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## How Far Away is Europe? Institutional Development in Europe's Balkan and Black Sea Neighbours

*Institutional development in new and potential member countries determines the success of deepening European integration. This paper argues that the timing of future enlargement should depend on institutional convergence between the EU and potential accession candidates. It therefore looks at institutional quality in the EU, in the EU's neighbouring Balkan and Black Sea regions, and especially in Bulgaria, Romania, Croatia, and Turkey, i.e. the next countries in the queue for entry. Three dimensions of institutional quality – legislative, administrative and judicial institutions – are analysed on the basis of the World Bank Governance Indicators using institutional quality in EU member states as a benchmark in order to reveal institutional deficits.*

Europe is becoming larger and more ambitious, but also more heterogeneous. With the May 2004 enlargement round, the European Union (EU) grew from 15 to 25 member states and an additional two, Bulgaria and Romania, are still in the queue for entry.<sup>1</sup> Of the western Balkan nations, Croatia has received a recommendation from the European Commission to prepare for membership negotiations,<sup>2</sup> while the remaining Balkan nations will continue to be regarded as potential members.<sup>3</sup> The decision on the start of negotiations with Turkey, part of the Black Sea region and now already waiting longer in the queue than the central and eastern European countries, is awaited for the end of this year.<sup>4</sup> For the other Black Sea neighbours, the "Wider Europe" Initiative provides a framework for privileged relations with the EU.<sup>5</sup>

Figure 1 shows that enlargement has made, and will make, the EU increasingly heterogeneous, in

terms both of income level and the values adopted by European societies. This process started with the southern enlargement (EU South) in the 1980s, has become more apparent with the present accession of new member states (NMS groups), and will be further increased by the potential entry of countries from the accession and non-accession groups (AC and NAC groups respectively).

At the same time when membership and heterogeneity increases, the project of a European constitution is intended to deepen European integration by means

<sup>1</sup> European Commission: Communication from the Commission to the Council and European Parliament: Roadmap for Bulgaria and Romania, Brussels, 13 November 2002.

<sup>2</sup> EIU (Economic Intelligence Unit): Country Report Croatia, update May 2004, London 2004.

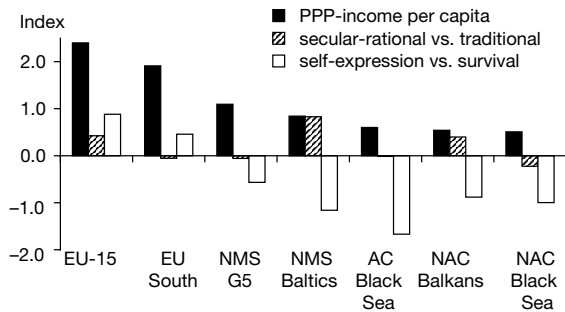
<sup>3</sup> European Commission: Stabilization & Association Process (SAP). Second Annual Report, Brussels 2003.

<sup>4</sup> European Commission: Regular Report on Turkey's Progress Towards Accession, Brussels 2003.

<sup>5</sup> European Commission: Wider Europe-Neighbourhood: Proposed New Framework for Relations with the EU's Eastern and Southern Neighbours, Brussels 2003.

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**Figure 1**  
**European Income and European Values at the Beginning of the 21st Century – How far away are the Balkan and Black Sea Regions?<sup>1</sup>**



EU-15 = Sweden, Finland, Denmark, United Kingdom, Ireland, Italy, Germany, Netherlands, Belgium, Luxembourg, France, Austria, Spain, Portugal, Greece

EU South = Spain, Portugal, Greece

NMS G5 = Poland, Czech Rep., Hungary, Slovenia, Slovak Rep.

NMS Baltics = Estonia, Latvia, Lithuania

AC Black Sea = Bulgaria, Romania

NAC Balkans = Croatia, Yugoslavia, Bosnia-Herz., Albania, Macedonia

NAC Black Sea = Ukraine, Moldavia, Turkey

<sup>1</sup>Population weighted averages; Cyprus and Malta are not considered as reference countries in this paper.

Sources: World Bank: World Development Indicators 2004, The World Bank, Washington DC 2004; World Values Survey: Inglehart Values, <http://www.worldvaluessurvey.org>, February 2004; own calculations.

of common domestic, foreign and security policies. By making central EU institutions more efficient, stronger and more democratic, the constitution should allow the handling of an increasing, and increasingly ambitious, community.<sup>6</sup> If this project fails, European matters will have to be settled through the “Flexibility Clause” of the Nice Treaty, in which the member states have been allowed to proceed further in certain political areas if they use the common institutions. The currency union and the Schengen Accord are two examples. With more and more member states this auxiliary solution bears formidable risks for the progress of European integration.

This contribution asks whether or not the institutional development of current and potential accession countries is adequate to master the challenges of

the integration process. The World Bank Governance Indicators (WBI)<sup>7</sup> are used to compare the level of institutional development in the EU with its Balkan and Black Sea neighbours. This benchmarking allows us to address the following questions.

- What is the role of institutions in the process of European integration under the conditions of enlargement, deepening and increasing heterogeneity?
- What is the current state of development in potential next-round accession countries and future EU neighbours?
- What does that state of development imply for the continuing accession process?

### Institutional Development and the European Integration Process

Institutional development is a precondition for entry into the EU. The process of EU enlargement is tightly bound to the concept of convergence. Membership of the EU demands the fulfilment of a series of political, legal and economic criteria.<sup>8</sup> The member candidates 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, 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). These “Copenhagen criteria” for EU membership ensure a certain level of institutional development. This implies that institutional development in Europe’s South-East will be extremely important for potential accession candidates in order to increase their chances of entry into the EU.

Accession candidates like other emerging market economies, will also benefit directly from institutional development.<sup>9</sup> Empirical studies clearly show that institutions are an important explanatory variable for

<sup>6</sup>J. Varwick: Fragezeichen Europa. Probleme und Perspektiven der erweiterten Europäischen Union, in: Reader Sicherheitspolitik, No. 5, 2004, pp. 82–96.

<sup>7</sup>D. Kaufmann, A. Kraay, M. Mastruzzi: Governance Matters III, Governance Indicators for 1996–2002, Policy Research Working Paper 3106, The World Bank, Washington DC 2003.

<sup>8</sup>F. Foders, D. Piazolo, R. Schweickert: Ready to Join the EU? On the status of reform in the candidate countries, in: World Economics, Vol. 3, 2002, pp. 43–72.

<sup>9</sup>R. Schweickert, R. Thiele: From Washington to Post-Washington? Consensus Policies and Divergent Developments in Latin America and Asia, Kiel Discussion Papers No. 408, Kiel Institute for World Economics, Kiel 2004.

differences in economic performance.<sup>10</sup> Some authors 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.<sup>11</sup> The link between institution building and economic development is even reinforced by an increase of social capital and the convergence of values.<sup>12</sup>

Therefore, it is rational for the EU to demand institutional convergence which can be expected to make the EU more homogeneous both economically and politically and, thereby, to decrease the costs of decision-making. This will be important for the EU in order to jump-start the ambitious project of a political union. Any delay in the catch-up process runs the risk of conflicting assessments of political and economic problems, thus undermining the integration process and making agreement more difficult. Any delay in the catch-up process will also put great stress on the EU budget in the form of transfer payments and agricultural subsidies.

### The World Bank Governance Indicators

Institutional development can be measured by the World Bank Governance Indicators (WBI). In a comprehensive project<sup>13</sup>, the World Bank compiled data for a large country sample from many different sources (e.g. the Global Competitiveness Report of the World Economic Forum and the country reports of the Economist Intelligence Unit) and came up with an as-

essment of six indicators, which can be aggregated to three dimensions of institutional quality:

- 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.

Notwithstanding technical and conceptual deficits<sup>14</sup>, institutions as defined by the WBI have been proven to explain economic development. Additionally, the monitoring of the EU according to the Copenhagen criteria looks at institutions which also figure prominently in the WBI: human rights, participation, rule-of-law, effectiveness of government, and control of corruption. Therefore, the WBI provide a good basis for analysing institutional development in the countries in the Balkan and the Black Sea regions from a bird's-eye view and for comparing their progress with the standards set by old and new members of the EU.

Table 1 shows the complete results for all dimensions of institutional quality and for all the sample countries listed in Figure 1. The indicator for overall institutional quality is calculated as the simple average of legislative, executive and judicial institutional quality. The following discussion is based on aggregations focusing primarily on the relative quality of institutions. The benchmark is provided by the various sub-groups of the currently 25 EU member countries as defined in Figure 1. Figure 2 shows the quality of overall, legislative, executive and judicial institutions in the EU and the Balkan and Black Sea regions ordered according to the average income of the country groups as in Figure 1.

<sup>10</sup> H. Edison: Testing the Links: How Strong are the Links Between Institutional Quality and Economic Performance, in: Finance & Development, Vol. 40, 2003, pp. 35-37; D. Rodrik: The Primacy of Institutions (and What this Does and Does Not Mean), in: Finance & Development, Vol. 40, 2003, pp. 31-34.

<sup>11</sup> D. Acemoglu, S. Johnson, J.A. Robinson: The Colonial Origins of Comparative Development: An Empirical Investigation, in: American Economic Review, Vol. 91, 2001, pp. 1369-1401; W. Easterly, R. Levine: Tropics, Germs, and Crops: How Endowments Influence Economic Development, NBER Working Paper 9106, National Bureau of Economic Research, Cambridge, Mass. 2002; D. Rodrik, A. Subramanian, F. Trebbi: Institutions Rule: The Primacy of Institutions over Geography and Integration in Economic Development, NBER Working Paper No. 9305, National Bureau of Economic Research, Cambridge, Mass. 2002.

<sup>12</sup> Economic development shifts the values of a society from "survival" to "self-expression" which, in turn, fosters the process of institution building, especially the demand for democratic structures. See R. Inglehart, H.-D. Klingemann, C. Welzel: Economic Development, Cultural Change and Democratic Institutions – Exploring Linkages Across 63 Societies, in: L.-H. Roeller, C. Wey (eds.): Die soziale Marktwirtschaft in der neuen Weltwirtschaft, WZB-Jahrbuch 2001, Berlin 2001.

<sup>13</sup> D. Kaufmann, A. Kraay, P. Zoido-Lobaton: Aggregating Governance Indicators, Policy Research Working Paper No. 2195, The World Bank, Washington DC 1999.

<sup>14</sup> On the technical level, one has to keep in mind that the data are based on interviews with local experts and thus include a strong subjective element. On the conceptual level, the problem is that despite a general consensus on the institutions which have to be analysed a number of questions about details – e.g. finding the right balance between competition and regulation – do not have a unique answer. In his programmatic article, Stiglitz even argued that with respect to competition policy a consensus is neither possible nor desirable, because economic research will not be able to identify a competition policy that is optimal for all countries at all times. See J. E. Stiglitz: More Instruments and Broader Goals: Moving towards the Post-Washington Consensus, WIDER Annual Lectures 2, World Institute for Development Economics Research, Helsinki 1998.

## INSTITUTIONAL CONVERGENCE

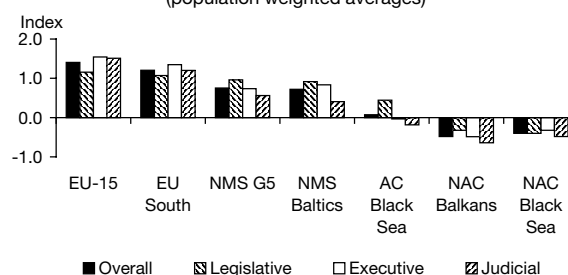
**Table 1**  
**World Bank Governance Indicators (WBI) for European Countries 2002<sup>a</sup>**

	Overall Institutions	Legislative Institutions	Executive Institutions	Judicial Institutions
EU-15	1.41	1.16	1.55	1.51
EU South	1.21	1.07	1.35	1.20
Belgium	1.45	1.21	1.63	1.51
Denmark	1.82	1.49	1.87	2.12
Finland	1.94	1.67	1.97	2.19
France	1.29	1.01	1.46	1.39
Greece	0.86	0.94	0.96	0.69
United Kingdom	1.64	1.14	1.89	1.89
Italy	0.93	0.96	1.03	0.81
Ireland	1.56	1.36	1.63	1.70
Luxembourg	1.82	1.48	1.98	2.00
Netherlands	1.83	1.50	2.01	1.99
Austria	1.64	1.31	1.73	1.88
Portugal	1.31	1.37	1.25	1.32
Sweden	1.80	1.54	1.77	2.09
Spain	1.27	1.03	1.47	1.31
Germany	1.58	1.29	1.68	1.78
NMS G5	0.75	0.96	0.74	0.56
Poland	0.69	0.91	0.64	0.52
Slovak Rep.	0.63	0.97	0.58	0.34
Slovenia	0.99	1.16	0.82	0.99
Czech Rep.	0.81	0.96	0.91	0.56
Hungary	0.96	1.13	1.00	0.75
NMS Baltics	0.72	0.92	0.84	0.41
Estonia	0.94	1.02	1.07	0.73
Latvia	0.64	0.87	0.77	0.28
Lithuania	0.69	0.91	0.80	0.37
AC Black Sea	0.07	0.44	-0.03	-0.19
Bulgaria	0.26	0.56	0.28	-0.06
Romania	0.01	0.40	-0.15	-0.23
NAC Balkans	-0.48	-0.32	-0.49	-0.64
Albania	-0.52	-0.26	-0.42	-0.89
Bosnia-Herzeg.	-0.73	-0.54	-0.92	-0.74
Yugoslavia	-0.70	-0.55	-0.67	-0.88
Croatia	0.29	0.51	0.19	0.17
Macedonia	-0.48	-0.61	-0.25	-0.57
NAC Black Sea	-0.40	-0.40	-0.32	-0.48
Moldavia	-0.43	-0.21	-0.40	-0.69
Turkey	-0.26	-0.54	-0.06	-0.19
Ukraine	-0.59	-0.23	-0.68	-0.88

<sup>a</sup> For the definition of country groups, see Figure 1; values for the country groups are population weighted averages; overall indicator is the simple average of the three institutional indicators. Indicators range from -2.5 to +2.5

Source: D. Kaufmann, A. Kraay, M. Mastruzzi: Governance Matters III, Governance Indicators for 1996-2002, Policy Research Working Paper No. 3106, The World Bank, Washington DC 2003.

**Figure 2**  
**Institutional Development in the EU, Balkan, and Black Sea Regions, 2002**  
(population weighted averages)



Source: Table 1.

### Institutional Development in South-East Europe

As predicted by the empirical literature, Figure 2 reveals a strong positive relationship between institutional and economic development. It is also evident that even the current enlargement has made the EU significantly more heterogeneous.

- While the southern European countries which joined the EU in the 1980s have closed the institutional gap to the EU-15 considerably, the new eastern European member countries reveal a significant institutional gap. This gap applies to all the institutional dimensions measured by the WBI.
- For the remaining accession countries, Bulgaria and Romania, institutional development is far removed from European standards. This finding is in sharp contrast to the European Commission's progress reports for the two countries which claimed that the political criteria for EU membership have already been fulfilled. This is not supported by the facts.
- Institutional development in the other countries in the Black Sea and Balkan regions is even worse. Especially the Balkan countries, which are still suffering from the disintegration and violent conflicts of the recent past and just beginning their nation-building, urgently need institutional development.

Figure 2 also shows a clear pattern of institutional development. In contrast to the old member states of the EU, the development of legislative institutions is far more advanced than executive and judicial institutions.<sup>15</sup> To some extent this seems to be quite natural

<sup>15</sup> With the exception of executive institutions in non-accession countries in the Black Sea region.

given the rather fast transformation from socialism to democracy and integration into a community with internationally high democratic and economic standards. The formal introduction of laws has still to be backed up by their implementation. To another extent, however, the backlog of the executive and judicial institutions may be the result of the legalistic and optimistic view of the European Commission driven by the political importance of eastern enlargement. Neglecting the assessment of actual implementation implies that problems of integration will show up in the next years with negative implications for the willingness of EU member states to allow for further enlargement.

Looking at the results for the four countries which are next in the queue for entry, Bulgaria, Romania, Croatia and Turkey, reveals that legislative institutions are far better developed in Bulgaria than in Romania while Croatia, notwithstanding its initial difficulties, almost matches Bulgaria. In contrast, Turkey ranges even below the average of the Black Sea countries. Although the progress made in Turkey during recent years is not yet fully reflected in the WBGI, the fact that Turkey has to fulfil the political criteria even before the start of accession negotiations and the legislative institutional disparity measured by the WBGI mean that the start of accession negotiations depends primarily on the political will of the EU member states.

A different picture is drawn by the indicator on executive institutions. As to be expected on the basis of the comparison of country groups, the development of executive institutions lags behind the development of legislative institutions in Bulgaria, Romania and Croatia. Although the difference from the standards set by EU member states is significant in all cases, Turkey together with these three countries forms the group of countries which comes closest.

Finally, the indicator on judicial institutions reveals that Croatia outperforms the other three countries, which, again, perform worse with respect to the other institutional indicators. This result should have an impact on Croatia's prospects of joining the EU. It is at least difficult to argue that Croatia should wait longer than Bulgaria and Romania if negotiations start soon and the chapters can be closed quickly. Additionally, the rather weak judicial institutions in the two accession countries support the view that further enlargement should take its time.

### Implications for Further Enlargement

The analysis of institutional development in Europe has demonstrated the challenges to European integration.

- Institutional development is of central importance to the process of integration.
- The countries in the Balkan and the Black Sea regions are still far removed from Europe in terms of institutional development.
- Europe, which has become considerably more heterogeneous by the recent enlargement, would become even more heterogeneous.
- Notwithstanding positive evaluations by the EU, institutional deficits are still evident in Bulgaria and Croatia but particularly in Romania and Turkey.<sup>16</sup>

One implication for the process of further enlargement is that Croatia should have good prospects of joining the EU in the next round of enlargement. Compared to the other countries institution-building in Croatia has been rather intensive and sustainable. Additionally, the EU has always favoured the regatta principle, i.e. that a group of countries, rather than single countries, join the EU at the same point in time. This regatta principle reduces the costs of an adjustment of negotiation weights, job allocations and financial funds. Hence, as long as Romania remains slow in closing the remaining chapters in negotiations with the EU, Croatia has a good chance of catching up and joining the EU together with Bulgaria and Romania.

While Croatia already has a perspective of joining the EU, the case of Turkey will decide where the enlargement process ends and where the Wider Europe region begins. The picture drawn by the World Bank Governance Indicators is not encouraging but, at the same time, does not speak against membership of Turkey. The examples of Croatia and other transformation countries suggest that even large reform deficits can be overcome in a relatively short time. For Europe such a process of catching up seems to be important given that deepening and widening integration needs a minimum of institutional homogeneity. Further enlargement should take its time.

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<sup>16</sup> For country studies on Bulgaria, Romania, Croatia and Turkey, cf. A. Gawrich, R. Schweickert: Institutionelle Entwicklung in Europa – Wie weit sind die südosteuropäischen Länder? in: Die Weltwirtschaft, No. 2, 2004, pp. 153-186.