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Analyzing Bottlenecks for Institutional Development in Central Asia – Is it Oil, Aid, or Geography?

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Lebenslauf
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Analyzing Bottlenecks for Institutional Development in Central Asia – Is it Oil, Aid, or Geography?*

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Abstract: The quality of institutions is considerable worse in Central Asia than in other transition countries. Based on a panel of 25 transition countries for the period from 1996 to 2005, this paper shows that oil and aid exert a negative influence on institutional development. At the same time, transition countries benefited from external incentives due to cultural proximity to the West or a membership perspective in either EU or NATO. However, the evaluation for Central Asia reveals that aid, oil, and geography explain part of the backlog but, even accounting for the fact that the countries are "far away" and do not benefit from external incentives as do other transition countries, there is a strong and homogenous negative regional component of bad governance. Hence, change might come but at a very low pace.

Keywords: EU, NATO, Transition Economies, Institutional Change, Governance, Central Asia

JEL-Classification: F15, F20, F50, P20, P30, O19

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1. Introduction

As has been exemplified by the case of the Eastern Enlargment of the EU, external drivers can speed up the convergence of weak governance structures towards Western standards considerably. 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). Europeanization, i.e. the adoption of EU rules by transition countries, is possibly “the most massive international rule transfer in recent history” (Schimmelpfennig and Sedelmaier 2005). This top-down process of “Enlargement Europeanization” has been guided by the Copenhagen criteria for accession to the EU which demand the fulfillment of comprehensive political, legal and economic criteria (Foders et al. 2002).

However, after the 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 at present exclusively reserved for the Western Balkan states. For FSU (Former Soviet Union republics, except the Baltic States) as well as for Mediterranean countries, European Neighborhood Policy (ENP) foresees support from the EU conditional on performance according to governance criteria. Nevertheless, compared to the big carrot of membership, ENP incentives may be too limited in order support internal drivers of institutional reform (Vinhas de Souza et al. 2006). For FSU countries in Central Asia, incentives for “Neighbourhood Europeanization” can be assumed to be even lower (Gawrich et al. 2008).

Table 1 reveals that relations of Central Asian transition countries with either EU or WTO and NATO are at a very early stage. Only Kazhakhstan, the Kyrgyz Republic, and Uzbekistan benefit from Partnership and Cooperation Agreements (PCAs) which have been ratified by the EU. These agreements date back to 1999, the year when PCA agreements have been concluded for the Caucasus countries as well. Different to Central Asian countries the latter group of countries reached a somewhat closer relationship with the EU recently. For Tajikistan and Turkmenistan, PCA agreements have not been ratified by the EU. The same applies when looking at WTO and NATO integration. Only the Kyrgyz Republic became a member of WTO in 1998 and only Kazakhstan moved from a Partnership for Peace (PfP) agreement with NATO, which is a standard for all transition countries including Russia, to an Individual Partnership Action Plan (IPAP) agreement in 2006.

In addition, Central Asian countries are not only far away from the Western community (and close to China and Russia for that matter), but are characterized by large inflows of resources either steming from oil or aid (Promfret 2006; Spechler 2008a). Hence, while not benefiting from close relations with the West, Central Asian countries also face the difficulty of fighting potential disincentive effects from resource curse effects. As long as financial inflows stemming from these sources “grease the wheels” and, at least for some years, create high growth rates the need for reforms is difficult to establish. In addition, big money is likely to create more corruption which renders it difficult to develop productive activities in a competitive environment.

Indeed, a first comparison with other transition countries reveals a rather low development of institutions in these countries. Table 2 presents indicators on institutional quality which have been standardized and which highlight different aspects of institutional quality. While the Freedom House indicator shows political rights and civil liberties and, hence, concentrates on the democracy aspect, the Heritage and EBRD indices reveal the quality of administrative and economic institutions. Finally, the World Bank Governance Indicators (WBGI) represent a more comprehensive view on institutional quality including legislative, administrative, and legal aspects. It is evident from the table that Central Asia, together with Belarus clearly hold the red lantern with respect to institutional quality. The only exception is economic freedom as measured by the Heritage index which has Tadjikistan above FSU average. This supports the hypothesis that institutional development may be rather difficult in the absence of external drivers providing carrots and sticks as was the case in “Enlargement Europeanization”.

However, the empirical evidence on external drivers of institutional change in transtition countries is rather limited. Recent papers focus mainly on internal economic, political, and cultural factors (Di Tommaso, Raiser, and Weeks 2007; Beck and Laeven 2006) treating an EU influence rather as a control variable than as a main determinant of institutional change. Hence, this paper fills an empirical gap by focusing on external influences and analyzing the influence of different international organizations European transition countries may join. These organizations often provide positive incentives for improving institutions. While papers analyzing the impact of trade relations include WTO membership (see, e.g., Bacchetta and Drabek 2004) and also the impact of the EU has received extensive attention, the accession to NATO as a determinant of institutional change has not. NATO membership has been mostly analyzed with respect to economic aspects of regional security (e.g. Sandler and Hartley 1999).

The paper shows that natural resources and capital inflows exert an insignificant or negative influence and that economic policy allows to break path-dependency. At the same time, transition countries benefited from external incentives provided from both EU and NATO. Below a membership perspective, ENP and NATO-MAP provide trade and security incentives respectively. This allows to assess the situation of the Central Asian countries in contrast to comparable FSU countries which may benefit (more) from external incentives. Section 2 gives a short overview of the existing literature which presents the theoretical arguments. Results from panel estimations for 25 transition countries for the period from 1996 to 2005 based on the World Bank Governance Indicators, the most comprehensive measure for institutional quality publicly available, are shown in section 3. Section 4 summarizes and draws policy conclusions for Central Asian FSU countries.

2. Empirical Evidence on External Drivers of Institutional Change

A political economy explanation of why institution building has varied so much across transition countries which are resource rich like Kazakhastan and Turkmenistan, and, to a lesser extent, Uzbekistan is provided by Beck and Laeven (2006). They argue that political entrenchment and reliance on natural resources critically determine whether the behavior of the ruling elite and thus the transition process are 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).

Concerning the influence of resource endowment on institution building, plenty of studies suggest that the adverse effect of resource abundance on institutional quality 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) whose rents are more dispersed throughout the economy, and with easy appropriation of rents through state institutions (Auty, 1997, 2001; Isham, et. al., 2005; Sala-i-Martin and Subramanian 2003; Murshed, 2004; Collier and

Hoeffler 2004; Ploeg 2007). Analyzing the political economy of resource-driven growth in the FSU countries, Auty (2001; 2006) finds that most resource-abundant countries engender a political state that is factional or predatory and whose government responds slowly to the challenges of economic reforms, 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. In contrast, other natural resources, measured for example as the share of agriculture in GDP, are not found to have a negative influence.

For Tajikistan and the Kyrgyz Republic large scale inflows of financial resources are rather coming from aid than natural resources. Hence, aid may create similar disincentive effects for improving institutional quality. As shown in the literature, 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 more sensitive to bad governance grow at a slower pace in countries that receive more aid (Rajan and Subramanian 2007).

Another source of disincentives for Central Asian countries stem from the lack of potential external drivers of institutional change. The literature on external drivers of institutional change in transition countries is clearly dominated by research on EU-ization by means of accession and neighbourhood policy (see, e.g., Beck and Leaven 2006; Pop-Eleches 2007; Di Tommaso et al. 2007) and seems to confirm a positive impact of basic agreements between the EU and transition countries.[1] At the same time, a potential impact of NATO which has Partnership for Peace (PfP) agreements with all former Soviet countries is disregarded, except for economic aspects of enlargement on regional security (see, e.g., Sandler and Hartley 1999; Andrei and Teodorescu 2005). In its Membership Action Plan (MAP) approved at NATO's Washington Summit in 1999, NATO accession requires a minimum of institutional standards. The "carrot" in this case is regional security rather than economic cooperation. Hence, it can be argued that NATO accession could have a positive effect which might be comparable to the impact of EU accession. In addition to the EU and NATO, the WTO may also provide major incentives for institution building. However, as reported in Busse et al. (2007) empirical studies largely fail to show a significant impact once trade flows are controlled for. In addition, some transition countries became WTO members long before entering the transformation process.

Clearly, cooperation with EU and NATO seems not to be completely irrelevant for Central Asia, but further steps towards deeper integration are not in the cards or would provoke Russian resistance as witnessed by the conflict in Georgia. Therefore, 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 is 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.
- Trade and capital flows may impact on the preconditions for institutional change through closer interaction 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 suffers 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). For the FSU 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 promote good governance in FSU countries. However, focusing on corruption, Hellmann, Jones, and Kaufmann (2002) show that foreign firms are 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.

While a comprehensive empirical analysis of all relevant external drivers of institutional change in transition countries is still missing, the analysis of internal determinants can be based on a variety of papers. The basic distinction is between economic and political factors.

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1 While this finding would allow for some optimism regarding weak incentives provided by ENP, the paper by Di Tommaso et al. (2007) uses indicators from the EBRD for measuring institutional change in terms of

The view that economic performance drives institutional development is supported by the modernization hypothesis which states that higher levels of economic development will lead to better institutional quality (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 crises may also be an important determinant 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 ruling autocratic regimes is relatively low. When citizens reject policy changes that are easy to renege upon once the window of opportunity closes, autocratic regimes must make democratic concessions to avoid costly repression (see also Brückner and Ciccone 2008). Apart from economic performance, also economic policy is important for 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 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).

All in all, there is established evidence on the importance of internal determinants of institutional change. However, any empirical analysis needs to condition on external determinants as well in order to avoid misspecification. For European and FSU transition countries, potentially relevant external factors comprise economic relations, proximity, and, at least to some extent, cooperation with EU and NATO.

We test this hypothesis for 25 transition countries using a comprehensive measure of institutional quality, i.e. the World Bank Governance Indicators (WBGI). The WBGI are calculated as the sum of six single indicators as provided by the World Bank (Kaufmann et al., 2007). 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

economic institutions only. However, the Europeanization strategy of the EU is not restricted to a narrow concept of economic institutions but targets political and legal institutions as well.

integrates legislative, administrative and legal aspects as well as political and economic institutions (Schweickert 2004).

A variety of explanatory variables are employed not only in order to assess their coefficients but also to proxy for important and otherwise unobserved country characteristics as previously described. All explanatory variables and their data sources which have been employed are listed in Table A1 and the complete set of regressions is presented in Drautzburg et al. (2008). In the following, only the results from the baseline model are presented which followed from eliminating insignificant variables in the comprehensive model.

Table 2 shows that both EU and NATO cooperation has a positive impact on the level of institutional quality in transition countries. EU BASIC is a dummy variable which takes the value of one in a country for each year after a Stabilization and Association Agreement (SSA) has been signed or a Partnership and Cooperation Agreement (PCA) came into force. This definition resembles that by Di Tommaso, Raiser and Weeks (2007). NATO MAP indicates whether a Membership Action Plan (MAP) has been established for a country. Proximity and interaction with western countries has an ambiguous effect. WESTERN indicates whether a country belongs to the western Christian community. These countries clearly have better institutions than other transition countries. At the same time, the negative coefficient of AID measuring aid inflows into transition countries supports arguments on rent-seeking behaviour rendering institutional reforms more difficult.

Internal economic determinants include indicators of economic policy as well as economic performance. In line with Di Tommaso, Raiser, and Weeks (2007) we measure economic policy using the LIBERALIZATION indicator provided by the EBRD. Di Tommaso et al. found a positive impact on an aggregated EBRD indicator of institutions and we expect a similar impact on a broader concept of institutions not constructed by the EBRD itself. Table 1 shows that this is indeed the case. In addition, LIBERALIZATION as well as NATO MAP are also significant in fixed effects regressions showing that economic reforms have a positive impact on institutional dynamics as well. Coefficients of internal political factors chosen to reflect both incentives for policy as well as initial conditions reveal the expected signs. COHESION reflecting whether the first post-communist government was relatively independent of the former communist party is a positive factor for institutional quality and TENSIONS, a dummy which measures whether the transition from communism involved conflicts, has a quite strong negative impact on institutions. This also applies to the availability of extractable resources as measured by the ENDOWMENT dummy and the MINERAL EXPORT variable.

All in all, our results confirm the arguments raised in the literature on institutional change in developing and transition countries that oil, aid, and geography matter for institutional development. As will be shown next, this implies a heavy burden for institutional change in Central Asia, i.e. for countries which are either resource rich, have to handly large scale aid inflows, and, all of them, far away from well governed countries in the West. However, both internal and external actors can influence institutional development in transition countries positively. Internal actors can break path-dependencies through economic policy reforms, whereas both EU and NATO can have some positive impact even through basic cooperation agreements.

3. Implications for Institution Building in Central Asia

As can be seen in Figure 1, only Kazakhstan shows an above average of institutional quality compared to FSU countries. Initially, the same applied to Kyrgyzstan which, together with Uzbekistan shows a clear negative trend. In the case of Kyrgyzstan, the Tulip revolution in 2005 brought an end to the deterioration of institutions under Akayev. The only country in Central Asia which improved institutional quality significantly since the mid-1990s is Tadjikistan albeit from a very low level if one considers that the "normal" range of the normally distributed WBGI index ranges between +/- 2.50. Additionally, the country suffered from civil war until 1997 and could only catch up later (see EIU var. iss.).

All in all, the picture reveals some heterogeneity with institutions converging and stabilizing in recent years. In 2006, three groups of Central Asian countries could be distinguished: Kazakhstan – the only country above FSU average; Kyrgyzstan and Tajikistan slightly below FSU average; and Uzbekistan and Turkmenistan which did not only perform much worse than the other Central Asian countries but also reveal bad institutions on an absolute level. This supports the hypothesis that institutional development may be rather difficult in the absence of external drivers providing carrots and sticks as was the case in "Enlargement Europeanization".

Tables 4 and 5 provide some explanations for the heterogeneity of institutional quality in Central Asia. While all of them "benefit" from modest incentives due to the PCA agreements with the EU, initial political conditions and progress with economic liberalization are quite different (Table 4). Clearly, there is no one-size-fits-all story but the three groups of countries share a common background. Kazakhstan like the others suffered from a negative value of the cohesion variable implying a very high share of votes for the communist party in the first elections. However, the country is the only one in Central Asia which did not suffer from tensions at independence. At the same time, economic liberalization according to the EBRD index is quite advanced with a value of 3.89 rather close to the maximum of 4.33. The impact from resource flows is mixed with low aid flows and high revenues from oil exports as indicated by the endowment indicator.

Compared to Kazakhstan, the other groups of countries suffered from tensions at independence but are quite different with respect to the other indicators. Tajikistan and Kyrgyzstan both reveal an advance level of economic liberalization but very high inflows of aid measured in percent of GDP. Uzbekistan and Turkmenistan did not receive substantial aid inflows but the resource endowment is at least on a medium level and economic reforms not substantial with Turkmenistan being rather close to where all socialist countries started at the beginning of transition (a value of 1 for the indicator). These results might suggest that aid inflows constitute more of a problem than a resource curse and that negative incentive effects from aid are not easily compensated by a liberal economic policy.

Table 5 supports this argument by combining the value of the exogenous variables with the coefficient estimated and shown in Table 3 (column 4). As can be seen, the negative impact of high resource endowment in Kazakhastan and Turkmenistan is about half of the negative impact of high aid flows in Tajikistan and Kyrgyzstan. However, economic liberalization could well compensate for some disincentives. Substantially more liberal economic policy in Kyrgyzstan accounts for an improvement of institutional quality of 0.7 percent. Nevertheless, Table 5 also reveals conditions which are fixed, at least in the near future, and which impact on institutional (non-)development. Not belonging to the group of transition countries which share western cultural values and which benefit from NATO MAP implies about a difference in institutional quality of about 1 standard deviation. In addition, the regional factor which is calculated as a residual points to a special situation in the region. It is quite striking that the level of this residual is quite homogenous across Central Asia. The only exception is Uzbekistan where, given the disadvantages measured by the determinants of institutions, institutional quality is even worse than in the other Central Asian countries.

The six dimensions of institutional quality measured by the World Bank provide some additional insights into the main bottlenecks for institutional development in the region. If compared to the “normal” pattern observed in the new member states of the EU (see, e.g., Schweickert 2004), the lowest quality of institutions is not measured for corruption but, with minor exceptions for political rights and/or stability. It is quite obvious that there is relative stability in some countries (Kazakhstan, Turkenistan) and voice in another (Kyrgyzstan) but in none of the countries stability and voice go together. In Tajikistan and especially in Uzbekistan, the level of voice and stability is worse than the level of institutional quality measured for the other four dimensions. Hence, corruption is a problem but – contrary to other countries with bad institutions – not the worst. In addition, the political challenge for the region would be to provide progress with respect to voice *and* stability.

All in all, these stylized facts from an empirical investigation for transition countries do fit quite well to the qualitative information provided by country studies and surveys on the region. It is beyond the scope of this paper to provide a detailed discussion of institution building in the region. But for our purpose it may be sufficient to refer to a recent survey of the region from Spechler (2008a) based on Ofer and Pomfret (2004), Pomfret (2006), and Spechler (2004). According to Spechler, common reasons for slow reforms are geographic and cultural distance with a low exposure to Western culture, dominant positions for ex-communist apparatchiks, weak nationalism, and clan structures with families and close associates of the presidents directly and secretly benefitting from enterprises operating within their countries. In addition, the sustainability of the situation is in a way guaranteed by inflow of financial resources due to commodity exports, remmitances or aid.

This implies that the situation of Central Asian countries is different from transition countries in the European Neighbourhood like Ukraine. For Ukraine, Melnykovska and Schweickert (2008) argue that business clans change direction demanding for better formal institutions and for opening up the country in order to protect their wealth acquired in the first stage of transition. In this sense, business elites might become driving forces of institutional change as was the case during the Orange Revolution. Central Asia is clearly far away from such a situation with no significant middle class and too much money still feeding the system. In addition, as also pointed out by Spechler (2008b), China and Russia present new models of oligarchic, state-directed capitalism on the borders of Central Asia. In other words, different to the EU and NATO which raise high demands in terms of democracy promotion and competition policies in exchange for cooperation, cooperation with China is considerably less “costly” for the ruling elites.

4. Summary and Policy Conclusions

The empirical findings on the determinants of institutional quality in transition countries presented in this paper imply that Central Asian countries clearly face a disadvantage. Central Asian countries do not belong to the western cultural community and have rather loose ties with western communities so far. However, given this lack of external drivers, other variables found to impact on the quality of institutions may well explain some of the differences between Central Asian countries. Looking at recent performance (Table 1), the best performer in Central Asia, Kazakhastan, is the only country which did not face tensions at independence. At the same time, the worst performers, Uzbekistan and Turkmenistan, are among the group of countries with the worst performance concerning economic liberalization measured by the EBRD index and, additionally, face potential disincentive effects for institutional reform stemming from medium or high level of resource endowment. Interestingly, countries with high levels of aid inflows, Tajikistan and Kyrgyzstan, range between these two groups of Central Asian countries. The fact that these countries show a strikingly divergent development since the mid-1990s may support the argument that foreign aid inflows may well provide disincentives for institutional development but that it is not the single most important determinant. Nevertheless, the challenge for foreign donors remains that the will to do something good will actually lead to improvement.

A more detailed analysis of the determinants and dimensions of institutional quality revealed a substantial extent of path-dependency:

- Being far away from Europe, Central Asian countries are not attracted by EU or NATO incentives. In addition, potential cooperation with other regional players, Russia and China, which are much less demanding in terms of political and economic reforms lends support to a multi-vectoral approach. Taking a little bit of everyone helps to sustain the current situation.
- The political challenge is to provide voice *and* stability. If there is progress than it is restricted to one of these dimensions. Obviously, the clan structure based on presidential systems initially run by, mostly, ex-communist apparatchiks is feeded well by a variety of inflows: aid, remmitances, commodity exports.
- As a consequence, there is an important regional factor. Institutions are worse than predicted by the normal pattern. Change might come but with a very slow pace. Civil society and business interests (apart from clan structures) can be assumed to remain too weak for the time being.

Table 1: Integration of Transition Countries into EU, WTO and NATO

Country	EU								WTO			NATO				
	Membership	Accession Negotiations End	Accession Negotiations Begin	Membership Strong Notice	EA / EAAP* SAA Signed	ENPAP / 4CS / EA* Agreed	PCA / CA in Force	PCA / CA signed	Membership	Accession Negotiations Begin	Application received	Membership	MAP	Intensified Dialogue	IPAP	PfP
EU Members 04																
Czech Republic	2004	2002	1998	1997	1995	1991			1947			1999	1997			1994
Estonia	2004	2002	1998	1997	1995				1999	1994	1994	2004	1999			1994
Hungary	2004	2002	1998	1997	1995	1991			1973			1999	1997			1994
Latvia	2004	2002	2000	1997	1995				1999	1995	1993	2004	1999			1994
Lithuania	2004	2002	2000	1997	1995				2001	1995	1994	2004	1999			1994
Poland	2004	2002	1998	1997	1995	1991			1967			1999	1997			1994
Slovak Republic	2004	2002	2000	1997	1995	1991			1947			2004	1999			1994
Slovenia	2004	2002	1998	1997	1996		1993	1993	1994	n/a	n/a	2004	1999			1994
EU Members 07																
Bulgaria	2007	2004	2000	1997	1995	1993			1996	1991	n/a	2004	1999			1994
Romania	2007	2004	2000	1997	1995	1993			1971			2004	1999			1994
Balkans																
Albania				2003	2006		1992	1992	2000	1999	1992		1999			1994
Croatia			2005	2003	2001				2000	1996	1993		2002			2000
Macedonia				2003	2001		1998	1997	2003	2000	1994		1999			1995
Southern Caucasus																
Armenia						2006	1999	1996	2003	1996	1995				2005	1994
Azerbaijan						2006	1999	1996		2002	1997				2005	1994
Georgia						2006	1999	1996	2000	1998	1996			2006	2004	1994
EU east neighbours																
Moldova						2005	1998	1994	2001	1997	1993				2006	1994
Ukraine						2005	1998	1994	2008	1995	1993			2005		1994
EU north east neighbours																
Russia						2003	1997	1994		1995	1993					1994
Belarus							**	1995		1997	1993					1995
Central Asia																
Kazakhstan							1999	1995		1997	1996				2006	1994
Kyrgyz Republic							1999	1995	1998	1997	1996					1994
Tajikistan							***	2004		2004	2001					2002
Turkmenistan							****	1998								1994
Uzbekistan							1999	1996		2002	1994					1994

Definitions: PCA - Partnership and Cooperation Agreement; CA - Cooperation Agreement; ENPAP - European Neighbourhood Policy Action Plan; 4CS - Four Common Spaces; EA - Europe Agreement; EAAP - Europe Agreement Additional Protocol; SAA - Stabilization and Association Agreement; Membership Strong Notice - the Luxembourg Summit of 1997 for Central and East European countries or the Thessaloniki Summit of 2003 for Western Balkans; MAP - Membership Action Plan; IPAP – Individual Partnership Action Plan; PfP – Partnership for Peace

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 Tajikistan 06/12/2005, ratification not completed by EU. — **** PCA was ratified by Turkmenistan 11/02/2004, ratification not completed by EU.

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)

Table 2 – Institutional Quality in FSU and EU Benchmark Countries, 2007

Institutional Quality		Country	Institutions (FH, Herall, WBGIall, EBRDinst), average	WBGIall 2007	FH 2007	Herall 2007	EBRDinst 2007
high (1> and >=0.75)	New EU Members	Estonia	**0.80**	0.68	1.00	0.78	0.75
		Lithuania	**0.75**	0.64	1.00	0.72	0.64
medium high (0.75> and >=0.50)		Latvia	**0.71**	0.64	0.92	0.68	0.61
		Bulgaria	**0.65**	0.55	0.92	0.62	0.52
		Romania	**0.62**	0.52	0.83	0.61	0.50
	above FSU average	Ukraine	**0.53**	0.42	0.75	0.53	0.41
medium low (0,50> and >=0,25)		Georgia	**0.49**	0.45	0.50	0.69	0.32
		Moldova	**0.48**	0.40	0.58	0.59	0.36
		Armenia	**0.48**	0.44	0.42	0.69	0.36
		Kyrgyzstan	**0.41**	0.33	0.42	0.60	0.30
		Kazakhstan	**0.41**	0.38	0.25	0.60	0.39
	FSU		**0.40**	0.35	0.31	0.54	0.37
	below FSU average	Russia	**0.39**	0.35	0.25	0.54	0.43
		Azerbaijan	**0.35**	0.34	0.25	0.55	0.27
		Tajikistan	**0.32**	0.30	0.25	0.57	0.18
		Belarus	**0.26**	0.29	0.08	0.47	0.20
		Uzbekistan	**0.25**	0.25	0.00	0.53	0.21
low (0.25>)		Turkmenistan	**0.16**	0.23	0.00	0.43	0.00

Notes: Initial Values have been standardized into a range from 0 (lowest) to 1 (highest) value. WBGIall – average of six World Bank Governance Indicators; FH – average of Freedom House Indicators on civil and political rights, democratic governance, rule of law and freedom of media around the world; Herall – Heritage Index of Economic Freedom; EBRDinst – average of EBRD Institutional Indicators on enterprise reform and governance indicator, banking reform index and non-banking financial sector reform indicator). All averages are unweighted except for the FSU aggregate which is a population-weighted average for 11 post-Soviet republics participating in the Commonwealth of Independent States, including Georgia). Ranking according to the aggregate indicator Institutions.

Source: World Bank, Freedom House, Heritage Foundation, EBRD, own calculations.

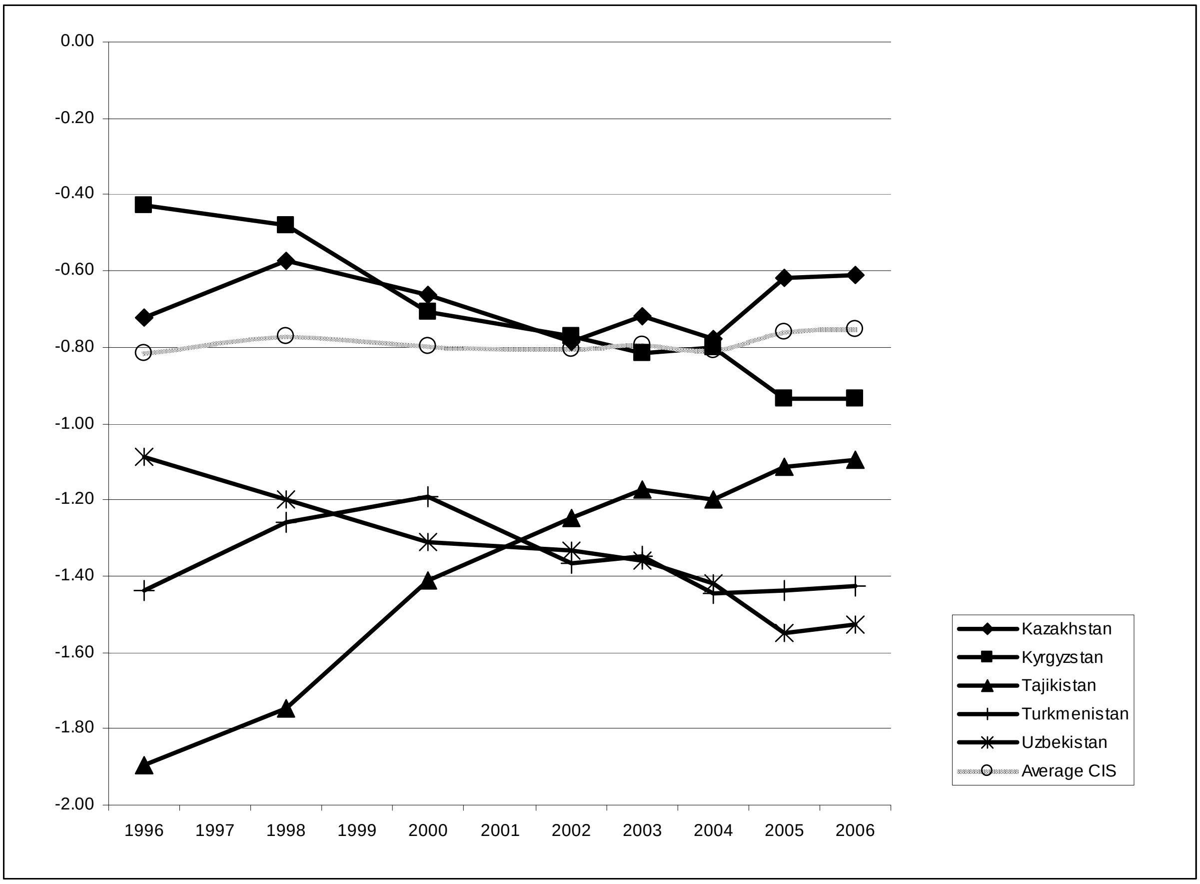
Table 3 - Baseline model estimates, 1996 – 2005

	(1) POLS	(2) Pooled IV	(3) POLS	(4) Pooled IV	(5) POLS	(6) Pooled IV
EU BASIC	1.301 ***	1.268 ***	1.450 ***	1.522 ***	1.336 ***	1.423 ***
	(3.88)	(3.33)	(4.07)	(4.08)	(3.42)	(3.54)
NATO MAP	1.512 ***	1.539 ***	1.720 ***	2.011 ***	1.660 ***	1.919 ***
	(5.27)	(3.21)	(5.45)	(3.97)	(5.32)	(3.73)
LIBERALIZATION	1.400 ***	1.512 ***	1.686 ***	1.582 ***	1.706 ***	1.574 ***
	(5.67)	(3.67)	(5.73)	(3.30)	(5.90)	(3.22)
AID	-0.139 **	-0.152 ***	-0.237 ***	-0.230 ***	-0.209 ***	-0.205 ***
	(-2.79)	(-2.91)	(-4.11)	(-3.50)	(-3.97)	(-3.11)
WESTERN	4.091 ***	3.995 ***	3.912 ***	3.823 ***	3.981 ***	3.900 ***
	(9.34)	(10.17)	(7.85)	(8.20)	(8.05)	(8.40)
TENSIONS	-2.023 ***	-1.981 ***	-1.228 **	-1.230 ***	-1.219 **	-1.221 **
	(-9.01)	(-8.82)	(-2.53)	(-2.62)	(-2.24)	(-2.41)
COHESION	0.008 **	0.008 ***	0.004	0.005	0.006 **	0.006 ***
	(2.63)	(2.71)	(1.34)	(1.61)	(2.69)	(3.09)
MINERAL EXPORTS	-0.062 ***	-0.061 ***				
	(-6.37)	(-6.73)				
ENDOWMENT			-1.056 ***	-1.027 ***	-0.670 **	-0.679 ***
			(-5.43)	(-6.16)	(-2.43)	(-2.91)
ENDOWMENT x AID					-0.151 **	-0.141 ***
					(-2.59)	(-2.66)
R-squared	0.96	0.95	0.95	0.95	0.96	0.95
adjusted R-squared	0.95	0.95	0.95	0.94	0.95	0.95
No. observations	123	123	123	123	123	123
Wald test, p-value	0.00	0.00	0.00	0.00	0.00	0.00
Time dummies	yes	yes	yes	yes	yes	yes
Hansen test, p-value	n/a	0.27	n/a	0.25	n/a	0.15

	(7) FE	(8) FE IV	(9) FE	(10) FE IV	(11) FE	(12) FE IV
EU BASIC	0.012	0.196	-0.007	0.258	0.020	0.303
	(0.03)	(0.47)	(-0.02)	(0.62)	(0.06)	(0.75)
NATO MAP	1.542 ***	3.282 ***	1.550 ***	3.461 ***	1.520 ***	3.569 ***
	(5.24)	(3.92)	(5.35)	(3.77)	(5.51)	(4.00)
LIBERALIZATION	1.287 ***	3.148 *	1.269 ***	3.157 *	1.273 ***	3.090 *
	(3.31)	(1.73)	(3.20)	(1.90)	(3.02)	(1.91)
AID	-0.109	-0.133	-0.111	-0.194	-0.089	-0.215
	(-0.88)	(-0.54)	(-0.88)	(-0.65)	(-0.70)	(-0.76)
MINERAL EXPORTS	-0.004	0.004				
	(-0.23)	(0.14)				
ENDOWMENT x AID					-0.337	-0.245
					(-1.33)	(-0.79)
R-squared	0.46	-0.11	0.46	-0.18	0.49	-0.21
adjusted R-squared	0.41	-0.51	0.42	-0.59	0.44	-0.65
No. observations	123	123	123	123	123	123
Wald test, p-value	0.00	0.02	0.00	0.03	0.00	0.03
Time dummies	yes	yes	yes	yes	yes	yes
Hansen test, p-value	n/a	0.66	n/a	0.71	n/a	0.70

Note: Dependent variable: aggregate WBGI; for the definition of variables see Table A1. Heteroskedasticity and autocorrelation robust t-statistics in parentheses. *** $p < 0.01$, ** $p < 0.05$, * $p < 0.10$.

Figure 1: Institutional Quality in Central Asian countries measured by aggregate WBGI index, 1996 - 2006



Source: See Table A1

Table 4 – Determinants of Institutions in Central Asia - Looking for Differences, 2006

	WBGIall	Tensions	Cohesion	Liberalization	Aid	Endowment
Kazakhstan	-0.61	no	-0.88	3.89	0.76	high
Tajikistan	-1.10	yes	-0.98	3.67	11.58	low
Kyrgyzstan	-0.93	yes	-1.00	4.22	13.62	low
Uzbekistan	-1.53	yes	-1.00	2.67	1.34	medium
Turkmenistan	-1.43	yes	-1.00	1.89	0.89	high

Source: See Table A1; own calculations.

Table 5 – Accounting for Institutional Distance, 2006

	WBGIall	Regional	EU Basic	Tensions	Cohesion	Liberalization	Aid	Endowment	NATO MAP	Western
Kazakhstan	-0.61	1.65	0.19	0.00	-0.001	1.17	-0.03	-0.29	0.33	0.64
Tajikistan	-1.10	1.76	0.19	-0.23	-0.001	1.10	-0.41	0.00	0.33	0.64
Kyrgyzstan	-0.93	1.68	0.19	-0.23	-0.001	1.27	-0.48	0.00	0.33	0.64
Uzbekistan	-1.53	2.10	0.19	-0.23	-0.001	0.80	-0.05	-0.15	0.33	0.64
Turkmenistan	-1.43	1.64	0.19	-0.23	-0.001	0.57	-0.03	-0.29	0.33	0.64

Source: See Tables 3 (column 4) and A1; own calculations.

Table 6 – Institutions in Central Asia – A Diversified Picture

	Voice and Acountability	Political Stability	Government Effectiveness	Regulatory Quality	Rule of Law	Control of Corruption	WBGIall
Kazakhstan	-1.03	0.06	-0.53	-0.42	-0.82	-0.92	-0.61
Kyrgyzstan	-0.7	-1.2	-0.86	-0.57	-1.18	-1.09	-0.93
Tajikistan	-1.27	-1.3	-1.06	-0.98	-1.06	-0.91	-1.10
Turkmenistan	-2.0	-0.27	-1.45	-2.12	-1.44	-1.28	-1.43
Uzbekistan	-1.86	-1.94	-1.24	-1.66	-1.44	-1.02	-1.53

Source: See Table A1; own calculations.

Table A1: Overview of variable specifications and data sources

Variable	Description	Source
Dependent Variable		
WBGI	Sum of the the six WBGI sub-indices (voice and accountability, political stability and absence of violence, government effectiveness, regulatory quality, rule of law, and control of corruption)	WBGI; http://www.govindicators.org
Explanatory Variables - External Factors		
Membership		
EU BEGIN NEGOTIATIONS	Dummy variable equals 1 starting in the year accession negotiations with the EU began.	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	Dummy variable, equals 1 for all countries except: Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyz Republic, Moldova, Russia, Tajikistan, Turkmenistan, Ukraine and Uzbekistan.	EU Agreement Database
EU STRONG NOTICE	Dummy variable equals 1 starting in the year in which the country received a strong notice of membership by the EU.	EU Agreement Database
NATO MAP	Dummy variable equals 1 starting in the year a membership action plan was established.	NATO; www.nato.int; http://www.bits.de/frames/databasesd .htm
NATO MEMBER	Dummy variable equals 1 starting in the year of NATO accession.	same
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.	WDI; http://ddp- ext.worldbank.org/ext/DDPQQ/mem ber.do?method=getMembers&userid =1&queryId=136
AID	Official Development Assistance and Official Aid (Share of GDP), average over current and past two years.	WDI
Proximity		
WESTERN	Dominance of protestant or catholic Christianity (=1, otherwise 0).	CIA World Factbook; https://www.cia.gov/library/publicati ons/the-world-factbook/
Explanatory Variables - Economic Factors		
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
Economic Performance		
GROWTH	Growth GDP, geometric average over current and past two years.	WDI
INITIAL INCOME	GDP per capita at PPP	WDI
INFLATION	Inflation, consumer prices (annual %), geometric average over current and past two years.	WDI
Explanatory Variables - Political Factors		
Opportunities		
COHESION	(absolute value of largest non communist party vote) - (ex KP vote in first post-transition election).	EBRD Transition Report (1999)
INITIAL RIGHTS	individual political rights, measured from 7 to 1 (highest)	Freedom House
TENSIONS	Binary variable: conflict yes or not.	Heidelberger Institut für Internationale Konfliktforschung; http://www.hiik.de/start/index.html
Incentives		
ENDOWMENT	Resource reserves, dummy variable, rich=2, moderate=1, poor=0.	de Melo (2001); Auty (2006)
MINERAL EXPORTS	Weighted average of fuel exports and ores and metals exports (% of merchandise exports), 3 year moving average. The relative weight of ore and metal exports equals 2.75; a restriction which could not be rejected in F-tests in several models.	WDI

Table A2: Determinants of Institutions in Transition Countries – Individual Country Performance, 2006

	WBGIall	Voice and Acountability	Political Stabitity	Government Effectiveness	Regulatory Quality	Rule of Law	Control of Corruption
Level of EU-Cooperation							
EU Membership 2004 CZE, EST, HUN, LVA, LTU, POL, SVK, SVN	0,62	0,98	0,49	0,68	0,83	0,44	0,28
EU Membership 2007 BGR, ROU	0,12	0,46	0,16	0,00	0,41	-0,16	-0,15
SAA Partnership ALB, HRV, MKD	-0,05	0,21	-0,04	0,06	0,10	-0,34	-0,31
PCA Cooperation ARM, AZE, GEO, MDA, UKR, RUS, BLR, **KAZ, KGZ, TJK, TKM, UZB**	-0,67	-0,76	-0,59	-0,53	-0,50	-0,87	-0,76
Level of NATO-Cooperation							
Membership CZE, EST, HUN, LVA, LTU, POL, SVK, SVN, BGR, ROU	0,48	0,83	0,40	0,48	0,71	0,27	0,16
MAP ALB, HRV, MKD	-0,05	0,21	-0,04	0,06	0,10	-0,34	-0,31
Partnership for Peace ARM, AZE, GEO, MDA, UKR, RUS, BLR, **KAZ*, KGZ, TJK, TKM, UZB**	-0,76	-0,89	-0,71	-0,61	-0,64	-0,93	-0,80
Western or Eastern Affiliation							
Western HRV, CZE, EST, HUN, LVA, LTU, POL, SVK, SVN	0,60	0,95	0,49	0,67	0,80	0,41	0,26
Eastern ALB, ARM, AZE, BLR, BGR, ROU, MKD, MDA, UKR, GEO, RUS, **KAZ, KGZ, TJK, TKM, UZB**	-0,67	-0,75	-0,63	-0,55	-0,53	-0,86	-0,73
Tensions							
Peaceful Transition EU04, EU07, **KAZ**, BGR, SVN	-0,23	-0,36	0,21	-0,19	-0,02	-0,49	-0,50
Violent Transition the rest	-0,43	-0,41	-0,45	-0,32	-0,28	-0,61	-0,54
Political Cohesion							
High ARM, POL, SVN, LTU, SVN, HUN, GEO, HRV, CZE, EST, LVA, RUS	-0,24	-0,24	-0,32	-0,05	-0,01	-0,45	-0,40
Medium UKR, ALB, BGR, MKD, MDA	-0,38	-0,04	-0,23	-0,48	-0,31	-0,64	-0,58
Low **KGZ, TKM, UZB, TJK, KAZ**, AZE, ROU, BLR	-0,86	-1,05	-0,72	-0,80	-0,83	-0,94	-0,81

(contd.)

Table A2 (contd.)

	WBGIall	Voice and Acountability	Political Stability	Government Effectiveness	Regulatory Quality	Rule of Law	Control of Corruption
Liberalization							
Top 10 % EU04, ALB, ARM, BGR, HRV, MKD, GEO, **KGZ**, ROU	0.33	0.65	0.24	0.36	0.57	0.11	0.03
Medium MDA, AZE, **KAZ**, UKR, RUS, **TJK, UZB**, BLR	-0.76	-0.89	-0.72	-0.60	-0.63	-0.93	-0.79
Lowest 10 % **TKM**	-1.43	-2.00	-0.27	-1.45	-2.12	-1.44	-1.28
Aid							
Low EU04, BLR, RUS, HRV, **KAZ, TKM**, ROU, UKR, **UZB**	-0.40	-0.40	-0.37	-0.28	-0.27	-0.59	-0.52
Medium BGR, AZE, MKD, MDA, GEO, ALB	-0.38	-0.26	-0.50	-0.36	-0.09	-0.57	-0.53
High ARM, **TJK, KGZ**	-0.88	-0.96	-1.06	-0.80	-0.58	-0.99	-0.91
Resource Endowment							
High AZE, **KAZ**, RUS, **TKM**	-0.72	-0.93	-0.67	-0.48	-0.49	-0.91	-0.80
Medium GEO, POL, ROU, UKR, **UZB**	-0.33	-0.07	-0.41	-0.31	-0.25	-0.50	-0.42
Low the rest (**TJK, KGZ**)	0.04	0.11	0.17	0.06	0.19	-0.13	-0.16

Note: * IPAP since 2005

Source: See Tables 3 and A1; own calculations.

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