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Comparative Analysis of the Quality of Institutions in the European Countries

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Abstract

The paper focuses on the comparative analysis of the quality of public governance and underpinning institutional framework in the European countries. The paper attempts to identify typical groups of countries with similarities in the quality of general public institutions. The countries included in the analysis will be the EU countries, selected EFTA and Western Balkan Countries..

Generally, the institutional quality is not easy to measure and in principle relies to a large extent on qualitative assessments (Kaufman et al, 2008). Therefore, the analysis will rely on the results of the executive surveys conducted by the World Economic Forum, which provides for a solid analytical tool with identical survey questions answered in the same time by a defined and controlled sample of educated professionals within the business sector.

However, the analysis has not focused on the standard "Institution" pillar, as defined by the WEF, created using the survey indicators on the legal protection, corruption, productivity of public spending, burden of regulation, security, quality of auditing standards and regulation on corporate governance. Apart from that, further survey indicators are used, including the quality of education; general infrastructure and effectiveness of anti-monopoly policy.

We created a new five pillars' composite indicator of the quality of institutions and measured it in terms of difference to average rank of survey response in the EU15 members to identify the relative quality of public institutions.

1. Introduction

The paper provides the comparative analysis of the quality of economic governance and the underpinning institutional framework of the European countries and their impact on their international competitiveness. The paper attempts to identify typical groups of countries with similarities in the quality of general public institutions and determine the factors behind institutional similarities/differences in explaining their international competitiveness levels.

In the second chapter we briefly deal with the question why the quality of institutional framework of a certain country (legislative framework, regulative norms, formal and informal rules and codes; governance arrangements and policies) matters for economic growth and competitiveness at both country and business sector levels. We briefly determine the components of institutional quality we will examine and our starting assumptions as a departing theoretical and policy framework for the analyses that follows.

In third chapter we elaborate the methodological approach in the analysis of World Economic Forum (WEF) survey data made for Global Competitiveness Index on the basis of which we attempt to measure institutional quality. For the purpose of this exercise, we construct the composite institutional indicator which is not identical with the "Institution" pillar, as defined by the WEF. It is created by constructing 5 pillars based on 25 various survey indicators on the quality of legal protection, quality and burden of regulation, level of corruption, productivity of public spending, security, quality of auditing standards and regulation on corporate governance. Apart from that we have added survey indicators that are important for an overall assessment of the quality of institutional framework, including those of quality of education, general infrastructure and effectiveness of anti-monopoly policy. Selected indicators of institutional quality we use as an explanatory tool for attained levels of international competitiveness in 2003-3008 period.

The analysis in fourth chapter attempts to find an answer to a question if there is a convergence between European countries in the "institutional quality index" and which countries demonstrate positive/negative trends and if there are any significant deviations when looking into the old and new members as well as the selected EU "outsiders" during the 2003-2008.

In the fifth chapter we provide some more detailed findings of the main trends at the level of 5 sub indexes (pillars) of the institutions quality, in order to identify which institutional pillars and which countries make for the most of the identified trends of change of the quality of institutions.

In the concluding sixth chapter we summarize the similarities and differences among European countries and attempt to identify the defining underlying factors in institutional competitiveness for clusters of countries that were determined on the basis of our analysis.

2. The quality of institutions in European countries and impact on economic growth and competitiveness- why does it matter?

The link between quality of institutions and economic growth has been theoretically well founded, repeatedly studied and empirically tested (North, 1990; North 1997; Olson et al. 2000; Rodrik, 2004; Campbell, 2004; Pedersen 2008). In particularly since the beginning of the 1990s,the economists have widely acknowledged the idea that the good economic institutions in both public and private sectors are instrumental to economic growth1.The institutional framework conducive to functional market economy is primarily very important for the business community but ultimately for all citizens; their living standards and general quality of life. The well designed institutions could trigger economic growth and act as an important growth accelerators (Housemann, Prichett and Rodrik, 2004). At the business sector level, this link is most evident in investment decisions whereby investors take into account the quality of institutions as a very important factor for the ease of doing business and when assessing overall risk of future business conduct in one country. The institutional framework could create incentives but also disincentives for economic transactions and business decisions. Firms are generally keen to invest in countries with high respect and protection of property rights; developed legal framework and enforced rules of law; well developed public services without burdensome bureaucracy, redundant regulation and corruption. It is important that government policies are transparent, judiciary does not hinder business and there is a strong protection against crime and fraud. Institutional failures, on the other hand, significantly raise transaction costs for firms if public institutions fail to adequately enforce property rights, business contracts or fail to ensure adequate level of information on market to all market agents. Apart from that some rules of conduct and institutional dimensions that fall within the area of "ethical behaviour" were also included into our analysis, with indicators of business ethics and public trust in (financial) honesty of politicians, i.e. those created by the private sector subjects themselves are also very important. These are the elements we have taken into account when measuring the overall quality of current European institutional framework that affects the decisions of enterprises and market actors and consequently on the countries' competitiveness rank.
In short, our analysis departs from the assumption that the quality of institutional framework does matter for the efficiency of economic transactions and economic growth. It determines the path of economic growth of a country to large extent and increases our understanding of factors influencing the economic growth patterns (Pederson, 2008: Rodrik, 2004; Olson et al, 2000). We similarly argue that the international competitiveness is better in the countries which are better governed and *that differences in performance could be also attributed to the quality of economic governance and institutional framework*. We also consider institutional change as an important public policy instrument and institutional analyses as useful explanatory tool for policy makers. In the exercise done for the purpose of this paper by attempting to measure the quality of institutional framework we attempt to measure also the international economic competitiveness at the country and business sector levels.

So what factors affect the quality of institutions and institutional competitiveness in European countries? Are there significant differences and what division lines, if any, could be noted? Our starting assumption is that being part of a EU single market affects the quality of economic governance to a large extent. One would expect that important differentiation or even division lines will be formed among EU members (insiders) and non-EU members (outsiders). The other expectation is that within the EU itself, clear division lines in the quality of institutional framework would be formed among Euro Area and non-Euro Area members.

[1] The theoretical background could be found in the number of works of many neo-institutional economists started from North, 1990; Williamson (1994); Hodgson (1998); La Porta et al (1999); Boettke (2000), Pejovich (1995) and many others. For the good overview of literature of literature see Campbell (2004).

The analysis that follows would reveal if these assumptions were correct for the sample of countries analyzed (EU, selected EFTA and Western Balkan countries).

The current EU economic governance regime and practice as well as underpinning institutional framework reflects to a great extent the prevailing “soft” coordination methods as apart from the monetary policy, most economic policies remained in the competence of national policy-making. For that reason, the current economic governance mechanisms have leaned more towards the regime of soft intergovernmental coordination than implementing efficient and harmonized EU-wide mix of economic and social policies. The current economic governance also reflect s divisions among member countries functions of state and markets that is also present in economic theory and policy practice (Begg, 2008; Marcussen, 2006; Dyson, 2002; Umbach and Wessles, 2008; Dahausse, 2008). The divisions are also substantial between euro zone and non-euro zone members (Dyson, 2008).

In this paper we focus on how the quality of institutional framework affects the convergence to the EU-core countries (EU-15) as a “moving target goal”, measuring it by several World Economic Forum indicators of institutional competitiveness.

3. Measuring European Institutional Quality - Methodological Approach

The analysis that follows is based on the data from the Executive Opinion Survey, published by the World Economic Forum in the Global Competitiveness Reports for the period between 2004 and 2008. The WEF survey indicators measure the business community perception of many competitiveness factors that can not be measured by the hard data. The survey is conducted every year in a large number of countries, with identical set of questions and clearly defined sample, providing for a sound base for analyses.

There is a general problem of the analysis of the WEF survey data that are subject to changes in the overall business sentiment i.e. perception that proved to be rather volatile. However, the executive survey complements the formal methods of measuring the institutional development, by trying to depict the impact of the quality of institutions, as witnessed by the end-users i.e. the business community.

Although the Global Competitiveness Report already used the “Institutions” index i.e. pillar of competitiveness, it was not suitable for the purpose of our analysis. We intended to have a somewhat different and wider scope of the analysis and to create certain sub indexes, to capture specific issues of the quality of institutions. We have selected 25 survey indicators to construct 5 „pillars“, which denote different aspects of the quality of institutions. The pillars and corresponding indicators are listed in the table below.

Table 1: Methodological approach – creating indexes

	Subindexes	Indicators	Original survey questions
	JUDICIARY, PROTECTION OF NORMS AND POLICE SERVICES	Judicial independence	Is the judiciary in your country independent from influences of members of government, citizens or firms? (1 = No – heavily influenced ; 7 = yes – entirely independent)
I		Business costs of crime and violence	The incidence of common crime and violence in your country: (1 = Imposes significant costs on businesses ; 7 = Does not impose significant costs on businesses)
N		Business costs of organized crime	Organized crime (mafia-oriented racketeering, extortion) in your country: (1 = Imposes significant costs on businesses ; 7 = Does not impose significant costs on businesses)
S		Property rights protection	Property rights in your country, including over financial assets, are: (1 = Poorly defined and not protected by law ; 7 = Clearly defined and well protected by law)
T		Reliability of police services	Police services in your country: (1 = Cannot be relied upon to enforce law and order ; 7 = Can be relied upon to enforce law and order)
I			
T	**REGULATIVE INSTITUTIONS**	Burden of government regulation	Complying with administrative requirements for businesses (permits, regulations, reporting) issued by the government in your country is: (1 = Burdensome ; 7 = Not burdensome)
		Soundness of banks	Banks in your country are: (1 = Insolvent and may require a government bailout ; 7 = Generally healthy with sound balance sheets)

U T I O N S		Regulation of security exchanges	Regulation of securities exchanges in your country is: (1 = Not transparent, ineffective and subject to undue influence from industry and government ; 7 = Transparent, effective and independent of undue influence from industry and government)
		Strength of auditing and accounting standards	Financial auditing and reporting standards regarding company financial performance in your country are: (1 = Extremely weak ; 7 = Extremely strong – the best in the world)
		Protection of minority shareholders' interests	Interests of minority shareholders in your country are: (1 = Not protected by law ; 7 = Protected by law and actively enforced)
	INSTITUTIONS FOR PROTECTION OF MARKET COMPETITION	Extent of market dominance	Corporate activity in your country is: (1 = Dominated by a few business groups ; 7 = Spread among many firms)
		Local competition	Competition in the local market is: (1 = Limited in most industries ; 7 = Intense in most industries)
		Effectiveness of antitrust policy	Anti-monopoly policy in your country is: (1 = Lax and not effective at promoting competition ; 7 = Effective and promotes competition)
		Intellectual property protection	Intellectual property protection and anti-counterfeiting measures in your country are: (1 = Weak and not enforced ; 7 = Strong and enforced)
		Quality of competition in the ISP sector	The competition among Internet Service Providers in your country ensures high quality, infrequent interruptions and low prices: (1 = Strongly disagree ; 7 = Strongly agree)
	ANTI-CORRUPTION INSTITUTIONS	Business costs of corruption	Do illegal payments to influence government policies, laws or regulations impose costs or otherwise negatively affect your company? (1 = Yes, they have a significant negative impact ; 7 = No, they have no impact)
		Irregular payments in public contracts	In your country, how frequently would you estimate that firms make undocumented extra payments or bribes connected with the following: d. Awarding of public contracts and licenses: (1 = Common ; 7 = Never occurs)
		Irregular payments for public utilities	In your country, how frequently would you estimate that firms make undocumented extra payments or bribes connected with the following: b. Public utilities (e.g., telephone or electricity): (1 = Common ; 7 = Never occurs)
		Favoritism in decisions of government officials	When deciding upon policies and contracts, government officials in your country: (1 = Usually favor well-connected firms and individuals ; 7 = Are neutral)
		Public trust of politicians	Public trust in the financial honesty of politicians in your country is: (1 = Very low ; 7 = Very high)
	PUBLIC SECTOR INSTITUTIONS	Government spending wastefulness	The composition of public spending in your country: (1 = Is wasteful ; 7 = Efficiently provides necessary goods and services not provided by the market)
		Agricultural policy cost	Agricultural policy in your country: (1 = Is excessively burdensome for the economy ; 7 = Balances the interests of taxpayers, consumers and producers)
		Quality of the educational system	The educational system in your country: (1 = Does not meet the needs of a competitive economy ; 7 = Meets the needs of a competitive economy)
		Quality of public schools	Primary schools in your country are: (1 = Of poor quality ; 7 = Among the best in the world)
		Overall infrastructure quality	General infrastructure in your country is: (1 = Underdeveloped ; 7 = Extensive and efficient by international standards)

The scores of the WEF survey questions are in the range from 1 (worst) to 7 (best), averaged at the level of each country and published as such in the Global Competitiveness Reports. We have calculated our indicators (I_{ij}) for each country (i) and each indicator (j) and by measuring these original WEF scores, against the average scores for the "old" EU15 members[2],

The result shall be interpreted as below EU15 average for the values below 100, and vice versa. For instance, the indicator value "125" denotes that the respective country has scored 25% above the EU15 average for certain indicator. For 29 countries and 25 original values of

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[2] By using the following formula:

$$I_{ij} = 100 * \frac{S_{ij}}{\frac{\Sigma S_{EUj}}{14^2}}$$

where Sij are the original WEF survey scores for all 29 countries and $S_{EU\,j}$ are the WEF scores for the 14 "old" EU countries. Luxemburg was not included in the analysis, together with Malta and Cyprus due to a small size of these countries, and late inclusion of in the WEF Global Competitiveness Report.

survey quetions, we have calculated altogether 725 indicators, for each of 6 years under review.
The calculated figures for each of 25 indicators were agregated (as simple averages) to the level of 5 subindexes. The identical procedure was applied to calculate the final “Institutions” index, from the 5 subindexes. Using that procedure, we have calculated 29 final “Institutions Quality” indicators for each year under review, to be able to depict more broad trends. The calculated 145 subindexes for each year provide us with a tool for in-depth assessment at the level of each of 5 subindexes.

The analysis is focused on benchmarking the values of these indexes basically at two levels. First level is the “old” EU members that joined EU until 1995. However, Norway and Switzerland were also included in this group, since the two countries generally share a common path of institutional development with the “old” EU members, especially with former EFTA countries (Austria, Sweden, and Finland). The second group includes all other members, although containing also 3 SEE countries (Croatia, Macedonia and Serbia) in order to illustrate development of institutions in these countries that also intend to become EU members soon.
The analysis has two main purposes. The first is to identify if there is a trend of convergence in the quality of institutions (within the scope of the method used), for both groups of countries. The second purpose of the analysis is to provide some more detailed findings of the main trends at the level of 5 sub indexes (pillars) of the institutions quality, in order to identify which institutional pillars and which countries make for the most of the identified trends of change of the quality of institutions. In our analyses we consider upgrading and convergence of the quality of institutions as an important indicator and illustration of positive link between good governance and economic performance.

4. Main trends – is there a convergence in the quality of institutions?

Good governance institutions have undoubtedly contributed to economic development and growth of EU countries over the last 50 years[3], but especially since the formation of single market in 1992. Our analyses though focuses to the limited time horizon from 2003-2008 by attempting to measure if there is convergence in the levels of institutional quality both among EU insiders and outsiders.

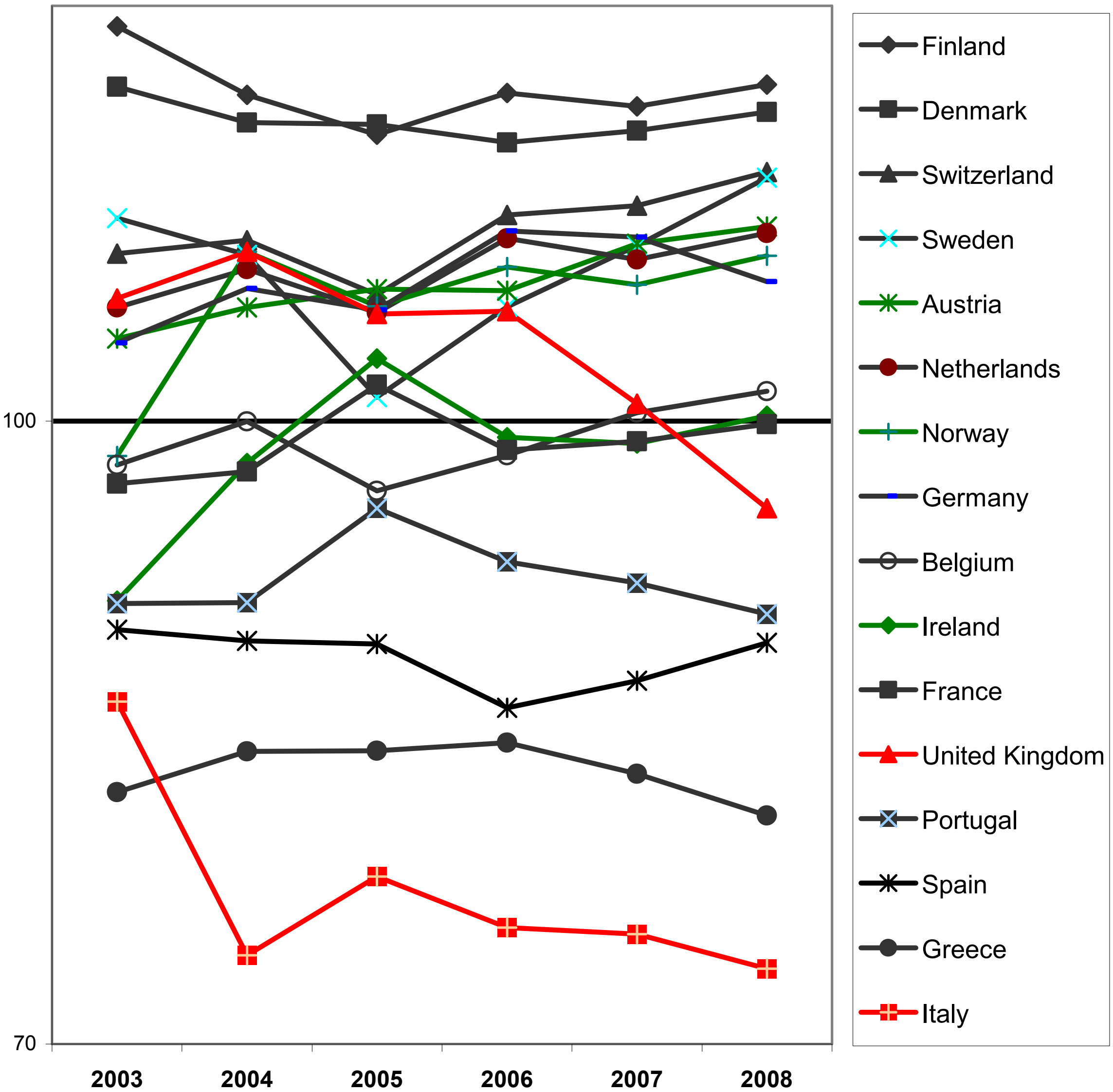
Although several analysed indicators of institutional quality in the EU-members, falls under the jurisdiction of the European Commission[4], and these are mainly commonly agreed regulatory and legislative framework within *acquis communautaire* determined by the treaty on EMU, most of our selected indicators are still mainly under a competence of national legislation and policy-making. Out of our 5 pillars, only some regulatory and partly institutions of protection of market competition are under auspices of the EU institutions. However, several institutions are to a large extent subject to the national legislations and policies by accepting EU and international standards which relates in particularly to selected indicators such as fighting crime, enforcing property rights, accounting standards and education. Apart from that, certain elements of institutional quality, such as judiciary and anti-corruption are by any means to be improved in all member states, especially in the countries that historically faced the most significant problems. Therefore, a trend of convergence in the quality of regulatory and other institutions (broadly defined) shall illustrate extent of successful integration of the EU institutions. In our analyses we will examine the EU members and gravitating "outsiders" such as EFTA countries Switzerland and Norway, as well as selected Western Balkan candidate countries.

As it seams, according to the analytical approach that we have used and in the period under review the „Old" EU members have diverged rather than converged in the quality of selected institutions. Italy, Greece and Portugal were clearly falling down from the convergence line throughout 2003-2008 and even the United Kingdom in the last two years 2007-2008. On the other hand, Switzerland, Austria, Netherlands and Norway, Ireland went up above all the others, while France is, especially since 2005, struggling to catch-up an average EU-15 institutional quality line.

[3] Easterly and Levine, 1997; Johnson, Kaufman and Schleifer, 1997; Lippert and Umbach 2005.

[4] Renewed Lisbon Governance instruments within the OMC rely heavily on voluntary arrangements, leaving the individual member states to support the EU economic reform by own policies, taking more responsibility for it, and at the same time learning from other experiences (benchmarking), while viewing the Commission role more as a facilitator rather than the manager or controller of what is being done (EC, 2008)

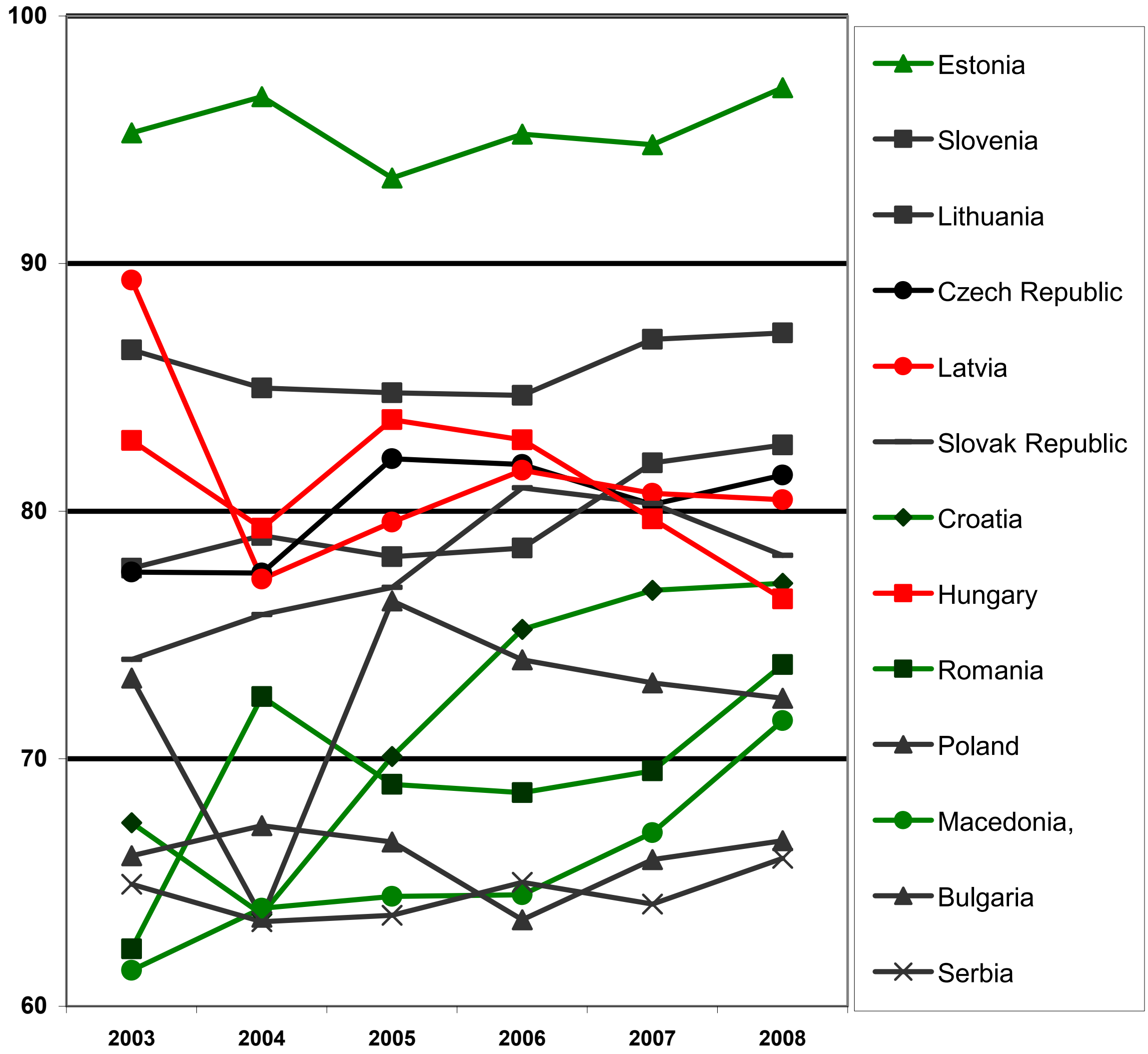
FIGURE 1: Institutions quality index 2003-2008 – „Old members“



Source: WEF survey database, own calculation

It is interesting to observe that the “new” EU member states face a certain stalemate in the quality of institutions, without clear convergence towards the EU average. Only Estonia, Slovenia and Lithuania were moving towards the EU15 average level converging, others seam not. Hungary, Latvia and Poland have been significantly worsening their institutional quality, as perceived by their business communities measured in WEF indicators. One rather simplified explanation might be that the economic governance mechanisms within the EU within the OMC do not exert such pressures to converge as prior to the membership when the drive of Europeanization of their institutions was almost “a must”. The South-East European future members show upwards trend in the case of Macedonia and Croatia (as candidate countries both under strong pressure of Europeanization), while Serbia seems to have been lagging behind with reforms.

FIGURE 2: Institutions quality index 2003-2008 – New and future members

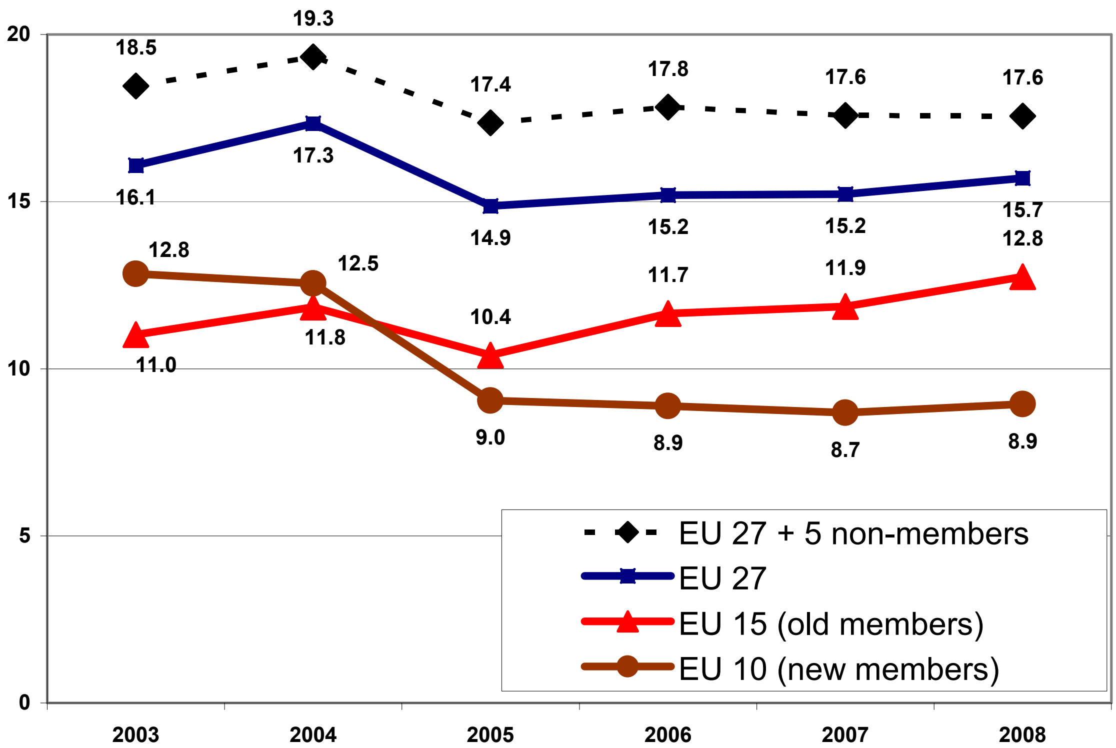


Source: WEF survey database, own calculation

With an attempt to measure the level and direction of convergence, we have calculated simple **Coefficient of variation**[5] for the selected groups of countries. The results are shown in Figure 3.

[5] Coefficient of variation (CV) is a normalized measure of dispersion of a probability distribution. It is defined as the ratio of the standard deviation to the mean (average value).

FIGURE 3: Coefficient of variation of *the Institutions quality* index



Source: WEF survey database, own calculation

Results of the calculated convergence indicator were rather interesting. Until 2005, a strong convergence between EU 10 (new members) is obvious, with a stagnation since.
In the case of EU15 (old members), a similar one-off convergence episode occurred in 2005, however a rather clear trend of divergence is evident for the whole period under review. As a result, on the level of EU27, a convergence move is evident in 2005 and a slow divergence process in the last 3 years under review. For the whole sample of countries (including non-members), we may detect also a one-off convergence move in 2005 and a virtual stagnation afterwards. It is not easy to explain the sudden move in the year 2005, which may be attributed to “enlargement euphoria”, that moved perception of the quality of institution (as well as the perception of overall competitiveness) upwards in a number of countries.

From the presented data, and using the method employed in this analysis we could draw two main conclusions. The first one is that in the new member countries, no real convergence of the institutional quality towards the EU average is detectable. The second conclusion is that the old member countries show clear divergence trend.

5. Detailed analysis – What has happened?

In further analysis we will try to identify in more detailed level, what led to the above described trends in the quality of institutions, within the period under review, and by using the methodology we employed. The presented trends at the level of countries indicate that there was rather significant change of the overall *Institution quality* index. In order to illustrate that, we have chosen 8 countries, with the largest difference of the values of the index within the period 2003 - 2008. We have grouped the selected countries in 4 “clusters”, each consisting 2 countries, as shown in Table 2.

Table 2: “Clusters” of the countries sampled for detailed analysis

Country groups	Direction of change of the „Institutions“ index	Countries	Change of *Institutions quality* index (percentage points) 2003 - 2008
„Old“ EU members + Switzerland & Norway	Improved	Norway	10
		Ireland	9
	Worsened	Italy	-13
		United Kingdom	-10
„New“ EU members + candidate countries (Croatia)	Improved	Romania	11
		Croatia	10
	Worsened	Latvia	-9
		Hungary	-6

By using this simplified approach, Norway and Ireland seem to have been clear “winners” in the period under review, while situation in Italy and the UK deteriorated. Out of new EU members and candidates, Romania and Croatia advanced, while Latvia and Hungary lost some ground.

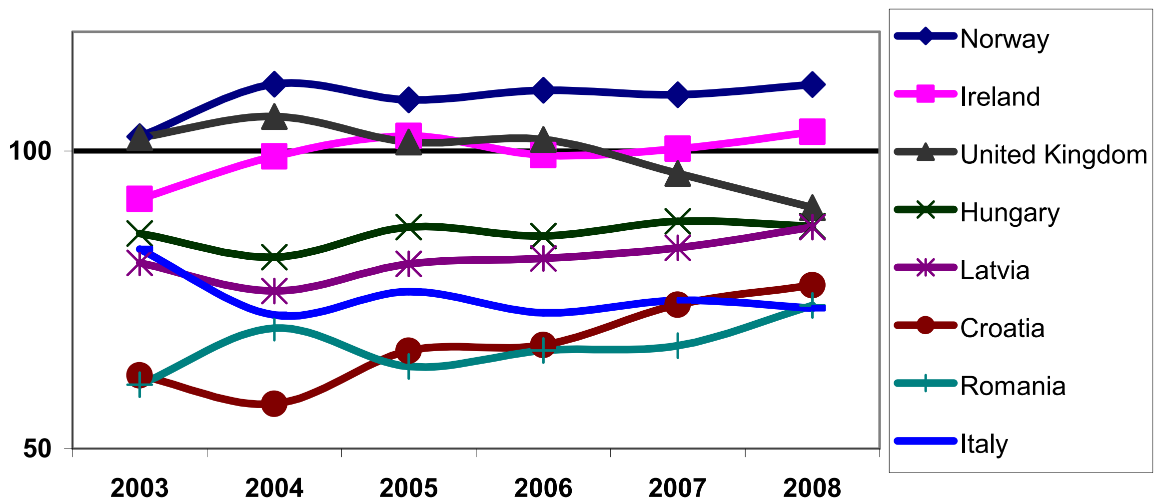
To look into more details, we will analyse dynamics of change at the level of the five main sub indexes and detailed level of indicators for these selected countries, that contributed the most to the virtual stalemate in the convergence of the institutional quality in the recent years.

5.1. Judiciary, protection of norms and police protection institutions

These issues are of the highest importance for doing business in a safe and secure and predictable environment, and to a significant extent was subject of attention and policy action in most of the European countries. The selected old EU members show clear divergence. Norway and Ireland stand high above the new member states, and this was true also for the UK until the last two years when it lost ground due to a simultaneous fall in all five indicators (with the lowest level of 78% for *Business costs of crime and violence.* Italy was performing very low, what is hardly surprising having in mind that these areas remain weak points of its institutional framework for many years. The position of Italy has further deteriorated to a very low level, with 64% score for *Judicial independence* and 61% of *Business cost of organized crime* in 2008.

Contrary to the EU15, the selected new EU members all show upward developments but are still far behind the average EU-15 institutional quality line. The most of improvements is within *Business costs of crime and violence*, while *Judicial independence* remains very significant problem. It is interesting to note that organized crime is perceived not to impose very significant costs on business in these countries, as compared to the EU15 average. A possible explanation may be that corruptive and criminal conduct is focused more to influence public funds and politicians, while private sector is relatively less exposed to organized crime.

FIGURE 4: Judiciary, protection of norms and police protection



Source: WEF survey database, own calculation

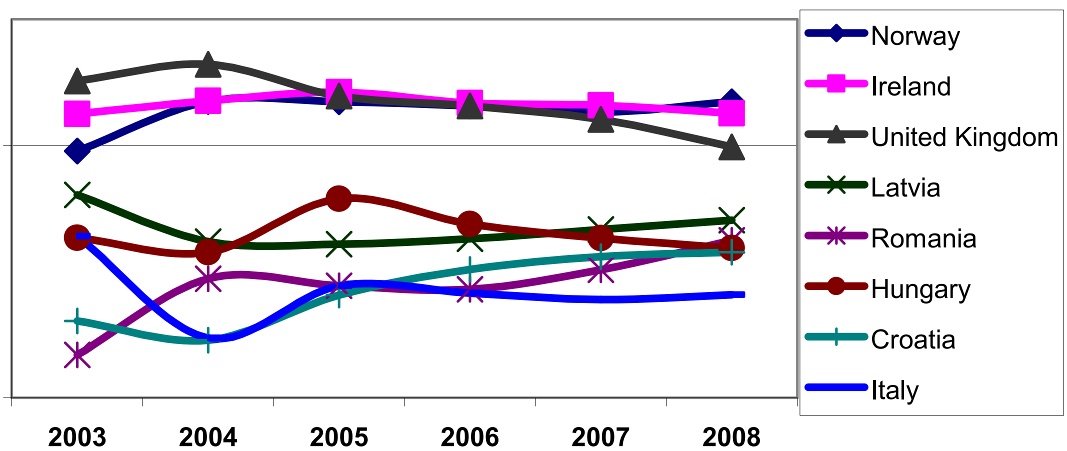
5.2. Regulatory framework institutions

Regulatory quality indicators have become important in the EU when measuring the success of the Lisbon Strategy in achieving its goals in member states. European Commission adopted in 2004 an integrated regulatory impact assessment to measure various costs and benefits associated with the legislative and regulatory changes as well as a cumulative impact of quality of regulatory environment on the economic performance and competiveness of member states (European Council, 2004). Traditionally, for many years these were the assessment tools of OECD and World Bank[6] which have measured it by composite indicators in yearly surveys for World Governance Indicators with an attempt to link regulatory reforms and modes of public governance with performance indicators of the examined countries. Reducing the regulatory burden as a restraining factor of country competitiveness is also one of the avenue to go (regulatory guillotine) in line with the goal of decreasing administrative burden for business set by the revised Lisbon Strategy.

For Regulatory framework, our constructed "regulatory quality pillar" which consists of indicators of regulatory burden; soundness of banks; strength of auditing and accounting standards; regulation of stock exchange and protection of minority shareholders, has shown that "old" members generally record stagnation i.e. neither convergence nor divergence is detectable. Only clear trend is downwards for the UK, but considered methodology used, this could reflect the strong impact of financial crisis on the perception of selected indicators of regulatory quality by the surveyed business executives, while the indicators with the strongest decline were *Regulation of Security exchanges* and *Soundness of banks*.

Still, there is a clear and noticeable distance between Norway, Ireland and the UK, that seem to have much better institutional framework than the other countries included, within the scope of the analytical method we used. New member states and Croatia seam to be more converging towards each other in terms of regulatory quality, and not towards the core EU-15, pointing towards an ample scope for better regulatory impact assessments of adopted new regulations.
Interestingly, new members again show upwards trend, driven by the improved perception of the *Soundness of banks,* with only Hungary losing ground in the last 3 years, due to deterioration of *Burden of government regulation* from 89% in 2002 to 72% in 2008.

FIGURE 5: Regulatory framework institutions



Source: WEF survey database, own calculation

[6] See Worldwide Governance Indicators, World Bank, http://info.worldbank.org/governance/wgi/sc_country.asp

5.3. Institutions for the protection of market competition

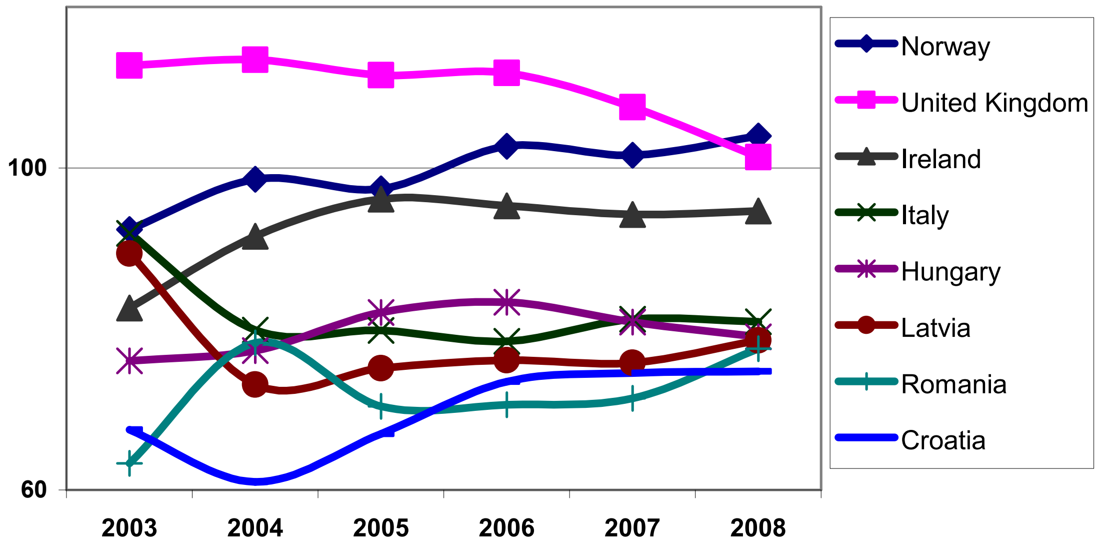
This is a field of clear divergence between the selected new members when measured by selected indicators (effectiveness of antitrust policy, extent of market dominance, quality of competition in the ISP sector, intellectual property protection decentralisation of corporate activity). After joining the EU, the pressure for adjustments of market structure has eased, coupled with some imperfect mechanisms of control within the OMC to adjust to EU competition rules within the new members themselves, could be the possible reasons. Also, dealing with competition rules, especially in the areas such as state aid to loss-making heavy industries, for some new CEE and SEE members were hard to comply with successfully due to weak capacities of anti-trust agencies. The same was with Croatia with regard to its steel and shipbuilding industry.

Italy and the UK fell significantly due to perceived decrease of *Competition in the ISP* sector, as well as *Effectiveness of antitrust policy*. Norway improved significantly for all 5 indicators of market competition, which is worth noting as opposed to a common sense that Norway, as non-member country is less included in the trends of increased market competition.

It is also interesting to note a similar trend in Croatia, however at a much lower level, indicating that surveyed executives feel increased competitive pressure, presumably due to opening of markets within the process of alignment to the acquis communautaire**.**

The distinction between Norway, Ireland and the UK and the new members is large and clear, and the UK, notwithstanding the loss of (perceived) position was still postioned above the EU15 average in 2008.

FIGURE 6: Institutions for the protection of market competition



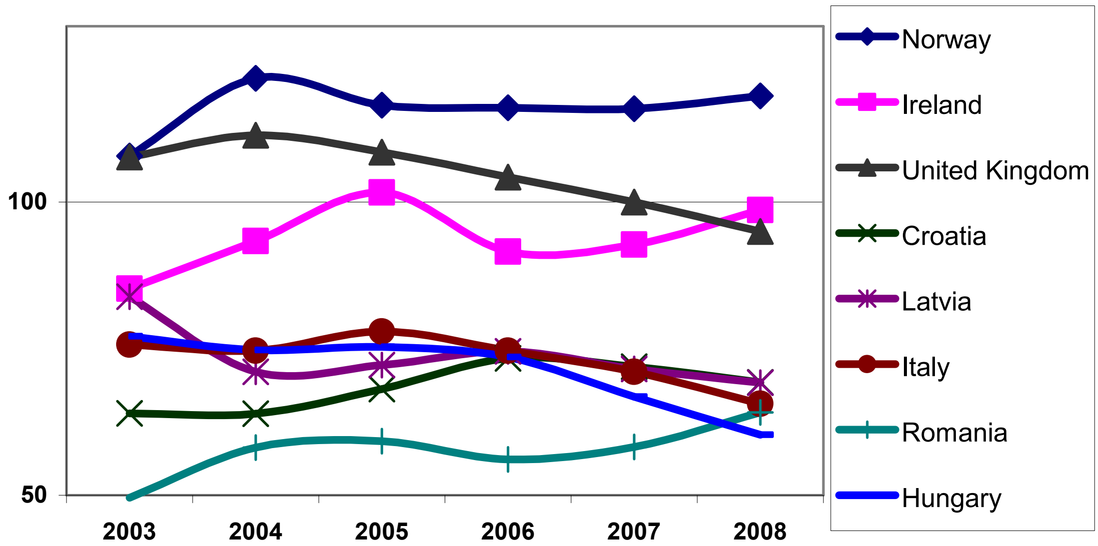
Source: WEF survey database, own calculation

5.4. Anti-corruption institutions

In this particular field (with indicators such as irregular payments in public contracts, business costs of corruption, irregular payments for public utilities, favouritism in decisions by government officials, public trust of politicians); divergence is clear for the old members, consistent with the movements of the overall Institutions index. The fall in Italy was immense, due to deterioration of perceived corruption of public servants and politicians. In the UK the most notable fall occurred in *Public trust of politicians*, from a position 16% above the EU15 average in 2005 to 15% below the average in 2008.

However, the 3 “old” EU members are still very much ahead with the (perceived) quality of anti-corruption institutions and policies, while the new members are further falling down from the already very low initial position. The only example is Romania, which significantly improved its initially quite disastrous position with immense improvement in the perception of corruption connected with public contracts and public utilities.
The perception of the examined indicators in Latvia and Hungary worsened notably, mostly with regard to trust in financial honesty of politicians and neutrality of government officials when deciding upon public policies and public procurement contracts.

FIGURE 7: Anti-corruption institutions



Source: WEF survey database, own calculation

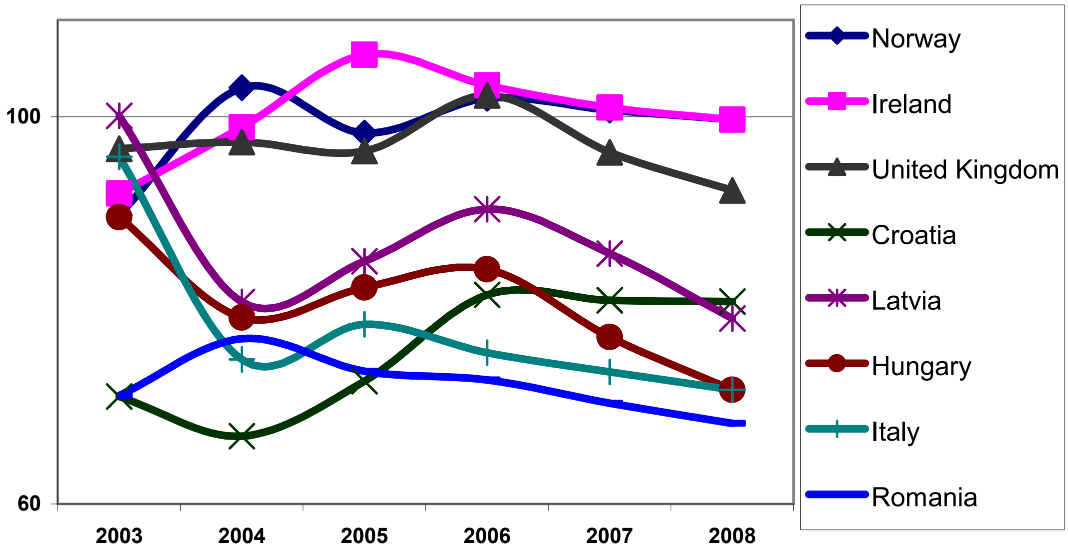
5.5. Public sector institutions

Regarding the quality of institutions having impact on the level of public sector and spending (quality of educational system; quality of public schools, government spending wastefulness, agriculture subsidies, overall public infrastructure quality), there is no advance even for the countries that gained the most in the overall index. The problem of productive use of public spending still remains important issue in the countries under review.

Developments were very similar also for the new and future members, with only Croatia showing a clear improvement in the perception of *Quality of public schools* and *Overall infrastructure quality*. Italy seems to lost the most in terms of public sector institutional quality, while worsening both in perception of unproductive loss of budgetary outlays and quality of service provided through public sector. Latvia and Hungary also worsened their position most notably in the perception of *Government spending wastefulness*, and to a less extent, *Quality of education*. The message is rather clear while the business community would like to see more public money invested in education and less spent unproductively.

According to the perceived developments in the selected countries, and within the scope of the methodology used, it seems that the gap between the quality of public sector institution in the new and old members has not been reduced, but rather widened.

FIGURE 8: Public sector institutions



Source: WEF survey database, own calculation

6. Concluding remarks

The paper attempted to demonstrate significant differences among the EU and selected non-EU countries in the 25 various indicators of institutional quality we measured by constructing our own “institutions” index based on WEF Executive Survey Indicators for Global Competitiveness Index Report.

Our analyses found interesting differences in terms of change of institutional quality even among the core EU-15 countries, and especially when compared with two most advanced EFTA countries. Some old EU members such as Italy, Greece and Portugal (throughout 2003-2008) and even the UK (especially in 2007-2008) were clearly demonstrating falling down convergence trends. Additionally, no real convergence trend of the new EU members could be detected from the presented data. Furthermore, the EU and future members from Western Balkans seam to be either stagnating or clearly diverging from an average EU institutional quality levels.

Leaving aside academic discussions[7] on difficulties and limitations of measuring the quality of institutions by composite governance indicators such as regulatory quality, rule of law, control of corruption, government effectiveness in delivery of policy goals, government accountability, ensuring absence of violence etc) which rely heavily on assessments and perceptions from WEF survey, we still found it an useful explanatory tool for cross-country comparison of their impact on economic performance an international competitiveness levels.

Regardless the fact that the new EU-members have progressed considerably in complying with the formal convergence criteria, and also as measured by the general WEF Global Competitiveness Index, looking into more detailed indicators we have shown that they as well as Croatia as “soon to be” a member, still have much to reform, especially in several examined fields of the quality of institutions. Directed efforts are needed especially when it comes to improving judiciary independence; enforcement of business contracts as well as in fight against corruption and organized crime especially in Western Balkan countries.

More detailed examination of specific indicators of institutional quality that directly affect the business transactions costs show that nominal convergence and transposition of EU norms des not necessarily guarantee their enforcement. The gap between the adopted and enforced norms is still rather high while effectiveness of government to deliver the good governance and institutional quality still low. As many other similar studies have demonstrated[8], converging institutional environment in terms of quality requirements especially in the new EU members and candidate countries is still very much a “work in progress”. This comes to be true even for some of “old” EU members.

[7] See Kaufman et al. (2007)
[8] World Governance Indicators, 2008; Doing Buisness, 2008, Transparency International Index, 2008.

ANNEX: Detailed data – values of indicators for the selected countries (in alphabetic order).

J1	Judicial independence	**T1**	Burden of government regulation	**C1**	Quality of competition in the ISP sector
J2	Business costs of crime and violence	**T2**	Soundness of banks	**C2**	Effectiveness of antitrust policy
J3	Business costs of organized crime	**T3**	Regulation of security exchanges	**C3**	Extent of market dominance
J4	Property rights protection	**T4**	Strength of auditing and accounting standards	**C4**	Intellectual property protection
J5	Reliability of police services	**T5**	Protection of minority shareholders' interests	**C5**	Local market dominance
R1	Irregular payments in public contracts	**P1**	Quality of the educational system		
R2	Business costs of corruption	**P2**	Quality of public schools		
R3	Irregular payments for public utilities	**P3**	Government spending wastefulness		
R4	Favoritism in decisions of government officials	**P4**	Agricultural policy cost		
R5	Public trust of politicians	**P5**	Overall infrastructure quality		

		Judiciary, protection of norms and police protection					Regulative institutions					Institutions for the protection of market competition					Anti – corruption institutions					Public – sector institutitons				
country	**year**	**J1**	**J1**	**J3**	**J4**	**J5**	**T1**	**T2**	**T3**	**T4**	**T5**	**C1**	**C2**	**C3**	**C4**	**C5**	**R1**	**R2**	**R3**	**R4**	**R5**	**P1**	**P2**	**P3**	**P4**	**P5**
Croatia	2003	50	79	68	51	64	72	79	71	73	65	68	64	87	52	67	68	57	80	63	52	72	82	75	79	47
Croatia	2004	43	71	65	54	54	68	74	69	74	59	65	53	71	53	63	61	69	81	56	52	70	79	67	64	54
Croatia	2005	54	79	68	63	67	77	88	77	76	64	70	60	84	59	62	71	73	79	66	51	71	80	74	74	65
Croatia	2006	58	76	72	65	65	91	82	79	82	67	75	67	90	65	70	73	76	79	73	66	82	92	81	81	73
Croatia	2007	59	87	80	70	75	88	87	80	84	73	81	69	68	67	88	71	76	82	69	62	77	93	82	80	74
Croatia	2008	57	95	86	70	80	88	91	79	82	75	89	66	65	67	87	68	78	83	62	56	75	92	79	84	74
Hungary	2003	90	88	88	89	75	89	79	90	87	82	58	77	87	78	81	77	74	96	68	71	87	93	113	96	60
Hungary	2004	83	85	86	84	73	84	73	87	87	85	61	80	88	77	81	78	74	92	67	62	87	95	72	73	69
Hungary	2005	82	92	88	93	81	92	89	89	91	96	70	85	98	76	81	76	78	96	68	59	90	98	75	79	69
Hungary	2006	77	93	89	90	80	87	85	88	89	88	73	86	97	81	78	74	73	93	65	62	88	97	70	89	77
Hungary	2007	79	97	92	90	83	81	84	89	87	86	74	83	72	79	96	67	62	89	59	57	75	89	63	83	75
Hungary	2008	77	96	94	87	82	72	85	88	89	84	77	80	69	74	94	59	54	86	53	49	66	83	57	82	72
Ireland	2003	96	82	92	94	95	112	107	105	102	98	54	94	89	87	88	91	97	99	82	58	112	106	102	82	58
Ireland	2004	103	91	100	105	98	121	107	102	106	98	71	101	93	95	97	99	101	99	97	70	111	112	93	110	69
Ireland	2005	114	94	98	106	100	118	106	104	109	105	79	101	92	105	103	104	108	99	109	89	123	114	101	116	78
Ireland	2006	112	89	97	105	94	120	104	97	104	107	77	98	101	95	106	98	97	98	91	75	119	116	85	121	74
Ireland	2007	107	92	100	104	97	112	104	105	106	105	79	95	102	98	97	99	95	98	91	80	117	113	88	116	70
Ireland	2008	110	95	105	106	100	107	104	103	106	105	79	100	98	102	94	107	102	103	97	85	116	111	94	110	67
Italy	2003	81	88	64	89	95	79	89	90	90	80	104	92	95	85	82	77	74	84	80	63	91	106	99	107	77
Italy	2004	65	80	58	76	83	62	82	73	65	65	85	78	96	71	69	83	79	94	65	52	75	84	64	86	65
Italy	2005	66	89	57	85	85	66	84	94	73	71	87	77	88	80	67	88	78	97	68	58	72	93	69	91	67
Italy	2006	65	78	51	83	86	63	84	88	76	71	86	77	82	74	74	88	79	94	62	50	71	85	67	91	64
Italy	2007	68	81	60	83	83	66	84	79	76	72	87	77	84	77	82	73	78	88	63	53	70	86	60	90	62
Italy	2008	64	84	61	80	80	69	86	80	76	71	85	74	89	79	78	60	75	84	61	49	67	84	55	91	62
Latvia	2003	77	84	81	81	82	122	88	85	85	82	88	83	115	74	86	83	78	83	89	86	98	87	118	118	80
Latvia	2004	61	87	82	79	73	93	90	83	85	72	75	72	90	57	71	69	74	86	72	54	87	82	85	81	69
Latvia	2005	66	93	91	79	77	104	89	76	83	70	81	74	85	61	75	68	77	87	71	58	87	84	86	99	69
Latvia	2006	69	91	94	80	76	103	88	78	84	72	84	72	89	61	74	74	84	86	72	57	94	94	95	97	72
Latvia	2007	69	96	95	83	76	100	89	84	85	74	85	73	72	62	88	73	81	87	65	51	87	90	90	91	72
Latvia	2008	66	103	103	88	75	100	90	86	88	77	89	76	73	66	89	69	77	88	63	49	76	86	79	85	70
Norway	2003	103	110	102	96	101	99	97	97	97	106	102	94	87	92	86	108	104	100	103	123	98	98	89	79	86
Norway	2004	115	114	110	108	109	109	104	102	104	115	99	108	85	110	91	116	111	103	130	145	109	103	116	81	107
Norway	2005	113	111	111	103	104	111	102	109	105	107	101	102	93	100	91	117	114	104	113	135	98	98	126	73	97
Norway	2006	115	113	111	103	109	118	101	108	102	102	106	106	101	102	98	111	109	104	120	137	108	104	122	78	98
Norway	2007	109	115	111	104	109	114	102	103	103	105	109	104	95	101	99	112	110	103	120	134	111	101	116	81	95
Norway	2008	108	119	114	106	109	111	103	106	106	109	115	105	96	106	100	115	114	105	120	137	112	92	114	88	93
Romania	2003	44	73	68	60	59	66	73	69	63	63	74	58	69	52	63	48	47	61	47	44	91	91	54	71	49
Romania	2004	54	82	75	67	73	99	77	76	73	69	81	68	104	60	77	54	59	70	60	47	89	86	75	81	54
Romania	2005	49	69	69	67	65	94	80	77	72	65	75	62	77	56	82	59	54	74	59	50	86	86	68	78	50
Romania	2006	52	70	79	67	64	96	80	72	71	66	66	66	88	56	76	57	57	71	53	42	83	89	63	87	42
Romania	2007	55	68	77	68	69	109	81	72	71	68	73	69	75	59	81	61	58	77	53	43	78	86	64	82	42
Romania	2008	58	86	84	70	73	110	87	74	78	76	88	73	80	64	83	75	62	84	53	47	74	79	69	78	42
UK	2003	110	90	100	108	103	99	107	114	113	119	116	115	104	113	116	114	106	100	108	110	91	87	110	104	91
UK	2004	110	98	106	111	103	109	107	114	117	117	115	116	107	112	118	114	110	103	116	114	96	88	106	99	98
UK	2005	113	90	99	108	98	94	106	112	114	113	111	111	109	113	114	112	106	102	107	116	98	88	102	99	95
UK	2006	113	95	98	106	97	102	106	105	109	109	116	110	109	110	113	108	107	102	106	98	99	94	110	104	104
UK	2007	108	84	95	100	94	99	104	103	107	108	110	107	108	106	106	105	102	98	101	94	96	92	96	99	99
UK	2008	102	78	89	92	91	97	95	99	105	103	105	101	100	97	104	101	100	96	93	85	96	94	82	94	96

Source: WEF survey database, own calculation

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