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Institutional Convergence of CIS Towards European Benchmarks

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Abbreviations

Country	Country Code
Czech Republic	CZE
Hungary	HUN
Poland	POL
Slovakia	SVK
Slovenia	SVN
Estonia	EST
Latvia	LVA
Lithuania	LTU
Bulgaria	BGR
Croatia	HRV
Romania	ROU
Turkey	TUR
Albania	ALB
Bosnia and Herzegovina	BIH
Macedonia	MKD
Serbia	SRB
Armenia	ARM
Azerbaijan	AZE
Belarus	BLR
Georgia	GEO
Kazakhstan	KAZ
Kyrgyzstan	KGZ
Moldova	MDA
Russia	RUS
Tajikistan	TJK
Turkmenistan	TKM
Ukraine	UKR
Uzbekistan	UZB

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Abstract

The empirical analysis of the determinants of institutional development in transition countries as well as the qualitative country studies summarized in this publication allow for *some* optimism concerning a potential impact of the EU on institution building and governance quality in CIS countries. Regression analysis reveals a positive impact of EU cooperation agreements below a membership perspective. Alternatively to the EU, entry into the NATO accession process also exerts incentives for better institutions which are often overlooked. In contrast, WTO membership is not found to have any impact on institution building in CIS countries. While there is room for some EU-related optimism given the results from the regression analysis it depends on the country-specific ENP action plans and programs whether or not ENP cooperation actually leads to Europeanization or institutional convergence towards EU standards in the CIS. The case studies on the effectiveness of Neighborhood Europeanization through ENP in Ukraine, Georgia, and Azerbaijan reveal that current EU policies towards these countries can be, at best, seen as a catalyst but not as a main driver of institutional convergence. A perspective for a stake in the internal market is on the long horizon for Ukraine only. ENP mechanisms for conflict resolution in Georgia and Azerbaijan have been rather weak before the recent clash in Abkhazia and South Ossetia. The top-down institutional convergence, i.e. an EU-first strategy, worked well for Enlargement Europeanization but implemented in the ENP it significantly reduces the leverage of the EU to create a ring of well-governed neighbour states.

Preface

This report summarizes the analysis of institutional development in CIS countries and its convergence towards EU standards.[1] Building EU-style institutions is a precondition for entry into the EU. The process of EU enlargement is tightly bound to the concept of convergence, as membership in the EU requires fulfillment of a series of political, legal, and economic criteria. Candidate countries must demonstrate political stability as a guarantee for a democratic and lawful order, including maintaining human rights standards and ensuring the protection of minorities (political criteria). Furthermore, the potential members must fully implement the "*Acquis Communautaire*" (the entire body of EU law) into national legislation, and adopt the goals of the political, economic and monetary union (legal criteria). Finally, the candidates must have a fully functioning market economy with the ability to maintain competitiveness in the internal market (economic criteria). Increasingly, institutional development is not only extremely important for potential accession candidates but for any country that has any "association" relationship with the EU.

Beyond any EU accession or association perspective, emerging market economies will also benefit directly from institutional development. Empirical studies clearly show that institutions are an important explanatory variable for differences in economic performance. Some authors (e.g. Rodrik 2000; Acemoglu, Johnson, and Robinson 2001; Rodrik, Subramanian, and Trebbi 2002) even suggest that institutional weaknesses are the *only* fundamental reason for development failures, i.e. that long-run differences in income levels are solely determined by differences in institutional quality.

In the interim report (Deliverable 24')[2], we have provided a quite comprehensive overview on theoretical foundations of institutional change and developed an extended database including alternative indicators and potential determinants. Drawing on this work documented in the interim report, Section A starts with a categorization of established institutional indicators according to the EU's Copen-

[1] The authors thank the participants of the ENEPO workshops, which were organized by CASE in Kyiv and Warsaw, for helpful comments on an earlier draft. We would like to thank Marek Dabrowski, Maryla Maliszewska, Anna Maciążek, Akelyeva Irina, Gleb Shymanovich, and Michaela Rank for comments and excellent editorial support.

[2] See http://www.case.com.pl/dyn/plik--15324587.pdf

hagen criteria. Based on four indicators – the World Bank Governance Indicators, Index of Economic Freedom, EBRD index, and Polity IV – a stylized picture is developed showing institutional development in CIS countries as compared to other transition countries, i.e. new member states of the EU, Balkan countries, and groups of CIS countries.

Since the interim report we completed the quantitative part of our work with an econometric study on determinants of institutional change in transition countries (Section B). This study uses the World Bank Governance Indicators (WBGI), in our view the most comprehensive measure of institutional development. The study fills a gap in the literature because it explicitly models different types of potential external drivers while other studies concentrate on internal (political, economic, cultural) drivers in the first place (Di Tommaso, Raiser, and Weeks 2007; Beck and Laevan 2006). We distinguish between institutional influences, trade and capital flows, and proximity measures. Among the institutional influences we distinguish between different depth of integration with the EU but we also consider a potential impact of NATO and WTO agreement. We found that both basic EU cooperation agreements as well as the start of the membership process had a positive influence on institutional development. In addition, economic liberalization policies also improved governance in transition countries which support optimism about breaking path-dependency due to political tensions and cultural settings. Most importantly for our work, it provides the working hypothesis for our country studies that below-membership incentives from the EU may matter as well as economic reform policies which point to a potential role of the business sector as an important actor for institutional change in transition countries.

In the qualitative part (Section C), we provide country analysis of institutional and economic developments in the European Neighborhood Policy (ENP) countries Azerbaijan, Georgia, and Ukraine. We have chosen these countries as they represent the most enthusiastic (Georgia, Ukraine) and more reluctant (Azerbaijan) participants of the ENP. In such a way, we take into account varying political preconditions for Europeanization through the ENP. In Section C, we provide a very short summary of our analytical framework and the results of the qualitative studies. The qualitative studies analyze the individual relationship between the EU and each of these states, which is not only influenced by the ENP itself, but also by the previous forms of cooperation like PCAs and lilateral issues related, for example to economic cooperation or national conflicts. We introduce Section C by providing some comparative statistics, again drawing on the work documented in the interim report.

A. Introduction – Institutional Development in CIS Countries

Transition of former socialist countries into market economies was a phenomenon which inspired rethinking the role of institutions in reform programs. While the so-called Washington Consensus concentrated on structural adjustment and stabilization, the 1990s brought an increasing economic literature on the impact of institutions on economic development (Acemoglu and Robinson 2006; Rodrik 2006; Schweickert and Thiele 2004). The search for empirical evidence inspired international and private institutions to create indicators in order to measure institutional development.

Hence, the emergence of indicators that are able to sufficiently observe institutional change within an economic framework has only recently been addressed. Even though a large number of economic indicators such as GDP, trade shares, financial flows, as well as indicators on political stability were available, measures that relate to the overall concept of institutional development were with few exceptions inexistent for a long time.

In the mid 1990s, international financial institutions have developed the concept of governance and evaluated the quality of government and the soundness of economic policy in transition economies. Therefore, they created qualitative and quantitative indicators to assess the quality of governance and tried to identify the causality chains behind growth, institutional quality and government performance in order to improve policy recommendations, lending scenarios and to be able to track the transition process. Indicators of institutional quality are subject of interest by scholars, policy-makers and financial analysts alike. In contrast to the risk indicators, which were used previously, governance indicators try to catch certain "soft" aspects that contribute to growth as e.g. ethical values.

The focus in this paper will be on the indicators that evaluate the quality of institutions within the transition process. Until the late 1990s, the only individual indicators on some separate governance elements have existed (for more information on governance indicators see Appendix 1 and Appendix 2 in the interim report[3]). *Polity IV Index* constructed by the *Center for International Development and Conflict Management* gives information on regime and authority characteris-

[3] http://www.case.com.pl/dyn/plik--15324587.pdf.

tics for all independent states. *Bertelsmann Foundation* identifies the status of democratization and market liberalization and created *Transformation Index*. *Transparency International* measures *corruption*. *Freedom House* monitors *civil and political rights, democratic governance, rule of law and freedom of media* around the world. *The Heritage Foundation* identifies institutions that determine the degree of *economic freedom*. *Costs of doing business created by the World Bank* supplies the information about complexity of entrepreneurship and the institutional environment in a single country. The *EBRD* identifies the level of liberalization in the economic terms with such indicators as *price liberalization, foreign exchange and trade liberalization and small scale privatization*; as well as institutional development providing *enterprise reform and governance indicator, banking reform index and non-banking financial sector reform indicator*. Therefore, it was impossible to deliver a general view on governance and institutional development.

Starting in 1996, the World Bank came up with aggregate indicators which cover institutional development rather comprehensively (Kaufmann et al. 2005). These indicators report on six dimensions of governance which referring to Schweickert (2004) can be matched into three groups:

Legislative Institutions:

- Political Stability and Absence of Violence;
- Voice and Accountability.

Executive Institutions:

- Government Effectiveness;
- Quality of Regulations.

Judicial Institutions:

- Rule of Law;
- Control of Corruption.

The World Bank Governance Indicators (WBGI) are, in our view, the most appropriate indicators to analyze the governance in a broad perspective and its consequences for economic development by introducing appropriate incentive structures, reducing uncertainty and promoting efficiency among participants of an economy, and, finally, providing policy rules to enforce the institutional setting.

However, critics argue that the current indicators have technical and conceptual deficits, as they provide only poor measures of key governance processes (Cout et al. 2002; Arndt and Oman, 2006; Knack, 2006; Kurtz and Shrank, 2006) and the data often face little objectiveness, as it is based on expert opinion or polls. The provided data also lack credibility as ratings tend to reflect the political or ideological agenda of organizations providing the ratings - good economic outcomes tend to receive high ratings. Another general critique is expressed concerning the weighting of indices. Ahrens (2002:38) states that often indirect measures (proxies) of institutions are used. For example, political instability is measured by coups or assassinations. Corruption measures often focus on the coordination of private interests, rather than on a combination of private and public interests. Different organizations measure corruption based on different questionnaires and there is no consistent concept that underlies the definition of corruption.

Despite these shortcomings of quantification, we had to rely on some measure of institutional quality in CIS countries. We choose to take the WBGI in the first place because, thinking about a potential impact of EU integration and neighborhood strategies or the convergence of CIS countries towards (Western) European standards, this set of indicators covers most of what constitutes the Copenhagen criteria: human rights, participation, rule-of-law, and effectiveness of government and control of corruption (Schweickert 2004). Nevertheless, we considered other indicators as well.

Referring to the Copenhagen criteria we divided indicators into three groups: political, economic and legal. First, we analyzed which of the individual indicators are included in or excluded in the WBGI. Special attention was on the economic criteria, as they involve not only economic institutional requirements, basically - administrative institutions, but criteria on a functioning of the market economy as well. Hence, we separated economic indicators on macroeconomic stability and liberalization from administrative indicators on governance (Table 1).

Based on the overview provided by Table 1 we base our descriptive analysis on four indicators which cover institutions quite comprehensively:

- World Bank Governance Indicators (WBGIall);
- Polity IV;
- Heritage Index of Economic Freedom (Herall);
- EBRD Institutional Indicator (EBRDinst).

As argued above, the WBGIall provides the broadest picture of institutional quality and an international comparable yardstick. The other three indicators may be seen as providing a kind of robustness check for the WBGI because they view institutions from a specific perspective. We use the Polity IV indicator in order to check whether a strictly political indicator provides a different picture. The EBRDinst and the Herall indicator are biased towards an economic view. While the EBRDinst indicator provides a European measure, the Herall indicator – like the WBGI – allows for international comparisons and is strongly biased towards a “western” or neo-liberal economic perspective. We think that this choice allows us to map institutional development in CIS countries fairly well.

In Table 2, these indicators have been standardized and aggregated for CIS countries, for our sample countries Ukraine, Russia, Georgia, and Azerbaijan as well as for our benchmark countries EU-Baltic and EU-NMS (New Member States: Romania and Bulgaria). As was to be expected, the Baltic countries outperform the NMS and CIS countries. One could clearly find in Table 2 that the WBGIall indicator provides an aggregate picture of institutional development since the country groupings remain fairly the same if one compares the WBGIall with the standardized aggregate.

There are, however, significant differences between the aggregate and the single indicators. These differences could be interpreted by the different perspective taken by the four indicators. E.g. the differences are generally more pronounced in the case of the Polity IV indicator. However, the differences in rankings could only be interpreted when integrating the determinants of institutional development which may be reflected differently in the four indicators on institutions.

Generally, it is fairly well established that countries with higher levels of income also show better institutions. Kaufmann (2004) evaluates “governance deficit” as the “distance” between a country’s actual governance level and the level required to support and sustain its income per capita level. Different to other theories, we adopt a European benchmark and we calculate the “income fragility” (Figure 1). The level of governance which insures sustainable income is one that a country is expected to place on the fitted trend line for its level of income. Figure 1 plots the strong positive correlation between real GDP per capita adjusted for differences in purchasing power and the governance, accounted as a simple average of the WBGI for the EU-27 member states in 2006.

An estimate of the income fragility for a country is derived by the vertical distance between the actual income estimate for one of CIS countries and the “best fit” estimate according to the governance level with respect to the trend line, drawn for correlation between income and governance in the EU.

While Ukraine and Azerbaijan are close to governance levels that are expected according to the income level, Russia and Turkmenistan show large governance deficits about the equivalent of three standard deviations in governance quality. For these countries with significant income fragility, it can be suggested that their income level may be particularly fragile in the medium to long term, unless concerted efforts to improve governance are under way. The other extreme is represented by Georgia and Armenia where governance is of around half a standard deviation above the trend line, implying that level of governance in these countries could support higher incomes in the future. Nevertheless, this approximation serves as an illustration and does not pretend to fully account for some other country specific characteristics like oil and gas endowments, as in case of Tajikistan and Uzbekistan.

At the same time, the trend line, calculated on the basis of data for the EU-27, actually represents an appropriate average for CIS countries as well. However, the variance around this average is much more pronounced around CIS compared to EU countries. This is consistent with the assumption that determinants other then the level of income are particularly relevant for CIS countries. It is of special interest in this context to consider external and internal determinants in an appropriate way. This was done by applying panel estimation techniques.

B. External vs. Internal Drivers of Institutional Change in Transition Countries

1. Introduction

The concept of Europeanization, i.e. the adoption of EU rules by transition countries, is possibly "the most massive international rule transfer in recent history" (Schimmelfennig and Sedelmeier 2005). The Copenhagen criteria of EU accession demand the fulfillment of a series of political, legal and economic criteria known as "Copenhagen Criteria" (Foders, Piazolo and Schweickert 2002). So far, the EU has indeed been successful in promoting democracy and economic development by fostering institution building in most central and eastern European transition countries (Roland 2006).

However, after Eastern Enlargement has been completed with the recent accession of Bulgaria and Romania in 2007, the "carrot" of membership for pushing institutional development in transition countries is currently reserved for the Western Balkan states exclusively. For CIS as well as for Mediterranean countries, ENP foresees support from the EU dependent on performance according to governance criteria. However, compared to the big "carrot" of membership ENP incentives may be too limited in order support internal drivers of institutional reform (Afanasyeva, Hammermann, and Schweickert 2007; Vinhas de Souza et al. 2006).

So far, the empirical evidence on external drivers of institutional change in transtition countries is rather limited. Recent papers mainly focus on internal economic, political, and cultural drivers (Di Tommaso, Raiser, and Weeks 2007; Beck and Laeven 2006) treating an EU influence rather as a control variable than as a main driver of institutional change. Hence, this paper fills an empirical gap by focusing on external influences in the first place. This implies to distinguish between EU cooperation and neighborhood instruments and the full-scale accession instruments. In addition, we consider all relevant clubs a European transition country may join and which provides positive incentives for better institutions. While papers analyzing the impact of trade relations include WTO membership (see, e.g., Busse et al. 2007), the accession to NATO as a driver for institutional change receives little attention. Our panel estimations indeed reveal that, in addition to EU agreements, NATO accession has a positive impact on institutional change in European transition countries.

2. External and Internal Drivers of Institutional Change

The case of European transition countries is clearly different from other developing and emerging market economies. Compared to developed countries, all of them show a backlog in terms of institutional development. However, the reunification of Europe after the breakdown of communist regimes has provided a strong pull effect concerning the development of good institutions. Looking at the various clubs which European transition countries may join, one could argue that EBRD, World Bank and IMF are important players providing incentives for reforms. While this is certainly true, there is no exclusive accession process which would demand institutional preconditions. Therefore, the impact of these institutions seems to be rather permanent and program specific. This is different for the EU but also for NATO and WTO (see Table 3 for the chronology of accession).

Concerning the impact of the EU on institutional change, there seems to be little doubt that membership matters. Way and Levitsky (2007) explain the institutional divide between a democratic Central and Southeastern Europe and an autocratic CIS by potential membership in the EU. Similarly, Pop-Eleches (2007) argues that post-communist democratization has been faster and less prone to reversals in the countries where for geographic, historical, cultural, and economic reasons the promise of deep integration with Western Europe was the strongest at the outset of the transition. According to Haughton (2007) the EU's 'transformative power' is strongest when deciding to open accession negotiations. The EU's influence is also shown to be stronger in some areas, especially in economic aspects necessary to establish the single market, while it is clearly weaker in other areas like minority protection. Schimmelfennig (2007) argues that only the credible conditional promise of membership has had the potential to produce compliance with liberal-democratic norms in norm violating transformation countries. According to case studies on Latvia, Slovakia and Turkey, EU democratic conditionality is shown to work through a strategy of "reinforcement by reward" through intergovernmental bargaining. These arguments are confirmed by Beck and Leaven (2006) who show that a dummy variable for EU membership provides an additional positive effect on institutional change in European transition countries as measured by the WBGI. However, the cross country approach adopted by this paper only allows to include control variables like EU membership one-by-one which creates serious problems of misspecification.

In contrast, only a few studies analyze the impact of the EU on institutional change by means of agreements below a membership perspective. Positive effects of links to the EU may be reached via a variety of channels: promotion of democratic attitudes among citizens, political incentives for elites (in government and in the opposition), domestic power balance shifts in favor of democratic politicians, and promotion of better democratic governance through incentives for public administration reform (Pop-Eleches 2007). Hence, democracy is promoted by a combination of political conditionality with significant political and economic incentives. Di Tommaso, Raiser, and Weeks (2007) confirm the positive impact of basic agreements between the EU and transition countries which are open to all transition countries. While this would allow for some optimism regarding weak incentives provided by the ENP, the paper uses indicators from the EBRD for measuring institutional change in terms of economic institutions only. Apart from the fact, that the EBRD itself is an actor in the transition process and, hence, may provide biased views on success and failure, the Europeanization strategy of the EU is not restricted to a narrow concept of economic institutions but targets political and legal institutions as well. Hence, the robustness of the result is to be checked by estimating the impact of basic EU agreements on a broad concept of institutional development as measured by the WBGI and by considering the impact of a membership perspective at the same time.

While this process of EU enlargement figured prominently in the transition literature, NATO membership and enlargement is almost omitted. A few studies discussed NATO impact in terms of economic aspects of regional security (see, e.g., Sandler and Hartley 1999; Andrei and Teodorescu 2005) and democracy promotion (see, e.g. Barany 2004; Boonstra 2007; Epstein 2005). Interestingly, the NATO also has developed a concept for enlargement. As a procedure for nations wishing to join NATO, a mechanism called Membership Action Plan (MAP) was approved in NATO's Washington Summit in 1999. A country's participation in MAP entails the annual presentation of reports concerning its progress on five different measures. Four measures on organization, resources, safeguards, and compatibility – like the acquis in the case of the EU - rather look at the potential of (military) cooperation between the accession country and NATO. The first and possibly the most important measure demands the willingness to settle international, ethnic or external territorial disputes by peaceful means and to commit to the rule of law and human rights, and democratic control of the armed forces. Hence, NATO accession requires a kind of minimum institutional standards. The "carrot" in this case being regional security rather than economic cooperation. Hence, it could be argued that NATO accession could have a positive effect which might be comparable to the impact of EU accession (see, e.g., Schimmelfennig 2007 and Pop-Eleches 2007).

In addition to EU and NATO, the WTO also provides major incentives for institution building. Beyond its direct impact on import liberalization and macroeconomic policies, WTO membership helps to reduce incentives for corruption by providing countries with powerful institutional checks and balances in the international economic sphere. To become the WTO member, the set of institutions and policies should be implemented. Consequently, these WTO-conforming institutions and policies contribute to the openness of the economy, enhance the transparency and promote the rule of law (Bacchetta and Drabek 2004). The institutional quality is even affected long before the actual accession to the WTO in the process of the preparation and separate negotiations between countries. However, as reported in Busse et al. (2007) empirical papers largely fail to show a significant impact once trade flows are controlled for.

In addition to membership in international institutions, proximity (to the West) can be assumed to matter in various dimensions (Way and Levitsky 2007; Vinhas de Souza et al. 2006).

- Proximity to the West in terms of cultural norms could be assumed to provide a significant path-dependency concerning institutional development (Di Tommasso, Raiser, and Weeks 2007; Kitschelt 2001; La Porta, Shleifer, and Vishny 1999). A society's culture adapts rather slowly to changing economic circumstances because of a high persistence of cultural norms and human belief systems. At the same time, religious affiliation, like belonging to the community based on western Christianity, can be thought of as a proxy for a complex set of initial conditions.
- Nevertheless, trade and capital flows may impact on the preconditions for institutional change by closer experience with the outside world. Concerning trade flows, Busse et al. (2007) argue that any analysis on the relative impact of trade on income and growth would suffer from a lack of relevant control variables, if important determinants of a successful trade liberalization, such as institutional quality affecting the reallocation of resources, are not included. Their results confirmed earlier work showing that more open economies tend to have better institutions (see, e.g. Wei 2002; Islam and Montenegro 2002; IMF 2005). In the CIS context, Havrylyshyn (2006) claims that openness and sweeping reforms have reduced social pain in Central Europe and the Baltic states. He suggests that liberalization and openness ensure economic recovery and democratic institutions.

- Arguably, foreign direct investment (FDI) inflows may also help to promote good governance in CIS countries. However, focusing on corruption, Hellman, Jones, and Kaufmann (2002) show that foreign firms are somewhat more likely than domestic firms to pay kickbacks for public procurement contracts. Especially in countries where kickbacks are less common, foreign firms are more likely to engage in this form of corruption. In countries with a significant state capture problem, FDI firms are almost twice as likely as domestic firms to be engaged in efforts to capture the state. Hence, overall the presence of foreign firms seems to widen the gap between countries with good and countries with bad institutions.
- The allocation of aid has become more selective in recent years, and has become more responsive to economic fundamentals and the quality of a country's policy and institutional environment (Claessens, Cassimon, and von Campenhout 2007). Hence, aid should support institutional change. However, a potential problem with aid inflows is created by their direct impact on government behavior. By expanding a government's external resources, foreign aid can weaken institutions by reducing accountability. Evidence suggests that industries which are most sensitive to bad governance grow at a slower pace in countries that receive more aid (Rajan and Subramanian 2007).

All in all, proximity in terms of culture and trade is assumed to have a positive impact on institutional change while the impact of capital flows is, at least, open to concerns about potential moral hazard problems related to the inflow of financial resources. So far, an empirical analysis of all relevant external drivers of institutional change in European transition countries is still lagging.

In contrast, the analysis of internal drivers can be based on a variety of papers. The basic distinction is between economic and political aspects. The view that economic performance drives institutional development is supported by the modernization hypothesis (see, e.g., Lipset 1959; Acemoglu et al. 2007). In the same vein, the Grand Transition view sees development as a process where steady economic growth causes transition of all institutions (Paldam and Gundlach 2008). However, economic shocks and macroeconomic instability may also be important factors of political transition (Acemoglu and Robinson 2006; Paldam 2002). These shocks give rise to a window of opportunity for citizens to contest power, as the cost of fighting with ruling autocratic regimes is relatively low. When citizens reject policy changes that are easy to renege upon the window of opportunity closes, autocratic regimes must make democratic concessions to avoid costly repression (see also Brückner and Ciccone 2008). These arguments directly lead to the importance of economic policy, as opposed to economic performance, in driving institutional change. Looking at the typical sequencing of reforms suggests that economic liberalization and privatization, as well as the granting of basic political rights and liberties, preceded institutional reforms such as the establishment of a competition authority or the adoption of bank restructuring programs and stronger financial market supervision. Hence, policy can to some extent break path-dependence through economic and political liberalization (Di Tommaso, Raiser, and Weeks 2007; Havrylyshyn 2006).

A political economy explanation of why institution building has varied so much across transition countries is provided by Beck and Laeven (2006) arguing that political entrenchment and reliance on natural resources critically determined the behavior of the ruling elite and thus whether the transition process was catalytic or extractive. While this seems to support the pessimistic view that initial conditions determine future outcomes (Fish 1997; Kopstein and Reilly 2000; Guiso et al. 2006; Zweynert 2006), there is also a more optimistic view on the potential for institutional progress in rent-seeking societies which links economics and politics. Olson (2000) argues that the availability of short- term rents like non-renewable resources provides the basis for the rent-seeking strategy of "roving bandits" but that "roving bandits" could transform into "stationary bandits" after having reached the limits of their capacities to accumulate and control the wealth on the basis of informal institutions (see also Tornell 1998; Dixit, Grossman and Helpman 1997; Aslund 1995 and 1999).

Concerning the influence of resource endowment on institution building, plenty of studies suggest that the adverse effect of resource abundance on institutional quality on economic growth is particularly strong for easily accessible 'point-source' natural resources with concentrated production and revenues and thus massive rents, i.e., oil, diamonds, minerals and plantation crops rather than agriculture (e.g., rice, wheat and animals) where rents are more dispersed throughout the economy, and with easy appropriation of rents through state institutions (Auty, 1997, 2001; Isham, et. al., 2004; Sala-i-Martin and Subramanian 2003; Murshed, 2004; Collier and Hoeffler 2004; Ploeg 2007). Analyzing the political economy of resource-driven growth in the CIS countries, Auty (2001; 2006) finds out that most resource-abundant countries engender a political state that is factional or predatory and whose government responds slowly to economic reforms' challenges, distorts the economy in the pursuit of rents that are deployed to force industrialization and this leads to a staple trap. The negative influence is explained with rent-seeking behavior and lower pressure for political reform. Other natural resources, such as the share of agriculture in GDP, were not found to have a negative influence.

3. The Empirical Model

In line with the theoretical and empirical literature outlined above and as described in Section 2, we model the impact of external and internal drivers on institutions as measured by the WBGI. The WBGI is calculated as the average of six single indicators as provided by the World Bank[4]. We argue that this is the most comprehensive measure of institutional development which is available for international comparisons. The WBGI include indicators on voice and accountability, political stability and absence of violence, government effectiveness, regulatory quality, rule of law, and control of corruption. Hence, the aggregate indicator integrates legislative, administrative and legal aspects as well as political and economic institutions (Schweickert 2004). At the same time, the calculation of the indices considers measurement errors and provides standardized measures. By using the WBGI, we follow Beck and Laeven (2006) but we will consider a full model in terms of external and internal drivers of institutional change. In this respect, we modify and extend the framework of Di Tommaso, Raiser, and Weeks (2007). By the fact that key variables are comparable, we are able to provide a kind of robustness check with respect to different measures of the endogenous variable, i.e. institutional change.

As can be seen in Table 4, we group our explanatory variables into external drivers, internal economic drivers, and internal political drivers. This will allow us to distinguish between an economic and a political model of institutional change. According to Section 2, we consider both membership and proximity variables as external drivers. *Membership* is determined by accession to EU, NATO, and WTO. The derivation of the accession variables is shown in Table 3. We distinguish between two EU variables, i.e. an EU Accession variable reflecting the full-scale accession process and which varies from 0 (no agreement at all) to 5 (membership) and an EU Basic variable which is a dummy for all agreements which can be concluded by all sample countries, i.e. association agreements below any membership commitment on the part of the EU (see also Table 3 for details). The EU Basic variable is similar to the EU variable used by Di Tommaso, Raiser and Weeks (2007). In addition, we use an EU Potential dummy variable for all actual members or countries which have, by now, a membership perspective[5]. Concerning

[4] The data as well as details on the calculation procedure is provided by the World Bank under http://web.worldbank.org/WBSITE/EXTERNAL/WBI/EXTWBIGOVANTCOR/0,,contentMDK:21499997~pagePK:64168445~piPK:64168309~theSitePK:1740530,00.html

[5] The countries not eligible for membership are Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyz Republic, Moldova, Russia, Tajikistan, Turkmenistan, Ukraine and Uzbekistan.

NATO, the dummy variable reflects participation in a Membership Agreement Programme (MAP) assuming that this, comparable to EU Basic, provides an incentive for institutional reform in participating countries. Different from the EU and NATO, WTO membership is open to all sample countries. Hence, this dummy variable is one for all countries starting from the year when they entered WTO. Since we code the variables on a year-by-year basis, we can include them also in the presence of country fixed effects to asses the impact of changes of these variables over time. We expect that these variables should have a positive impact on institutional development.

Proximity is measured by cultural proximity, i.e. the dummy variable reflects if countries belong to the western Christianity community or not[6]. We do not consider other cultural variables because we found these to be highly correlated with our proximity variable while they do not reflect proximity to the same extent. We expect cultural proximity to have a positive impact on institutional change in European transition countries. In addition, economic relations constitute a form of proximity and are measured by FDI and aid inflows. We also test the impact of exports to non-transition countries in order to check for possible institutional spillovers through trade or to detect any evidence of learning by doing. While we would expect the trade variable to be positively related this seems less clear for the variables reflecting resource inflows which could create rent seeking effects.

Concerning *economic internal drivers*, we consider both policy and performance variables. In line with Di Tommaso, Raiser, and Weeks (2007) we measure *economic policy* in terms of aggregated EBRD *liberalization* indicator. Not very surprisingly, they found a positive impact of an aggregated EBRD indicator on institutions. We hypothesize that the EBRD liberalization indicator should reveal a comparable impact on a broader concept of institutions not constructed by the EBRD itself. With respect to *economic performance*, we took the usual suspects, i.e. *initial income* at the start of the transition process and economic growth. While we tried three year averages of growth and a recession variable for robustness checks, our main variable is accumulated *growth* during transition assuming that short run ups and downs do not impact on relatively persistent institutions. We also use *inflation* as a measure of macroeconomic stability. While initial income revealing path-dependency can be expected to have a positive impact on institu-

[6] Physical distance as in gravity models has been used in some robustness checks only, since it provided little additional explanatory power when membership effects are properly controlled for.

tions, this is less clear for growth and inflation[7]. Either growth or stability increase demand for good institutions or recession and instability push institutional reform.

As argued by Beck and Laeven (2006) the influence of *political drivers* may come from either *incentives* to create good institutions or from *opportunities* to misuse political power for extracting rents in case of resource economies. Regarding incentives, we consider that the way of gaining independence, i.e., whether there were any *tensions* during declaration of independence and in the following transition years, define the incentives to build up good institutions. We would expect that tensions reduce incentives for good governance, while the peaceful independence promotes it. Furthermore, *turnover* from communist to democratic parties can be assumed to have a positive impact on institution building in contrast to situations where the communist party or its successor party stays in power either alone or in a coalition with democratic parties. Finally, *cohesion* of political parties is assumed to have a positive influence on institutional reform. Concerning *opportunities*, we use a dummy variable measuring *endowment*. However, endowment does not necessarily reflect the exploitation of resources and the related resource flows which may create moral hazard problems. Therefore, we alternatively also include flow variables like *fuel exports* and *metal exports*. We would expect that resource measures have a negative impact on institution building.

4. Empirical Results

The empirical estimates are based on a panel of 25 transition economies and the years 1996 to 2005[8]. The empirical results based on Pooled OLS (POLS), Instrumental Variables (IV) and (country) fixed effects (FE) estimators are presented in Tables 5–7[9]. We proceed in three steps. Table 5 contains the results for the full model specification considering external as well as internal economic and internal political drivers of institutional change in transition countries. Tables 6 and 7 present partial models. First we show the results for separate economic and political

[7] Officially recorded GDP decline in transition countries has been overestimated (see Aslund 2001; Dabrowski 2002). However, we assume that the error value is the same across transition countries.
[8] Before 2002, WBGI data is only available each two years, i.e. 1996, 1998, and 2000.
[9] For details on model specification see Drautzburg T., Melnykovska I., Schweickert R. (2008).

models which in addition to external drivers (which are both of economic and political nature) contain only variables from the two blocks of economic and political drivers respectively (Table 6). Finally, we show a reduced model which only includes variables from the full model which are either significant in all IV or in all fixed effects estimates (Table 7).

Starting with the full model presented in Table 5, a first important result is that the EU variables show the expected signs and are significant in all versions of the model at least in the POLS estimates. EU Agreement clearly has a significant positive effect on institutional development across countries. As can be seen, our alternative specification of the EU impact shows that the EU Potential dummy is significant in the case of inclusion of EU Basic variable which has been tested in Di Tommaso, Raiser, and Weeks (2007). This implies that a basic relationship with the EU as shown by the significance of EU Basic variable is positive for institutional development. Hence, there is some optimism that the ENP can have an impact on governance in the neighboring countries like CIS. At the same time and as a matter of geography, proximity to the EU in terms of both distance and potential membership has an additional benefit. Our EU Accession indicator picks up both effects which confirm the specification of this variable.

The results for the remaining membership variables are strikingly different. As in other papers, a positive impact of WTO membership can not be confirmed by our regressions (see, e.g. Busse et al. 2007). To the contrary, NATO membership action plan is, with one exception, shown to be significantly positive. Arguably, the perspective of NATO membership provides to a certain extent different incentives from those offered by the EU: regional and international security. This result is of special interest because there is some discussion going on with respect to the future role of NATO and its relation to the UN and, concerning Europe, the EU (see, e.g., Varwick 2005; Sandler and Hartley 1999).

It seems important to notice the different effects of the EU and NATO variables. While the NATO variable generally fails to have a significant impact when both cross-sectional and within-country variation is taken into account, the opposite holds true for the EU Agreement variable. This might indicate that the models fail to approximate satisfactorily for country-specific effects. The NATO-effect is however more than a pure time-effect since the models control for time-fixed effects common to all countries.

The full model presented in Table 5 shows the results for FDI and aid inflows. While FDI is insignificant in all specification, our results seem to confirm a negative impact of aid found by other authors. Controlling for potential endogeneity problems, the significance of the negative impact shown in the POLS regressions disappear in the IV versions. However, there is a negative impact shown in our fixed effects versions of the model. While this effect is not robust across all estimated specifications it is plausible to assume that the level of aid flows does not have a positive impact on institutional performance as measured by the WBGI. One possible explanation for the absence of a positive impact of aid is that inflows of aid constitute an opportunity to relax fiscal control and to lower reform efforts in any country. However, since we do not include major recipients of aid flows, i.e. African countries, a far-reaching generalizations based on our sample are not warranted.

Another striking result is the significance of cultural proximity as shown by countries belonging to the group of countries sharing western Christianity as a cultural feature of their societies. This is perhaps the most robust result over all specification which we tried (see also below). Of course, this adds to path-dependency as an important feature of institutional development.

With respect to the economic variables, it is rather surprising that we do not find much significance regardless of the specification of the model or the regression method applied. There is one exception. Liberalization policies seem to matter. As was the case with aid, the IV regressions show that there may be endogeneity problems involved when regressions show significant results. Especially for economic liberalization it seems plausible to assume that a “reform shock” to institutional development might simultaneously affect liberalization policy. However, since liberalization is not very well predictable with its own lags, it might be that the different IV results are due to the additional prediction uncertainty. Focusing on the POLS and FE estimates, the results indicate that across countries as well as within countries economic liberalization leads to better governance over time. (We cannot see any systematic differences between the FE and POLS estimates).

The political variables in the full model reveal some substantial path-dependency. Looking at the incentive variables these are tensions at independence which seem to determine future institutional development negatively. There is only one case in which the turnover variable showing the involvement of democratic parties in government is weakly significant[10]. The resource variables seem to work slightly better. At least, fuel exports are shown to have a weakly significant negative effect on institution building as expected by the relevant literature on resource curse. More resources seem to be detrimental but different from aid this type of resources seems to matter more between countries than over time[11].

[10] This might, however, be caused by missing values in the turnover variable and therefore changes in the sample composition.
[11] However, this might be due to the lack of variation of resource exports within countries over time.

In Table 6, we present two sub-models because due to our limited data set and a quite substantial number of exogenous variables, significance of coefficients may suffer from a relatively low degree of freedom in the small sample. Hence, having potential misspecification in mind we have run economic and political models. The results are quite surprising. First, the results from the sub-models confirm the significance of the external impact variables, especially on EU accession and belonging to western community. Second, the economic and political blocks work strikingly better when excluding the alternative explanations. Looking at the IV versions of the regressions, all variables from the economic block are significant. The significantly positive effect of higher inflation seems to lend support to the crisis argument by Acemoglu and Robinson (2006), i.e. more instability may create a momentum for institutional reform. However, the growth variable points into the opposite direction. It shows that a better growth performance induces better governance. This would be consistent with the findings of Paldam (2002) and Paldam and Gundlach (2008). With respect to politics, the significance of tensions and cohesion point to a considerable path-dependency while turnover indicates that a higher degree of involvement of democratic parties lead to better institutions. Fuel exports show the expected negative effect which is, however, weak in the IV version. Looking at resource endowment as a dummy variable does not reveal better results for the resource impact on governance.

As has been argued above, restricting the model to either economic or political variables runs the risk of misspecification. Nevertheless, it provides a kind of overall robustness check to see that some variables remain significant when switching to the full model. In the last step, we deviated from the full model by presenting a reduced model which has only variables which worked in the full model either in its IV or in the fixed effects specification and independent of the EU variable included. This model is presented in Table 7.

The variables which have been picked from the full model are the EU variables plus NATO, aid flows, western Christianity, economic liberalization, and tensions at independence. As can be seen in Table 7, the EU variables worked as before. The NATO variable provides strikingly good results in the specification using EU Basic and EU Potential variables. This seems to reflect the fact that basic agreements with the EU and NATO both and independently of each other provide incentives for better governance while there is definitely something left to be explained for those countries which, in addition, have the chance of becoming full members of the EU. While western Christianity again provides significantly positive results through our all specification, the aid variable seem to be less robust. The same applies to tensions at independence which work well when economic liberalization is excluded but, overall, economic liberalization seems to provide a robust and positive impact on institution building which is also confirmed when checked by IV regressions.

5. Summary and Policy Conclusions

All in all, our models confirm a positive impact of the EU on institutional change in European transition countries. However, different to Di Tommaso, Raiser and Weeks (2007) and Beck and Laeven (2006), we are able to show that both membership *and* accession matters and that there is an additional and independent positive impact from NATO accession on institution building in transition countries. Other potential ***external drivers*** do not show a positive impact in our regressions while especially foreign aid may even create moral hazard problems. Differences between countries seem to matter less reflecting different absorption capacities while increases in aid flows over time have been found to impact negatively on institutional quality. In line with the majority of previous empirical studies we did not find a significant impact of WTO membership. As opposed to other papers we are not able to detect a robust impact of trade flows. Among our proximity variables, belonging to the community of western Christianity provided the most robust and positive effects.

Among potential ***internal drivers***, two determinants show the most robust impact on institutions: economic liberalization as measured by the EBRD liberalization indicator and tensions at independence. Clearly, economic reform matters not only for economic performance and for building of economic institutions as shown by Di Tommaso, Raiser and Weeks (2007) but for institutions measured on the basis of the comprehensive WBGI as well. At the same time, countries starting with unfavorable political conditions need more effort or external incentives for institution building.

Hence, there is a considerable element of ***path-dependency***. Clearly, countries belonging to the western community with respect to their cultural features, which could become EU members, and which do not suffer from political conflict at the start of the transition process have better starting conditions. In this respect, geography matters. However, there are additional variables which impact on good governance in any country in our sample: ***basic agreements with both the EU and NATO and economic liberalization matter most***.

All in all, the most important message of this paper is that even basic EU *and* NATO agreements *can* provide positive incentives for better governance. These are reasons for optimism: both institutions can have an impact below membership incentives and basic incentives are available for, at least, most European transition countries. Whether or not the ENP can build on this depends on country specific action plans. However, it is the impact of NATO agreements which is most surprising - at least at first sight - and desires further research. Beyond the EU, NATO may be able to trade (regional) security for development in a wider Europe.

C. Neighborhood Europeanization: Institutional Change under Weak Conditionality

1. Mapping Institutional Development in the CIS: Comparative Statistics

The empirical analysis in Section B revealed that internal and external drivers matter for explaining institutional change in the CIS. In our qualitative studies, we first concentrated on internal drivers by focusing on recent institutional changes in some countries of the CIS area, known as color revolutions (Melnykovska 2008). We explain the different trajectories followed by countries that launched color revolutions and those that remain authoritarian, contrasting revolutionary Ukraine with non-revolutionary Russia. We argue that both types of regime change came about for similar economic reasons, but had different implication for the political regimes, namely, that while the Orange Revolution is a discontinuous regime change, soft authoritarianism is a continuous one. Both reflect the preferences of the influential elite, i.e. business groups. The nature of political change depends upon the differences in characteristics within business groups, the availability of the oligarchic rents and the degree of implementation by which these preferences enter into Ukraine's and Russia's state politics.

For the case of Ukraine, we show that rather weak top-down incentives of the ENP have to be well targeted at supporting bottom-up drivers of institutional change in transition countries (Melnykovska and Schweickert 2008). The arguments by Havrylyshyn (2006) and Olson (2000) would imply that external influences could lead to changing preferences of domestic elites in favor of good governance. The study shows that Ukraine is a case in point. The heterogeneous group of oligarchs initially blocked reforms but changed their economic and political preferences and became driving forces behind the regime change and implementation of reforms during and after the Orange Revolution which narrowed the institutional gap between Ukraine and the EU. However, bottom-up forces after having supported a first wave of reforms urgently have difficulties to sustain their coalition. Strong business interests in good relations with the EU would provide the basis for rather weak but well-targeted ENP top-down incentives to make a difference.

The fact that the ENP has to work in a much more indirect way implies that it is necessary to identify the main internal drivers and to look at proximity to the EU. While including the main categories used in the regression analysis, Table 8 considers some additional variables as well as all four indicators on institutional development discussed in Section A. Table 8 is constructed by ranking all countries with respect to determinants of institutional change and showing the average level of institutional quality of country groups with similar characteristics according to these determinants. Hence, it is to be expected that country groups with better preconditions according to the determinants would show higher values of the standardized indicators on institutions shown in the columns on the right.

Looking at initial conditions and endowment this seems generally to be the case. Especially the performance of the countries grouped according to the value of the Polity IV indicator for 1991 (Democracy at Independence) reveal that today's institutions are determined to a large extend by path-dependency. CIS countries with bad governance back in 1991 did not improve in relative terms since then. A negative deviation from this overall picture is provided by the group of CIS countries which had the best starting conditions (Armenia, Belarus, Russia, and Ukraine).

Comparing the results for initial conditions according to human development and income (HDI, GNP) with those for political conditions, it seems to be evident that the Polity indicator and the WBGI indicator tell a somewhat different story compared to the other two indicators on institutional quality. Both Polity and WBGI sharply divide between CIS and non-CIS country groups, i.e. CIS country groups among themselves rank as is to be expected and the same is true for the EU countries but both rankings do not really fit together. At the same time, the difference in institutional quality is much more pronounced in the WBGI indicator which would be consistent with administrative and legal institutions performing much worse than political institutions. This is, however, not confirmed by the Heritage and EBRD indicators. They show a much more homogeneous picture for the ranking of all country groups. It is especially the Heritage indicator which does not point at generally lower levels of institutional quality in CIS countries. Here, especially the country groups including either Russia or Ukraine or both countries perform worse than what would be expected on the basis of initial conditions prevailing in these countries.

In the last row, net fuel exports are taken as an indicator for resource dependence. This is of course a very crude. However, oil and gas resources are usually those which are related to resource rent arguments, i.e. the assumption that the more resources a country has the more rent-seeking possibilities can be exploited which slows down the speed of institutional reform. However, the only indicator which to some extent supports this hypothesis is the Heritage indicator. This indicator shows two groups of countries. A first group consists of the EU countries and the fuel producing and exporting countries, among them Russia. A second group of countries which either import fuel from Russia for own consumption like Ukraine or which imports fuel from Russia for re-exporting like Belarus perform worse. The Heritage indicator has the worst grades for the re-exporting group which, again, lends some support for an enhanced resource rent hypothesis claiming that rents are related not only with exploitation but also with trading schemes.

A second set of indicators analyzes the explanatory power of indicators on learning by experience during the process of transition. Informal institutions matter for transition because in the absence of formal institutions they considerably shaped what resulted in a patchwork of institutional outcomes. These effects are difficult to measure and we approximated them by using the indicator on corruption (Freedom House). The graphs show the progress and the level of this indicator.

As was the case with initial conditions, the WBGI indicator seems to look at two different worlds – CIS and non-CIS – and to rank countries as expected but only within these two subgroups. The Polity indicator for institutional quality provides rather unsystematic evidence. Again, the economic indicators Herall and EBRDinst provide more plausible results. Taking, e.g., the EBRD index and excluding the Baltic countries with exceptionally good values, the graphs show an almost perfect negative correlation between corruption on the one hand and the quality of institutions on the other hand.

The last set of determinants has the picture with respect to geography and liberalization policy explaining institutional quality. Here again, a comparison of CIS and EU countries is almost impossible on the basis of the WBGI. However, the explanation of proximity to the EU either measured by the share of EU-Trade, shared borders with the EU or distance of capitals to Brussels work quite well as an explanation for institutional quality in CIS countries. This lends some support to the hypothesis that importing formal institutions mattered considerably for the CIS transition countries. An interesting result is provided in the case that institutional quality is measured by the EBRDinst index. In this case, the graphs show a perfect correlation which is not the case when institutional quality measured by the EBRDinst index is explained by liberalization – not exclusively but prominently of trade - measured by the EBRDlib index. This may be due to a bias of the EBRDinst index in favour of nearby countries. However, it also fits to the results from the other indicators which reveal that especially for one group of countries – Armenia, Georgia, the Kyrgyz Republic, and Moldova – liberalization policies did not show the expected pay offs in terms of institutional development.

As was said above, this is meant to provide a first approximation with respect to explanations for different institutional performance of CIS countries. All in all, it showed that initial conditions, endowments, learning processes, geography, and policy to some extent explain differences between country groups. At the same time, explanations are not perfect so they leave room for a country specific view and a more detailed introduction to a potential influence by the ENP.

Table 8 also contains some interesting information about institutional development and its determinants for our case studies. According to the WBGIall indicator, Ukraine and Georgia provide a similar level of institutional development which is higher than the level of institutional development in Azerbaijan and Russia. As can be inferred from Table 9, these similarities and differences are reflected by the classification of the countries with respect to the determinants of institutional development. Ukraine and Georgia are close to each other with respect to three out of four indicators in the category Geography, Trade and Policy (Volume of Trade, Borders, Distance) and found themselves in the same groups concerning three out of four indicators in the category Initial Conditions and Endowment (HDI, GNP, Fuel exports). In the same vein, Russia and Azerbaijan are in the same country groups concerning Resource Dependency and Liberalization.

The other three indicators of institutional development show a different picture concerning the relative position of the four countries. Here, Ukraine and Russia reveal a comparable level of institutions development. This is consistent with the categorization of the two countries concerning the indicator on Learning by Doing as well as on some indicators in the two other categories of determinants (Democracy at Independence, Liberalization, Borders and Distance). Hence, different indicators seem to tell slightly different stories about institutional development in CIS countries. Additionally, some explanatory variables are more consistent with the picture shown by one institutional indicator while other explanatory variables seem to fit better with institutions measured by the other institutional indicators.

This also applies to development of the indicators since the early-1990s and economic performance during transition (Figure 2):

- As a common feature all CIS countries faced a transition crisis and had to built institutions from scratch;
- Then institutional performance improved along a return of economic growth rates to normal after a deep crisis;
- Expect for Azerbaijan, the sample countries faced a standstill or setback of institutional development combined with some economic crises after initial improvement which may be labeled second wave of institution building;

- Azerbaijan did not face any kind of significant economic crisis and, recently, experiences acceleration of growth rates due to resource exploitation;
- Comparing the four indicators of institutional development, it is obvious that they reveal quite different paths of institution building in the four countries;
- Azerbaijan is again an exception with a continuous decline of the Polity IV indicator while the economic indicators and the WBGI indicator, the latter including economic aspects, improved.
- The EBRD indicator tends to reveal a rather continuous development of institutions (except for the setback in the case of Russia) which may support the argument that this indicator is biased towards what the targets of the EBRD in these countries have been;
- The WBGI show a cyclical development around a minor positive trend (if any) while the Heritage index has the cycles in different years and leads to the conclusion that institutions improved strongly over the observation period.
- Russia is the only country for which even the Heritage index does not show any improvement since the mid-1990s.

Table 10 shows the level of governance measured by the WBGI as the most comprehensive governance indicators, thereby grouping the transition countries according to their level of cooperation with the EU. The lower level of cooperation with the EU or NATO, the worse institutions are. Croatia is the only exception from this rule. It scores even better than the EU new members Romania and Bulgaria. While Ukraine overperformes in the indicator of voice and accountability, Georgia holds the leading positions on economic administrative and legal institutions. Georgia also overperforms in the indicators of government effectiveness and control of corruption. Evidently, the color revolutions have not brought the common path of institution building. The external impulse of the ENP to improve the governance quality does not work for Azerbaijan. It has the lowest level of institutions among ENP countries (even lower then Russia). Applying the 'paradox of plenty' approach, his result could be explained with the high resource rents moderating both external and domestic demand for better institutions.

All in all, this picture is consistent with some hypotheses concerning institution building in CIS countries. First, there is no evidence that major improvements of political institutions preceded the development of economic institutions. In the case of Azerbaijan, economic institutions improved although political institutions deteriorated. Second, the optimism about building up economic institutions have to be qualified due to potential biases of the EBRD indicator – due to the involvement of the bank in transition processes – and the Heritage index – due to an ideological bias honoring any development towards a market economy. Third, with some good will one may detect a positive or above trend development of institutions which is different for the two countries captured by the ENP, i.e. Ukraine and Georgia, but, recently, at least some of the indicators show a standstill or setback. Whether these developments are due to any involvement or non-involvement of the EU – as supported by the comparison of the country groups above – is not that obvious and has to be revealed by the country studies.

2. Comparative Country Studies ─ Ukraine, Georgia, and Azerbaijan

Comparing Ukraine to other ENP countries, Azerbaijan and Georgia, we developed an analytical framework distinguishing between democracy oriented Europeanization on the one side and sectoral i.e. policy oriented Europeanization on the other side. We believe that the ENP has in both areas different potentials. The main point in our analysis is that the ENP lacks strong mechanisms of conditionality – in contrast to EU enlargements processes. As weak forms of conditionality refer only to sectoral integration (e.g. access to internal market with the consequent benefiting from four freedoms of EU's single economic space), democratization incentives are far weaker.

Yet, until today, interpretations in the field of democracy promotion in the ENP are varying: "The Union seems quite satisfied with the 'soft' way in which the ENP promotes values. However, it has not been possible to reach a preference equilibrium with the ENP partners, given theirs view that the EU's promotion of values is unsatisfactory" (Barbé and Johansson-Nogués 2008, 91). Understandably, the "main accusations that the EU is biased…in this area stem from NGOs working in or with ENP partner countries" (ibid.). Naturally, we can expect that the respective non- or weak democratic states would not feel that deficit. Thus, it is necessary to regard both, the bottom-up and top-down perspective of democracy oriented Europeanization:

Top down democratization: democracy promotion directed to leadership. Because of the lack of conditionality, the most important instrument, the EU covers in the field of democracy promotion is (apart from informal or secret diplomacy, which we might not get information about), *political rhetoric* or *official diplomacy* towards ENP states, which would be expressed through declarations or demarches (Maier and Schimmelfennig 2007, reference to Smith 2001). In the context of compliance analysis, this would be called strategy of "blaming and shaming" (see for this e.g. Zangl 2001). As democratic deficits are not easy to measure in all areas, we concentrate on the most essential part of each liberal democracy: the elections.

Bottom-up democratization: democracy promotion directed to non-state civil society actors. Here, we consider three transmission channels. First, we compare the support to civil society groups, as bottom-up support to democracy is a very widespread field of multilateral and bilateral contacts and financing. Second, in our analysis we include financial support in the field of education. For this we take a closer look on the TEMPUS programme (Trans-European mobility scheme for university studies). Third, in ENP rhetoric and in several action plans, freedom of media is an essential part of supporting democracy in these states. In our case studies, we observe different developments of media space. All of the countries still face the need of further development of independent media. Regarding a well working media sector as essential for democracy, we analyze the projects directed to support media in our three countries of case studies.

In addition to democratization, the ENP includes a broad variety of ***sectoral integration areas*** in the APs with the partner states. In our analysis, we include those areas which help to understand the level of Europeanization of the regimes in Ukraine, Georgia and Azerbaijan. We focus on those elements that hint on core areas of good governance, *economic cooperation dimension* and the *Justice and Home-Affairs dimension,* in order to understand the proximity of these states to the EU. For analyzing these two policy areas we use six parameters: clarity of demands, level of rewards, level of EU’s support, forms of linkage, degree of affecting sovereignty, and local perception of demands.

Preliminary findings show that the role of ***Ukraine*** in the ENP is paradigmatic for the overall ENP. Ukraine shows the strongest will of going beyond the ENP and reaching EU membership and is therefore ambitious to fulfill ENP requirements at a high level. Furthermore, its relation to the ENP is ambivalent, as most of Ukraine elite do not accept the missing membership opportunity in the ENP.

Before 2004, the convergence of institutions towards EU standards was primary home-driven and minimal as well. This was due to disinterest of both the EU and Ukraine’s leadership. The ENP revealed the positive changes in EU priorities in the CIS, but without reform catalyst – an accession perspective – had little chances for success, unless a neighboring country began to converge towards EU standards on its own. The Orange Revolution largely driven by domestic forces marked the momentum for institutional reforms, even through not so fast and so comprehensive as expected by those who overestimated the “colorful” upheaval at the end of 2004.

Either orange or blue-and-white political groups are striving for close cooperation with the EU. However, under circumstances where the EU's membership for Ukraine is off agenda, there are a few small incentives for the divergent political groups to unite around the institutional convergence. Engaged in the power struggles, the Ukrainian leadership has little room for implementation of EU-style reforms.

Indeed, it has not been the Ukrainian leadership that drives the implementation of the AP priorities, but business groups and "EU-oriented" enclaves in the Ukrainian bureaucracy. The Ukrainian business groups, integrated into global markets, have used their influence on government politics to push the institutional convergence towards EU standards. However, this convergence takes place according to the costs-benefits calculations of the business groups and is not equally far-reaching in all spheres, but progressing in the economic sphere in particular. The convergence is also supported by the "bureaucratic enclaves" that successfully enforce reforms implementation. Remarkably, there are no opponents to the EU integration among domestic actors, but no active actions from the side of the proponents, too. This passivity is the reaction of the "vague" EU incentives and moderate or non-appropriate EU assistance.

Democracy promotion as the relatively new priority of the ENP in comparison with the PCA priorities becomes fruitful only after Ukraine begins to democratize on its own. However, the power struggle between the various branches of government and usage of the constitution-conflicting tools in these struggles hamper the effectiveness of the EU top-down mechanisms of democracy promotion. Thus, democracy promotion via the ENP seems to be more substantial in the terms of bottom-up mechanisms.

Due to the attractiveness of EU markets for the Ukrainian exporters as well as the large share of EU imports in the Ukrainian markets, the cooperation and respectively institutional convergence in the economic sphere are most successful.

In the aftermath of the enlargement, the EU becomes keen on legal harmonization to secure its external borders. Comparing to the PCA, the AP reveals a progress on legal harmonization, as far as it broadens the areas of approximation. Officially, the key priorities of JHA cooperation with the EU included the strengthening of the rule of law, and of administrative and judiciary capacity, migration and border management, money laundering, trafficking in human beings, drugs and corruption. Practically, the primary objective was to acquire the support of the EU's neighbors in minimizing risks related to different kinds of cross-border crime that threaten EU stability and security. Nevertheless, the far-reaching legal harmonization, especially in cross-border cooperation and illegal migration policies, despite of vague formulations of "common values", reflects an anticipated behaviour of the Ukrainian authorities and expectations of further incentives from the EU (similar to the facilitation of visa regime).

Yet, the EU still has the potential to carry forward and speed up the institutional change in Ukraine. The clarity on the future level and deepness of EU-Ukraine relationship would (if positive) unified the Ukrainian political elite and end the political crises. It would promote the come-back of positive attitudes to the EU among the population, currently disappointed with EU unwillingness to recognize its European aspirations and suffering from the new "curtains" of Schengen zone. Besides the EU, the convergence towards European values could be supported by intensifying Ukraine's cooperation or integration into other international organization with requirements on institution-building. Due to the growing importance of regional security, NATO becomes a significant external driver. Hence, the Ukrainian leadership is striving for the closer relationships with NATO and is ready to undertake commitments – to some part also on institutional quality - within the NATO Membership Action Plan.

In ***Georgia***, Eduard Shevardnadze took over power in 1992. Inner dispute was eased, while ethnic violence reached a peak. The outburst of ethno-political wars with the secessionist regions of Abkhazia and South Ossetia and the closing of almost all industrial facilities lead to an economic collapse of the young state. Both conflicts have remained unsolved until the resent clash between Gerogia and Russia and were hardly protected by ceasefire agreements. Georgia, meanwhile, seeked to establish a functioning and by-all recognized statehood.

By 2003, however, the situation grew unbearable. Widespread electoral fraud during the parliamentary elections in November 2003 led to what is today widely known as the so-called Rose Revolution. With the election of Mikhail Saakashvili as new President of Georgia, and parliamentary elections shortly after, Georgia experienced a change of power, and fundamental changes in domestic and foreign policies. Saakashvili's government initiated an ambitious policy of reforms, with a strong focus on bringing down corruption and facilitating democratic structures, rule of law, good governance and the introduction of a market economy. And indeed, Georgia's economy has impressively grown during the last years. The restoration of Georgia's territorial integrity, however, became top priority, and has entrapped Georgia already to several rather risky and impatient moves. Those moves, however, result also from the fact that the ongoing conflicts with Abkhazia and South Ossetia are obstacles for Georgia's ambitions to bring the country closer to EU and NATO membership.

Georgia experienced a significant reform in political, economic and social spheres since the change of regime in 2003. The first visible change was the radical police reform. Especially the corrupt traffic police which had entirely lived on discretionary charged fees disappeared from one day on the other. However, a lot yet needs to be done. Similarly to Azerbaijan, the party system remains weak, politics continue to be strongly politicized and the family or clan-oriented clan structure has practically remained. Like his predecessors President Saakashvili has taken over the role of the people's "patron" (Reisner 2006:11) while a comprehensive change of traditional perceptions and mentality within Georgia's society, though overdue, still has not been implemented. Persisting economic hardship which led to excessive migration continues to focus people on everyday survival rather than on revising positions, e.g., towards the countries minority groups.

The peaceful settlement of Georgia's internal conflicts (the Georgian-Abkhazian conflict), is the priority area in the EU-Georgian relations. Despite that until today the EU has shirked any responsibility for the ethno-political conflicts – the key problem of the entire South Caucasus region. The sole case of direct EU involvement concerns its financial support to the Joint Control Commission in South Ossetia via its European Security and Defense Policy (ESDP), which is marginal right now due to unwillingness of the parties to further cooperate with each other (Koenig 2004). Traditionally the EU regards the work on conflict prevention to be more efficient than post-conflict management. The EU has always preferred to retain a low overall profile leaving the mediation process to other external actors. A consistent strategy for the South Caucasus is missing. One reason is that the EU needs to seek constructive dialogue with Russia. This will only be possible when Russia sees the EU not as a competitor in the Black Sea region, but as a co-operative partner.

The EU's hesitative engagement in the conflict resolution processes negatively affects EU-Georgian relations. Saakashvili's Georgia repeatedly claims for stronger international engagement, and for the deployment of international peacekeeping forces in the regions of the conflict. However, their claims have remained unheard until now leading to growing frustration and increasing unwillingness to further co-operate with the EU in certain issues and to further support single EU activities in the regions of the conflict.

In comparison to the other case studies – Ukraine and Georgia – no second transition in a form of color revolution happened in ***Azerbaijan***. In terms of domestic political reforms, Azerbaijan belongs to the group of passive partners and seems to be reluctant to fulfill the EU's demands for democratization. In contrast to Ukraine and Georgia, obvious interest has advanced mostly from EU-side, rather than from the Azerbaijani government.

Instead of pushing for democratic election standards by using the means of specific sanction mechanisms, the EU seems to be more interested in stable political environment, which enables a reliable energy policy. The Ukrainian experience seems to leave a bitter aftertaste in that matter. Therefore the Azerbaijani leadership views it as the correct strategic choice to regard the energy security issue as much more important for the EU. They anticipate the EU would not mind the lack of reform steps as long as all agreements concerning energy issues are implemented (Babayev 2007). This request is encouraged because the ENP and the AP mechanisms for democracy promotion do not envisage any sanctions or incentives for (non-)compliance.

Since accepting the formal commitments for democracy and rule of law in the framework of the Council of Europe (CoE) accession in 2001 Azerbaijan has shown no noteworthy reform ambitions. Undoubtedly, the content of the reform demands is clear. The EU, the CoE and especially the OSCE/ODIHR have expressed demands for democratic elections. But because of the lack of sanctions and rewards, elite behavior will not be altered. The European Commission referred to the elections in 2005 as "*democratic litmus test*". Although these elections failed to comply with democratic standards no sanctions followed. Instead, the Action Plan and a special Memorandum concerning the most important issue (energy cooperation) have been signed. The socialization and intended "learning process" in Azerbaijan will not be achieved by a hypocritical behavior of the EU and other international actors. The general emphasis in the AP is to be interpreted remotely and can rather be seen as a product „from the EU's desire to address its own internal security problems related to cross-border crime and border management" (Occipinti 2007: 120). In comparison to Ukraine and Georgia, in case of Azerbaijan the energy policy is of the greatest importance within ENP mechanisms.

3. Summary and Policy Conclusions – Hypotheses on ENP Europeanization

ENP as a catalyst but not the main driver of Europeanization: Regarding the first results of our case studies, we assume that the role of the domestic situation is predominant for the pace and degree of Europeanization. Our three case studies show that a certain stage of willingness and domestic motivation for institutional reform in the direction of Good Governance, Democracy and Europeanization is an important pre-condition for implementing the ENP. Progress in Ukraine and Georgia concerning the ENP are first and foremost a *consequence of the home-driven dynamic for reform*, the willingness of the elites. Without the color revolutions, this progress could not have been expected. We conclude that the ENP may work as *a catalyst, but not a basic mechanism of Europeanization*. Our counter-example is Azerbaijan, which lacked domestic movement in favor of "second transitions". Here, implementation of the ENP remains half-hearted by the ruling elites and is based on cost-benefit calculations.

Internal market access as top-incentive for Ukraine only: Regarding the prospects of EU-integration, the access to EU's internal market is of most importance. For the moment it is a realistic perspective only for Ukraine and Moldova. The access to all four freedoms of the single EU economic space is even a more future dream. If we regard the internal-market-access as the most powerful incentive of the ENP today, we have to consider that currently there is a sharp segregation between ENP countries: those with realistic perspective for single market integration (Ukraine, Moldova) and those without (all other participants of the ENP). This is the most important difference with the EU enlargement process because being an accession country included a rather clear (and comparably timely) perspective of the final incentive – the membership. Furthermore, according to Europeanization theories the prospects of compliance are negative if incentives for being compliant are offered too far in future.

Weak Conflict resolution: Without analyzing the individual challenges in each of the ENP states, it is not possible to understand prospects of Europeanization in a thorough way. We identified conflict resolution as being one area with an overall influence on cooperation or non-cooperation. These are the important national conflicts, which affect both Georgia (Georgian-Abkhazian conflict) and Azerbaijan (Nagorno-Karabakh conflict with Armenia), both regarded as the so called frozen conflicts. Priorities of conflict resolution can be found in both APs, yet EU's engagement is very often regarded as of minor relevance. Concerning both countries, the EU is playing a rather minor role in conflict resolution and different forms of calculated passiveness can be observed. In Azerbaijan, we have the importance of energy relations instead. In case of Georgia the EU does not want to confront Russian interests in that region too much. This has negative influence on Europeanization, which must be taken into account in the overall evaluation of ENP cooperation framework.

Energy relations and EU' interest: As mentioned above, we cannot understand EU's strategy in the ENP correctly without regarding the obvious energy interests, which EU has in Azerbaijan and Ukraine. Azerbaijan is one target country of the EU's ambition to weaken energy dependence from Russia, whereas Ukraine is the most important transit country for Russian energy, delivered to EU. We argue that the importance of Russia in EU's energy policy affects the ENP like a huge shadow.

EU security first: A lot of scholars have been hinting on this fact already: It is a public secret, which has been proven in our case studies as well: ENP's border management component, i.e. the strategies and demands coping with better governance of the border regimes of Eastern European states, focuses, first and foremost, on EU own security interest. We still have to closer investigate the consequences of this priority for the implementation of EU's border policy demands. For sure, ENP participants are aware of this EU strategy and the relevance of their own interests.

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Tables and Figures

Table 1. Categorization of Indicators

		Copenhagen Criteria						
		POLITICAL		LEGAL		ECONOMIC		
						administrative		other economic
	World Bank Governmental Indicators	WBGIall						
		WBGI Voice and Accountability	WBGI Political Stability	WBGI Rule of Law	WBGI Control of Corruption	WBGI Government Effectiveness	WBGI Regulatory Quality	
Indicators included into the World Bank Governmental Indicators as Sources	Freedomhouse - Freedom of the World Indices	FHW Political Rights FHW Civil Liberties			FHW Corruption	FHW Governance FHW National Democratic Governance FHW Local Democratic Governance		
	Freedomhouse - Nation in Transition Indices	FHT Electoral Process FHT Civil Society FHT Independent Media						other economic data: GDP; GDP per capita, trade balance, inflation rate etc.
	Freedomhouse - Freedom of the Press Index	FH Freedom of the Press						
	Bertelsmann Transformation Indices	BTI Stateness BTI Organization of the Market and Competition BTI Stability of Democratic Institutions BTI Political and Social Integration		BTI Rule of Law BTI Private Propert		BTI Resource Efficiency BTI Consensus Building BTI International Cooperation	BTI Organization of the Market and Competition BTI Currency and Price Stability	
	European Bank of Reconstruction and Development Indices					Herall		EBRD index of price liberalisation EBRD index of forex and trade liberalisation EBRD index of competition policy
	Heritage Indices of Economic Freedom (Her)			Her Informal Markets Her Property Rights			Her Government Intervention Her Foreign Investment Her Banking Her Wages & Prices Her Trade Her Regulation	EBRDlib
Indicators not included into the World Bank Governmental Indicators as Sources	Transparency International Corruption Perception Index (CPI)			CPI				
	Cost of Doing Business Indices					Costs of Doing Business		
	Civicus	CIV Structure CIV Environment CIV Values CIV Impact						
	Polity IV Indices	Politiy IV						
	Heritage Indices of Economic Freedom	Her Fiscal Burden Her Monetary Policy						
	Bertelsmann Transformation Indices	BTI Political Transformation BTI Steering Capability				BTI Economic Transformation BTI Management-Index		
	European Bank of Reconstruction and Development Indices					EBRD index of large-scale privatisation EBRD index of small-scale privatisation EBRD index of enterprise reform EBRD index of banking sector reform EBRD index of reform of non-bank financial institutions EBRD index of infrastructure reform		EBRDins

Source: own summary.

Table 2. Institutional Quality in the CIS

Institutional Quality	**CODE**	**Institutions average**	**POLITY 2003**	**Herall 2007**	**WBGIall 2006**	**EBRDinst 2007**
high	–	–	–	–	–	–
medium high	EST	0.74	0.93	0.72	0.65	0.65
	LTU	0.75	1.00	0.72	0.64	0.64
	EU Baltic	0.74	0.93	0.72	0.65	0.65
	LVA	0.71	0.90	0.68	0.64	0.61
	BGR	0.66	0.95	0.62	0.54	0.52
medium	NMS	0.64	0.91	0.62	0.52	0.51
	ROU	0.63	0.90	0.61	0.52	0.50
	ARM	0.56	0.75	0.69	0.43	0.36
	UKR	**0.55**	**0.85**	**0.53**	**0.41**	**0.41**
	MDA	0.56	0.90	0.59	0.39	0.36
	GEO	**0.54**	**0.75**	**0.69**	**0.42**	**0.32**
	RUS	0.55	0.85	0.54	0.36	0.43
	CIS	0.48	0.66	0.54	0.35	0.37
medium low	KGZ	0.39	0.35	0.60	0.31	0.30
	KAZ	0.39	0.20	0.60	0.38	0.39
	TJK	0.35	0.35	0.57	0.28	0.18
	AZE	**0.33**	**0.15**	**0.55**	**0.33**	**0.27**
low	BLR	0.28	0.15	0.47	0.29	0.20
	UZB	0.24	0.05	0.53	0.19	0.21
	TKM	0.17	0.05	0.43	0.21	0.00

Source: World Bank, Polity Database, Heritage Foundation, EBRD.

Table 3. Chronology of EU, NATO, and WTO Accession

Group	Country	EU									WTO	NATO	
		Member	Accession negotiations end	Accession negotiations begin	Strong notice on member-ship	EA/ EAAP*/ SAA signed	weak notice on member-ship	ENPAP/ 4CS/EA agreed	PCA/ CA in force	PCA/ CA signed	GATT WTO member	Member	MAP/ Official invitation
EU Members 2004	Czech Republic	2004	2002	1998	1997	1995	1993	1991			1947	1999	1997
	Estonia	2004	2002	1998	1997	1995	1993				1999	2004	1999
	Hungary	2004	2002	1998	1997	1995	1993	1991			1973	1999	1997
	Latvia	2M4	2002	2000	1997	1995	1993				1999	2004	1999
	Lithuania	2004	2002	2000	1997	1995	1993				2001	2004	1999
	Poland	2004	2002	1998	1997	1995	1993	1991			1967	1999	1997
	Slovak Republic	2004	2002	2000	1997	1995	1993	1991			1947	2004	1999
	Slovenia	2004	2002	1998	1997	1996	1993		1993	1993	1994	2004	1999
EU Members 2007	Bulgaria	2007	2004	2000	1997	1995	1993	1993			1996	2004	1999
	Romania	2007	2004	2000	1997	1995	1993	1993			1971	2004	1999
Balkans	Albania				2003	2006***	2000		1992	1992	2000		1999
	Croatia			2005	2303	2001	2000				2000		2002
	Macedonia				2003	2001	2000		1998	1997	2003		1999
EU East Neighbors	Moldova							2005	1998	1994	2001		
	Ukraine							2005	1998	1994	2008		
Southern Caucasus	Armenia							2006	1999	1996	2003		
	Azerbaijan							2006	1999	1996			
	Georgia							2006	1999	1996	2000		
EU North East Neighbors	Russia							2003	1997	1994			
	Belarus								**	1995			
Central Asia	Kazakhstan								1999	1995			
	Kyrgyz Republic								1999	1995	1998		
	Tajikistan								***	2004			
	Turkmeni-stan								****	1998			
	Uzbekistan								1999	1999			

Notes: * European Agreements signed in 1991 with Poland, Hungary and CSFR did not involve any membership perspective and, therefore, could not be evaluated in the same way as European Agreements signed after 1993. European Agreements of 1991 were updated in 1995 with Europe Agreement Additional Protocol that includes membership perspective. — ** PCA was ratified by Belarus 04/05/1995, ratification not completed by EU. — *** PCA was ratified by Tajikistan 06/12/2005, ratification not completed by EU. — **** PCA was ratified by Turkmenistan 11/02/2004, ratification not completed by EU. — ***** SAA with Albania was signed in 2006.

Sources: EU Agreements Database (http://europa.eu/abc/history/1990-1999/index_en.htm; own summary);
WTO (http://www.wto.org/english/thewto_e/acc_e/completeacc_e.htm); NATO (www.nato.int; http://www.bits.de/frames/databasesd.htm)

Definitions:

PCA: The Partnership and Cooperation Agreement;
CA: The Cooperation Agreement;
ENPAP: The European Neighbourhood Policy Action Plan;
4CS: The Four Common Spaces;
EA: Europe Agreement;
EAAP: Europe Agreement Additional Protocol;
SAA: The Stabilization and Association Agreement;
MAP: Membership Action Plan.

'weak notice on membership': The Copenhagen Summit of 1993 for countries that became EU Members until 2007 or the Zagreb Summit of 2000 for Western Balkans.

'strong notice on membership': the Luxembourg Summit of 1997 for Central and East European countries or the Thessaloniki Summit of 2003 for Western Balkans.

Table 4. Exogenous Variables Used in the Regressions

Variable	Description	Source
Dependent Variable		
WBGI	Arithmetic average of the six WBGI sub-indices	WBGI; http://www.govindicators.org
External drivers		
Membership		
EU Accession	Time varying variable measuring the degree of association with the EU on a basis of agreements as PCA, SAA or ENP AP. Running from 0 = no agreements to 5 = membership.	EU Agreement Database
EU Basic	Dummy Variable, equals 1 for "potential members" if SAA ratified in the previous year or for other countries if PCA in force since previous year.	EU Agreement Database
EU Potential	Time-invariant dummy; equals 1 for all countries except Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyz Republic, Moldova, Russia, Tajikistan, Turkmenistan, Ukraine and Uzbekistan.	EU; http://europa.eu/abc/history/1990-1999/index_en.htm
NATO	Dummy variable equals 1 for all years following a membership action plan.	NATO; www.nato.int; Berlin Information Center for Transatlantic Security; http://www.bits.de/frames/databasesd.htm
WTO	Dummy variable equals 1 for all years following WTO or GATT accession.	WTO; http://www.wto.org/english/thewto_e/acc_e/completeacc_e.htm
Economic Relations		
FDI	Foreign Direct Investment, Net Inflows (Share of GDP), average over current and past two years.	World Bank: World Development Indicators Online
AID	Official Development Assistance and Official Aid (Share of GDP), average over current and past two years.	World Bank: World Development Indicators Online
EXPORTS	share of exports to non-transition countries, average over current and past two years in % of world exports.	Directions of Trade, IMF (2006)
Distance		
WESTERN	Dominance of protestant or catholic Christianity (=1, otherwise 0).	CIA World; https://www.cia.gov/library/publications/the-world-factbook/

Continue Table 4.

Variable	Description	Source
Internal drivers		
Economics		
Economic Policy		
LIBERALIZATION	Average of price liberalization and trade and foreign exchange liberalization, running from 1 to 4,66.	EBRD; http://www.ebrd.com/country/sector/econo/stats/tic.xls
INFLATION	Inflation, consumer prices (annual %), geometric average over current and past two years.	World Bank: World Development Indicators Online and, if missing, EBRD
Economic Performance		
INCOME	GDP per capita at PPP divided by initial GDP per capita, normal ppp.	World Bank: World Development Indicators Online
GROWTH	growth GDP, geometric average over current and past two years.	World Bank: World Development Indicators Online
Politics		
Incentives		
TENSIONS	Binary variable: conflict yes or not.	Heidelberger Institute für Internationale Konfliktforschung; http://www.hiik.de/start/index.html
TURNOVER	Dummy variable, indicates if communist party or successor party is in government, 0=comm; 0,5=comm influence; 1= non comm; na=not clear.	EIU Country Profiles; www.eiu.com
COHESION	(absolute value of largest non communist party vote) - (ex KP vote in first post-transition election).	EBRD Transition Report (1999)
Opportunities (Resources)		
ENDOWMENT	Resource reserves, dummy variable, rich=2, moderate=1, poor=0.	de Melo (2001); Auty (2006)
FUEL EXPORTS	WDI - Fuel exports (% of merchandise exports)	World Bank: World Development Indicators Online
METAL EXPORTS	WDI - Ores and metals exports (% of merchandise exports)	World Bank: World Development Indicators Online

Table 5. Aggregate Results and Comparative EU-Indicators

	IV	OLS	FE	IV	OLS	FE	IV	OLS	FE
EU Agreement	1,035*	0,617*	-0,005	0,648*	0,498***	-0,005			
	(1,75)	(1,72)	(0,02)	(1,83)	(3,02)	(0,02)			
EU Potential	-1,089	-0,405					1,789**	1,277***	
	(1,02)	(0,42)					(2,17)	(2,85)	
EU Basic							2,415***	1,223***	0,928***
							(2,98)	(3,71)	(2,87)
NATO	1,051	1,017***	1,431***	1,263*	1,024***	1,431***	3,463***	1,364***	1,410***
	(1,32)	(3,24)	(4,73)	(1,67)	(3,22)	(4,73)	(3,10)	(3,85)	(4,86)
WTO	-0,676	-0,019	0,084	-0,418	0,057	0,084	-1,360	-0,132	-0,386
	(0,98)	(0,04)	(0,24)	(0,70)	(0,14)	(0,24)	(1,34)	(0,32)	(0,90)
FDI	-0,027	0,000	-0,010	-0,040	-0,002	-0,010	-0,058	0,004	-0,003
	(0,77)	(0,03)	(0,66)	(1,20)	(0,13)	(0,66)	(1,11)	(0,30)	(0,22)
AID	-0,108	-0,201***	-0,270**	-0,163	-0,216***	-0,270**	0,035	-0,172***	-0,287***
	(0,72)	(2,86)	(2,43)	(1,33)	(3,62)	(2,43)	(0,27)	(3,03)	(3,95)
WESTERN	3,790***	3,839***		4,248***	4,015***	0,000	5,270***	3,901***	
	(3,90)	(5,13)		(5,45)	(6,36)		(5,44)	(6,24)	
LIBERALIZATION	1,291	1,376***	1,188**	1,285	1,322***	1,188**	-0,544	0,934***	0,734**
	(1,28)	(3,48)	(2,18)	(1,41)	(3,27)	(2,18)	(0,39)	(2,90)	(2,07)
GROWTH	0,226	-0,106	0,264	-0,677	-0,397	0,264	-1,445	0,067	0,347
	(0,21)	(0,14)	(0,14)	(0,83)	(0,69)	(0,14)	(1,23)	(0,10)	(0,22)
INCOME	0,000	0,000		0,000	0,000	0,000	-0,000	-0,000	
	(0,49)	(0,18)		(0,19)	(0,08)		(0,15)	(0,15)	
INFLATION	0,020	0,026	-0,098	-0,006	0,013	-0,098	-0,282	-0,095	-0,062
	(0,08)	(0,15)	(0,75)	(0,02)	(0,07)	(0,75)	(0,89)	(0,47)	(0,37)
TENSIONS	-1,522***	-1,617***		-1,685***	-1,655***	0,000	-2,317***	-1,867***	
	(4,37)	(6,65)		(5,48)	(6,94)		(4,93)	(6,49)	
RIGHTS	0,046	-0,006		0,067	0,007	0,000	0,133	-0,056	
	(0,22)	(0,04)		(0,37)	(0,04)		(0,66)	(0,36)	
TURNOVER	0,383	0,482	0,105	0,469	0,527*	0,105	0,400	0,526	1,078
	(1,02)	(1,55)	(0,21)	(1,47)	(1,80)	(0,21)	(0,83)	(1,58)	(1,39)
COHESION	0,552	0,544*		0,565	0,542	0,000	0,651	0,590	
	(1,56)	(1,68)		(1,63)	(1,66)		(1,24)	(1,63)	
FUEL EXPORTS	-0,012*	-0,016**	-0,019	-0,007	-0,014**	-0,019	-0,012	-0,021***	-0,004
	(1,71)	(2,57)	(1,01)	(0,98)	(2,40)	(1,01)	(0,90)	(3,43)	(0,19)
METAL EXPORTS	-0,045	-0,051**	-0,009	-0,048	-0,050**	-0,009	-0,043	-0,057**	0,037
	(1,10)	(2,09)	(0,24)	(1,25)	(2,04)	(0,24)	(0,81)	(1,99)	(0,80)
R-squared	0,97	0,97	0,62	0,97	0,97	0,62	0,93	0,96	0,57
adj R-squared	0,96	0,97	0,54	0,96	0,97	0,54	0,91	0,95	0,50
Observations	103,00	103,00	103,00	103,00	103,00	103,00	113,00	113,00	113,00

Table 6. Economic vs. Political Determinants

	IV	OLS	IV	OLS
EU Agreement	1,522***	1,370***	0,943***	0,965***
	(6,05)	(6,23)	(2,65)	(3,16)
EU Potential	-1,664**	-1,960***	0,102	-0,201
	(2,39)	(2,91)	(0,12)	(0,22)
EU Basic				
NATO	-0,718	0,343	0,323	0,734**
	(1,03)	(0,98)	(0,51)	(2,24)
WTO	-0,299	0,136	0,248	0,029
	(0,61)	(0,47)	(0,35)	(0,07)
FDI	-0,004	-0,015	0,019	0,039**
	(0,11)	(1,11)	(0,88)	(2,48)
AID	-0,007	0,005	-0,073	-0,077*
	(0,11)	(0,13)	(1,30)	(1,81)
WESTERN	2,936***	3,086***	4,071***	4,100***
	(7,86)	(8,82)	(7,60)	(7,45)
LIBERALIZATION	1,862***	1,348***		
	(4,65)	(6,03)		
GROWTH	2,201***	1,808***		
	(4,19)	(3,63)		
INCOME	0,000***	0,000***		
	(2,67)	(3,16)		
INFLATION	0,385**	0,204*		
	(2,25)	(1,87)		
TENSIONS			-1,513***	-1,546***
			(7,07)	(6,99)
RIGHTS			-0,016	-0,009
			(0,16)	(0,09)
TURNOVER			0,827***	0,868***
			(3,02)	(2,94)
COHESION			0,732**	0,644*
			(2,35)	(1,98)
FUEL EXPORTS			-0,011	-0,016**
			(1,61)	(2,37)
METAL EXPORTS			-0,007	-0,005
			(0,68)	(0,45)
R-squared	0,94	0,95	0,97	0,97
adj R-squared	0,93	0,94	0,96	0,96
Observations	127,00	127,00	106,00	106,00

Table 7. Reduced Model Versions

	OLS	OLS	OLS	FE	OLS	OLS	OLS	FE
EU Agreement, new	1,060***	1,413***	0,998***	-0,026				
	(5,03)	(5,99)	(4,60)	(0,07)				
EU Basic					1,168**	2,101***	1,127**	-0,019
					(2,53)	(5,25)	(2,57)	(0,05)
NATO	0,385	0,337	0,524	1,362***	1,318**	1,690***	1,433***	1,336***
	(0,77)	(0,61)	(1,06)	(3,78)	(2,75)	(3,75)	(3,19)	(3,24)
AID	-0,103**	0,110	-0,079	-0,035	-0,132**	0,086	-0,097	-0,035
	(2,19)	(1,54)	(1,42)	(0,27)	(2,45)	(1,26)	(1,51)	(0,28)
WESTERN	3,627***	4,356***	3,889***		4,260***	5,143***	4,544***	
	(7,25)	(11,02)	(9,57)		(6,90)	(10,64)	(9,28)	
LIBERALIZATION	1,915***		1,818***	0,975**	1,939***		1,795***	0,970***
	(6,74)		(5,63)	(2,56)	(5,51)		(4,55)	(2,85)
EU Potential	-0,425	0,213	-0,411		1,331**	2,504***	1,228**	
	(0,79)	(0,29)	(0,71)		(2,36)	(4,59)	(2,19)	
TENSIONS		-1,382***	-0,895			-1,623***	-1,144	
		(4,24)	(1,65)			(3,68)	(1,63)	
R-squared	0,93	0,90	0,94	0,32	0,92	0,89	0,92	0,32
adjR-squared	0,93	0,89	0,93	0,27	0,91	0,89	0,92	0,27
Observations	164,00	164,00	164,00	164,00	164,00	164,00	164,00	164,00

Table 8. Determinants of Institutional Development in CIS and EU Benchmark Countries

Determinant	Rank	Group Members	Determinant, value	Institutions			
				POLITY 2003	Herall 2007	WBGI all 2006	EBRD inst 2007
Initial Conditions and Endowment							
Democracy at Independence	high	EU Baltic	8.59	8.59	71.92	0.77	3.39
	medium high	ARM, BLR, RUS, UKR	6.06	6.30	53.76	-0.65	2.52
	medium high	NMS	5.79	8.26	61.50	0.12	2.86
	medium high	GEO, MDA	4.48	6.44	64.26	-0.48	2.25
	medium low	AZE, KAZ, KGZ, TJK	-2.82	-5.25	58.46	-0.81	2.13
	low	TKM, UZB	-6.85	-9.00	51.02	-1.51	1.64
Human Development at Independence	high	EU Baltic	0.88	8.59	71.92	0.77	3.39
	high	RUS, BLR, UKR, ARM, GEO	0.86	6.27	54.09	-0.65	2.51
	medium high	KAZ, AZE, MDA, TKM	0.78	-4.85	56.35	-0.79	2.09
	medium low	NMS	0.75	8.26	61.50	0.12	2.86
	low	UBZ, KGZ, TJK	0.69	-7.16	54.30	-1.37	1.78
Income at Independence	high	BLR, RUS	7674.62	6.11	53.58	-0.72	2.53
	high	EU Baltic	7602.83	8.59	71.92	0.77	3.39
	medium high	ARM, GEO, KAZ, UKR	5551.08	4.03	56.52	-0.49	2.45
	medium low	AZE, MDA, TKM	4525.58	-3.85	52.87	-0.95	1.81
	low	NMS	3874.84	8.26	61.50	0.12	2.86
	low	KGZ, TJK, UZB	2845.68	-7.16	54.30	-1.37	1.78
Resource	positive (rents)	AZE, KAZ, RUS, UZB, TKM	42.58	2.98	54.08	-0.82	2.40
	negative low	EU Baltic	-4.31	8.59	71.92	0.77	3.39
	negative medium	NMS	-7.38	8.26	61.50	0.12	2.86
	negative medium	BLR, KGZ, TJK	-13.88	-4.86	53.18	-1.04	1.80
	negative high	ARM, GEO MDA, UKR	-34.44	6.32	53.18	-0.46	2.45
Learning by Doing							
Progress in Control Corruption	high	BLR, TKM	0.92	-7.64	45.81	-1.18	1.51
	high	AZE, GEO, KAZ, TJK, UZB	0.43	-6.27	56.58	-1.08	1.97
	medium high	ARM, KGZ, MDA	0.00	2.76	62.09	-0.66	2.23
	medium low	EU Baltic	-0.10	8.59	71.92	0.77	3.39
	low	RUS, UKR	-0.25	7.00	53.84	-0.64	2.56
	low	NMS	-0 26	8.26	61 50	0.12	2.86
Corruption Level	high	KAZ, TKM, UZB	6.58	-8.02	54.09	-1.22	1.89
	high	AZE, BLR, TJK	6.25	-5.96	52.53	-1.01	1.81
	medium high	KGZ, MDA, RUS	6.00	6.70	54.35	-0.70	2.56
	medium low	ARM, UKR, GEO	5.67	6.73	55.49	-0.46	2.46
	low	NMS	4.00	8.26	61.50	0.12	2.86
	low	EL Baltic	3.25	8.59	71.92	0.77	3.39

continue Table 8.

Determinant	Rank	Group Members	Determinant, value	Institutions: POLITY 2003	Herall 2007	WBGI all 2006	EBRDinst 2007
Geography, Trade and Policy							
Progress in Liberalization	high	EU Baltic	3.33	8.59	71.92	0.77	3.39
	medium high	ARM, GEO, KGZ, MDA	3.16	3.36	63.88	-0.59	2.21
	medium high	NMS	3.14	8.26	61.50	0.12	2.86
	medium low	AZE, KAZ, RUS, UKR, TJK	2.81	5.32	54.42	-0.66	2.51
	low	TKM, UZ8, BLR	1.52	-8.51	50.13	-1.40	1.66
Volume of EU Trade	large	EU Baltic	71.39	8.59	71.92	0.77	3.39
	large	NMS	64.85	8.26	61.50	0.12	2.86
	medium	RUS, TJK	55.84	6.58	54.13	-0.71	2.54
	medium	ARM, AZE, BLR, KAZ	44.72	-5.58	56.42	-0.77	2.13
	small	MDA, UKR	27.14	7.08	53.84	-0.48	2.49
	small	GEO, TKM, UZB, KGZ	15.55	-6.65	54.15	-1.31	1.75
EU Borders	long	EU Baltic	4.50	8.59	71.92	0.77	3.39
	medium long	NMS	3.26	8.28	61.50	0.12	2.86
	medium long	RUS, BLR,UKR	2.71	6.32	53.53	-0.66	2.52
	short	MDA, GEO	0.74	6.44	64.26	-0.48	2.25
	no	TKM, UZB	0.00	-6.47	55.62	-1.10	1.92
Distance to EU	long	EU Baltic	1490.48	8.59	71.92	0.77	3.39
	medium long	NMS	1750.68	8.26	61.50	0.12	2.86
	medium long	BLR, UKR, MDA, RUS	2117.06	6.35	53.65	-0.66	2.52
	short	ARM, AZE, GEO	3432.90	-1.24	61.91	-0.63	2.11
	short	KAZ, KGZ, TJK, TKM, UZB	4369.58	-6.74	49.61	-1.09	1.70

Notes: Democracy at Independence measured with Polity IV in 1991; Human Development at Independence measured with HDI in 1990; Income at Independence measured with GNP per capita in 1989; Resource Dependence shows fuel net exports in 2000; Progress in Control of Corruption is due to the difference in Freedom House Corruption Indicator from 1999-2006; Corruption Level measured with Freedom House Corruption Indicator in 2006; Progress in Liberalization is due to the difference in EBRDlib 1989-2006; Volume of EU Trade shows the balance of trade with the EU.
Source: World Bank, Polity Database, Heritage Foundation, EBRD; De Melo 1996.

Table 9. Institutional Quality and Its Determinants in Selected Transition Countries

		Ukraine	**Georgia**	**Azerbaijan**	**Russia**	**CIS**	**EU Baltic**	**NMS**
Institutions								
POLITY, 2003	standardized	0,85	0,75	0,15	0,85	0,66	0,93	0,91
	real	7,00	5,00	-7,00	7,00	3,20	8,59	8,26
Herall, 2007	standardized	0,53	0,69	0,55	0,54	0,54	0,72	0,62
	real	53,35	68,70	55,36	54,01	54,37	71,92	61,50
WBGIall, 2006	standardized	0,41	0,42	0,33	0,36	0,35	0,65	0,52
	real	-0,47	-0,40	-0,87	-0,69	-0,76	0,77	0,12
EBRDinst, 2007	standardized	0,41	0,32	0,27	0,43	0,37	0,65	0,51
	real	2,50	2,17	2,00	2,58	2,37	3,39	2,86
Determinants								
Initial Conditions and Endowment								
Democracy at Independence		6	4	-3	6	3,28	8,59	5,79
Human Development at Independence		0,84	0,83	0,77	0,86	0,83	0,88	0,75
Income at Independence		5680	5590	4620	7720	6302,25	7602,83	3874,84
Resource Dependence		-38	-13	80	47	n.a.	-5,83	-5
Learning by Doing								
Progress in Control of Corruption		-0,25	0,5	0,15	-0,25	-0,03	-0,1	-0,26
Corruption Level		5,75	5,5	6,25	6	6,13	3,25	4
Geography, Trade and Policy								
Progress in Liberalization		2,89	3,22	2,89	2,78	2,64	3,33	3,14
Volume of EU Trade		27,11	19,42	46,68	55,89	43,26	71,39	64,85
EU Borders		2	0,5	0	3	1,99	4,5	3,26
Distance to EU		1836,2	3114,82	3659,48	2253,26	2677,39	1489,64	1769,69

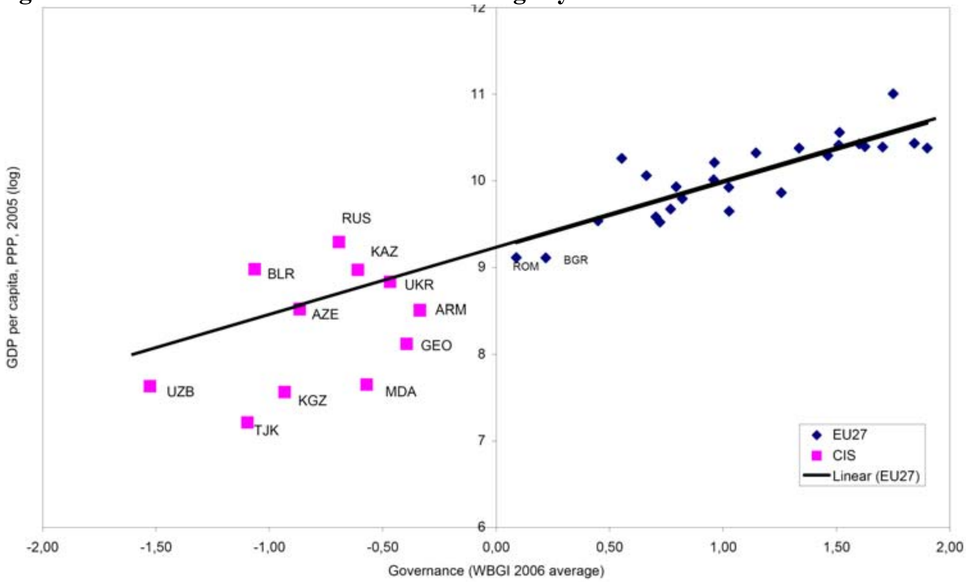
Source: World Bank, Polity Database, Heritage Foundation, EBRD; De Melo 1996.

Table 10. Institutional Development in the CIS According to EU Cooperation Level (2006)

Level of EU-Cooperation							
EU Membership 2004*	0.62	0.98	0.49	0.68	0.83	0.44	0.28
Czech Republic	0.79	0.96	0.75	1.01	0.95	0.73	0.36
Estonia	1.03	1.01	0.78	1.17	1.42	0.91	0.87
Hungary	0.32	1.14	0.73	0.71	1.10	0.73	0.51
Latvia	0.72	0.83	0.81	0.73	1.06	0.52	0.38
Lithuania	0.70	0.93	0.89	0.82	1.02	0.45	0.11
Poland	0.45	0.95	0.22	0.49	0.64	0.25	0.14
Slovak Republic	0.77	0.99	0.85	0.91	1.08	0.43	0.35
Slovenia	0.96	1.10	1.05	1.11	0.78	0.79	0.92
Baltics	0.77	0.91	0.84	0.86	1.11	0.56	0.34
EU Membership 2007	0.12	0.46	0.16	0.00	0.41	-0.16	-0.15
Bulgaria	0.22	0.56	0.29	0.14	0.54	-0.17	-0.05
Romania	0.09	0.43	0.12	-0.05	0.37	-0.16	-0.18
SAA Partnership	-0.05	0.21	-0.04	0.06	0.10	-0.34	-0.31
Albania	-0.39	-0.01	-0.37	-0.42	-0.14	-0.70	-0.67
Croatia	0.29	0.42	0.47	0.52	0.35	-0.03	-0.02
Macedonia	-0.28	0.07	-0.66	-0.20	-0.06	-0.46	-0.37
PCA Cooperation	-0.67	-0.76	-0.59	-0.53	-0.50	-0.87	-0.76
ENP Cooperation	-0.51	-0.29	-0.42	-0.56	-0.41	-0.71	-0.68
Ukraine	-0.47	-0.11	-0.27	-0.57	-0.47	-0.72	-0.67
Georgia	-0.40	-0.16	-0.86	-0.16	-0.22	-0.61	-0.36
Azerbaijan	-0.87	-1.14	-1.07	-0.70	-0.44	-0.86	-0.99
Non-ENP Cooperation	-0.84	-1.08	-0.81	-0.63	-0.71	-1.00	-0.83
Russia	-0.69	-0.87	-0.74	-0.43	-0.45	-0.91	-0.76

Note. PCA Cooperation includes ARM, AZE, GEO, MDA, UKR, RUS, BLR, KAZ, KGZ, TAJ, TKM, UZB. ENP Cooperation includes ARM. AZE. GEO. MDA. UKR. Non-ENP Cooperation includes RUS, BLR, KAZ, KGZ, TAJ, TKM, UZB.
Source: EU Agreement Data Base (own summary).

Figure 1. Governance Deficit and Income Fragility in 2006



Note: no Data on GDP per capita for Turkmenistan in 2006.
Source*:* World Bank (2006); own calculations.

Figure 2. Institutions in the Sample of Countries, 1990-2007