-fledged democracy and stronger institutions compatible with a market

economy. Improved procedures were introduced in the constitution and in the electoral system that brought them closer to international standards for democratic elections. But it also created new political realities and divisions among the pro-reform forces and led to political instability. Since 2006, the country has entered a profoundly unstable period characterised by early elections and frequent changes of governments and clashes between political opponents (including the arrest, conviction and imprisonment of former pro-reform Prime Minister Timoshenko) leading to a failure to fully consolidate democratic institutions and to a collapse of trust in the political elite. Political institutions have been inadequately reformed and are ineffective by international standards (Griffits et al., 2010). Despite this uneven progress in building political institutions, the underlying political consensus on the main directions of the socio-economic development agenda of Ukraine towards a functioning market economy integrated with the EU has remained intact. In 2011, some progress was observed in institutional and structural reforms (EBRD, 2011). For instance, the new anti-corruption law that became effective in July 2011 aimed to reduce red tape and introduce measures to make public administrative institutions more effective.

In Moldova, the situation is similar with regard to changes in institutional and governance structures. However, democratic consolidation has been further held back by the frozen conflict over the secession of the eastern region of Transnistria. The situation has not been resolved for many years, and most analysts consider this to be the main reason why it has not been possible to transform the country into a well-governed democratic state (Nieman and de Wekker, 2010). Although the secession of Transnistria has not been internationally recognized, it still poses a serious political problem for Moldova as it blocks its transformation and EU integration efforts.

Figure 2 about here

Figure 2 shows the change over time in the scores for the indicators of voice and accountability. It shows relatively little progress for either the NMS or ACC regions, while ENP region has recorded some relatively strong improvement with noticeable catching up from a very low base level.

Figure 3 about here

Figure 3 shows progress in control of corruption. The weakest performers are the countries from the ENP region, which have gradually fallen down the control of corruption rankings, following a strong improvement from 2004 to 2005. The weakness of their institutions in dealing with corruption reflects embedded elements of culture, history and behaviour. Ukraine needs a concerted effort to catch up with the Western Balkan accession and candidate countries. Combatting corruption is among the priorities of the Association Agreement of Ukraine with the EU (December 2011). Moldova has done better, but there is a clear gap between ENP and ACC countries in this respect. The ACC countries have made the most progress overtaking the NMS region in 2007 and continuing to gain in the ranks. This most likely reflects the effect of EU conditionality in the run-up to accession in the ACC region, and the subsequent falling behind when this conditionality was lifted after countries (Bulgaria and Romania in this case) acessed the EU in the NMS region.

Taking individual countries into account, despite progress in compliance with democratic principles and the rule of law, Ukraine and Moldova are both fragile in terms of political stability, freedom of expression, media freedoms, and the implementation of electoral processes[6]. Both are characterised by low levels of government accountability and confusing responsibility chains. Dealing with corruption is the greatest problem these countries face. This is not surprising, given the political struggles and social and economic instability of the last decade. The global financial crisis has only aggravated the problems of public governance in Ukraine and Moldova.

Croatia is the best ranked country overall for all three indicators (see Table A1) since it has successfully complied with all the required political conditionality during the accession process, and transposed most of the common legal rules and adjusted its institutional system to the EU *acquis communautaire* as a precondition for joining the EU on 1 July 2013. Macedonia is trailing with much lower scores, especially when it comes to perceptions of political stability[7].

Somewhat surprisingly, the indicators for both Bulgaria and Romania are weaker than for Croatia, indicating problems in the control of corruption, freedom of media and civil liberties and political stability. Romania made some progress in political stability after joining the EU, but not in other dimensions, while in Bulgaria, indicators for the control of corruption, voice and accountability of government have worsened since 2007. Intensified monitoring over combating corruption and increasing the effectiveness of the judiciary over the last five years have failed to produce improvements in these areas. Given this outcome, the tougher accession conditionality for Croatia and other candidate countries seems to be justified as the motivation for policy change appears to be much higher in the pre-accession period.

2.2   Corruption perception index

The WGI scores are composed from sub-indices drawn from Freedom House and Transparency International, which have a rather different focus from one another. We therefore complement our analysis of corruption indicators by looking at the *Transparency international Corruption Perception Index* dataset, which provides more detail about how the problem of corruption in public administration is dealt with.

Figure 4 about here

As can be seen from Figure 4, the greatest improvement in the fight against corruption has taken place in the ACC countries, which now rank highest in the perceptions of corruption index, although far away from the optimum, with a score of only 4 out of a possible 10. The ENP countries have made some improvements but still score below both ACC and NMS states. In terms of individual country rank order, Croatia is best placed according to the Transparency international Corruption Perception Index for 2011, and its rank has remained between 66th – 67th place from 2004 to 2011. Perceptions on the extent of corruption have worsened in Bulgaria, and its rank fell from 54th to 86th place from 2004 to 2011. Ukraine plunged even further, from 122th to 152th place over the same period, while Moldova improved its rank by just two places over the eight years (from 114th to 112th). This illustrates the weak capacities of the current institutions in ENP countries to effectively deal with the problem of corruption.

The *Global Corruption Barometer*, 2011, provides information about corruption by sector. Figure 5 shows the deviation of the ENP and ACC countries in relation to the benchmark case

of the NMS. The ENP countries are found to be the worst placed in relation corruption in political parties and the judiciary, while the ACC countries perform better in all sectors especially for public officials, civil servants and the police.

Figure 5 abut here

An additional indicator from the Global Corruption Barometer is the perception of how many people pay a bribe. In Croatia, according to *Global Corruption Barometer 2011*, only 5% of people are reported to pay a bribe[8], in Bulgaria 8%, in Macedonia 21%, in Romania 28%, while in Ukraine this proportion is above one third (34%) and even higher in Moldova 37%. These data thus s the view that the most important policy area in the ENP countries is strengthening institutions to combat corruption, state capture and bribery in order to reduce the transaction costs these phenomena impose on the economy. Having such a high percentage of people who pay a bribe suggests that the government administration (public officials and civil servants) pursue their own agendas and do not serve the interests of their societies, which seriously increases transaction costs and reduces potential economic growth in the ENP region.

2.3   Democratic consolidation

Freedom House provides additional indicators of political stability, respect for political rights and freedoms, local democratic governance, free media, the expression of other civil liberties and control of corruption. These indicators are grouped into various including consolidated democracies (scores 1.00-2.99); semi-consolidated democracies (3.00-3.99);

transitional or hybrid regimes (4.00-4.99); semi-consolidated authoritarian regimes (5.00-5.99) or consolidated authoritarian regimes (6.00-6.99).

Moldova and Ukraine have shown considerable progress in the last eight years, although they have difficulty in complying with democratic standards and are still considered as only partly free societies with respect to political and civil liberties. The Freedom House data reveals a deterioration in democratic conditions in the Ukraine in the last two years (Freedom House, 2012) as the country's status moved from "Free" to "Partly Free" (limited respect for political rights and civil liberties) due to negative political developments, especially the conviction and imprisonment of Yulia Timoshenko on doubtful charges. The deterioration was especially visible in the indicator measuring civil liberties and freedom of expression.

In Moldova, there were no significant shifts in the assessment of the level of the democratic governance, as the country remained only "Partly Free" throughout the period, although there were some signs of progress in 2011 especially with regard media environment and loosening of the political influence over the media. On the other hand, there were setbacks in the protection of minority rights, including gay rights, where the government was forced to withdraw a EU-backed Anti-Discrimination Law.

The Freedom House data also confirm that Croatia, Bulgaria, Romania and Macedonia belong to the group of consolidated democracies and could be considered as free societies with democratic respect of political and civil liberties, free media, academic and other freedoms. Their ability to control corruption is higher, despite the fact that the problems remain.

3 QUALITY OF PUBLIC SERVICES

In this section we measure the quality of public services in four dimensions that support economic growth: education, research and development (R&D), innovation, and the use of information and communication technologies (ICT). We use INSEADs Global Innovation Index 2012, which is based on a variety of primary information sources including UNESCO, the International Telecommunication Union, the UN Public Administration Network, the World Intellectual Property Organization, the World Bank Development Indicators and the Wikimedia Foundation. In order to get longer perspective on changes over years, due to missing data for Moldova and Ukraine in the INSEAD database, we complemented this analysis by constructing supplementary index based on the World Economic Forum (WEF) data. Some indicators capture public policies directly (government prioritization of ICT) while other indicators measure the ability of the educational system to produce experts able to use sophisticated skills in business strategies. Other indicators measure quality of public institutions indirectly by assessing their impact on the private sector (see Tables A3). The four dimensions are each derived on the basis of three indicators that are set out in the Appendix (see Table A5). To make the data comparable, we use the original rank values for each indicator, as presented in the WEF Global Competitiveness Survey data, 2006-2010. Taking the average of these rank values gives the score for each dimension. Finally, we take the average value of the four dimensions to create a single Index of the Quality of Public Institutions. These scores are normalised in relation to values for the EU15=100 (see Figure 6) in order to identify the gap between the ACC, ENP and NMS regions in relation to the EU15 countries[9].

The overall score for Ukraine is not as low as one might expect, given the relatively low level of development. The score for the NMS countries (Bulgaria and Romania), is lower than for Croatia and not much different to Macedonia. Moldova stands out as having the lowest value of the Index.

Considering the individual dimensions that make up the index, Croatia has similar values across all four dimensions (see Table A3). Romania is more advanced in innovation and education, while significantly lagging behind in use of ICT. The Ukraine is similar, with rather good performance in education, but very low in the use of ICT. Bulgaria has a significantly low score in the use of ICT. Moldova has good performance in innovation, while education and R&D lag behind. Finally, Macedonia has the weakest performance with relatively low scores in R&D and use of ICT.

In order to show the relative performance across regions, values of the index and its dimensions were compared to the average of the "old" EU members (EU15=100). This exercise shows how much are the three regions lag behind the EU15 countries (see Figure 7). The data show an improvement in the index of the quality of public institutions between 2006 and 2008, but a strong relapse in the case of the NMS between 2008 and 2010 with the relative value of the index falling even below the level achieved in 2006. The ENP countries also fell behind somewhat, but not as far as the NMS countries. It is surprising that the ACC countries seem to be doing better in terms of this relative index than the NMS, reflecting the

relatively effective public sector institutions in Croatia. The ENP countries lag significantly behind both the ACC and NMS regions.

Figure 7 about here

The indicators are compared to the average for the EU-15 (old EU-members) and changes over time are compared to identify convergence or divergence trends for the South East Europe region as a whole (i.e. for all six countries). To assess whether the six countries converge or diverge from each other, we calculated the coefficient of variation for these countries (see Table 1).

Table 1: Coefficient of Variation of indicators and Quality of Public Institutions Index

	Education	ICT	Innovation	R&D	INDEX
2006	0.061	0.087	0.121	0.099	0.084
2008	0.052	0.062	0.089	0.087	0.061
2010	0.058	0.052	0.075	0.091	0.053

Source: Authors calculations based on WEF, GCI, survey data

Table 1 shows that the coefficient of variation (CV), for the overall index decreased over time indicating a relative convergence among the three regions and hence of the ENP to the NMS benchmark. The changes in the CV for the individual dimensions show a variety of patterns. While the CV in all dimensions decreased between 2006 and 2008, after the onset of the economic crisis the CV began to diverge again between 2008 and 2010 for the dimensions of education, and R&D, while continuing to decline for the use of ICT and in innovation. The increase in the CV for education and R&D in recent years reflects a weakening of the quality of public institutions in sectors that are critical for the future growth of the economies in South East Europe as a whole.

4 CONCLUSIONS

The paper has investigated the patterns of change in institutional reform in several countries representing the European Neighbourhood Policy (ENP), the accession countries (ACC) and the new member stats (NMS). Several conclusions emerge from the analysis.

Firstly, the ENP countries show a weaker performance over time than candidate countries or the new member states of South East Europe. Political stability, governmental accountability, and control of corruption all score lower on the various indicators we have examined in the ENP region than in the ACC or NMS regions. In addition while the ACC and NMS regions are broadly improving the quality of their political and institutional governance, the ENP region seems to be falling behind in most respects. The creation of "endogenous institutions" and the introduction of incentives to eliminate the deeply rooted tolerance for corruption in the Western Balkans and ENP countries would help to eliminate the "governance gap" between these countries and the EU.

Secondly, we have focused our attention on the issue of corruption in which the ENP region appears to be doing relatively worse than the ACC or NMS regions. Looking at a variety of indicators we have shown that the ACC region has moved ahead of the NMS region in some respects, due to the strong impact of accession conditionality, while there is evidence of backsliding among the NMS after they became EU members in 2007. Additionally we found that corruption perceptions are relatively unfavourable in the ENP in the sectors of political parties and the judiciary, while they are relatively better in the ACC countries in the sectors of public officials and the police.

Thirdly, although Ukraine and Moldova have shown considerable progress in democratic consolidation over the last eight years, they lag behind other comparator countries in the study as they are still considered as only "partly free" societies with respect to political and civil liberties, and in some respects are even backsliding in relation to some of the available indicators. We conclude that, the EU has not yet played an important role as a "transformative power" shaping faster institutional convergence in the ENP region and there is a danger that the reform processes will either stagnate or "run out of steam" if the EU does not take a more decisive role in the process. In sum, the process of institutional reform appears incomplete due to an absence of a clear European perspective.

Fourthly, We constructed an index of institutional quality in the public sector and use this to track changes over time between the three regions and individual countries. The analysis showed some evidence of convergence in performance between countries suggesting that the ENP has caught up to some extent with the EU average at least to that of the NMS region. The analysis of quality of public service institutions in particuar sectors also revealed that while the index scores for education and innovation have fallen behind the EU average since the onset of the economic crisis, capacities for change are progressing based largely on an improvements in R&D and the use of ICT. Such progress should be commended and further supported by the EU institutions and assistance programmes.

Finally, providing more consistent EU association policies towards the ENP countries and a clearer commitment to their European future might encourage further democratization and the creation of more efficient market institutions than has happened so far. This would give Ukraine and Moldova a better perspective on their accession aspirations. Croatia is a good example, as the pace of institutional and economic reforms quickened after the signature of

the Stabilisation and Association Agreement with the EU in 2001, and again after membership negotiations began in 2005. There is a need for greater efforts to ensure "joint ownership" of reforms, because the motivation for democratic reforms in states with weak institutions cannot come only from within these societies through the actions of domestic pro-reform forces. Given the fact that improved institutions of governance and advances in democratic development are among the top priorities of the ENP policies for Ukraine and Moldova, it is rather surprising that the EU has failed to promote stronger transformative processes and to encourage a faster evolution of democratic governance institutions in both countries. The EU has therefore failed to maximise its "transformative power" to promote institutional convergence[10]. Under such circumstances, there is a danger that reform processes will either stagnate or "run out of steam" if they are postponed indefinitely. If the EU does not take a more decisive role, the process could even go into reverse.

REFERENCES

ACEMOGLU, D. & ROBINSON, J. (2012), *Why Nations Fail: The Origins of Power, Prosperity and Poverty*. Profile Books, London, UK.

ACEMOGLU, D., JOHNSON, S. & ROBINSON, J. (2004), Institutions as the fundamental cause of long-term growth. In: *Handbook of Economic Growth*, MIT, Boston, pp. 385-472

ACEMOGLU, D. & JOHNSON, S. (2005), Unbundling institutions. *Journal of Political Economy*, 113 (5): 949-995.

ALTMANN, F.L., DEIMEL, J. & SCHMIDT, A.G. (2010), Democracy and good governance in the Black Sea region. *Policy Report IV*, Bertelsmann Stiftung

ASCANI, A., BARTLETT, W., BOSCHMA, R., CRESCENZI, R., IAMMARINO, S., MONASTIRIOTIS, V. & WESSELINK, E. (2012), Conceptual framework for the assessment of the impact of differentiated/incomplete integration on both the New Member States and the Neighbouring Countries. Deliverable 1.3, FP7 Project SEARCH.

ATELJEVIĆ, J. & BUDAK, J. (2010), Corruption and public procurement: example from Croatia. *Journal of Balkan and Near Eastern Studies*, 12(4): 375-397.

BARTLETT, W. & PRICA, I. (2011), The variable impact of the global economic crisis in South East Europe. *LSEE Papers on South East Europe*, London: LSE.

BECK, T. & LAEVEN, L. (2006), Institution building and growth in transition economies. *Journal of Economic Growth*, 11: 157-186.

BUDAK, J. & SUMPOR, M. (2009), Nova institucionalna ekonomika i institucionalna konvergencija. *Ekonomski pregled*, 60 (3-4): 168-195.

BUDAK, J. (2006), Corruption in Croatia: Perceptions Rise, Problem Remain. *Croatian Economic Survey*, 9(1): 35-68

CAMPBELL, J. L. (2004), *Institutional Change and Globalisation*. Princeton: Princeton University Press.

ČUČKOVIĆ, N.; JURLIN, K. (2009), Economic Governance and Competitiveness: Some Evidence from Croatia and the New EU Members. *Proceedings of the 8th International Conference "European Challenges: Financial Crisis and Climate Change", Bol-Split, May 21-23*, 8: 471-492

DREHER, A. AND GASSEBNER, M. (2007), Greasing the wheels of entrepreneurship? The impact of regulations and corruption on firm entry. CESifo Working Paper Series, No. 2013, Munich: CESifo Group

EBRD (2004-2011), Transition Reports. London: European Bank for Reconstruction and Development

FREEDOM HOUSE (2012), Country Reports, 2004-2011,

GRIFFITS, M. D., KICKUL, J. & CARSRUD, A. L. (2009), Government bureaucracy, transactional impediments, and entrepreneurial intentions, *International Small Business Journal*, 27(5), pp. 626-642.

GLOBAL CORRUPTION BAROMETER (2011), Transparency International

GRODELAND, A. B. & AASLAND, A. (2011) "Fighting corruption in public procurement in post-communist states: Obstacles and solutions", *Communist and Post-Communist Studies*, 44(1), pp. 17-32.

HAUSMANN, R., PRITCHETT, L. & RODRIK, D. (2004) "Growth accelerators", *NBER Working Paper no .10566,* Washington: National Bureau for Economic Research.

JURLIN, K. & ČUČKOVIĆ, N. (2010) "Comparative analysis of the quality of European institutions 2003-2009: convergence or divergence?", *Financial Theory and Practice*, 34(1): p:71-98.

KAUFMANN, D., KRAAY, A. & MASTRUZZI , M. (2010), "The Worldwide Governance Indicators: Methodology and Analytical issues", *Policy Research Working Paper no. 5430*, World Bank, Washington DC.

MONASTIRIOTIS, V. & BORELL, M. (2012), "Political and Political Economy Literature on the ENP: Issues and Implications", WP1/05 Search Working Paper, FP7 Project SEARCH

NIEMAN, A. & DE WEKKER, T. (2010), "Normative power Europe? EU relations with Moldova", *European Integration online Papers*, 14(4)

NORTH, D. (1997) "The contribution of the new institutional economics to an understanding of the transition problem", *WIDER Annual Lectures,* Helsinki: UNU/WIDER.

NORTH, D. (1990), *Institutions, Institutional Change and Economic Performance*, Cambridge: Cambridge University Press.

PEDERSEN, K. O. (2008) "Institutional competitiveness: how nations came to compete", *Working Paper no.47*, Copenhagen Business School, Copenhagen.

RODRIK, D. (2008), *One Economics, Many Recipes: Globalization, Institutions and Economic Growth*, Princeton: Princeton University Press,

RODRIK, D. (2004) "Getting institutions right", CESinfo DICE Report 2

TRANSPARENCY INTERNATIONAL (2003-2009) Transparency International Annual Report

SIGMA (2007) Ukraine Governance Assessment: SIGMA Report Update

UNODC (2011) *Corruption in Croatia: Bribery as Experienced by the Population*, Vienna: United Nations Office on Drugs and Crime

WESSELINK, R. & BOSCHMA, R. (2012) "Overview of the European Neighbourhood Policy: Its History, Structure and Implemented Policy Measures", *SEARCH Working Paper* WP1/04

WORLD BANK (2004-2011) Worldwide Governance Indicators Dataset, Washington DC: The World Bank

APPENDIX

Table A1. Political stability; accountability and control of corruption, 2004-2010

Year	Croatia	Macedonia	Ukraine	Moldova	Bulgaria	Romania
Political stability						
2004	65.9	19.2	27.9	34.1	45.7	46.2
2005	60.1	15.9	38.5	32.2	51.0	49.0
2006	62.5	25.0	43.8	31.3	59.6	51.0
2007	67.3	29.8	48.6	40.4	58.7	51.4
2008	66.8	33.2	45.2	34.6	57.7	51.0
2009	67.8	35.1	31.8	26.5	58.3	57.8
2010	67.0	29.2	42.0	31.1	57.9	54.7
Voice and accountability						
2004	71.6	45.2	27.9	30.3	65.9	60.6
2005	63.5	47.6	39.4	31.3	64.4	59.1
2006	60.6	52.9	47.1	38.0	66.8	62.0
2007	59.1	54.3	48.1	37.5	68.3	60.1
2008	62.5	52.9	49.0	37.0	67.3	60.6
2009	64.5	52.6	48.8	35.1	63.0	60.2
2010	60.7	52.6	44.1	47.9	62.6	61.1
Control of corruption						
2004	61.0	38.0	20.0	15.1	59.0	48.8
2005	60.0	39.5	29.8	31.2	57.1	50.2
2006	59.0	43.9	27.8	32.2	55.1	54.1
2007	59.7	46.6	24.3	32.0	52.4	54.4
2008	59.2	51.9	22.8	33.0	48.1	55.8
2009	58.4	56.0	15.8	27.3	51.7	51.2
2010	59.3	56.5	17.2	26.8	52.2	53.6

Source: WGI dataset 2011, The World Bank, available at:

http://info.worldbank.org/governance/wgi/sc_country.asp

Table A2. Political Freedom Status, Civil Liberties and Political Rights in Bulgaria and Romania, 2004-2011

	Ukraine	Moldova	Croatia	Macedonia	Bulgaria	Romania
Political Freedom						
2004	4.0	3.5	2.0	3.0	1.5	2.0

2005	3.5	3.5	2.0	3.0	1.5	2.5
2006	2.5	3.5	2.0	3.0	1.5	2.0
2007	2.5	3.5	2.0	3.0	1.5	2.0
2008	2.5	3.5	2.0	3.0	1.5	2.0
2009	2.5	4.0	1.5	3.0	2.0	2.0
2010	2.5	3.5	1.5	3.0	2.0	2.0
2011	3.0	3.0	1.5	3.0	2.0	2.0
Civil Liberties						
2004	4.0	4.0	2.0	3.0	2.0	2.0
2005	3.0	4.0	2.0	3.0	2.0	2.0
2006	2.0	4.0	2.0	3.0	2.0	2.0
2007	2.0	4.0	2.0	3.0	2.0	2.0
2008	2.0	4.0	2.0	3.0	2.0	2.0
2009	2.0	4.0	2.0	3.0	2.0	2.0
2010	2.0	4.0	2.0	3.0	2.0	2.0
2011	3.0	3.0	2.0	3.0	2.0	2.0
Political rights						
2004	4.0	3.0	2.0	3.0	1.0	2.0
2005	4.0	3.0	2.0	3.0	1.0	3.0
2006	3.0	3.0	2.0	3.0	1.0	2.0
2007	3.0	3.0	2.0	3.0	1.0	2.0
2008	3.0	3.0	2.0	3.0	1.0	2.0
2009	3.0	4.0	1.0	3.0	2.0	2.0
2010	3.0	3.0	1.0	3.0	2.0	2.0
2011	3.0	3.0	1.0	3.0	2.0	2.0

Source: Freedom House, Country Reports, 2004-2011, http://www.freedomhouse.org/report/freedom-world/freedom-world-2012

Table A3. Quality of the Public Sector Institutions Index (rank values)

	Bulgaria	**Romania**	**Croatia**	**Macedonia**	**Moldova**	**Ukraine**
EDUCATION	**47.0**	**37.0**	**37.3**	**57.0**	**62.0**	**22.0**
School life expectancy	53	38	52	65	90	36
Pupil-teacher ratio (secondary)	46	51	13	49	34	n.a.
Tertiary enrolment	42	22	47	57	62	8
RESEARCH AND DEVELOPMENT	**48.7**	**51.0**	**38.0**	**70.7**	**66.7**	**46.0**
Gross expenditure on R&D (% GDP)	52	57	40	80	53	37
GERD financed by business (% of total)	51	47	41	76	90	57
Researchers, (per million population)	43	49	33	56	57	44
INNOVATION	**47.7**	**28.7**	**36.7**	**56.7**	**21.7**	**40.7**
National patent application (per billion GDP in USD PPP)	47	32	41	57	15	25
Royalty and licence fees receipts	37	19	42	36	35	32

(per 000 GDP)					
Creative goods exports (% total exports)	59	35	27	77	15	65
USE OF ICT INFRASTRUCTURE	**48.7**	**52.3**	**33.7**	**55.7**	**57.7**	**70.3**
Government online service index	71	61	40	84	61	88
Use of ICT index	46	45	33	48	57	81
Wikipedia monthly edits (per population 15-69)	29	51	28	35	55	42
QUALITY OF PUBLIC SECTOR INSTITUTIONS INDEX	**48.0**	**42.3**	**36.4**	**60.0**	**52.0**	**44.8**

Source: Global Innovation Index 2012, INSEAD, supplemented by WEF survey data. Note: The scores of the indexes (dimensions) are calculated as simple averages of the ranks of the underlying indicators, which means the lower value is favourable

Table A4: Indicators and Index of Quality of Public Institutions (relative to EU15=100)

Indicator	Year	EU15	EU10	Bulgaria	Croatia	Macedonia	Romania	Ukraine	Moldova	SEE average	SEE CV
Education	2010	100	89.2	73.9	84.1	78.1	80.0	82.1	72.4	78.4	0.058
Education	2008	100	93.2	77.9	82.7	81.9	83.0	83.9	72.9	81.9	0.052
Education	2006	100	92.2	78.1	85.7	79.5	86.5	82.4	73.4	81.5	0.061
ICT	2010	100	92.5	80.9	79.0	83.9	72.8	76.7	74.8	78.0	0.052
ICT	2008	100	92.0	82.5	80.1	79.1	73.8	77.3	69.0	78.6	0.062
ICT	2006	100	88.9	75.3	78.4	64.3	73.2	70.8	63.2	70.0	0.087
Innovation	2010	100	75.1	62.3	69.4	57.9	63.1	66.8	57.5	62.8	0.075
Innovation	2008	100	77.3	61.4	70.9	56.8	65.8	66.9	56.8	64.4	0.089
Innovation	2006	100	75.6	58.4	75.1	55.2	61.8	67.3	56.1	63.1	0.121
R&D	2010	100	80.5	65.9	72.6	62.0	61.5	67.9	55.8	64.3	0.091
R&D	2008	100	82.5	67.8	73.8	62.3	69.4	71.4	57.8	68.9	0.087
R&D	2006	100	79.8	65.8	77.5	61.4	71.6	70.9	59.7	68.2	0.099
INDEX	2010	100	84.4	70.8	76.2	70.5	69.2	73.2	65.1	70.8	0.053
INDEX	2008	100	86.2	72.4	76.8	69.9	72.8	74.7	64.0	73.3	0.061
INDEX	2006	100	84.0	69.2	79.1	64.9	73.0	72.7	62.9	70.5	0.084

Source: See Table A3

Table A5: The dimensions, survey indicators and questions used to create the survey based Institutional Quality of Public Sector Index

Education	Quality of the educational system	How well does the educational system in your country meet the needs of a competitive economy? (1 = Not well at all; 7 = Very well)
	Quality of math and science education	How would you assess the quality of math and science education in your country's schools? (1 = Poor; 7 = Excellent – among the best in the world)
	Quality of management schools	How would you assess the quality of management or business schools in your country? (1 = Poor; 7 = Excellent – among the best in the world)
R&D	Quality of scientific research institutions	How would you assess the quality of scientific research institutions in your country? (1 = Very poor; 7 = The best in their field internationally)
	Local availability of specialized research and training services	In your country, to what extent are high-quality, specialized training services available? (1 = Not at all available; 7 = Widely available)
	Production process sophistication	In your country, how sophisticated are production processes? (1 = Not at all – labour-intensive methods or previous generations of process technology prevail; 7 = Highly – the world's best and most efficient process technology prevails)
Innovation	Capacity for innovation	In your country, how do companies obtain technology? (1 = Exclusively from licensing or imitating foreign companies; 7 = By conducting formal research and pioneering their own new products and processes)
	Competitive advantage	What is the competitive advantage of your country's companies in international markets based upon? (1 = Low-cost or natural resources; 7 = Unique products and processes)
	Extent of marketing	In your country, to what extent do companies use sophisticated marketing tools and techniques? (1 = Very little; 7 = Extensively)
ICT	Government prioritization of ICT	How much priority does the government in your country place on information and communication technologies? (1 = Weak priority; 7 = High priority)
	Online government	To what extent are online government services (e.g. personal tax, car registrations, passport

	services	applications, business permits, customs procedures and e-procurement) available in your country? (1 = Not available at all; 7 = Extensively available)
	Extent of business Internet use	To what extent do companies within your country use the Internet in their business activities (e.g. buying and selling goods, interacting with customers and suppliers)? (1 = Not at all; 7 = Extensively)

---

[11] The important empirical work on measuring institutional quality has been done by the World Bank; World Economic Forum, OECD; EBRD, Transparency International, Freedom House and others. For the theoretical background see the works of many neo-institutional economists started from North, 1990; Williamson (1994); Hodgson (1998); La Porta et al (1999); Rodrik (2004, 2008); Acemoglu, Johnson and Robinson (2004); Acemoglu and Johnson (2005); Boettke (2000). For the good overview of literature of literature see Campbell (2004).

[2] These papers were also produced within the SEARCH project

[3] Croatia became a member state of the EU on 1st July 2013, but during most of the period covered by this paper. Croatia became an EU candidate state in June 2004.

[4] The data for 2011 are still not publically available.

[5] Macedonia became a candidate for EU membership in December 2005

[6] Data are provided in the Appendix

[7] The opening of negotiations on the Macedonia's EU membership application has been blocked by Greece in a dispute over the name of the country, which Greece disputes.

[8] For comparison, according to UNODC Report "*Corruption in Croatia: Bribery as Experienced by the Population*" (2011) based on field survey results of systemic and petty corruption which focuses more on people's experiences with bribe rather than perceptions, the rate of population paying bribes to public officials is higher and amounts around 11%.

[9] The EU 15 are the member states of the EU prior to the eastern Enlargement of 2004.

[10] Many analysts note that in the last decade the EU has more prioritised self-interests in the policies towards ENC countries (for instance energy security supply) then true democratic transformation of these countries (c.f. Altmann et al, 2010, Niemann and de Wekker, 2010).
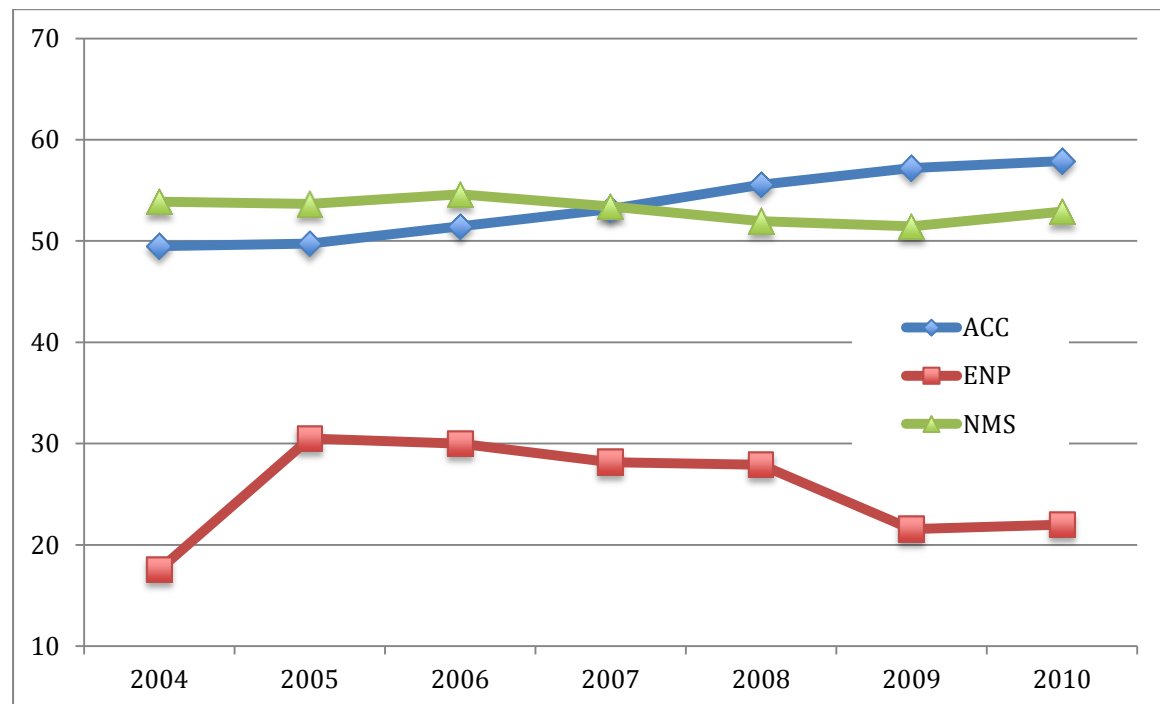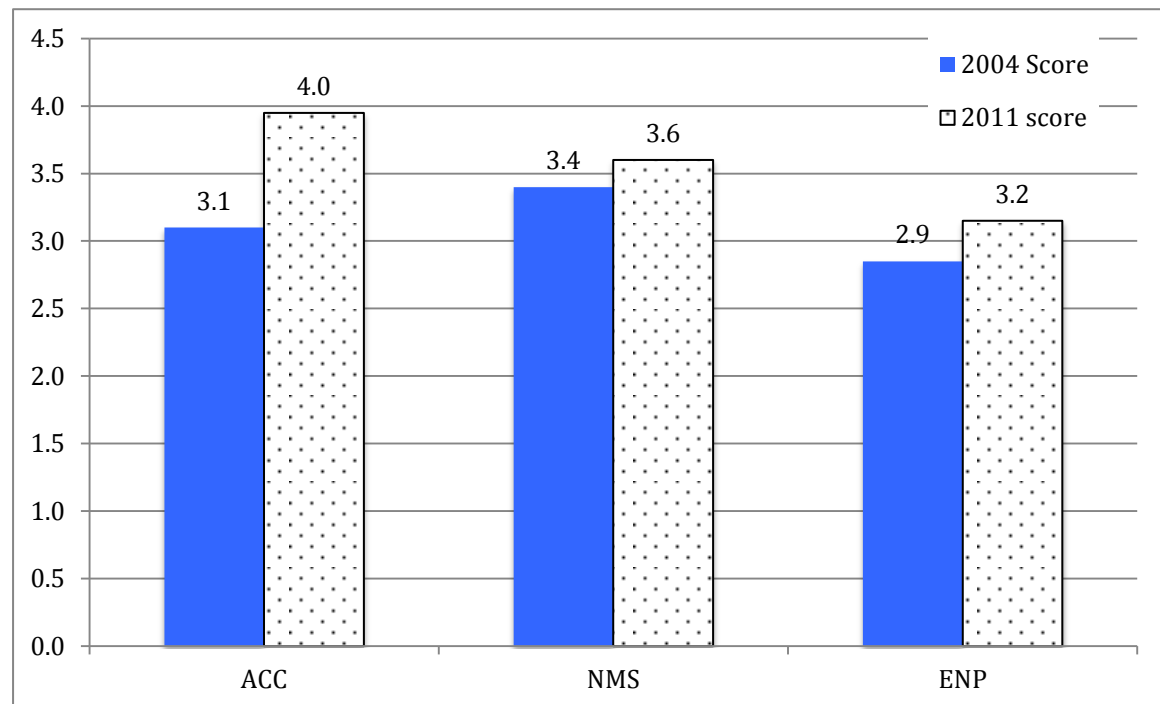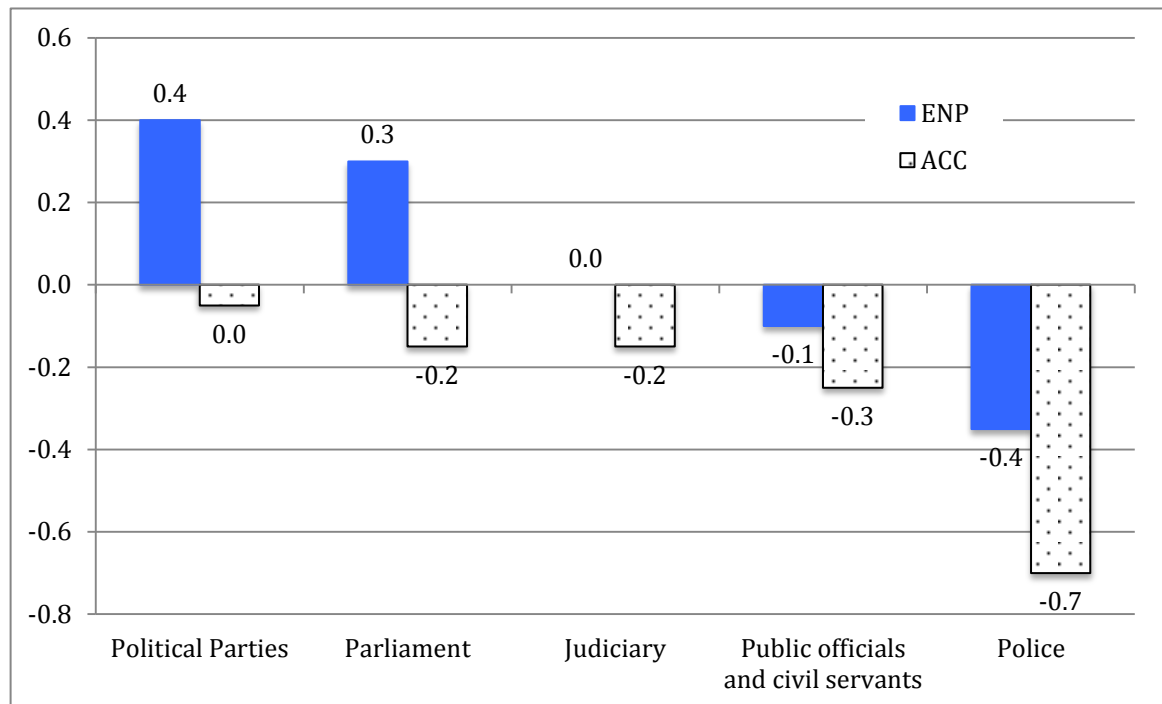
Figure 1: Political Stability
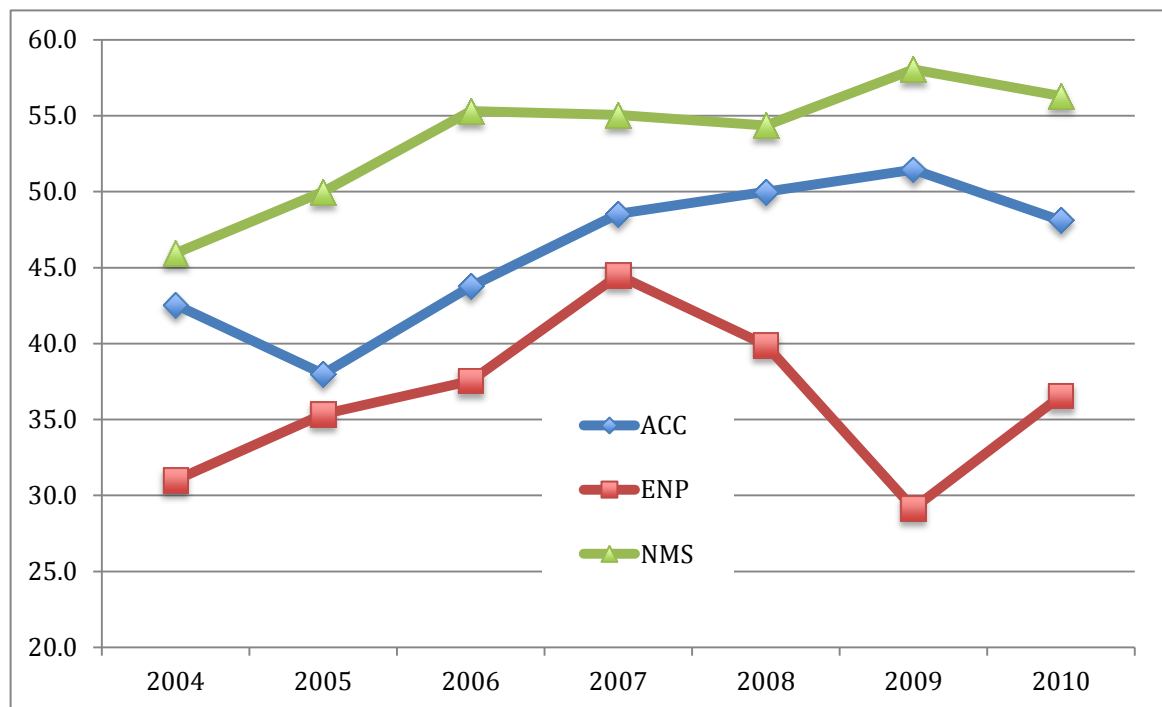
Source: World Bank WGI dataset 2011. Note: "ACC" refers to Croatia and Macedonia, "NMS" refers to Bulgaria and Romania, "ENP" refers to Moldova and Ukraine.

Figure 2: Voice and Accountability
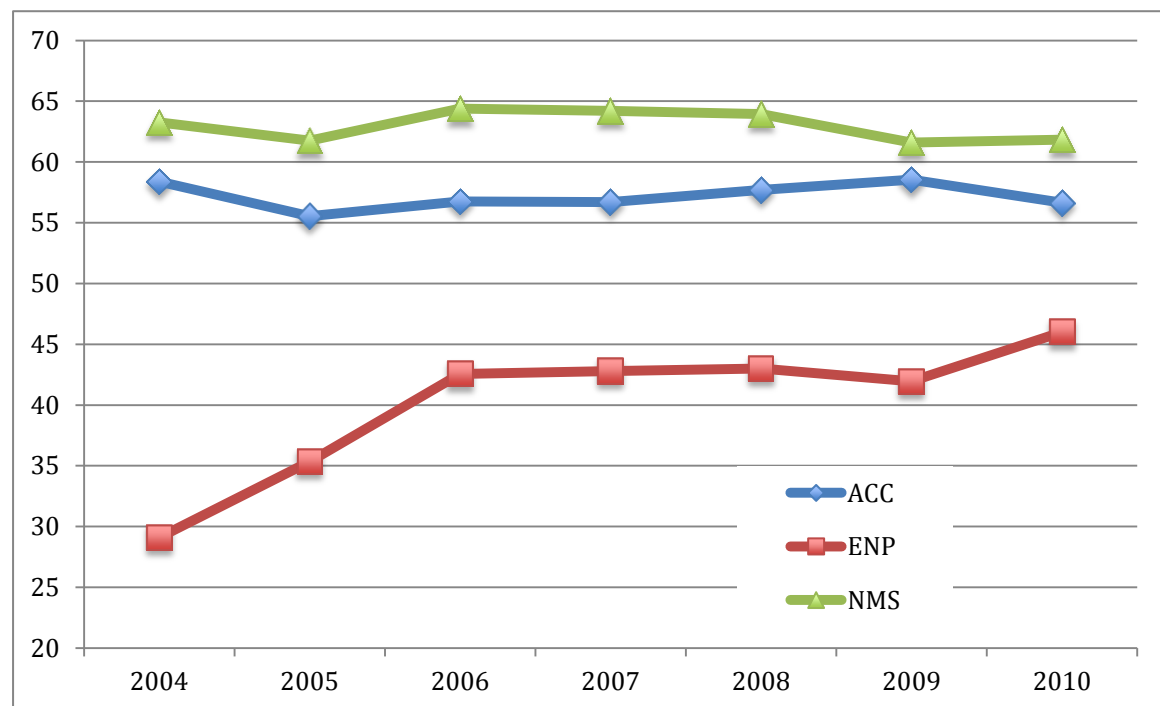
Source: World Bank WGI dataset 2011. Note: "ACC" refers to Croatia and Macedonia, "NMS" refers to Bulgaria and Romania, "ENP" refers to Moldova and Ukraine.

Figure 3: Control of Corruption

Source: World Bank WGI dataset 2011. Note: "ACC" refers to Croatia and Macedonia, "NMS" refers to Bulgaria and Romania, "ENP" refers to Moldova and Ukraine.

Figure 4: Corruption Perception Index (CPI) Scores

Source: Corruption Perception Index, Transparency International, 2004 and 2011. Note: CPI score relates to perceptions of the degree of corruption as seen by business people and country analysts and ranges between 10 (corruption free) and 0 (highly corrupt). "ACC" refers to Croatia and Macedonia, "NMS" refers to Bulgaria and Romania, "ENP" refers to Moldova and Ukraine
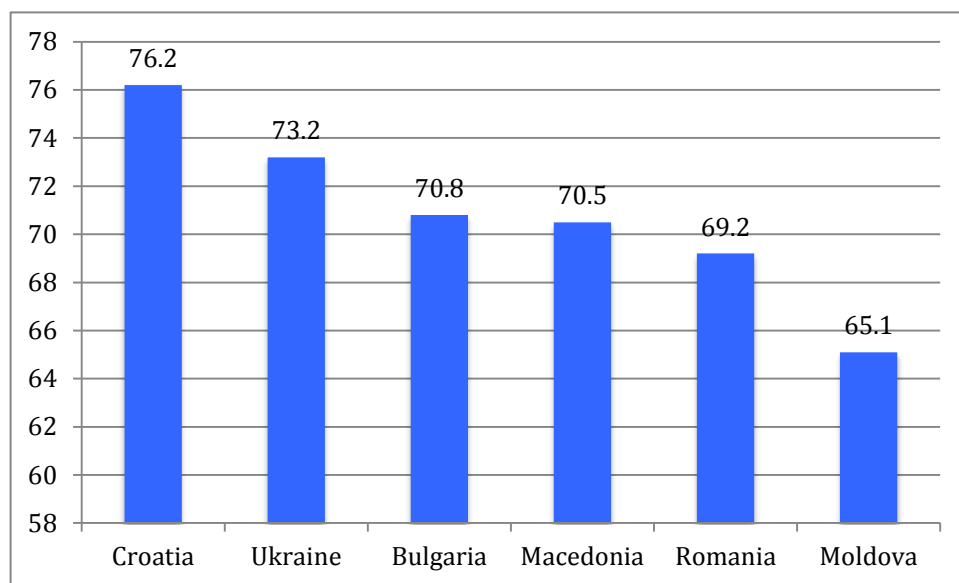
Figure 5: The extent to which different institutions were perceived by the public to be affected by corruption in 2011, (deviation in ACC and ENP country scores from NMS country scores).

Figure 6: Index of Quality of Public Institutions in relation to EU15=100 (2010)

Source: Table A4

Figure 7: Index of Quality of Public Institutions by Region (relative to EU 15=100)
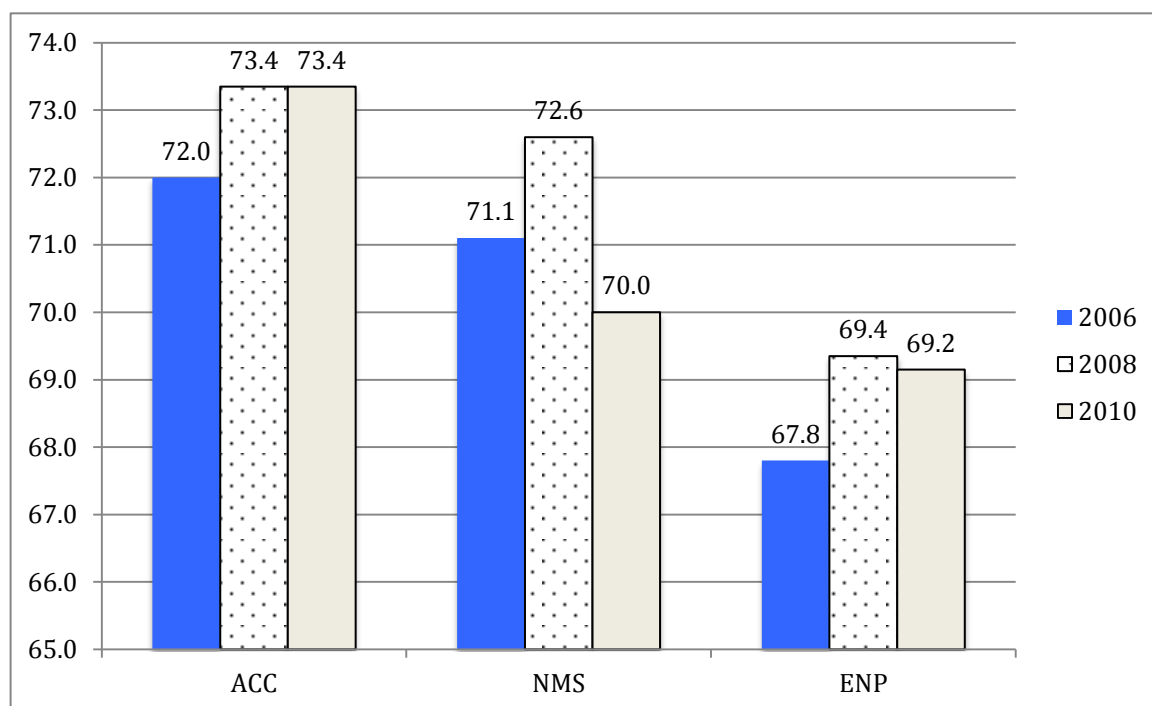
Source: See Table A3. Note: "ACC" refers to Croatia and Macedonia, "NMS" refers to Bulgaria and Romania, "ENP" refers to Moldova and Ukraine.