Different Features of Transition Economies: Institutions Matter

Jelena Trivić and Saša Petković

Abstract Process of transition is most simply defined as a process which includes moving from centrally planned to market oriented economy. There is no uniqueness about which countries are transitional ones, as their geographical, cultural, economic and overall social context disables forming of one unique sample that would fit in every analysis. The main aspects of transition process are liberalization, macroeconomic stabilization, privatization and legal and institutional reforms. Our definition of institutions assumes Douglass North's concept of institutions which defines institutions as the rules or regulations (humanly devised constraints) that structure political, economic and social interaction while institutional environment comprises institutions (formal and informal ones) and an enforcement mechanism. The quality of institutions in this chapter is measured by World Governance Indicators. The subject of this chapter is the analysis of quality of institutions and institutional environment in five Western Balkan countries and analysis of implications of institutional environment on overall standard of living and competitiveness of these countries. Our results indicate that Western Balkan countries lag significantly behind Central European countries in terms of institutional quality. The widening gap between the standard of living in Western Balkan countries and Central European countries in last 10 years indicates that the crucial problem in Western Balkan countries is the speed of reforms.

Keywords Institutions • Transition • Western Balkans • Central Europe • World Governance Indicators

1 Introduction

In the recent economic history, transition countries represent a useful laboratory to assess changes of economic systems from one type to another (Estrin, Hanousek, Kocenda, & Svejnar, 2009). According to Joseph Stiglitz (1999) the last century has been marked by two great economic experiments. The first one is the emergence of

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the Soviet Union in 1917, and the second is the moving back from centrally planned economies, in which state ownership prevailed, to a market economy where private ownership prevails. As Ramadani and Dana (2013, p. 218) state: "Transitional economies provide a particularly fascinating backdrop for the development of entrepreneurship".

There is no uniqueness about which countries are transitional ones, as their geographical, cultural, economic and overall social context disables forming of one unique sample that would fit in every analysis. Due to their size, different methods of transition and achieved results, many authors put their attention on Russia and China, especially in the first years of transition. Central European countries such as Poland, Czech Republic, Slovakia, Slovenia, Hungary as well as Baltic states, came into the focus of research while approaching and entering the EU, which also occurred in Bulgaria and Romania in 2007 and in Croatia in 2013. Bosnia and Herzegovina, Macedonia, Serbia and Montenegro are rarely found in samples of cross-country analysis of transition economies. Slovenia was the only ex-Yugoslavian country that was very often included in researches, while in case of Croatia the situation is different. Probably the most used examples of transition economies are those included in Transition Report of *European Bank for Research and Development* which in 2013 included 34 very different countries and group of countries (EBRD, 2013).[1]

As we will show, the heart of transitional process is *institutional building*. In this paper institutions are defined as "the rules of the game" according to Douglas North's and New Institutional Economics' definition.

The subject of this paper is the analysis of quality of institutions in five Western Balkan (WB) countries compared to five Central European (CE) countries that serve as a benchmark. Our *scope* is to determine how far are Western Balkan countries from the Central European countries in terms of institutional quality and in that context our scope is to determine what kind of implications it has for overall standard of living in all analyzed countries. We test the *hypothesis* that better institutions or better institutional environment is highly correlated and thus inter-related with economic development and that these two influence each other. Our results indicate that Western Balkan countries lag significantly behind Central European countries in terms of institutional quality. Institutions, as the rules by which the game on the market is played, are far from good in WB countries compared to CE countries and thus there are very huge differences in the average standards of living between these two samples. The widening gap between the standard of living in five WB countries and five CE countries in last 10 years indicates that the crucial problem in WB countries is the speed of reforms.

[1] Even if analyzed by many authors as an example of unique transitional country, progress in transition is not assessed in China by Transition Reports, as it would require individual analysis due to its size and special path of reforms.

2 Transition Process: Some Key Aspects

2.1 Defining Transition and Transition Process

Process of transition is most simply defined as a process which includes moving from centrally planned to market oriented economy. More precise definition says that transition process is the "reform process in countries that have made the decision to move from a planned socialist system to a private market economy, one in which private ownership predominates and most resources are allocated through markets" (Fischer & Gelb, 1991, p. 91). It also requires interplay of the economics and politics, i.e. reform process is reformation of the both in its essence (Murrell, 1996). Process of transition means social, economic and political transformation in ex communist countries (Petković & Berberović, 2013, p. 14).

What are the main aspects of transition process which more or less prevailed in all transition countries? According to IMF (2000) and some authors (Fischer & Gelb, 1991; Havrylyshyn & Wolf, 1999; Žarković, 2012) these are the following:

1. Liberalization
2. Macroeconomic stabilization
3. Privatization
4. Legal and institutional reforms

As Kolodko (1999, p. 2) claims: "A market economy requires not only liberal regulation and private ownership, but also adequate institutions". Similarly, Dana and Dana (2003, p. 52) claim that transition process is a function of all causal variables including culture, historical experience, and government policy.

2.2 Shock Therapy vs. Gradualism

There are in general two opposed strategies of transition from socialism to capitalism: a "big bang" or shock therapy approach and gradualist approach (Roland, 2002, p. 29).

Advocates of the big bang approach argued for fast macroeconomic stabilization, price liberalization and dismantling institution of old communist system, the process that Svejnar (2002) called reforms of "Type I". The essence of this kind of reforms was to adopt programs as fast as possible. In countries of the Central Europe where reforms started in 1990, transition process was mostly of "big bang" type (Roland & Verdier, 1999). After these countries experienced sharp initial fall in output, economic recovery followed and they relatively quickly moved towards European Union membership. The most characteristic examples of this type of reforms are Czech Republic and Poland in Central Europe and Russia. Probably the most famous practitioner of "big bang" approach in many ex socialist countries was Jeffrey Sachs. Big bang approach in Poland, according to

Jeffrey Sachs himself, was a success story "despite huge controversy, deep fears, and great intellectual and political debates" (Sachs, 2012). Afterwards, Sachs was invited to advise Russian reforms although Sachs himself never regarded Russian reform to be shock therapy. By some authors Russia has suffered from "shock without therapy" (Roland & Verdier, 1999, p. 2). After the collapse of Russian economy in early years of transition, Sachs resigned in January 1994.

The essence of gradualist approach ("Type II" approach) was the need for precise sequencing of reforms where reforms were regarded as incremental process (Roland, 2002, p. 29). The often cited example of good performed gradualist approach was the case of China which can be regarded as a type of gradualist approach *per se*. Transition of Type II approach included enforcement of laws, institutional building and regulations that support a market oriented economy (Svejnar, 2002). After assessing the experience of transition in countries of Central and Eastern Europe, Former Soviet Union countries and China, many authors tried to explain why gradualist approach gave better results than big bang approach at least in initial stages of transition (Popov, 2007; Roland, 2000; Stiglitz, 1999; Svejnar, 2002). Although, Central European countries which based their reforms more or less on "big bang" approach found ways for economic recovery and good institutional arrangements.

2.3 When Transition Ends?

In that context, one can reasonably ask a question "When transition ends?". This question depends on "terminal point" (Svejnar, 2002). According to the World Bank (2002) this terminal point occurs when historical productivity discrepancies in old, restructured and new enterprises disappear. Regarding the achieved per capita income that signifies the end of transition, in publication of World Bank the answer is indirect. It depends "on the success of disciplining the old sector and encouraging the new one" (World Bank, 2002, p. 19). In the book "When Transition is over?" of Anett Brown from 1999, several authors also tried to answer this question. Some of the authors thought that this was unanswerable question (Lavigne, 1999) but also indirectly answered that for CEE countries transition is over when they enter the EU (Lavigne, 1999). Some other authors as Kornai (1999) pointed three very precise indicators that implied the end of transition. These are: (1) the communist party no longer has monopoly power; (2) the private sector accounts for dominant part of the GDP, (3) and the market is the dominant coordinator of economic activities. Svejnar (2002, p. 26) offered his own view on transition end, which happens when these states substitute central planning by a market and when they achieve sustainable and sufficient economic growth that allows them to interact with the advanced economies without substantive protectionism. For countries like Poland, Czech Republic, Slovakia, Hungary and Slovenia, in 1999 Kornai predicted transition to be over when they enter EU. At least for these countries it seems that transition is completed, although there are some EU

countries such as Croatia, Bulgaria and Romania where transition is far from over. In countries that started transition few years after 1990s such as other Balkan countries, the process is also still ongoing and the question is still open, although transition process is not at the heart of economic debate as it was in 1990s.

3 Institutions and Institutional Quality as a Cornerstone of Transition Process

3.1 Defining Institutions

Discussion about gradualism and shock therapy leads to the discussion on how important is the role of *institutions* for the transition, as one of its element. The most used definition of institutions assumes Douglass North's concept of institutions. According to North (1990, p. 3) institutions are the rules, regulations (humanly devised constraints) that structure political, economic and social interaction; they consist of both: formal rules (constitution, laws, property rights) and informal constraints (sanctions, taboos, customs, tradition and codes of conducts). The purpose of the rules and conventions is to define the rules by which the game is played, monitored and enforced. Organization or individuals are entities which devise and implement these institutions. Institutional environment in that sense comprises institutions (formal and informal ones) and an enforcement mechanism (Tešić, 2010, p. 103).

Similarly, using the definition within New Institutional Economics (NIE), World Bank (1998, p. 11) defines institutions as formal and informal rules and their enforcement mechanisms that shape the behavior of individuals and organizations in the society.

"Deeper" determinants of economic growth, beside physical and human capital accumulation and technological change, also include institutions (Rodrik, Subramanian, & Trebbi, 2002, p. 2). Many other authors, based primarily on the North's definition of institutions, explored their role in economic performances and proved positive relationship between institutional development and growth (Acemoglu, Johnson, & Robinson, 2004; Acemoglu & Robinson, 2010; Dollar & Kraay, 2003; Eicher & Leukert, 2009; Hall & Jones, 1998; Knack & Keefer, 2005; La Porta, de Silanes, Schleifer, & Vishny, 1998).

While exploring the role of institutions in economic development, Hall and Jones (1998, p. 2) coined a new term—*social infrastructure*, which includes institutions and government policies that determine economic environment within which individuals accumulate skills, and firms accumulate capital and produce output.

3.2 Institutions in Transition Economies: Some Theoretical Issues

Economists of NIE were not at the heart of debate in the early years of transition. Murrell (2003) explored usage of NIE postulates in the process of transition, and concluded that the main reason why institutions were not regarded as crucial factor of transition was the assumption that development of institutional framework was slow and could not contribute to transition process in the short-run. But after some time, more and more authors started to analyze institution building in transition economies and to relate the quality of institution with the progress in reforms (Campos, 2000; Efendic, Pugh, & Adnett, 2010; Fischer & Sahay, 2004; Kolodko, 1999; Murrell, 2003; Popov, 2007; Roland, 2002; Svejnar, 2002).

Kolodko (1999) blames Washington consensus for neglecting the significance of institutional building in transition economies. Aware of the fact that institutions change very slowly, he finds that they have very strong influence on economic performance. According to him, institutional framework is the most important element of the long-run growth, and "unlike certain liberalization measures, institution building by its nature must be a gradual process" (Kolodko, 1999, p. 225).

Arguing that International Financial Institutions (IFIs) were well conscious of the need for institutional development in transition economies, Fischer and Sahay (2004) tried to prove that IFIs made many efforts in helping to build institutions. Beside debate of the role of IFIs in transition economies, they have also admitted the crucial role of institutions for the transition process.

One of the main conclusions of the authors who explored the role of institutions in transition economies is that institutions do change over time (Campos, 2000). Analyses of transition economies proved on experiment that institutions are not a static factor of economic growth and development, and that there is an ample room for policy choices in attempt to create good institutional framework (Kolodko, 2002; Murrell, 2003).[2]

3.3 Measuring Institutions and Data Sources

But, what constitutes these "rules of the game", i.e. institutions?

Maybe the best way to answer the previous question is to see how we can measure institutions across countries; by which data and variables. There are several data sources and indicators used in empirical work as measures of institutions:

[2] Douglas North, the Nobel laureate who defined institutions and institutional change, referred to the role of institutions and their importance for transition economies in his annual lecture for UNU/WIDER (North, 1997).

1. *World Governance Indicators*, developed by Kaufmann et al. (2010) and supported by the World Bank, composed of six variables: voice and accountability, political stability, government effectiveness, regulatory quality, rule of law and control of corruption. Governance Indicators are used by Beck and Laeven (2005), Murrell (2003);
2. *International Country Risk Guide* developed by the Political Risk Service in 1980 which monitors political, economic and financial risk. Some of the variables include measures of institutional quality such as Government Repudiation of Contracts, Risk of Expropriation, Corruption, Law and Order, and Bureaucratic Quality. These are used for example by Knack and Keefer (1995), Campos (2000), Hall and Jones (1998), La Porta et al. (1998);
3. *Index of Economic Freedom* developed by the Heritage Foundation;
4. *Economic Freedom of the World* developed by the Fraser Institute;
5. *Corruption Perception Index* developed by the Transparency International.

For measuring institutional change in transition economies, authors usually use EBRD's Transition Reform indicators which measure structural and institutional reform compared to the developed market economies (Efendic et al., 2010). According to them, Transition Indicators are the best proxies of institutional change in these economies, as transition in its essence is a process of transformation from centrally planned towards market oriented economies, while Campos (2000), the World Bank (1994, 1998) and Streeten (1996) put emphasize on *governance* as a proxy of overall institutional quality in the analysis of institutional quality.

4 Quality of Institutions in Western Balkan Countries Compared to Central European Countries

4.1 Unit and Methods of Analysis

The sample includes two different groups of countries: five Western Balkan countries—*Albania*, *Bosnia and Herzegovina*, *Croatia*, *Macedonia and Serbia*, and five countries of CEE—*Czech Republic*, *Hungary*, *Poland and Slovakia* plus *Slovenia*. We choose two samples of culturally and geographically close countries which all belong to European continent and all aspire to become members of EU or they already are. Thus they share or will share the same systems, attitudes and values. In the first sample, transition is far from over, while in the second it could be regarded as finished. Regardless the fact that Croatia became a member of EU, we put it with Western Balkans as the membership happened very recently. For CEE as Kornai (1999) suggested, transition ended by entering EU a decade ago.

Institutions are measured by World Governance Indicators Database (2014) which indicates quality of *Governance* in certain country. Kaufman, Kraay, and Mastruzzi (2010, p. 4) define *Governance* as traditions and institutions by which authority in a country is exercised which includes the process by which

governments are selected, monitored and replaced, the capacity of the government to effectively formulate and implement sound policies and the respect of citizens and the state for the institutions that govern economic and social interactions among them. Each variable of six indicators goes from −2.5 to 2.5 where lower value indicates lower result.

The goal of the research is to determine what Western Balkans can learn from the experience of CEE countries, and how far they are from CEE countries in the sense of institutional building. Moreover, we will determine the nature and strength of relationship between quality of institutions and economic development measured by GDP per capita in PPP[3] by method of correlation in both samples of countries. Quality of institutions will also be put in relation with competitiveness of countries measured by the Global Competitiveness Index.

4.2 Results and Discussion

Figure 1 shows averaged movement of the first element of institutional framework *Voice and Accountability (VACC)* which "captures perceptions of the extent to which a country's citizens are able to participate in selecting their government, as well as freedom of expression, freedom of association, and a free media" (World Governance Indicators, 2014).[4]

It is obvious that WB countries lag extremely behind CEE countries but the closing of averages through time is evident. The difference in 1996 was around 1.6 points in absolute value while in 2012 it was around 0.8, which is twice less.

Figure 2 shows averaged movement of the second element of institutional framework *Political Stability (PS)* which "measures perceptions of the likelihood that the government will be destabilized or overthrown by unconstitutional or violent means, including politically-motivated violence and terrorism" (World Governance Indicators, 2014).

As for the previous parameter, the difference is substantive but again, with closing tendency. The difference in 1996 was around 1.55 and in 2012 it was 1.1.

Figure 3 shows averaged movement of the third element of institutional framework *Government Effectiveness (GE)* which "captures perceptions of the quality of public services, the quality of the civil service and the degree of its independence from political pressures, the quality of policy formulation and implementation, and the credibility of the government's commitment to such policies" (World Governance Indicators, 2014).

The tendency of closing the averages of WB to CEE countries is again evident but substantive space in quality of government effectiveness still exists. The difference in 1996 was 0.95 points in absolute value while in 2012 it was 0.45.

[3] PPP stands for Purchasing Power Parity.

[4] All tables with data for following figures can be found in Appendices (Tables 1, 2, 3, 4, 5, 6, and 7).

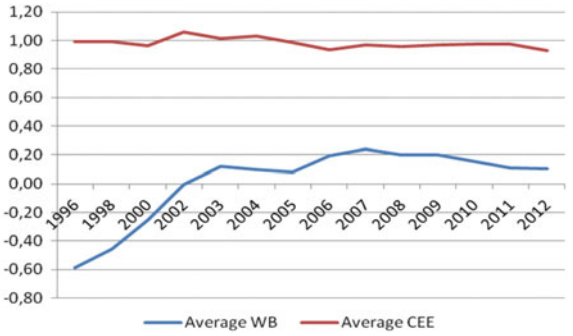

Fig. 1 Comparison of voice and accountability between averages in WB and CEE countries (source: World Governance Indicators Database, 2014)

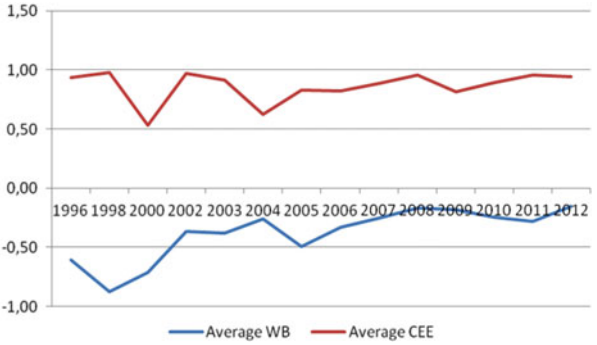

Fig. 2 Comparison of political stability between averages in WB and CEE countries (source: World Governance Indicators Database, 2014)

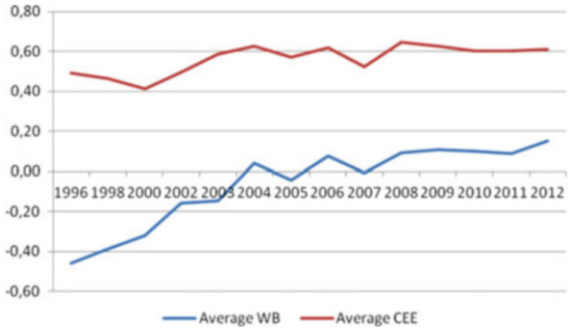

Fig. 3 Comparison of government effectiveness between averages in WB and CEE countries (source: World Governance Indicators Database, 2014)

Figure 4 shows averaged movement of the fourth element of institutional framework *Regulatory Quality (RQ)* which "captures perceptions of the ability of the government to formulate and implement sound policies and regulations that permit and promote private sector development" (World Governance Indicators, 2014).

The difference of Regulatory Quality in average in WB countries is far away from CEE countries in average, and the difference in 2012 was 0.75 in absolute value.

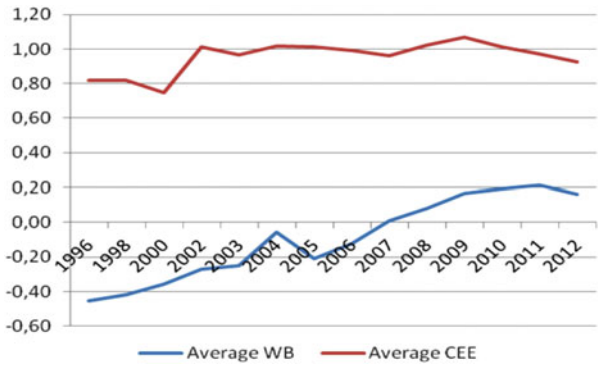

Fig. 4 Comparison of regulatory quality between averages in WB and CEE countries (source: World Governance Indicators Database, 2014)

Figure 5 shows averaged movement of the fifth element of institutional framework *Rule of Law (ROL)* which "captures perceptions of the extent to which agents have confidence in and abide by the rules of society, and in particular the quality of contract enforcement, property rights, the police, and the courts, as well as the likelihood of crime and violence" (World Governance Indicators, 2014).

Maybe the most important variable of institutional quality *Rule of Law* shows the signs of improvement in WB but the difference still remains. In absolute value it was 1 point in 2012 which is relatively 20 % less on the scale from −2.5 to 2.5.

Figure 6 shows averaged movement of the last element of institutional framework *Control of Corruption (COC)* which "reflects perceptions of the extent to which public power is exercised for private gain, including both petty and grand forms of corruption, as well as capture of the state by elites and private interests" (World Governance Indicators, 2014).

Corruption is regarded as the most important informal institution especially in transition countries (Bevan & Estrin, 2004).

Finally, in Fig. 7 we show average of all six indicators of institutional quality measured by World Governance Indicators from 1996 to 2012 for WB countries and for CEE countries in average.

In average, WB countries lag significantly behind CEE countries. It is also evident that they are approaching but the difference is still clear amounting 0.8 points on the scale from −2.5 to 2.5.

Having in mind these differences between WB and CEE countries, considering institutional quality in these countries, we are also interested in evaluating the relationship between institutional quality and economic development in all ten countries of our interest. The rationale behind this is to evaluate importance of institutions for *standard of living* of the citizens in the countries of interest. Correlation between quality of institutions estimated by average of six World Governance Indicators and Economic Development measured by GDP per capita in PPP in international dollars is shown in Diagram 1. Variables of institutional quality include average in 3 years period from 2010 to 2012 while GDP/pc is average in 3 years with 1 year in advance (from 2011 to 2013) in each country. The rationale for this is the assumption that institutions will have the impact on economic development in subsequent time.

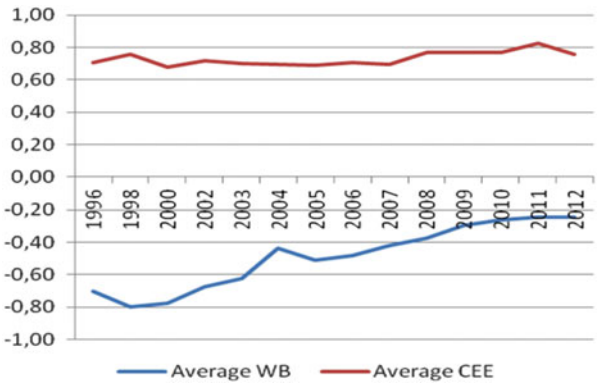

Fig. 5 Comparison of rule of law between averages in WB and CEE countries (source: World Governance Indicators Database, 2014)

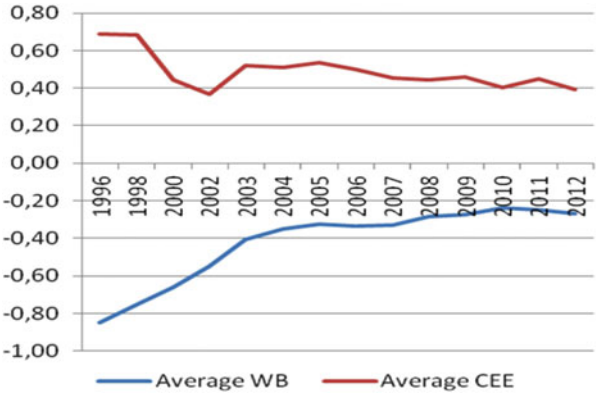

Fig. 6 Comparison of control of corruption between averages in WB and CEE countries (source: World Governance Indicators Database, 2014)

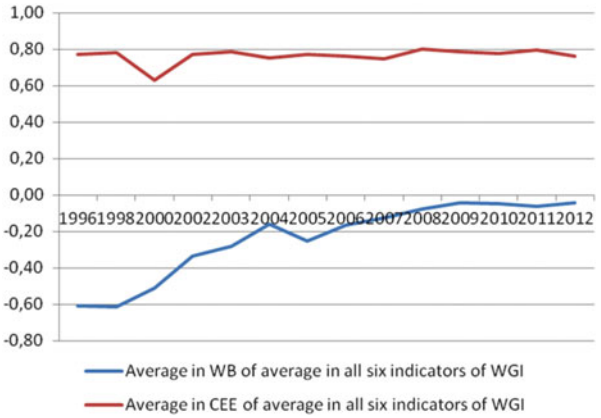

Fig. 7 Comparison of average of six indicators of governance between averages (source: World Governance Indicators Database, 2014)

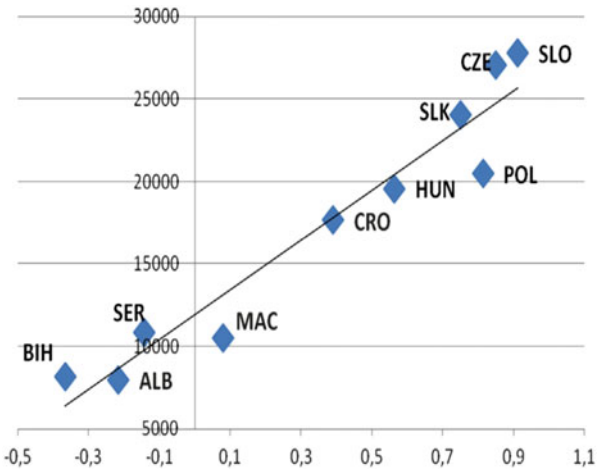

Diagram 1 Relation between institutional quality and GDP/pc in PPP (source: World Governance Indicators Database, 2014; IMF World Economic Outlook, 2014)

Correlation coefficient of 0.96 shows strong and positive relationship between these two variables in last 3 years. We used average from last 3 years in order to avoid some extremes that could happen in 1 year for both indicators. The results shown in this diagram are expected as institutional quality and economic development are interrelated and influence each other. It is logical to expect that more developed countries will have better institutional quality, and vice versa, but the strength of relationship is astonishing. For correlation of 0.96 we can say that it shows very strong correlation which means that these two variables move together almost perfectly in each country.

An interesting analysis using the same method of correlation can be done for the relationship between institutional quality measured in the same way as for previous diagram and competitiveness level of these countries which is estimated each year in the Global Competitiveness Report. Data for Global Competitiveness Index which show competitiveness level of certain country range from 1 to 7 with higher value indicating better result. For institutions we use 3-year averages from 2010 to 2012 and for competitiveness level averages from 2011 to 2013, for each country.

As in the previous diagram, the correlation is positive and strong. Correlation coefficient is 0.89 indicating a strong positive correlation although not as strong as between institutions and economic development. The results shown in Diagram 2 are expected as institutional quality and competitiveness level are also interrelated but the strength of relationship is again astonishing.[5]

We saw that institutions are highly correlated with GDP/pc in all ten countries. This means that countries with better institutions can easily provide better life for their citizens.

The main problem for WB is shown in the next Diagram. Even if *average* of institutional quality in WB are closing to *average* in CEE in last 10 years, the gap

[5] Data for Diagram 1 and Diagram 2 are in Appendices in Table 8.

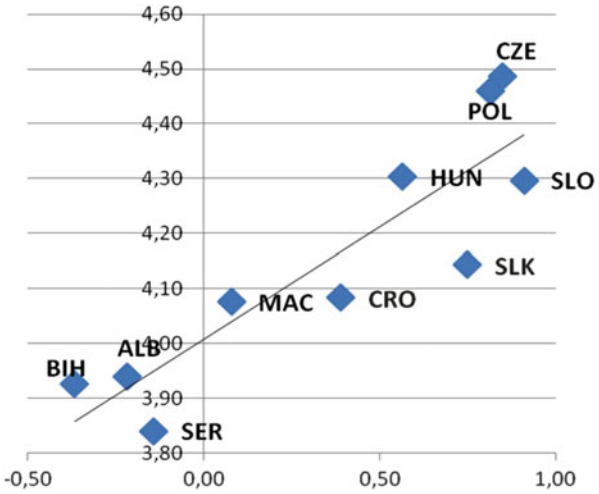

Diagram 2 Relation between institutional quality and competitiveness level (source: World Governance Indicators Database, 2014; The Global Competitiveness Index Data Platform, 2014)

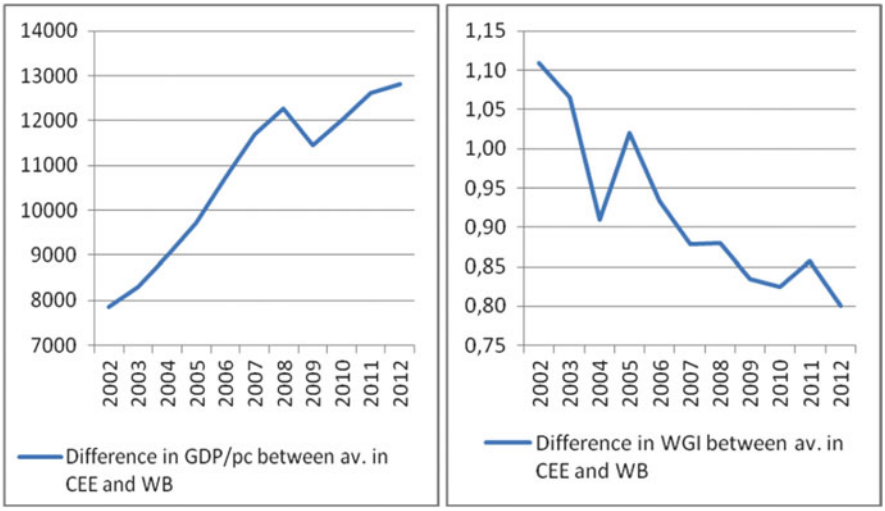

Diagram 3 Widening absolute difference in GDP/pc (*left side*) and shrinking absolute difference in WGI (*right side*) between averages in WB and CEE (source: IMF World Economic Outlook Database, 2014; World Governance Indicators Database, 2014)

between *average* GDP/pc in CEE countries and *average* GDP/pc in WB countries is widening in the last 10 years.[6]

What Diagram 3 indicates is that for WB the speed of reforms is a crucial problem. Since they have not caught the "transition train" in time, it seems that WB

[6] Data for Diagram 3 are in Appendices in Table 9.

countries are now indeed “stuck in the transition”. The progress they are maybe making is not enough to catch even the countries of New Europe regarding the standard of living in these countries. Too much time has been wasted, and the world now is changing much faster than it was 25 years ago.

5 Conclusions and Implications

Defining and examining the basic characteristics and achievements of reform process in transition countries is indeed a difficult task. Not only because there is no uniqueness about which countries are in transition, but also because the transition process began nearly 25 years ago in most of the countries, and it is still unclear when it will end.

Theoretical background especially stresses the importance of institutional building in transition economies. All transition countries are doomed to gradualist approach as the essence of every reform is building of good institutions. The pure reform of the market without building of institutional environment is meaningless. This was a fundamental error that many transition countries made. Adequate institutional environment provides a framework in which companies, individuals and organizations can operate freely and in which transaction costs are kept to a minimum.

The aim of this study was to examine the position of the Western Balkan countries in the transition process. We compared the quality of institutions measured by six indicators of governance in five Western Balkan countries with five countries of Central Europe which served as a benchmark. Our comparative analysis showed that Western Balkan countries in average still significantly lag behind Central European countries in terms of institutional quality and governance. In that sense, they have a lot work to do in reforms of institutions and the primary task is to improve the rule of law as one of the most important institution of the market system.

It was shown that there is a strong and positive correlation in all ten countries between economic development and institutions and between competitiveness and institutions. This indicates that institutions, defined as the rules of the game, create essential framework for economic growth and development of any nation. Even Tomaš (2013, p. 116) is right when says that today there is more democracy and more market economy than ever before particularly in Bosnia and Herzegovina, we conclude for all five Western Balkan countries in our sample, that progress in transition is far from complete and plenty of job had been left undone, especially in Bosnia and Herzegovina due to its complicated political structure.

Future research might consider the following questions: (1) What can WB countries gain from their European perspective? (2) What is the importance of institutions for overall business infrastructure? and finally (3) Which institutions are crucial for SMEs sector and entrepreneurial development?

Appendices

Table 1 Voice and accountability

Country/territory	1996	1998	2000	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Albania	−0.76	−0.45	−0.32	−0.04	0.06	0.03	0.03	0.05	0.09	0.16	0.13	0.11	0.07	0.01
BiH	−0.18	−0.13	−0.25	−0.20	0.14	0.12	0.18	0.16	0.10	−0.03	−0.04	−0.13	−0.22	−0.14
Croatia	−0.16	−0.34	0.47	0.51	0.58	0.64	0.43	0.44	0.48	0.43	0.44	0.43	0.46	0.48
Macedonia, FYR	−0.50	−0.32	−0.43	−0.22	−0.04	−0.14	−0.08	0.13	0.25	0.18	0.15	0.09	−0.01	0.00
Serbia	−1.32	−1.03	−0.73	−0.05	−0.14	−0.17	−0.17	0.18	0.28	0.25	0.32	0.27	0.25	0.17
Average WB	−0.58	−0.46	−0.25	0.00	0.12	0.10	0.08	0.19	0.24	0.20	0.20	0.16	0.11	0.10
Czech Republic	1.00	0.91	0.68	0.98	0.97	0.95	0.88	0.93	0.96	1.00	1.02	1.00	0.99	0.93
Hungary	1.01	1.08	1.16	1.16	1.13	1.14	1.16	1.02	1.04	0.96	0.90	0.90	0.82	0.72
Poland	1.01	1.06	1.06	1.07	0.97	1.00	0.90	0.76	0.84	0.92	1.01	1.03	1.03	1.06
Slovak Republic	0.63	0.68	0.81	0.97	0.92	0.96	0.92	0.92	0.93	0.91	0.86	0.89	0.97	0.96
Slovenia	1.32	1.22	1.10	1.12	1.08	1.09	1.07	1.07	1.06	1.01	1.05	1.04	1.05	0.98
Average CEE	0.99	0.99	0.96	1.06	1.01	1.03	0.99	0.94	0.97	0.96	0.97	0.97	0.97	0.93

Source: World Governance Indicators Database (2014) and calculation of authors

Table 2 Political stability

Country/territory	1996	1998	2000	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Albania	−0.43	−0.66	−0.65	−0.39	−0.33	−0.45	−0.49	−0.49	−0.20	−0.03	−0.05	−0.19	−0.29	−0.16
BiH	−0.64	−0.63	−0.59	−0.25	−0.44	−0.03	−0.47	−0.42	−0.60	−0.51	−0.65	−0.70	−0.84	−0.54
Croatia	−0.18	−0.04	0.15	0.53	0.52	0.64	0.43	0.54	0.59	0.55	0.59	0.58	0.60	0.58
Macedonia, FYR	−0.63	−0.88	−0.78	−1.12	−1.03	−0.90	−1.18	−0.74	−0.43	−0.30	−0.29	−0.49	−0.58	−0.44
Serbia	−1.15	−2.19	−1.70	−0.60	−0.61	−0.56	−0.77	−0.56	−0.61	−0.56	−0.49	−0.44	−0.30	−0.22
Average WB	−0.60	−0.88	−0.71	−0.37	−0.38	−0.26	−0.50	−0.33	−0.25	−0.17	−0.18	−0.25	−0.28	−0.16
Czech Republic	1.04	0.81	0.26	0.95	0.85	0.63	0.91	1.01	0.98	1.01	0.88	0.96	1.10	1.04
Hungary	0.91	1.12	0.82	1.18	1.11	0.81	0.98	0.96	0.72	0.72	0.52	0.67	0.74	0.67
Poland	0.72	0.74	0.22	0.65	0.54	0.11	0.34	0.33	0.64	0.86	0.90	0.99	1.06	1.03
Slovak Republic	0.81	1.08	0.57	0.85	0.91	0.54	0.85	0.76	1.01	1.07	0.88	1.02	0.96	1.06
Slovenia	1.21	1.13	0.79	1.21	1.15	1.03	1.05	1.06	1.07	1.12	0.90	0.83	0.94	0.92
Average CEE	0.94	0.98	0.53	0.97	0.91	0.62	0.83	0.82	0.89	0.96	0.82	0.89	0.96	0.94

Source: World Governance Indicators Database (2014) and calculation of authors

Table 3 Government effectiveness

Country/territory	1996	1998	2000	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Albania	−0.80	−0.69	−0.83	−0.57	−0.61	−0.44	−0.63	−0.46	−0.38	−0.35	−0.24	−0.27	−0.20	−0.28
BiH	−1.26	−1.08	−0.86	−0.97	−0.77	−0.57	−0.72	−0.60	−0.81	−0.59	−0.70	−0.73	−0.76	−0.47
Croatia	0.07	0.06	0.31	0.34	0.38	0.47	0.48	0.56	0.47	0.57	0.61	0.63	0.56	0.70
Macedonia, FYR	0.62	0.62	0.62	0.97	0.89	0.91	0.97	1.08	0.90	1.01	0.89	0.91	0.93	0.92
Serbia	−0.92	−0.85	−0.85	−0.55	−0.62	−0.17	−0.31	−0.20	−0.22	−0.19	−0.04	−0.05	−0.10	−0.11
Average WB	**−0.46**	**−0.39**	**−0.32**	**−0.16**	**−0.15**	**0.04**	**−0.04**	**0.08**	**−0.01**	**0.09**	**0.11**	**0.10**	**0.09**	**0.15**
Czech Republic	0.84	0.94	0.96	1.02	0.96	0.90	0.80	0.88	0.72	0.71	0.68	0.67	0.68	0.62
Hungary	−0.62	−0.62	−0.78	−0.50	−0.33	−0.13	−0.28	−0.10	−0.20	−0.02	−0.09	−0.15	−0.11	−0.07
Poland	0.78	0.67	0.60	0.49	0.55	0.49	0.48	0.42	0.40	0.48	0.52	0.64	0.62	0.66
Slovak Republic	0.57	0.54	0.57	0.57	0.68	0.91	0.94	0.92	0.74	0.87	0.86	0.83	0.83	0.83
Slovenia	0.89	0.79	0.73	0.90	1.07	0.97	0.92	0.98	0.94	1.19	1.16	1.03	0.99	1.02
Average CEE	**0.49**	**0.46**	**0.41**	**0.50**	**0.59**	**0.63**	**0.57**	**0.62**	**0.52**	**0.65**	**0.63**	**0.60**	**0.60**	**0.61**

Source: World Governance Indicators Database (2014) and calculation of authors

Table 4 Regulatory quality

Country/territory	1996	1998	2000	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Albania	−0.42	−0.19	−0.26	−0.25	−0.47	−0.16	−0.30	−0.09	0.07	0.15	0.25	0.23	0.24	0.17
BiH	−0.70	−0.82	−0.48	−0.56	−0.48	−0.19	−0.49	−0.42	−0.26	−0.16	−0.10	−0.10	−0.04	−0.06
Croatia	−0.16	−0.10	−0.04	0.30	0.48	0.54	0.49	0.38	0.46	0.49	0.55	0.55	0.52	0.44
Macedonia, FYR	−0.25	−0.14	−0.12	−0.20	−0.19	−0.04	−0.19	−0.02	0.12	0.22	0.26	0.28	0.33	0.35
Serbia	−0.74	−0.85	−0.89	−0.65	−0.60	−0.44	−0.55	−0.45	−0.34	−0.29	−0.12	−0.02	0.03	−0.08
Average WB	**−0.45**	**−0.42**	**−0.36**	**−0.27**	**−0.25**	**−0.06**	**−0.21**	**−0.12**	**0.01**	**0.08**	**0.17**	**0.19**	**0.22**	**0.16**
Czech Republic	1.02	0.92	0.73	1.19	1.18	1.08	1.12	1.11	1.03	1.16	1.33	1.30	1.21	1.06
Hungary	0.88	1.01	1.07	1.31	1.12	1.18	1.11	1.21	1.19	1.19	1.08	1.02	1.03	0.97
Poland	0.65	0.68	0.73	0.75	0.72	0.81	0.81	0.71	0.77	0.82	0.95	0.99	0.94	0.96
Slovak Republic	0.52	0.44	0.54	0.94	0.96	1.16	1.18	1.14	1.03	1.12	1.06	1.00	1.00	1.03
Slovenia	1.03	1.05	0.66	0.86	0.87	0.86	0.83	0.78	0.80	0.83	0.91	0.75	0.68	0.61
Average VG	**0.82**	**0.82**	**0.75**	**1.01**	**0.97**	**1.02**	**1.01**	**0.99**	**0.96**	**1.02**	**1.07**	**1.01**	**0.97**	**0.93**

Source: World Governance Indicators Database (2014) and calculation of authors

Table 5 Rule of law

Country/territory	1996	1998	2000	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Albania	−0.93	−1.20	−1.24	−0.92	−0.88	−0.76	−0.81	−0.73	−0.70	−0.64	−0.53	−0.44	−0.49	−0.57
BiH	−0.26	−0.64	−0.64	−0.67	−0.69	−0.49	−0.56	−0.50	−0.48	−0.41	−0.36	−0.37	−0.35	−0.23
Croatia	−0.61	−0.34	0.01	−0.17	−0.05	0.05	0.09	−0.05	0.04	0.08	0.14	0.17	0.18	0.21
Macedonia, FYR	−0.41	−0.48	−0.66	−0.63	−0.56	−0.25	−0.37	−0.56	−0.46	−0.37	−0.27	−0.29	−0.26	−0.24
Serbia	−1.28	−1.33	−1.34	−0.97	−0.94	−0.74	−0.91	−0.56	−0.50	−0.53	−0.44	−0.40	−0.32	−0.39
Average WB	**−0.70**	**−0.80**	**−0.78**	**−0.67**	**−0.62**	**−0.44**	**−0.51**	**−0.48**	**−0.42**	**−0.37**	**−0.29**	**−0.26**	**−0.25**	**−0.24**
Czech Republic	0.84	0.84	0.60	0.83	0.84	0.74	0.82	0.84	0.86	0.89	0.94	0.93	1.02	1.01
Hungary	0.83	0.79	0.85	0.93	0.89	0.89	0.83	0.96	0.92	0.89	0.76	0.75	0.74	0.60
Poland	0.67	0.76	0.65	0.63	0.51	0.40	0.42	0.35	0.37	0.51	0.60	0.66	0.75	0.74
Slovak Republic	0.15	0.18	0.29	0.24	0.33	0.50	0.52	0.52	0.45	0.57	0.50	0.53	0.57	0.46
Slovenia	1.05	1.22	1.01	0.96	0.95	0.92	0.86	0.87	0.88	0.98	1.06	0.98	1.04	0.98
Average VG	**0.71**	**0.76**	**0.68**	**0.72**	**0.70**	**0.69**	**0.69**	**0.71**	**0.70**	**0.77**	**0.77**	**0.77**	**0.83**	**0.76**

Source: World Governance Indicators Database (2014) and calculation of authors

Table 6 Control of corruption

Country/territory	1996	1998	2000	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Albania	−1.09	−1.01	−0.82	−0.86	−0.77	−0.67	−0.75	−0.81	−0.66	−0.55	−0.49	−0.49	−0.65	−0.72
BiH	−0.35	−0.28	−0.49	−0.35	−0.30	−0.31	−0.20	−0.29	−0.38	−0.36	−0.37	−0.32	−0.31	−0.30
Croatia	−0.82	−0.72	−0.21	0.25	0.16	0.20	0.14	0.09	0.08	−0.04	−0.10	−0.03	0.01	−0.04
Macedonia, FYR	−0.96	−0.67	−0.66	−0.88	−0.66	−0.49	−0.44	−0.37	−0.35	−0.17	−0.10	−0.06	−0.04	0.02
Serbia	−1.03	−1.08	−1.12	−0.91	−0.47	−0.48	−0.38	−0.28	−0.35	−0.30	−0.31	−0.29	−0.25	−0.31
Average WB	**−0.85**	**−0.75**	**−0.66**	**−0.55**	**−0.41**	**−0.35**	**−0.33**	**−0.33**	**−0.33**	**−0.28**	**−0.28**	**−0.24**	**−0.25**	**−0.27**
Czech Republic	0.65	0.55	0.08	0.36	0.44	0.38	0.46	0.30	0.23	0.27	0.33	0.26	0.30	0.23
Hungary	0.58	0.65	0.69	0.52	0.60	0.65	0.62	0.61	0.56	0.38	0.34	0.25	0.32	0.28
Poland	0.54	0.67	0.55	0.33	0.38	0.11	0.22	0.17	0.19	0.35	0.37	0.41	0.49	0.59
Slovak Republic	0.36	0.25	0.15	−0.10	0.31	0.39	0.49	0.40	0.30	0.30	0.23	0.24	0.24	0.07
Slovenia	1.32	1.30	0.77	0.72	0.86	1.02	0.89	1.02	0.98	0.91	1.02	0.85	0.90	0.81
Average VG	**0.69**	**0.68**	**0.45**	**0.37**	**0.52**	**0.51**	**0.54**	**0.50**	**0.45**	**0.44**	**0.46**	**0.40**	**0.45**	**0.39**

Source: World Governance Indicators Database (2014) and calculation of authors

Table 7 Average of six indicators of institutional quality

Country/territory	1996	1998	2000	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
VACC	−0.58	−0.46	−0.25	0.00	0.12	0.10	0.08	0.19	0.24	0.20	0.20	0.16	0.11	0.10
PS	−0.60	−0.88	−0.71	−0.37	−0.38	−0.26	−0.50	−0.33	−0.25	−0.17	−0.18	−0.25	−0.28	−0.16
GE	−0.46	−0.39	−0.32	−0.16	−0.15	0.04	−0.04	0.08	−0.01	0.09	0.11	0.10	0.09	0.15
RQ	−0.45	−0.42	−0.36	−0.27	−0.25	−0.06	−0.21	−0.12	0.01	0.08	0.17	0.19	0.22	0.16
ROL	−0.70	−0.80	−0.78	−0.67	−0.62	−0.44	−0.51	−0.48	−0.42	−0.37	−0.29	−0.26	−0.25	−0.24
COC	−0.85	−0.75	−0.66	−0.55	−0.41	−0.35	−0.33	−0.33	−0.33	−0.28	−0.28	−0.24	−0.25	−0.27
Average all 6 averages—WB	**−0.61**	**−0.62**	**−0.51**	**−0.34**	**−0.28**	**−0.16**	**−0.25**	**−0.17**	**−0.13**	**−0.08**	**−0.05**	**−0.05**	**−0.06**	**−0.04**
VACC	0.99	0.99	0.96	1.06	1.01	1.03	0.99	0.94	0.97	0.96	0.97	0.97	0.97	0.93
PS	0.94	0.98	0.53	0.97	0.91	0.62	0.83	0.82	0.89	0.96	0.82	0.89	0.96	0.94
GE	0.49	0.46	0.41	0.50	0.59	0.63	0.57	0.62	0.52	0.65	0.63	0.60	0.60	0.61
RQ	0.82	0.82	0.75	1.01	0.97	1.02	1.01	0.99	0.96	1.02	1.07	1.01	0.97	0.93
ROL	0.71	0.76	0.68	0.72	0.70	0.69	0.69	0.71	0.70	0.77	0.77	0.77	0.83	0.76
COC	0.69	0.68	0.45	0.37	0.52	0.51	0.54	0.50	0.45	0.44	0.46	0.40	0.45	0.39
Average all 6 averages—CEE	**0.77**	**0.78**	**0.63**	**0.77**	**0.78**	**0.75**	**0.77**	**0.76**	**0.75**	**0.80**	**0.78**	**0.78**	**0.80**	**0.76**

Source: World Governance Indicators Database (2014) and calculation of authors

Table 8 Three years average of institutional quality, GDP/pc and competitiveness level in the Western Balkans and Central European Economies

Country/ territory	Overall institutional quality (average 2010, 2011, 2012)	GDP/pc PPP international dollars (average 2011, 2012, 2013)	Competitiveness level (average 2011, 2012, 2013)
Albania	−0.218	7,991.315	3.940
BiH	−0.366	8,150.586	3.927
Croatia	0.391	17,678.714	4.083
Macedonia, FYR	0.079	10,539.068	4.077
Serbia	−0.142	10,843.902	3.840
Czech Republic	0.849	27,043.467	4.487
Hungary	0.563	19,575.442	4.303
Poland	0.813	20,507.835	4.460
Slovak Republic	0.750	24,037.894	4.143
Slovenia	0.911	27,800.035	4.297

Source: World Governance Indicators Database (2014); IMF World Economic Outlook Database (2014); The Global Competitiveness Index Data Platform and calculation of authors

Table 9 Absolute difference in GDP/pc and absolute difference in WGI between averages in Western Balkans and Central European Economies

Country/territory	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Albania	4,444	4,768	4,993	5,376	5,833	6,312	6,876	7,131	7,454	7,774	7,997
Bosnia and Herzegovina	4,924	5,175	5,571	6,044	6,601	7,196	7,757	7,602	7,764	8,031	8,127
Croatia	12,421	13,350	14,188	15,254	16,506	17,818	18,553	17,417	17,270	17,665	17,618
FYR Macedonia	6,328	6,622	7,050	7,600	8,211	8,926	9,539	9,505	9,877	10,336	10,465
Serbia	6,474	6,786	7,598	8,315	8,911	9,679	10,288	10,044	10,309	10,725	10,722
Average GDP pc WB	**6,918**	**7,340**	**7,880**	**8,518**	**9,212**	**9,986**	**10,603**	**10,340**	**10,535**	**10,906**	**10,986**
Average all six WGI indicators—WB	**−0.34**	**−0.28**	**−0.16**	**−0.25**	**−0.17**	**−0.13**	**−0.08**	**−0.05**	**−0.05**	**−0.06**	**−0.04**
Czech Republic	17,047	18,049	19,476	21,180	23,294	25,195	26,243	25,045	25,877	26,916	27,000
Hungary	13,616	14,469	15,740	16,967	18,208	18,732	19,309	18,166	18,660	19,394	19,497
Poland	11,072	11,737	12,698	13,568	14,863	16,306	17,481	17,893	18,796	19,843	20,562
Slovak Republic	12,694	13,553	14,642	16,060	17,903	20,298	21,867	20,895	22,024	23,308	24,142
Slovenia	19,449	20,409	21,843	23,434	25,494	27,894	29,403	26,979	27,452	28,145	27,837
Average GDP pc CEE	**14,776**	**15,643**	**16,880**	**18,242**	**19,952**	**21,685**	**22,861**	**21,796**	**22,562**	**23,521**	**23,808**
Average all six WGI indicators—CEE	**0.77**	**0.78**	**0.75**	**0.77**	**0.76**	**0.75**	**0.80**	**0.78**	**0.78**	**0.80**	**0.76**
Difference in WGI between av. in CEE and WB	*1.11*	*1.06*	*0.91*	*1.02*	*0.93*	*0.88*	*0.88*	*0.83*	*0.83*	*0.86*	*0.80*
Difference in GDP/pc between av. in CEE and WB	*7,857*	*8,303*	*9,000*	*9,724*	*10,740*	*11,699*	*12,258*	*11,456*	*12,027*	*12,615*	*12,822*

Source: World Governance Indicators Database (2014); IMF World Economic Outlook Database (2014)

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