

## 2. Reforming the Judiciary: Learning from the Experience of Central, Eastern, and Southeastern Europe

*The countries of Central, Eastern, and Southeastern Europe (CESEE) have made major progress in raising living standards over the past two and a half decades. This progress was supported by a radical transformation of their economies and institutions. Using case studies and empirical analysis, this chapter explores the role of internal and external factors, particularly accession to the European Union (EU), in supporting reforms to strengthen the effectiveness of the judiciary. The findings suggest that, beyond initial conditions, an enabling environment for judicial reforms was created by factors and policies that (1) improved the distribution of resources and opportunities, (2) upgraded rules and procedures to recruit and train civil servants, and (3) increased transparency and accountability. The European Union and the Council of Europe (CoE) acted as strong external anchors in catalyzing reforms. However, there were also some reversals of reforms, and the sustainability of reforms appears to depend mainly on domestic factors. These findings might offer insights in particular for countries aiming to join the European Union, but also for others seeking to improve the effectiveness of their judiciary.*

### Why Focus on Judicial Reforms?

CESEE countries have made significant progress in improving institutions since the transition to market economies, but they need a new wave of structural reforms to sustain the rapid convergence of incomes. The fast convergence before the global financial crisis, particularly in the CESEE EU countries, was supported by high productivity gains from rapid integration into European

supply chains, strong capital inflows attracted by underbanked economies, and extensive economic and institutional reforms implemented during the transition and EU accession. However, total factor productivity growth dropped substantially after the global financial crisis, and investment suffered. Projected declines in the working-age population, partly because of continued emigration, along with skill shortages compound the looming headwinds. With external conditions expected to be less supportive than during the transition, boosting potential growth requires a better environment for domestic savings and investment and, hence, new and more difficult institutional and governance reforms (Thomsen 2017a, 2017b). Sound legal institutions are vital in this regard.

Judicial reform and control of corruption are viewed as key structural reform priorities in many European countries. For example, the IMF has highlighted enhancing justice systems' efficiency and capacity to facilitate debt resolution in several countries (IMF 2015); improving contract enforcement and protection of property rights in Kosovo, Serbia, and Slovenia; and strengthening anticorruption efforts in Bulgaria, Greece, Hungary, Italy, Romania, and Ukraine. Recognizing progress made in many other structural reform areas, the May 2016 *Regional Economic Issues: Central, Eastern, and Southeastern Europe* suggested that incomplete reforms of judicial systems and protection of property rights in many CESEE economies may explain a significant part of the productivity gaps with the EU15.<sup>1</sup> Hence, judicial reforms may have considerable potential to boost incomes in the region (Figure 2.1). Judicial reforms continue to be high on policymakers' agendas and are relevant for all EU countries, but particularly for countries that aspire to join the European Union.

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<sup>1</sup>The EU15 are Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, Sweden, and the United Kingdom.

The IMF has long recognized the importance of good governance, including the rule of law, for long-term, inclusive growth (IMF 1997, 2017a). Institutions that contribute to good governance need to be effective in serving the well-being of all in society as opposed to only a few (Box 2.1). Recently, the IMF has highlighted the pernicious effects of corruption, especially on inclusive growth and on citizens' trust (IMF 2016a). In discussing the 2017 Board Paper on the IMF's role in governance, Directors called for further work in this area. In the October 2017 Global Policy Agenda, the IMF Managing Director stated that “[s]trengthening governance is essential in building support for reforms needed to raise long-term growth and ensure a domestic level-playing field” and that “[t]he Fund will strengthen its engagement on governance and corruption issues” (IMF 2017d). This study seeks to contribute to this work stream.

CESEE countries greatly improved their institutions, including the judiciary, during the transition and EU accession, and hence their experiences can provide useful insights. By choosing to join the European Union, most countries in the region have committed to the goal of effective rule of law. The differences in the institutional quality in these countries—despite somewhat similar settings, major reforms everywhere, and the common goal of EU accession—provide historical and recent background to study the factors affecting institutional progress. Hence, this chapter focuses on the 20 CESEE countries that are EU members or seek to join the European Union.<sup>2</sup>

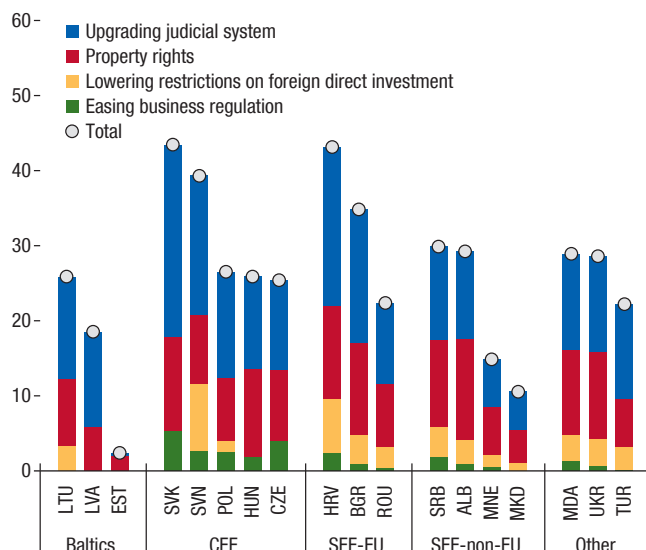
This chapter focuses on the effectiveness of justice systems and, to a more limited extent, the protection of property rights.<sup>3</sup> A country's legal framework is a critical element of its business environment, as it affects all economic

<sup>2</sup>The CESEE countries are Albania, Bosnia and Herzegovina, Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Kosovo, Latvia, Lithuania, Macedonia, FYR, Moldova, Montenegro, Poland, Romania, Serbia, the Slovak Republic, Slovenia, Turkey, and Ukraine.

<sup>3</sup>In addition to an effective judiciary, property rights protection requires effective enforcement and foreclosure regimes, enforcement agents, bailiffs, notaries, and credit and land registries— aspects not covered in this chapter.

**Figure 2.1. CESEE: Estimated Efficiency Gains from Institutional Reforms**

(Percent; potential improvement in total factor productivity)



Source: IMF May 2016, *Regional Economic Issues: Central, Eastern, and Southeastern Europe*.

Note: Data labels use International Organization for Standardization (ISO) country abbreviations.

interactions and hence economic outcomes. The World Bank's *2017 World Development Report* emphasizes that the rule of law is “the very basis of good governance needed to realize full social and economic development,” but that the existence of laws does not assure these outcomes (World Bank 2017). Hence, the report calls for a focus on “the role of law,” which means its effect on the functions of the legal system rather than its form. Effective rule of law also plays a key role in control of corruption (Lagarde 2016, 2017). Within the rule of law, the effectiveness of the justice system and protection of property rights—which depend on the justice system to a large extent, but also on other elements—are critical to economic outcomes.<sup>4</sup>

This chapter explores the question of what might encourage judicial reforms. It adds several country case studies to the literature, as well as

<sup>4</sup>Many other economic institutions, such as fiscal and financial institutions, are important, but have been the subject of other studies. For example, the November 2016 *Regional Economic Issues: Central, Eastern, and Southeastern Europe* focused on government efficiency.

a comprehensive empirical analysis, with a view to distilling concrete policy lessons for countries that endeavor to improve the effectiveness of their judiciary systems. Importantly, the analysis does not provide legal assessments, but tries to address the following questions:

- What were the specific reforms of the justice system and protection of property rights and the context in which they took place?
- How have judicial reforms evolved over time, and how do they compare across countries?
- Which factors facilitated these reforms?
- What was the role of domestic factors and of the European Union in enabling change?

The chapter begins with an analytical framework that explores factors affecting institutional quality. Drawing on the framework, the section that follows presents country experiences. The chapter then offers a stocktaking of CESEE progress on judicial effectiveness, discusses factors that may have contributed to judicial reforms, and puts forth conclusions.

## How to Analyze Institutional Quality: Conceptual Framework

The literature offers several theories to analyze differences in institutional quality that are combined in this chapter into a unified framework. As factors affecting judicial effectiveness are likely to be similar to those determining broader institutional quality, this section draws on the literature on institutions. Institutions that contribute to good governance need to be effective in serving the well-being of everyone in society.<sup>5</sup> Institutional theories can be grouped into several approaches (Annex 2.1). This chapter adopts a political economy framework,

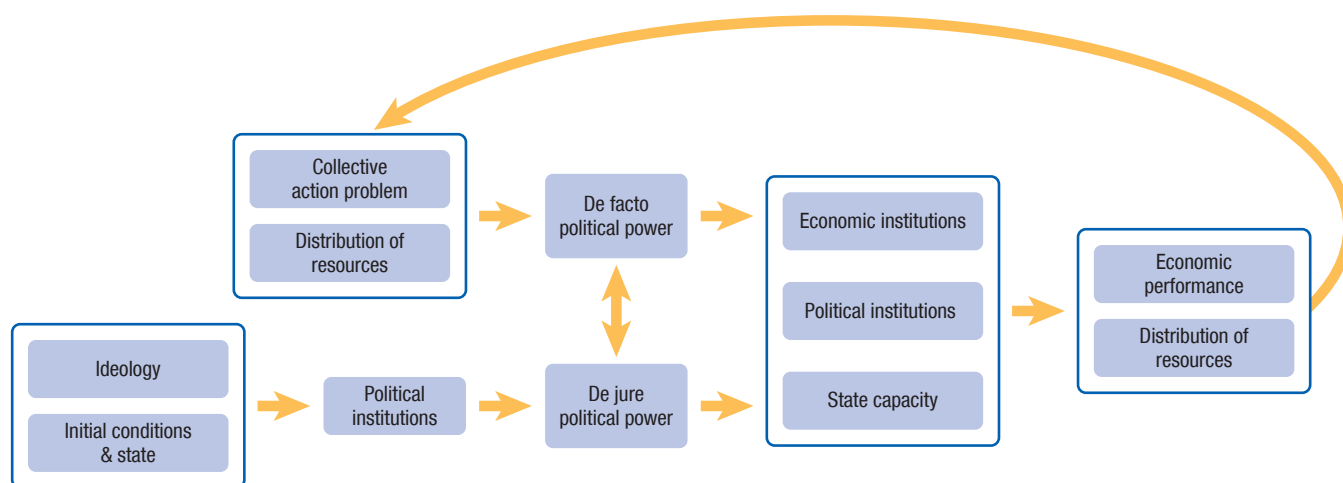
<sup>5</sup>Acemoğlu, Johnson, and Robinson (2005) refer to effective institutions as “inclusive institutions” and contrast them with “extractive institutions,” Fukuyama (2011) speaks of “accountable government” versus “patrimonialism,” and Mungiu-Pippidi (2015) refers to “ethical universalism” versus “particularism.”

building mainly on Acemoğlu, Johnson, and Robinson (2005), a seminal paper on the political economy approach. This framework encompasses two critical features: (1) economic institutions’ distributional consequences, which in turn affect institutions, giving rise to important feedback loops; and (2) politicians’ inability to commit to act only in the public interest, exacerbating collective action problems (Figure 2.2).<sup>6</sup> De jure political power depends on political institutions, which result from initial conditions, ideology, and state capacity. De facto political power also depends on resource distribution and how different groups in society interact via bargaining. Given preferences of different groups in society, those with the most political power (both de facto and de jure) determine prevailing institutions and use them in their interest. Institutions then affect economic outcomes, the distribution of resources, and state capacity in subsequent periods, generating feedback loops between resource distribution and political and economic institutions.

According to this framework, in societies without dominant players, gaining political power is more competitive, leading to rules-based decision making and effective institutions. A concentrated distribution of resources and opportunities limits possibilities for many people to gain power. Many have expressed concern about large firms’ influence on the rules of the game (Guriev 2017; Zingales 2017). Conversely, civil society tends to promote participatory processes and effective institutions.

The greater a society’s ability to solve collective action problems, the more likely it is to establish effective institutions. Societies with less fragmentation along various dimensions (for example, ethnicities and cultures) tend to find it easier to reach agreement and solve their collective action problems (Trumbull 2012). Fragmentation in this context measures divisiveness and power imbalances as opposed to diversity. More diverse societies, particularly those where the views of different groups are well represented and

<sup>6</sup>In this context, the collective action problem is the inability to take actions that maximize the well-being of society as a whole.

**Figure 2.2. Factors Shaping Institutional Quality<sup>1</sup>**

<sup>1</sup>The figure builds on the framework presented in Acemoğlu, Johnson, and Robinson (2005) and includes some extensions to incorporate other channels summarized in Annex 2.1.

respected (that is, minority rights), might actually be better at finding common ground. Higher levels of transparency and accountability alleviate information asymmetries, discourage rent-seeking behavior, and may help overcome trust deficits, thereby facilitating time-consistent behavior in the pursuit of long-term goals, coordination, and cooperation (World Bank 2017).

The capacity of the public administration is also important for institutional quality. In countries with established rules and procedures for hiring and training public employees, political interference in public administration decision making is more limited and public service provision is better (Andrews, Pritchett, and Woolcock 2012). However, the capacity of the public administration itself may depend on powerful groups' decisions regarding state capacity.

Initial conditions and the external environment influence many of the above-mentioned elements through different channels:

- *Initial conditions:* History, geography, culture, societal norms, the initial level of development, and legal origins can matter in various ways.
- *External shocks:* Threats to sovereignty or crises could create a common purpose and make it easier to solve collective action problems, though the opposite could also occur. Technological change and other shocks could alter the distribution of resources and change the balance of power.
- *Openness:* Greater openness may promote a better judiciary to the extent that investors reward rules-based business environments and businesses adapt to global standards. Import competition in domestic markets may reduce the monopolization of power.
- *External anchors:* A prominent example is the European Union. The expected benefits from EU accession may have outweighed the loss of domestic policy autonomy for politically powerful groups, helping overcome domestic resistance to reforms (Box 2.2). The CoE (all countries concerned except Kosovo are members) has also helped CESEE countries advance judicial reforms through its binding and nonbinding legal standards. Assistance from international financial institutions may also provide incentives for broader institutional reforms.

The empirical analysis in this chapter considers all the factors presented in the above framework, while most previous studies test the relevance of specific hypotheses. The September 2005 *World Economic Outlook* found that openness and accountability were associated with higher institutional quality, while natural resource abundance was negatively associated with it. More recent studies suggest that imperfect accountability, limited transparency, and high income inequality hinder institutional quality (Ganiou Mijiyawa 2013; EBRD 2013). Several studies provide evidence of the beneficial role of an external anchor, such as the European Union (EBRD 2013; September 2005 *World Economic Outlook*). However, others argue that institutional reforms slowed after countries were offered EU membership and even reversed in some cases after the countries joined (Mungiu-Pippidi 2015). Prima facie, high and positive correlations are observed between the current level of economic aspects of the rule of law and the initial equality of resource distribution, transparency, and the capacity of public administration (Figure 2.3).<sup>7</sup> However, more analysis is needed to understand causality given the feedback loops between institutions and economic outcomes.

This section refers to the EU concepts of effective justice systems and protection of property rights. The European Commission's *Acquis Judiciary and Fundamental Rights Chapter* states that “the establishment of an independent and efficient judiciary is of paramount importance. Impartiality, integrity and a high standard of adjudication by the courts are essential for safeguarding the rule of law. Equally, member states must fight corruption effectively, as it represents a threat to the stability of democratic institutions and the rule of law.” The *Acquis* notes that effective protection of property rights—established by the European Human Rights Convention and the EU Charter of Fundamental Rights—hinges on enforcement capacity, which requires an effective judiciary. This section focuses on the judiciary's efficiency,

<sup>7</sup>Initial conditions are taken as 1993 because the early 1990s denote the beginning of the CESEE transition, and due to data availability.

independence, and impartiality in order to capture the overall effectiveness of the judicial system.

This chapter uses a wide range of information sources. It relies extensively on the standard setting and evaluations of the CoE bodies—the European Commission for the Efficiency of Justice (*Commission européenne pour l'efficacité de la justice*—CEPEJ) and the Group of States against Corruption (GRECO)—and the European Commission's reports, as well as on other studies and experts. However, CEPEJ data and the EU Justice Scoreboards start in 2010 or later. To have quantitative indicators over a long period for more countries and dimensions, and following most previous studies, we also employ data from the World Bank's *Worldwide Governance* and *Doing Business Indicators*, the World Economic Forum, the Varieties of Democracy Institute, and other sources (Annex 2.2). Most of these data are perception based and thus more subjective than other economic indicators. Nevertheless, economic decisions are based on agents' perceptions of many factors, including governance, effectiveness of the judiciary, and property rights protection. CoE 2015 notes that “. . . other factors, such as public perception, political culture and safeguards against corruption have a clear impact on the ability of courts and judges to command legitimacy and do their job.” The case studies that follow here rely on many sources to understand the context in which judicial reforms took place.

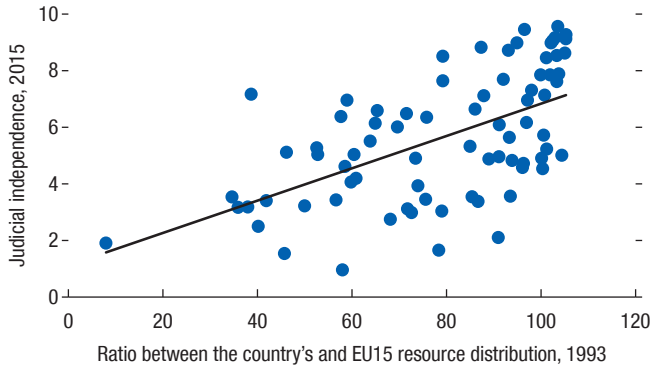
## Country Case Studies

This section analyzes judicial reform episodes in six countries: Bosnia and Herzegovina, Croatia, Estonia, Poland, Romania, and Serbia. Employing the framework presented earlier, the section discusses factors shaping judicial effectiveness, such as the equality of resource distribution, transparency and accountability, state capacity, political power, and the role of external anchors. The mix of cases aims to ensure adequate representation across the region. We include countries with initial conditions more conducive to an effective judiciary (Estonia,

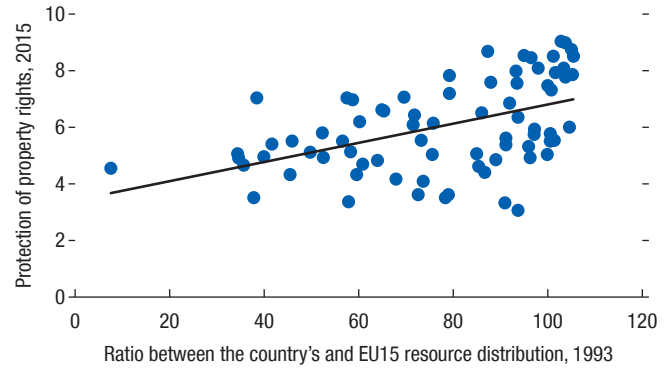


**Figure 2.3. CESEE: Initial Level of Fundamentals and Aspects of the Rule of Law<sup>1</sup>**  
*(Index; 0 = worst, 10 = best)*

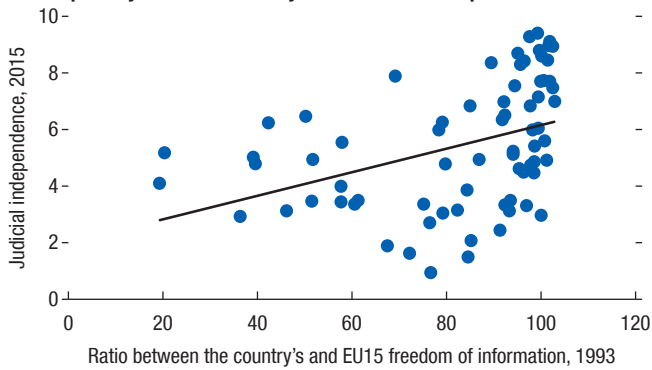
**1. Resource Distribution versus Judicial Independence**



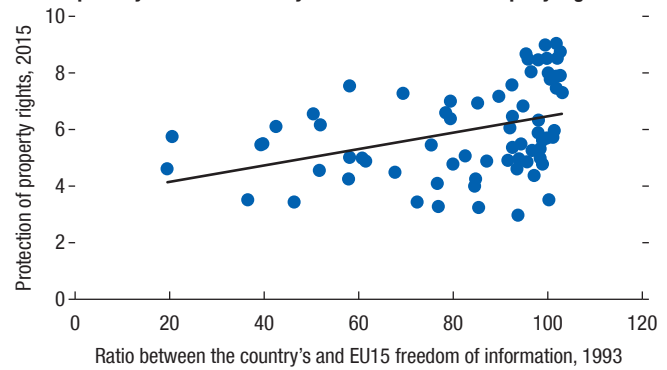
**2. Resource Distribution versus Protection of Property Rights**



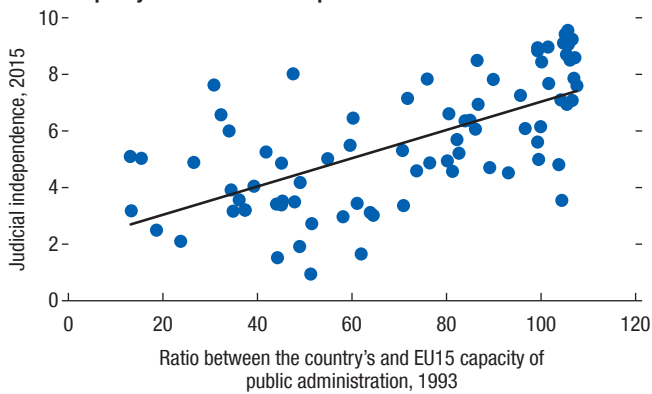
**3. Transparency and Accountability versus Judicial Independence**



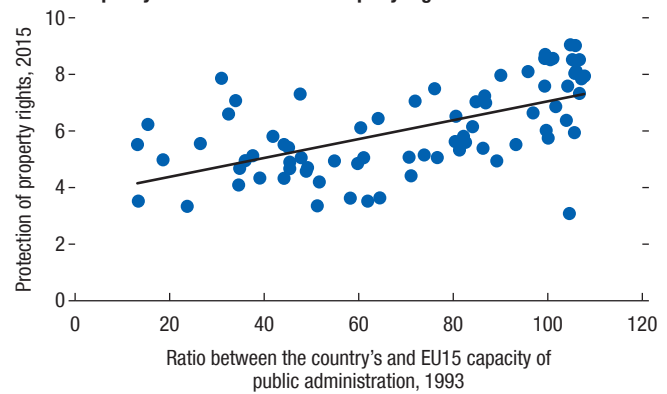
**4. Transparency and Accountability versus Protection of Property Rights**



**5. State Capacity versus Judicial Independence**



**6. State Capacity versus Protection of Property Rights**



Sources: World Economic Forum; University of Gothenburg; Varieties of Democracy Institute (V-Dem); and IMF staff calculations.  
 Note: EU15 countries are listed in text footnote 1.

<sup>1</sup>Based on available worldwide distribution of advanced and emerging market economies.

Poland), a country that faced more challenging domestic fundamentals (Romania), and countries that went through civil strife (Bosnia and Herzegovina, Croatia, Serbia). For each country, the analysis focuses on periods when significant

judicial reforms occurred in order to uncover drivers of change.

## Estonia

Conducive initial conditions and carefully designed policies helped establish effective institutions in Estonia. Estonia's favorable initial conditions included a vibrant civil society. A relatively inclusive reform process ensured widespread distribution of privatized assets and eliminated barriers to foreign trade and investment by reducing high tariffs and nontariff restrictions. This limited the formation of national oligopolies and enhanced transparency and accountability to enable the involvement of citizens in the political process. Significant early investment in the capacity of the judiciary was also instrumental for judicial independence.

Estonia's transition involved a major and rapid overhaul of the institutional framework. Initial reforms laid out solid foundations for an independent judiciary. The Court Act and the Legal Status of Judges Act, adopted in 1991, regulated the functions of the judiciary (Gherasimov 2015). Drawing on Estonia's 1938 constitution, a new constitution adopted in 1992 provided the basis for the separation and balance of powers and guarantees for judicial independence. The new constitution reinstated a parliamentary democracy founded on legal continuity with the pre-Soviet Estonia (Pärna 2005). The guarantees took the form of life tenure for judges and protection against their removal from office (OSI 2001), while decisional independence and impartiality were assured by limits on judges' cross-branch or outside activity (GRECO 2013). The new judicial system became operational in 1993.

Subsequent reforms solidified the judiciary's independence and efficiency. The 2002 Courts Act helped reduce the influence of the Ministry of Justice and eliminated political involvement in disciplining judges by transferring the authority to initiate proceedings against judges from the ministry to the Legal Chancellor. Further, the 2010 Courts Act introduced shared oversight of the administration of courts by the Ministry of Justice and the Court Administration Advisory Council (leaving the Ministry of Justice in charge

**Figure 2.4. Estonia: Judicial Independence and Protection of Property Rights**  
(Index; 0 = worst, 10 = best)



Sources: World Economic Forum; and IMF staff calculations.

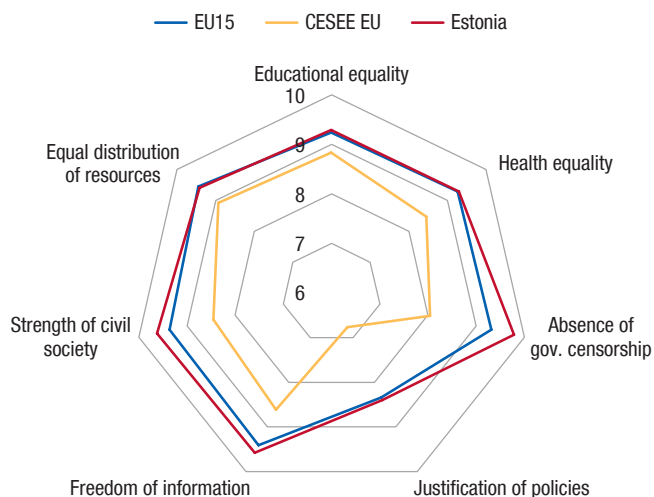
of budgetary issues, however). In recent years, the integrity of the judiciary improved further (for example, via supervision of judges' assets and interest declarations), and so did efficiency (Figure 2.4).

The privatization process ensured broad distribution of resources, fostering effective institutions. Estonia's privatization aimed at putting assets into the hands of those with the incentives and skills to use them effectively, while ensuring wide participation across society (Nellis 1996). The 1993 Privatization Law guaranteed broadly equal rights to domestic and foreign investors and physical and legal persons, while entities with more than a 30 percent public stake were excluded. By 1995, divestiture was largely completed, having turned many people into private owners and contributed to attaining income inequality levels similar to the EU average (Taube and Weber 1999; Laar 2007).<sup>8</sup>

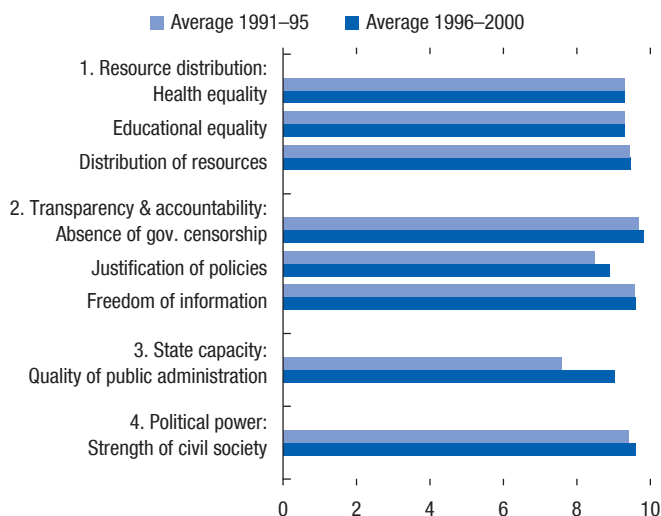
<sup>8</sup>However, some point to limited integration of the Russian-speaking minority as a cost of the otherwise inclusive reform strategy (OSCE 2014; ECRI 1999, 2015).

**Figure 2.5. Estonia: Factors Affecting Institutional Quality<sup>1</sup>**  
(Index; 0 = worst, 10 = best)

**1. Cross-Country Comparison, 1993**



**2. Evolution over Time, 1991–2000**



Sources: Varieties of Democracy Institute (V-Dem) database (version 6.2); and IMF staff calculations.

Note: EU15 countries are listed in text footnote 1.

<sup>1</sup>Equal distribution of resources measures poverty and the distribution of goods and services as well as the levels of inequality in these distributions and the proportion of the population ineligible for social services.

The rapid and sustained progress on institutional reforms was underpinned by favorable domestic factors (Figure 2.5). Specifically:

- The distribution of resources and opportunities in Estonia in the mid-1990s was similar to the EU average.
- The strength of civil society and the control of political corruption were similar to the EU15 average by the mid-1990s, providing checks and balances.<sup>9</sup>
- Government censorship was effectively abolished following the establishment of a private press and private broadcasting during 1991–94. Further, the media assumed a watchdog role regarding political scandals (Vihalemm and Masso 2003). Legal guarantees of access to information and extensive use of e-government increased transparency and accountability.

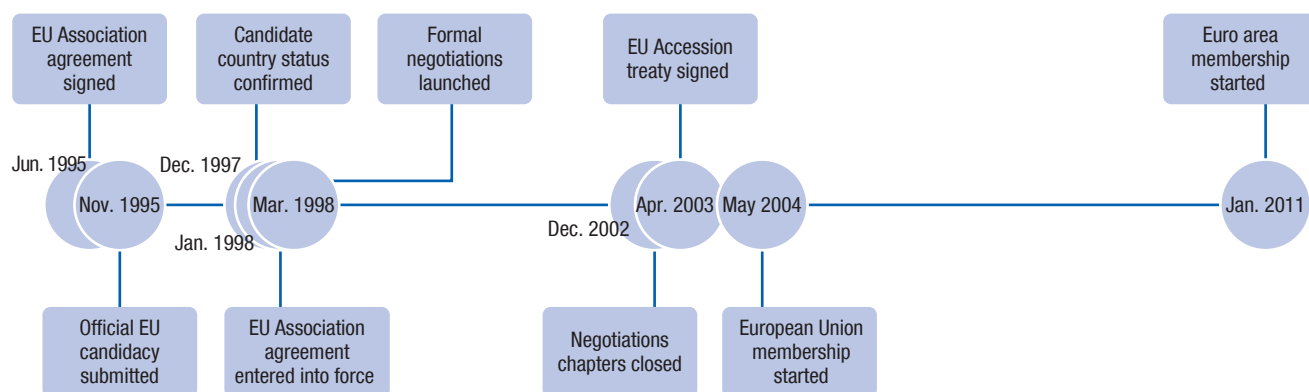
- The introduction of a modern legal and administrative framework for the civil service greatly strengthened public sector capacity, with assistance from various countries and institutions. A large part of the civil service was replaced with new personnel selected based on merit. This was considered one of the most comprehensive administrative reforms in the region (Sarapuu 2012; Tõnnisson and Randma-Liiv 2008).

Given the strong domestic drive for reforms, the European Union mainly provided benchmarks guaranteeing high standards in Estonia. EU accession negotiations began informally in 1993. The Free Trade Agreement with the European Union came into force in 1995 (Figure 2.6). The European Commission deemed Estonia’s respect for the rule of law and protection of property rights in line with its requirements in 1998.

<sup>9</sup>Control of corruption declined between 2001 and 2011, but has improved again in the past few years and is now comparable to the EU15 average.



Figure 2.6. Estonia: EU Accession Timeline



Source: European Commission.

## Poland

Favorable initial conditions combined with the commitment to EU membership helped Poland achieve significant progress in judicial reform, but the process has been neither smooth nor linear. While Poland had strong initial conditions in terms of an active civil society and freedom of information that promoted significant reforms early in the transition, these conditions were not enough to ensure sustained progress in judicial reforms. Insufficient efforts to build the capacity of the judiciary, combined with deterioration in the equality of incomes and opportunities, appear to have contributed to some reversals in judicial independence. Commitment to EU membership supported by the country's vibrant civil society helped overcome some of these setbacks. However, in 2017 the European Commission launched an infringement procedure against Poland over legislation regarding the judiciary on concerns that the legislation may undermine its independence.

Poland's active civil society before the transition provided some favorable initial conditions for institutional reform (Figure 2.7). According to Bruszt and others (2009), political opposition before 1989 was more intense in Central and Eastern Europe, especially in Poland, compared with other communist countries. A vibrant civil society, and notably the role of the trade unions, was important for the formation of institutions

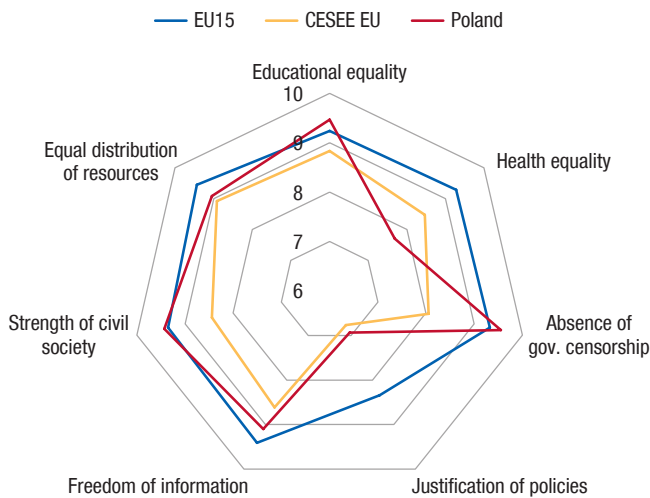
that provided checks and balances. Moreover, a massive expansion of media outlets enabled debates over social problems.

With a strong civil society and freedom of information, reforms of property rights and the judiciary started early. The 1989 constitutional amendments sanctioned the independence of judges and introduced the separation of the judiciary from other branches of government. Together with the 1988 Law on Economic Activity, this laid the foundation for freedom of business activity and property rights protection (Figure 2.8). A critical step in establishing judicial autonomy was the creation of the National Judicial Council, which recommends judgeship candidates to the president. When the preaccession process started in 1994, the judiciary had already been deeply transformed. In its first report, the European Commission stated that "the independence of the Polish judiciary vis-à-vis other institutions appears secured" (EC 1997). A new constitution approved in 1997 further separated powers and strengthened the Constitutional Tribunal and property rights protection. Perceived judicial independence was at a high level already in 1995, but deteriorated thereafter.

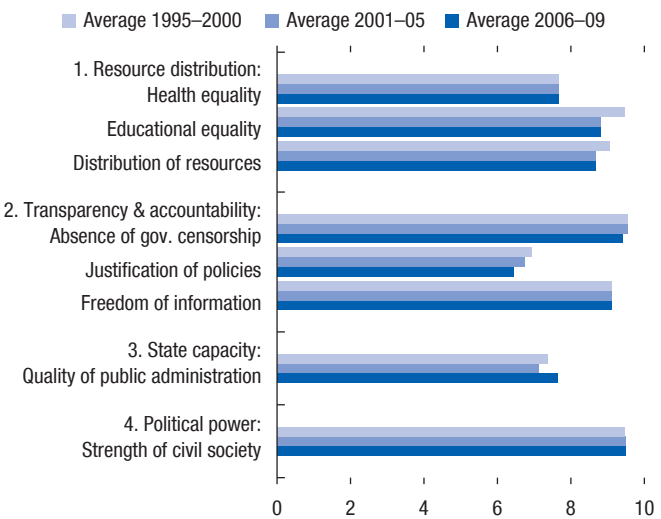
While privatization was not smooth, neither was it hasty, which helped limit resource concentration. About 70 percent of small and medium enterprises (SMEs) were privatized by the end of the 1990s

**Figure 2.7. Poland: Factors Affecting Institutional Quality<sup>1</sup>**  
(Index; 0 = worst, 10 = best)

**1. Cross-Country Comparison, 1993**



**2. Evolution over Time, 1995–2009**

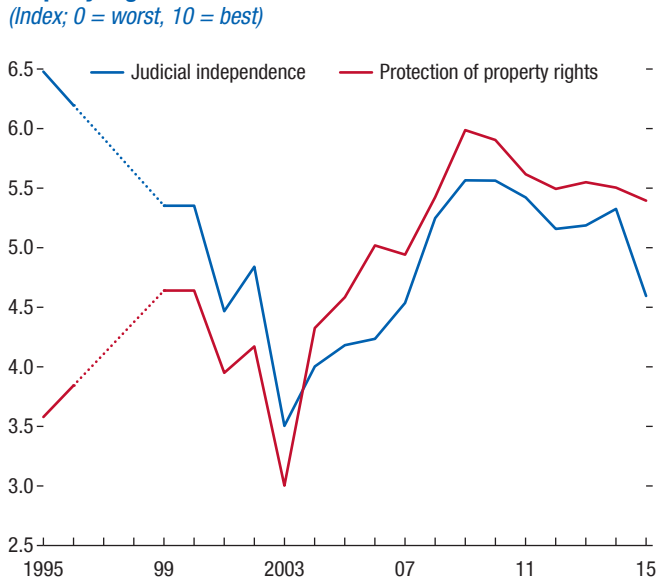


Sources: Varieties of Democracy Institute (V-Dem) database (version 6.2); and IMF staff calculations.

Note: EU15 countries are listed in text footnote 1.

<sup>1</sup>Equal distribution of resources measures poverty and the distribution of goods and services as well as the levels of inequality in these distributions and the proportion of the population ineligible for social services.

**Figure 2.8. Poland: Judicial Independence and Protection of Property Rights<sup>1</sup>**  
(Index; 0 = worst, 10 = best)



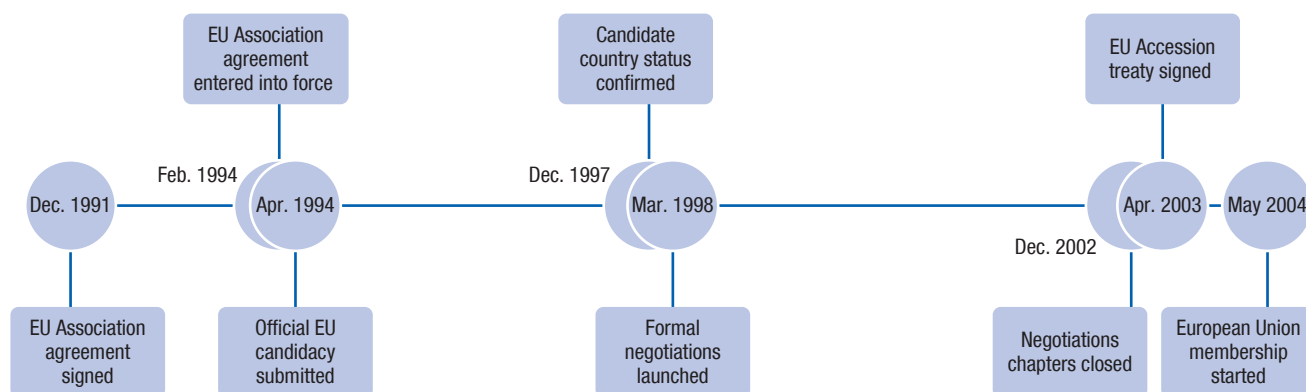
Sources: World Economic Forum; and IMF staff calculations.

<sup>1</sup>Missing data for 1996–99 have been interpolated.

(Iwanek and Wellisz 1993). However, large-scale privatization took much longer than expected (Patena 2015). This slow process allowed private firms to emerge and compete for acquisition of public assets, which may have limited resource concentration. Meanwhile, state-owned enterprises (SOEs) still play an important role in the economy and dominate some sectors.

However, Poland’s judicial system witnessed a considerable deterioration during 1997–2003. The systemic judicial reforms and sizable changes in the opportunities available in the private and public sectors—as growth rapidly expanded jobs and pay in the former, while the latter did not adjust as quickly—created significant challenges for judiciary effectiveness. The system was not prepared for the large influx of cases caused by the systemic changes to the legal system and the economy (Freedom House 2003; Kucharczyk and Zbieranek 2010). This resulted in long processing times for legal cases and difficulties in enforcing court decisions (EC 1997). Many low-paid judges left to join the private sector, further diminishing judiciary capacity. Instances of corruption among

Figure 2.9. Poland: EU Accession Timeline



Source: European Commission.

the judiciary were observed in the 2000s, as long waits for routine commercial court decisions created incentives for bribery (EC 2000). The perception of corruption, the capacity of public administration, and equality of incomes and opportunities deteriorated during 1998–2003 (Kucharczyk and Zbieranek 2010).

Despite these setbacks, the commitment to reforms under the EU accession framework provided a strong impulse to rebuild trust in the judiciary (Figure 2.9). Poland's vibrant civil society once again fostered a civil movement resulting in a high turnout in the 2007 elections. Voters expressed dissatisfaction with some government measures viewed as undermining the rule of law. The EU oversight combined with the media's role helped address these challenges, as reflected in the improvement in Poland's ranking on the control of corruption index over its 2006 ranking (Ekiert and Soroka 2013). Another positive development was the reestablishment of an open and competitive process for recruiting senior government officials after 2007, resulting in a notable improvement in Poland's ranking on the index of public administration capacity.

The confluence of these positive developments may have contributed to the improvement in the 2007–09 perceived judicial independence. In response to several rulings by the European Court of Human Rights against Poland due to

the length of proceedings, the government passed a law in 2004 aimed at addressing the undue length of court proceedings (Kucharczyk and Zbieranek 2010). In 2009, the government also increased judges' salaries in response to massive protests (Kucharczyk and Zbieranek 2010). In October 2009, the Parliament revised the 1985 Act on Public Prosecution, separating the Ministry of Justice and the Office of the Public Prosecutor General, although this was reversed in 2016. The CoE acknowledged the constitutional independence of the Polish judiciary, pointing to only limited involvement of the Justice Minister (GRECO 2013).

In the summer of 2017, the EC launched an infringement procedure against Poland on concerns about judicial independence arising from new legislation. The government is undertaking judicial changes with the stated purpose "to meet people's expectations and increase the democratization of the judiciary" (Polish Justice Ministry 2017), including raising the efficiency of courts and reducing case backlogs. In 2016, the European Commission used a new EU framework (see Box 2.2) and initiated the rule of law investigation regarding the amendments to the Constitutional Tribunal adopted during 2015–16. The 2017 Law on Ordinary Courts Organization gives discretionary power to the minister of justice to prolong the mandate of judges who have reached retirement age (differentiated for women

and men), as well as to dismiss and appoint court presidents. The EC is concerned that the minister's discretionary power will undermine the courts' independence, and it is also concerned about gender discrimination. The EC launched the infringement procedure in July 2017 and issued a reasoned opinion in September 2017 after receiving the Polish authorities' letter regarding the approved law (EC 2017a, 2017c). Two additional draft laws that concern the Supreme Court and the National Judicial Council, vetoed by the president in July 2017, are currently being redrafted. Discussions between the Polish authorities and the EC are ongoing.

## Romania

Romania's experience demonstrates the key role of an external anchor when domestic dynamics pose challenges to strengthening institutions. Civil society had been suppressed and the post-transition government did not have an appetite for reform. Privatization resulted in more concentrated resource distribution. Little investment in the capacity of the judiciary left the system with politically connected judges who resisted reforms. The EU accession played a catalytic role in strengthening civil society, freedom of information, and state capacity. This led to greater demand for and improvement in judicial independence and capacity. Nevertheless, Romania's achievements in judicial reform remain incomplete, and problems persist with the implementation of court decisions (EC 2016a; GRECO 2016).

In an environment of weak civil society, the government that came to power in 1990 made little progress on reforms. The austerity program introduced in the 1980s to repay the country's national debt resulted in shortages of basic goods and frequent electricity blackouts (Dăianu 2004). Oppression coupled with feelings of mistrust and secrecy cultivated by the old regime weakened civil society (Rossi 2012). Neither the student movement nor peripheral grassroots movements had the organizational capacity to replace the

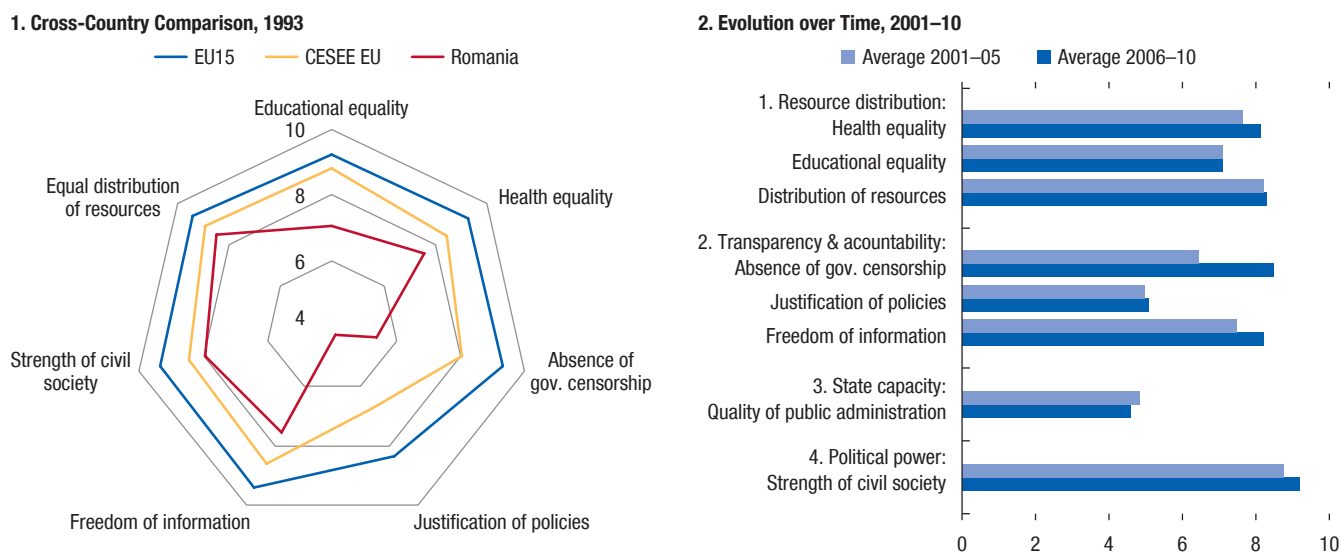
National Salvation Front (NSF) Party, which originated in the Communist Party. The NSF stayed in power longer than the originally expected interim role (Agh 2004; Siani-Davies 2005; Pralong 2004; Paramio 2002; Rossi 2012). Also, prevalent corruption hindered reforms, which previous elites bitterly opposed (Roman 2002; Dallara 2014).

In this challenging environment, judicial reforms faced many difficulties despite the EU accession process. Magistrates were generally loyal to the old regime, which limited judiciary independence (Demsorean, Parvulescu, and Vetrici-Soimu 2009). In 2002, the European Union postponed Romania's accession until 2007. The 2003 constitution institutionalized a powerful Superior Council of the Magistracy (SCM) charged with the careers, appointments, promotions, and evaluations of magistrates. However, *de facto*, all these competencies were exercised by the Justice Ministry (Coman 2009). The lack of judicial independence also weighed on property rights protection.

Romania's postcommunist privatizations contributed to the emergence of political and business elites who resisted reforms to the judiciary and protection of property rights. The privatization of large enterprises was long and contentious. Many viable large-scale enterprises were sold at fire sales, while the insolvent ones continued to burden the state (Gabanyi 2004; Bacon 2004). Members of the elite used their political power and control over state resources to solidify their control over the economy, politics, and the judiciary (Gabanyi 2004). Moreover, several nationalist political forces opposed foreign investors' participation in privatization (Paramio 2002). All this resulted in a significant concentration of resources, with the Gini coefficient—a measure of inequality—rising by 10 percentage points by the late 1990s.

A turning point came in 2004, when civil society gathered strength, capitalizing on the move toward EU accession. Civil society organizations launched an anticorruption campaign for the 2004 election, offering to screen political parties' candidates

**Figure 2.10. Romania: Factors Affecting Institutional Quality<sup>1</sup>**  
(Index; 0 = worst, 10 = best)



Sources: Varieties of Democracy Institute (V-Dem) database (version 6.2); and IMF staff calculations.

Note: EU15 countries are listed in text footnote 1.

<sup>1</sup>Equal distribution of resources measures poverty and the distribution of goods and services as well as the levels of inequality in these distributions and the proportion of the population ineligible for social services.

on integrity criteria (Mungiu-Pippidi 2015).

The earlier adoption of freedom of information legislation driven by EU accession facilitated this campaign. Civil society organizations used it to expose politicians' dishonest behavior and won several litigation cases against the government. This coincided with some decline in the perception of the corruption in politics. These factors, together with the prospect of EU accession, created common ground for the formation of an opposition coalition, despite unfavorable initial conditions (Vachudova 2006).

Tangible reforms started in 2004 (Figure 2.11). Following the elections, the new minister of justice quickly implemented judicial reforms and an anticorruption strategy to fulfill EU requirements (Dallara 2010; Mendelski 2012). A law envisaging the appointment of the courts' presidents and prosecutors was approved against the SCM's opposition (Coman 2007; Carp 2007), but declared unconstitutional by the Constitutional Court, which included several members of the SCM and the old Communist Party (Dallara 2014). A revised version of the law was adopted,

which included weaker provisions for judicial reforms. Although the European Union accepted this version, it introduced the Cooperation and Verification Mechanism (CVM) to address areas deemed in need of further progress, including the judiciary's independence and impartiality and the fight against corruption (EC 2007; Dallara 2014).

After EU accession in 2007, judicial reform slowed (Figure 2.12). The reform-minded minister of justice was replaced in the reshuffling of the government in 2007. Parliament endorsed a revised criminal code providing legal ways to protect corrupt officials, although adoption of the code was postponed and it was later modified (Dallara 2014). In addition, the government attempted to restrict the Constitutional Court's powers and threatened to impeach judges (Blokker 2013; Dallara 2014). The European Union also criticized Romania for not respecting values of democracy and the rule of law (EC 2009), and the country's ranking on the index of perceived judicial independence deteriorated.



**Figure 2.11. Romania: Judicial Independence and Protection of Property Rights**  
(Index; 0 = worst, 10 = best)



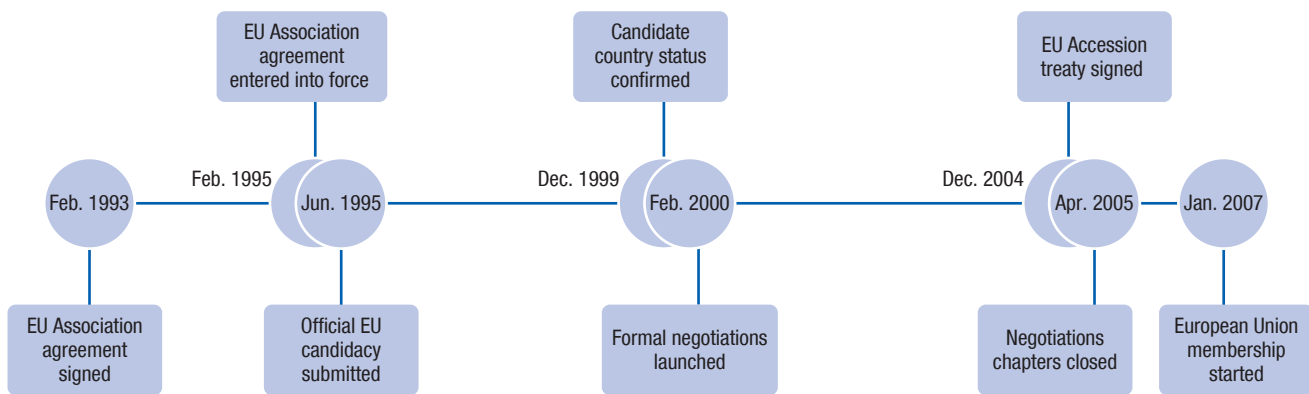
Sources: World Economic Forum; and IMF staff calculations.

The situation improved after 2011 with the emergence of a new generation of judges more open to reforms and a further strengthening of civil society. The National Institute for the Magistracy, which implemented the EU-driven reform of judicial training, started to graduate a new generation of well-trained judges (Piana and others 2013). Many Romanian judges involved in some CoE expert committees and other international judicial networks supported the

diffusion of best practices (Piana 2009). GRECO’s recommendations and the CVM promoted transparency, independence, and accountability of the justice system. The judiciary’s efficiency also improved, as evidenced by a 30 percent decline in disposition time for noncriminal cases over 2010–14 and more recently supported by increased resources allocated to the judiciary.

The trend regarding judicial reforms in Romania was positive until 2016, but since early 2017 some signs of slowing down seem to be emerging. As described in several CVM reports, a track record pointing to good progress and growing irreversibility of the reforms was evident with stronger judicial institutions and strengthened corruption prevention. However, “a number of key issues already identified in earlier reports have remained outstanding” (January 2017 CVM). This includes areas such as the independence of the judiciary and the effectiveness of the anticorruption framework. The authorities’ comprehensive “Strategy for the Development of the Judiciary 2015–2020” sets out the structural reform steps to be taken until 2020. The strategy is now underway and should bring major benefits to the users of the justice system and improve public trust in the system, provided its implementation is sufficiently robust. The population has been alert to signs of reversal as of 2017, as evidenced by public demonstrations. Overall the Romania case study shows that significant progress is possible,

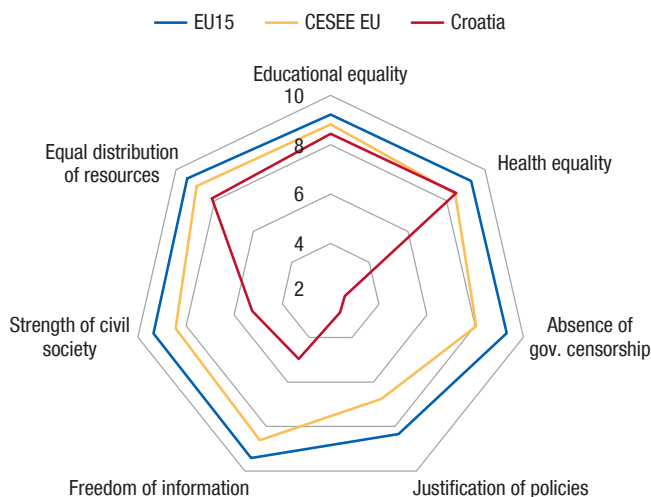
**Figure 2.12. Romania: EU Accession Timeline**



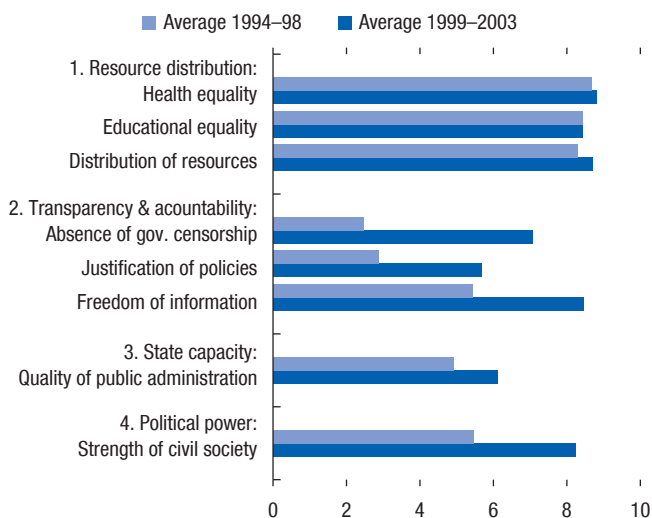
Source: European Commission.

**Figure 2.13. Croatia: Factors Affecting Institutional Quality<sup>1</sup>**  
(Index; 0 = worst, 10 = best)

**1. Cross-Country Comparison, 1993**



**2. Evolution over Time, 1994–2003**



Sources: Varieties of Democracy Institute (V-Dem) database (version 6.2); and IMF staff calculations.

Note: EU15 countries are listed in text footnote 1.

<sup>1</sup>Equal distribution of resources measures poverty and the distribution of goods and services as well as the levels of inequality in these distributions and the proportion of the population ineligible for social services.

but requires sustained efforts for the reforms to become embedded and deliver a better functioning judiciary for all its citizens.

## Croatia

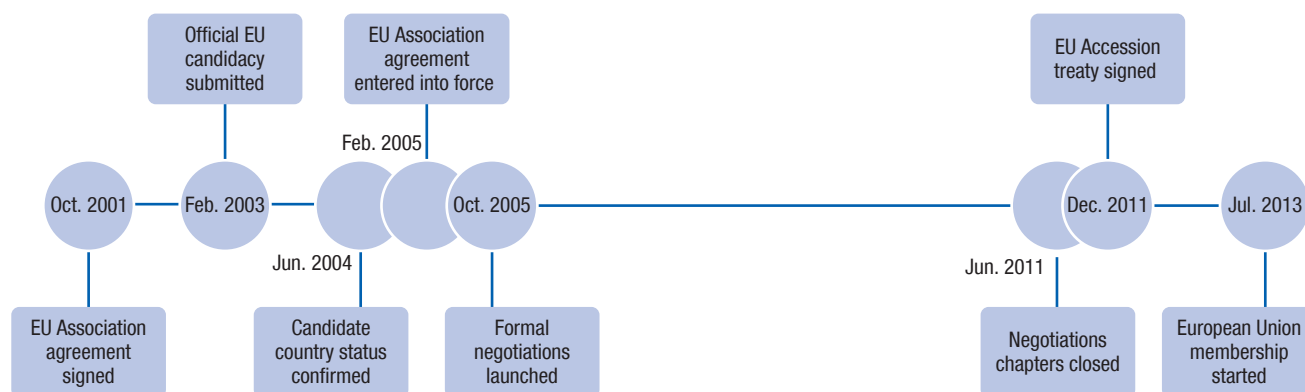
Institutional reforms in Croatia were slow during the initial stages of the transition, mainly owing to military conflict, but prospects for EU accession catalyzed reforms. Citing national security concerns, the government monopolized power, including over the justice system, during 1991–2000 (Blitz 2003; Dallara 2014; Jović 2006). The 1993 Court Act created the State Judicial Council (SJC), an independent body responsible for the selection and dismissal of judges. However, in practice, the SJC became a “lever in the hands of the executive” (Uzelac 2003) and political influence over judges’ removals and appointments continued until 2000 (GRECO 2014). A large outflow of judges limited the judiciary’s capacity (Dallara 2014). After the war ended, civil society increasingly demanded institutional changes, and transparency improved.

EU accession prospects were instrumental in encouraging reforms, though implementation gaps remain.

The judiciary’s inefficiency and poor implementation of privatization hindered property rights protection. Slow and inefficient court proceedings, poor case management, and low administrative and professional capacity were factors that undermined trust in effective enforcement of creditors’ and property rights. Privatization, which mostly took place in the 1990s, at times involved appointing new managers close to the ruling party, a trend that discouraged foreign investors and concentrated resources (Bartlett 2007).

The power of civil society groups increased and transparency improved starting in the late 1990s, catalyzing reforms (Figure 2.13). With the end of the war, and despite the unfavorable initial conditions, civil society gained some strength. The Croatian Judges Association became more critical of government actions and recorded significant victories against SJC rulings (Dallara

**Figure 2.14. Croatia: EU Accession Timeline**



Source: European Commission.

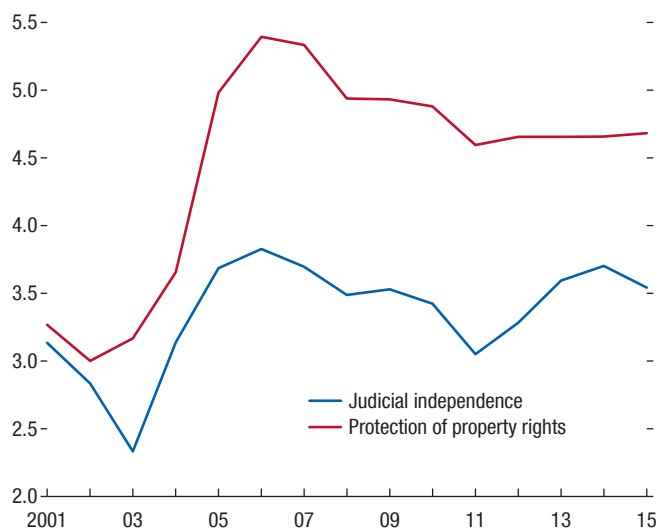
2014). In the late 1990s, the first public survey conducted regarding the Croatian judiciary highlighted the long duration of proceedings and case backlogs, helping to build reform momentum (Dallara 2014).

EU accession prospects and membership in several CoE bodies incentivized reforms. The government that took office in 2000 embarked on major reforms, including judicial reform. The signing of the association agreement with the European Union followed in 2001 (Figure 2.14). After 2000, the appointment procedures for judges were radically modified, providing limitations on political appointments (Dallara 2007). The main measures aimed at reducing political interference and making SJC membership incompatible with being chief justice. Other provisions gave the Constitutional Court broader powers to appeal SJC decisions.

The process of EU accession was instrumental in advancing judicial reforms (Figure 2.15). Croatia adopted the first Justice System Reform Strategy in 2005 and implemented one of the best rationalization reforms for the territorial reorganization of courts, achieving a 50 percent reduction in backlogged cases (Madir 2011; Carnevali 2013). In 2008, Croatia adopted a revised Justice System Reform Strategy that broadened justice reform as a prerequisite for continuing negotiations with the European

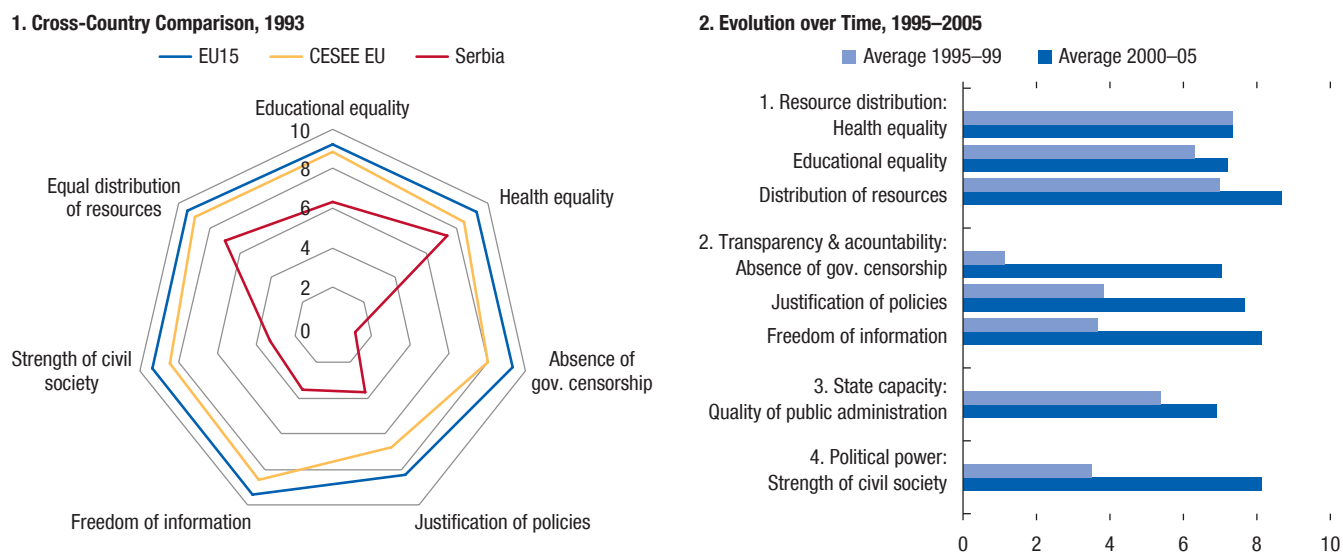
Union. In 2010, the constitution was amended to strengthen judicial independence and reduce political interference in the SJC. Also, new selection procedures based on verified qualifications were introduced for the appointment of judges and prosecutors, limiting the Justice Ministry's power and increasing the autonomy of the SJC and the State Prosecutorial Council. In 2010, a new strategy was adopted for the period until 2015 as a requirement for closing

**Figure 2.15. Croatia: Judicial Independence and Protection of Property Rights**  
(Index; 0 = worst, 10 = best)



Sources: World Economic Forum; and IMF staff calculations.

**Figure 2.16. Serbia: Factors Affecting Institutional Quality<sup>1</sup>**  
(Index; 0 = worst, 10 = best)



Sources: Varieties of Democracy Institute (V-Dem) database (version 6.2); and IMF staff calculations.

Note: EU15 countries are listed in text footnote 1.

<sup>1</sup>Equal distribution of resources measures poverty and the distribution of goods and services as well as the levels of inequality in these distributions and the proportion of the population ineligible for social services.

negotiations with the European Union. Due to a challenging political environment, initially the Croatian government's cooperation with the International Criminal Tribunal for the Former Yugoslavia (ICTY) was erratic, despite this being a condition of European Union membership (Rajkovic 2012; Menz 2013). By 2013, however, Croatia complied, which was deemed a major step in judicial reform progress, paving the way to its joining the European Union.

By 2008, the EC deemed the protection of property rights to be generally assured, but enforcement to be weak. While the legal system put heavy emphasis on the rule of law, in practice, legal certainty was often limited. Regulations were sometimes inconsistent, and administrative bodies frequently lacked legal expertise. Thus, executive ordinances did not always comply with the original legal mandate. As a result, citizens and companies often lacked confidence in administrative procedures and frequently perceived acts of administrative bodies as arbitrary (Bartlett, Bönker, and Petak 2014). Reported threats and

harm to prosecutors also undermined judicial independence (CoE 2016).

## Serbia

Serbia's institution-building path was uneven, as lingering effects of civil strife adversely affected domestic factors and relations with the European Union, weakening its role as an external anchor. The limited progress in judicial independence achieved after the fall of President Slobodan Milošević was not sustained. Reforms were stop-and-go, probably owing to increased concentration of resources related to flawed privatization and limited progress on transparency (Figure 2.16).

After the war, improving the effectiveness of the justice system became a priority as part of the broader reform agenda and possible EU accession (Figure 2.17). The efficiency of the judiciary had been undermined by an uneven workload between urban and rural courts, case backlogs, and the lack of a free legal aid system (EC 2016b). Political influence over the selection and appointment

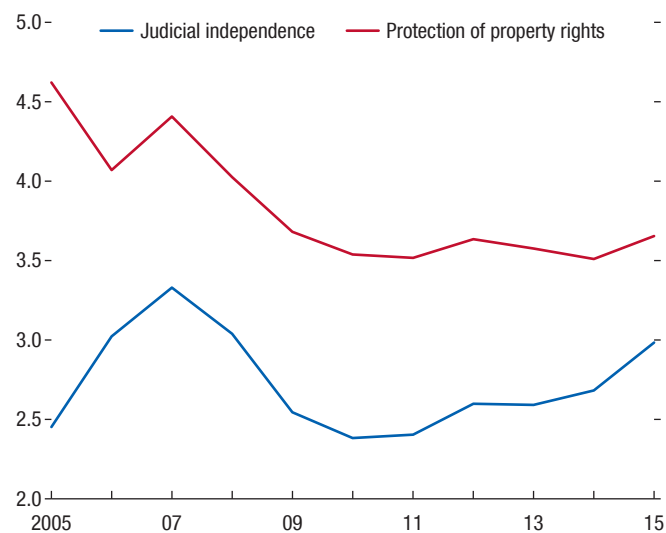
of judges was common (Dallara 2014). When reforms started, about half of active judges were dismissed. In 2001, a temporary government embarked on overhauling legislation and strongly encouraged judges in important positions to resign. But because of the lack of sufficient candidates to fill positions, this measure had a limited effect compared with that in other CESEE countries (Pavlovic 2003).

Various domestic players continued to resist judicial reforms, though increased transparency helped achieve some progress. In 2001, several laws were enacted to provide a legal basis for the operation of general and specialized courts and prosecutors' offices, and for professional freedoms and guarantees for judges and public prosecutors (OSCE 2011). The introduction of a self-governed body responsible for recruiting and selecting magistrates was a major change. However, its establishment was delayed when the National Assembly attempted to amend the bill to control nominations. Under pressure from civil society, freedom of information improved, which appeared to promote more rules-based systems.

Increased cooperation with the European Union succeeded in advancing judicial reforms in the early and mid-2000s, the period that saw the greatest improvement. In 2001, the European Union launched the Stabilization and Association Process with Serbia and identified the country as a potential EU candidate in 2003 (Figure 2.18). Cooperation with the European Union helped overcome political resistance to judicial reforms, particularly concerning the self-governing body (Dallara 2014). With the new 2006 constitution approved, a new wave of judicial reforms established the self-governing High Judicial Council and reformed the State Prosecution Council (GRECO 2015a). These steps led to a considerable improvement in perceived judicial independence in 2005–07.

However, reforms stalled, reflecting continued power struggles and a deteriorating relationship with the European Union as a consequence of lingering effects of the war. In 2006, the European Union suspended negotiations with Serbia due to

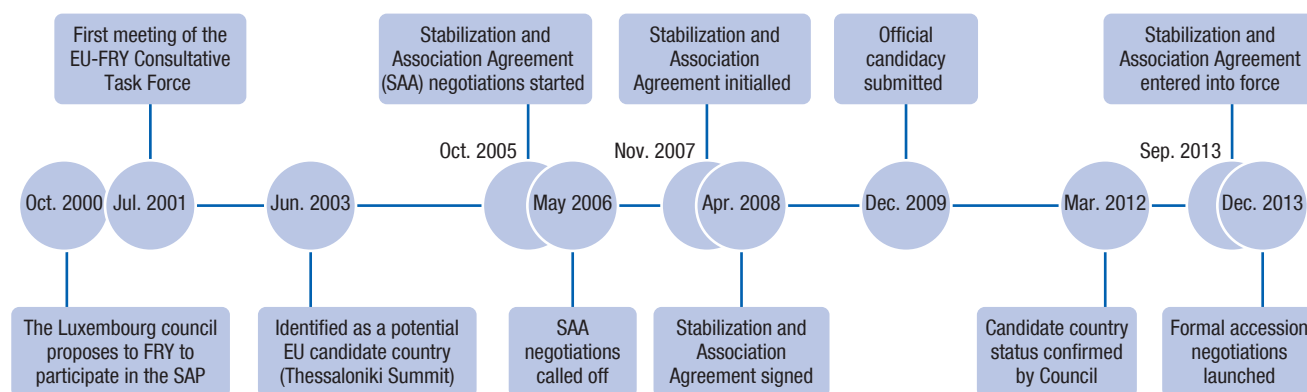
**Figure 2.17. Serbia: Judicial Independence and Protection of Property Rights**  
(Index; 0 = worst, 10 = best)



Sources: World Economic Forum; and IMF staff calculations.

lack of collaboration with the ICTY. A distinct antireform alliance formed between judges worried about losing their jobs and political parties seeking to maintain effective control over the judiciary (Begović and Hiber 2006). The lack of further progress on transparency and accountability, and considerable deterioration in income inequality, may have supported the formation of this alliance. Serbia's 2005 Gini coefficient was 5 percentage points higher than in 2000. Moreover, privatization was hasty, and special groups, some connected to the ruling party, received special treatment and protection for their firms (Radulović and Dragutinović 2014). Domestic business elites utilized their connections with politicians to preserve and even tighten barriers to entry (Pestic 2007; Begović 2013). The independence of self-governing bodies was hampered by the selection of the High Judicial Council members by the National Assembly instead of by peers (GRECO 2015a). The country still faces important challenges in cooperating with the ICTY, and such cooperation remains one of the European Union's demands during Serbia's accession talks (Ristic 2016).



**Figure 2.18. Serbia: EU Accession Timeline**

Source: European Commission.

Note: FRY = Federal Republic of Yugoslavia; SAA = Stabilization and Association Agreement; SAP = Stabilization and Association Process.

In this environment, the improvement in judicial independence and efficiency was not sustained, though some progress has been made recently. The 2009 judicial reforms failed to improve judicial efficiency (GRECO 2015a). The perceived independence of the judiciary deteriorated, and by 2010 it was at the level of 2005. The main concern was related to the provision requiring reappointment of judges, which limited judges' protection against removal and was denounced by the CoE (Murret 2010). Despite this criticism, in 2009 many judges were dismissed without clear criteria and without the right to contest the decision (Dicosola 2012). Closer integration with the European Union after 2010 provided a new impetus for judicial reforms, and the Constitutional Court reversed the 2009 decision on reappointment of all judges. Despite the improvement, perceived judicial independence in 2015 did not return to the level achieved in the mid-2000s, and trust in the judiciary remained limited (GRECO 2014, 2015a). As of 2014, a significant portion of judges (25 percent) and prosecutors (33 percent) reported that the judiciary was not independent, according to the World Bank Judicial Review. Judicial efficiency also remained troublesome, with disposition time some 30 percent higher than in other non-EU CESEE countries. The 2016 EC report notes that “the judicial system has reached some level of

preparation,” but that further steps are needed to tackle its independence (EC 2016b).

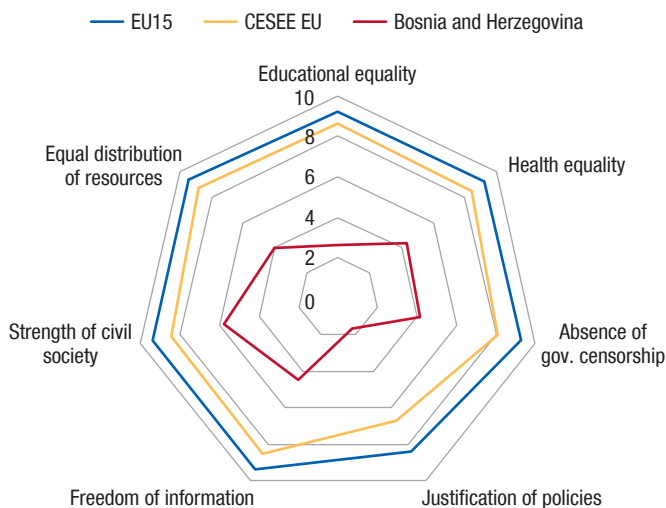
## Bosnia and Herzegovina

Bosnia and Herzegovina has made some progress in institutional reforms, but its case demonstrates that external intervention cannot substitute for a domestic reform drive. The rigid and decentralized structure enshrined by the Dayton Peace Agreement has allowed ethnicity-based politics to weaken reform efforts, including judicial reforms. Bosnia and Herzegovina's current governance framework resulted from the 1995 Dayton Peace Agreement, which vested most government functions in the two semiautonomous entities—the Federation of Bosnia and Herzegovina and the Republika Srpska—and established above these entities the Institutions of Bosnia and Herzegovina (or “State”), though with a limited mandate. The countries guaranteeing the peace settlement installed the Office of the High Representative, which has extraordinary power to dismiss elected governments and officials. Although this architecture has succeeded in maintaining peace for a quarter century, it has not helped the country develop effective institutions (Figure 2.19).

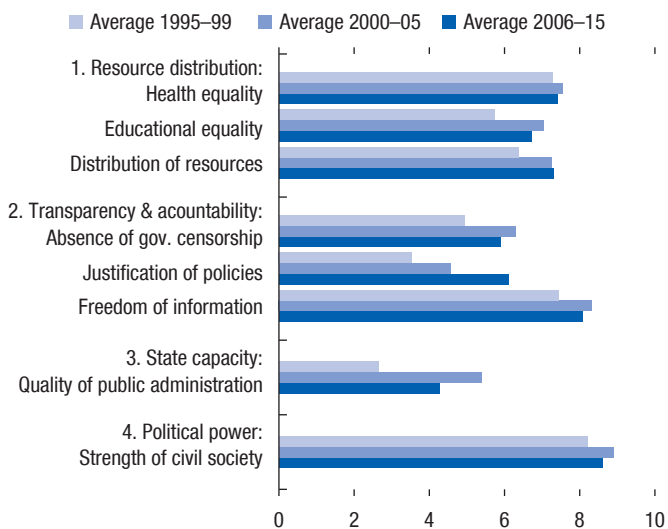
Judicial reform momentum picked up in the early 2000s as the Office of the High Representation took on a forceful role (Figure 2.20). With EU

**Figure 2.19. Bosnia and Herzegovina: Factors Affecting Institutional Quality<sup>1</sup>**  
(Index; 0 = worst, 10 = best)

**1. Cross-Country Comparison, 1995**



**2. Evolution over Time, 1995–2015**



Sources: Varieties of Democracy Institute (V-Dem) database (version 6.2); and IMF staff calculations.

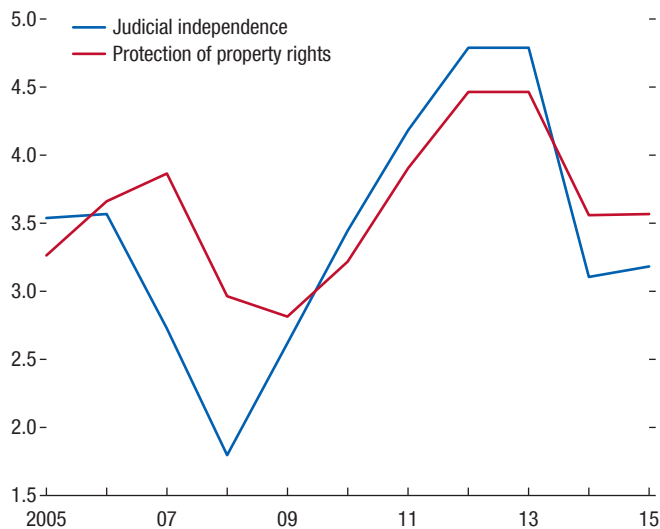
Note: EU15 countries are listed in text footnote 1.

<sup>1</sup>Equal distribution of resources measures poverty and the distribution of goods and services as well as the levels of inequality in these distributions and the proportion of the population ineligible for social services.

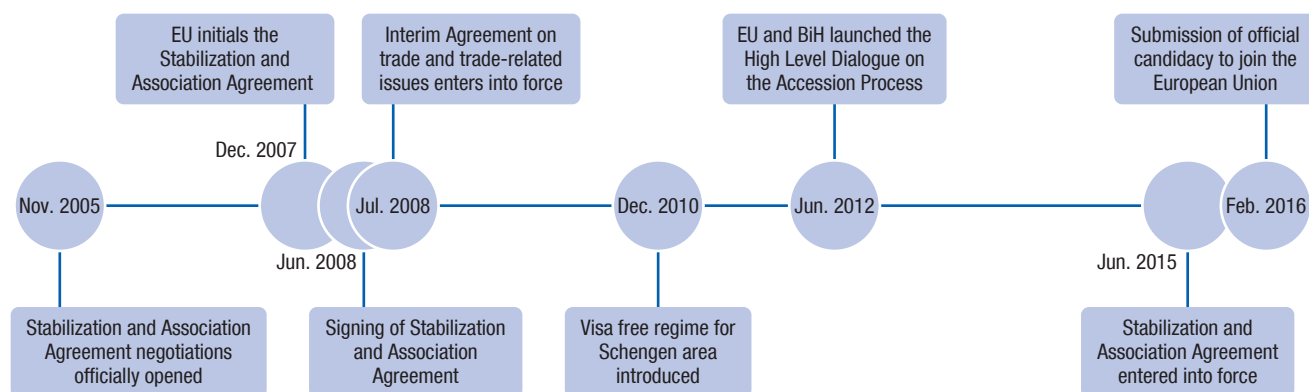
support, it began formally coordinating judicial reforms. The entities adopted laws on judicial and prosecutorial functions that represented the first major step toward the creation of a harmonized legal framework. In 2003, the Office of the High Representation introduced procedural laws that introduced harmonized country-wide civil and criminal procedures (HJPC 2017). Mid-decade reforms of the state-level judiciary also helped strengthen judicial independence. In 2004, the entities and the State agreed to establish the High Judicial and Prosecutorial Council, an independent body with the power to appoint and discipline judges and prosecutors. The State-level court and prosecutors became functional in 2005 (OSCE 2017). Early compliance problems with the ICTY were overcome in the early 2000s.

After 2006, judicial reform momentum weakened even as the country’s domestic revenue mobilization improved and external anchors shifted. The international community began to shift away from supporting the direct approach of the Office of the High Representative to the incentive-driven EU accession process. While

**Figure 2.20. Bosnia and Herzegovina: Judicial Independence and Protection of Property Rights**  
(Index; 0 = worst, 10 = best)



Sources: World Economic Forum; and IMF staff calculations.

**Figure 2.21. Bosnia and Herzegovina: EU Accession Timeline**

Source: European Commission.

Note: BiH = Bosnia and Herzegovina.

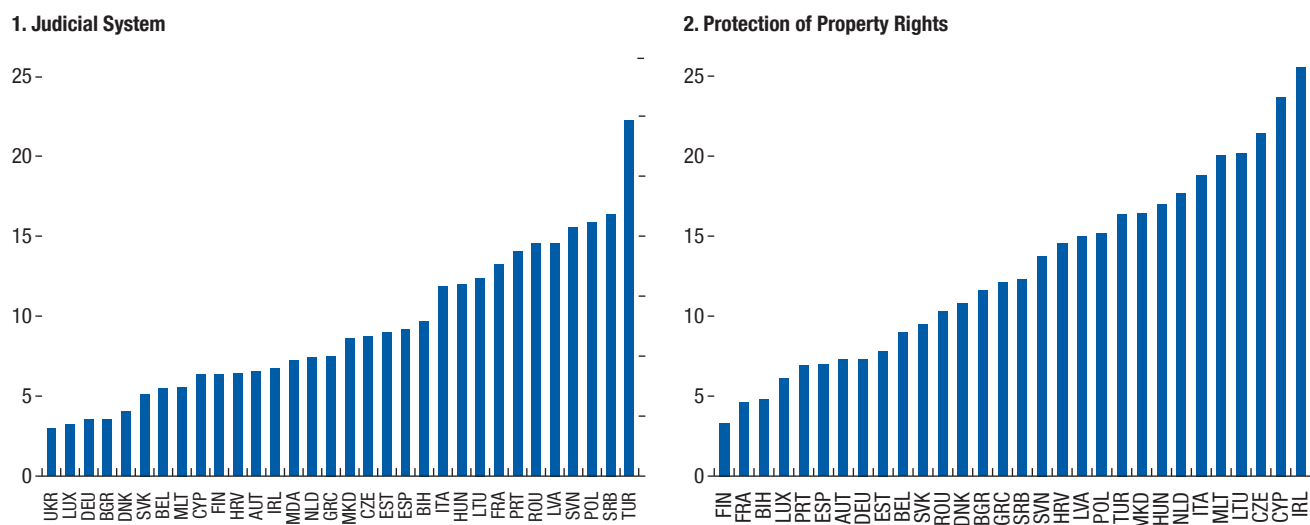
the latter provided long-term incentives for institutional reforms, implementation over the short term was hampered by Bosnia and Herzegovina's heavily decentralized structure and inter-entity tensions. Reforms stalled, and a constitutional reform package was defeated in the State Parliament in 2007. While discussions to reengage on judicial reform subsequently picked up, progress on the ground was not as strong as that indicated by the index shown in Figure 2.20, which is based on perceptions.

Despite episodic improvements, judicial performance in Bosnia and Herzegovina remains weak. The structure of governance is fragmented, contributing to judicial ineffectiveness. Entity laws are not harmonized horizontally, coordination among judicial institutions is lacking, and governments exercise undue influence on judicial budgets (OSCE 2017; CoE 2016). Persistent interethnic squabbles have prevented implementation of many Constitutional Court decisions (EC 2016c). Courts are slow to issue judgments, despite some improvement in the clearance rate and disposition time of cases. Because judgments remain unenforced (EBRD 2017), plaintiffs often reinitiate new lawsuits. Judges are perceived as subscribing to legal approaches seen as more favorable to political parties representing their ethnicity. The quality of judgments on economic and financial cases is

often poor; many judges award disproportionate compensation without addressing the underlying problem. International indicators also reflect the weaknesses in Bosnia and Herzegovina's judicial system: the overall state of judicial effectiveness in the country is poor compared with regional peers (European Commission for Efficiency of Justice 2016), and the public's perception of the judiciary is also negative (GRECO 2015b). The enforcement of property rights is also weak.

Judicial reforms are back in focus, supported by the European Union, but the outcome is uncertain. In 2015, the authorities adopted the Reform Agenda, which lays out plans to improve the rule of law and is supported by Bosnia and Herzegovina's international partners, with the European Union in the lead (meaningful progress on the agenda is a prerequisite for EU candidate status (Figure 2.21).) The IMF's Extended Fund Facility, approved in 2016, contributes to this agenda by aiming to strengthen governance of state development banks and SOEs. Box 2.3 reviews reforms related to governance in IMF-supported programs in selected CESEE countries (Kosovo and Ukraine).

**Figure 2.22. Consistency of Similar Indicators from Different Sources<sup>1</sup>**  
(Standard deviation)



Sources: Varieties of Democracy Institute (V-Dem); World Bank, Doing Business; World Economic Forum (WEF); and IMF staff calculations.

Note: Data labels use International Organization for Standardization (ISO) country abbreviations.

<sup>1</sup>Standard deviations are calculated across different indicators, ranked by percentiles of the distribution and then averaged over time. For the judicial system, the following indices are used: judicial independence and impartiality of courts from the WEF and judicial accountability from the V-Dem. For the protection of property rights, indices used are protection of property rights from the WEF, protection of property rights from the Heritage Foundation, and enforcement of contracts from the World Bank's Doing Business Indicators.

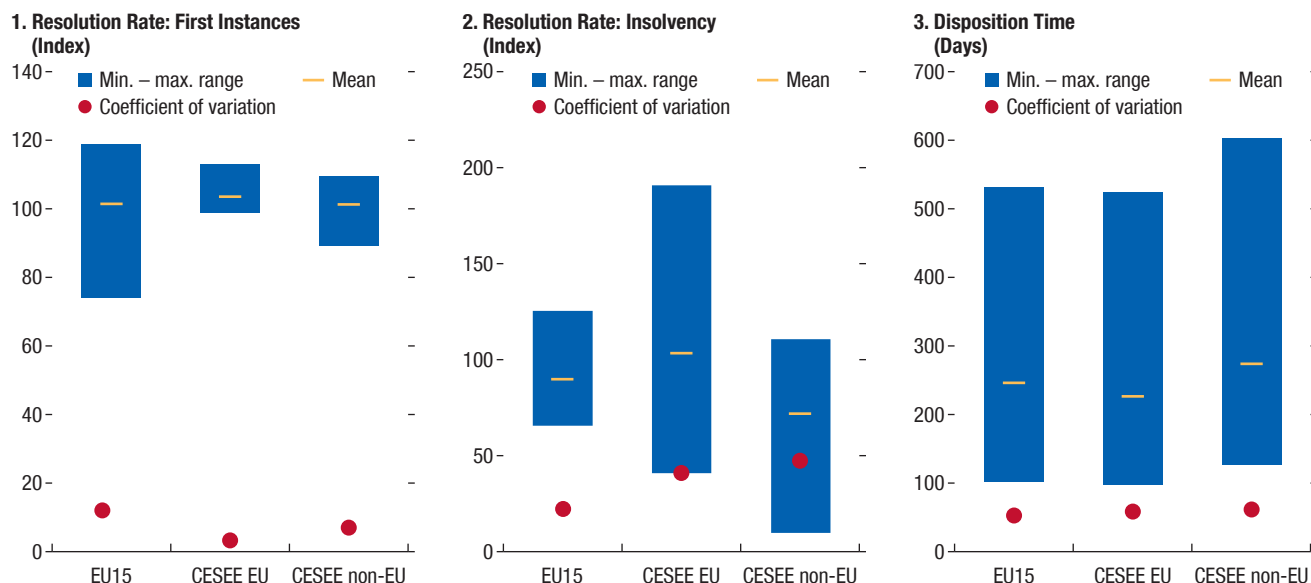
## Evolution of the Effectiveness of CESEE Justice Systems and Property Rights Protection

This section reviews the evolution of judicial effectiveness in all the 20 CESEE countries covered. We include the rule of law indicator, for which data are available starting in the 1990s; indicators on the judiciary's efficiency, independence, and impartiality; and protection of property rights, for which data start in the 2000s. The data show significant progress as well as setbacks over the past two decades, as seen in the case studies.<sup>10</sup> The average standard deviation across indicators from different sources measuring judicial system effectiveness and protection of property rights provides an indication of whether different sources of information agree (Figure 2.22). For some countries, the differences are relatively small, suggesting that there is broad consensus, while for others, indicators from

different sources vary significantly, suggesting greater uncertainty and hence the need for a more cautious assessment.

CEPEJ data indicate that CESEE EU countries perform well in terms of justice system efficiency compared with the EU15, but there is significant heterogeneity. CEPEJ hard data indicate that CESEE EU countries, on average, have slightly higher resolution rates compared with CESEE non-EU countries, or even the EU15 (Figure 2.23). For insolvency cases, however, the resolution rate in CESEE non-EU countries is significantly lower than in EU countries. Further, substantial variation exists, with the Czech Republic and Slovenia at the high end of the spectrum and Croatia and Romania at the low end. Disposition time data show comparable efficiency levels in CESEE-EU countries and the EU15, with similar variation within the two groups. Other efficiency indicators presented by the EU Justice Scoreboard also point to some CESEE EU countries having greater judicial efficiency than some of the EU15 countries (EC 2017). CESEE non-EU countries have

<sup>10</sup>The rule of law is a broader indicator, while the judiciary's effectiveness (including efficiency, independence, and impartiality) and the protection of property rights are components of the rule of law.

**Figure 2.23. CESEE: Case Resolution Rate and Disposition Time, 2014<sup>1</sup>**

Source: European Commission for the Efficiency of Justice.

Note: EU15 countries are listed in text footnote 1.

<sup>1</sup>For resolution rate: values higher than 100 indicate that more cases are resolved than received. For disposition time: higher values indicate higher theoretical duration for a court to solve the pending cases. Criminal cases are excluded.

longer disposition times and hence overall lower efficiency.

Despite significant progress, the CESEE's perceived judicial indicators on average still appear weaker than in the EU15. Comparing the four indicators presented in Figure 2.24, the perceived differences between the CESEE and the EU15 average are smallest for the rule of law and largest for judicial independence. The 2016 Eurobarometer Survey suggests that the perceived independence of courts and judges among the general public and companies is lower in CESEE-EU countries than in the EU15 (though with significant in-group variations), which is attributed to greater interference by governments or politicians (Figure 2.25). This is despite the fact that the EU Justice Scoreboard suggests that CESEE-EU countries do not significantly deviate in terms of de jure safeguards of judicial independence from the EU15.<sup>11</sup> Typically,

<sup>11</sup>The EU Justice Scoreboard provides information on safeguards related to the status of judges regarding their appointment, evaluation, possible transfer without consent, and potential dismissal (EC 2017b).

CESEE-EU countries perform better than CESEE non-EU countries.

Cross-country variations are significant for all four indicators, with the best-performing CESEE countries perceived to have judicial indicators exceeding those of some EU15 countries. Importantly, while many CESEE countries are in the middle two quartiles of the global distribution for the rule of law indicator, 10 or 11 CESEE countries are in the lower quartile for the other three indicators, broadly in line with the case study findings and GRECO's evaluations. There are also up to three EU15 countries in the lower quartile for judicial independence and impartiality, in line with GRECO reports that note concerns arising especially regarding judicial independence and impartiality in over a third of CoE member countries (CoE 2015, 2016).

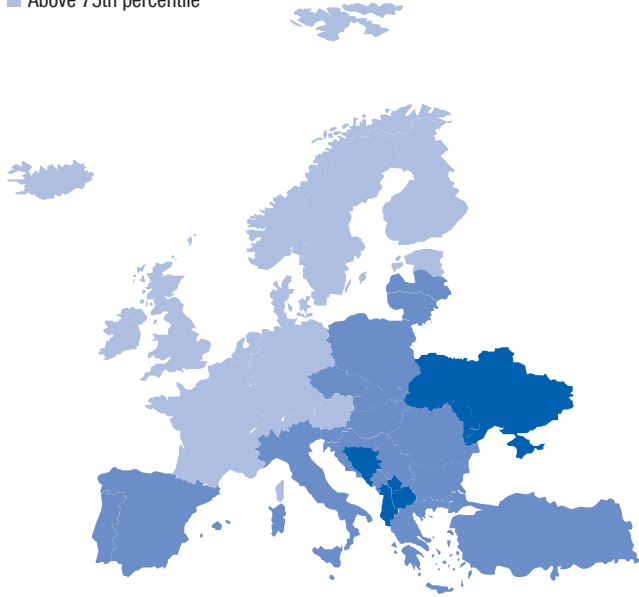
Regulatory enforcement in CESEE countries seems weaker than de jure indicators suggest. On average, the CESEE countries in the study rank around the 57th percentile of the rule of law index global distribution. However, the region ranks lower, around the 48th percentile, on



**Figure 2.24. Europe: The Rule of Law and Some of Its Components**  
*(Lighter blue = better; darker blue = worse)<sup>1</sup>*

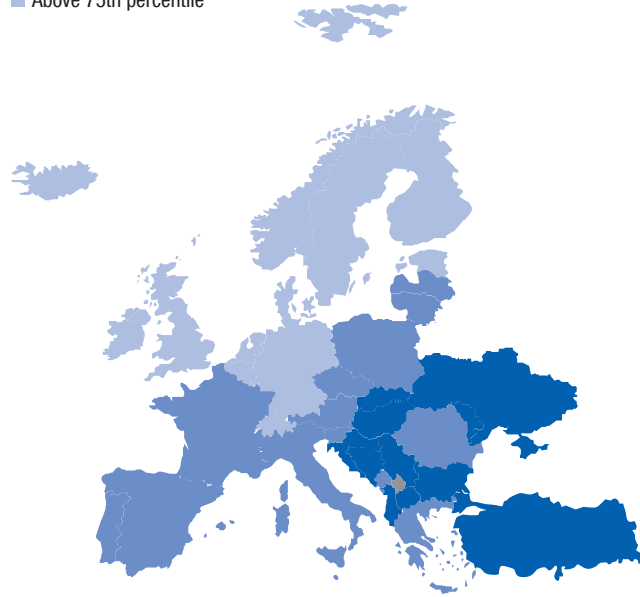
**1. Rule of Law, 2016**

- Below 25th percentile
- Between 25th and 75th percentiles
- Above 75th percentile



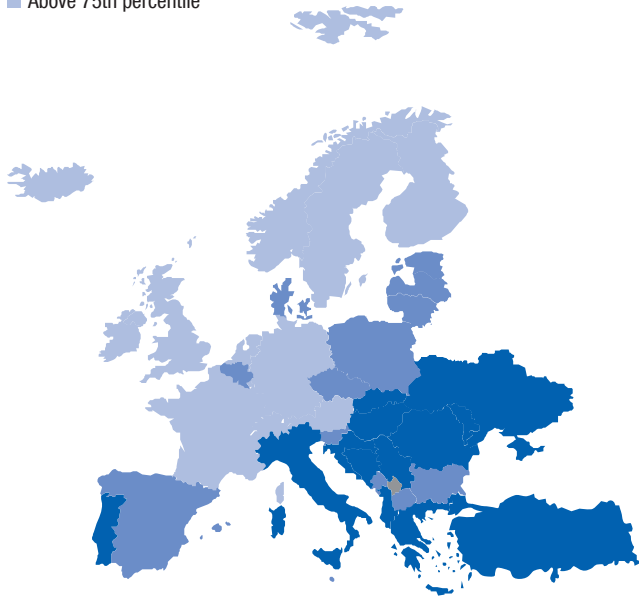
**2. Judicial Independence, 2015**

- Below 25th percentile
- Between 25th and 75th percentiles
- Above 75th percentile



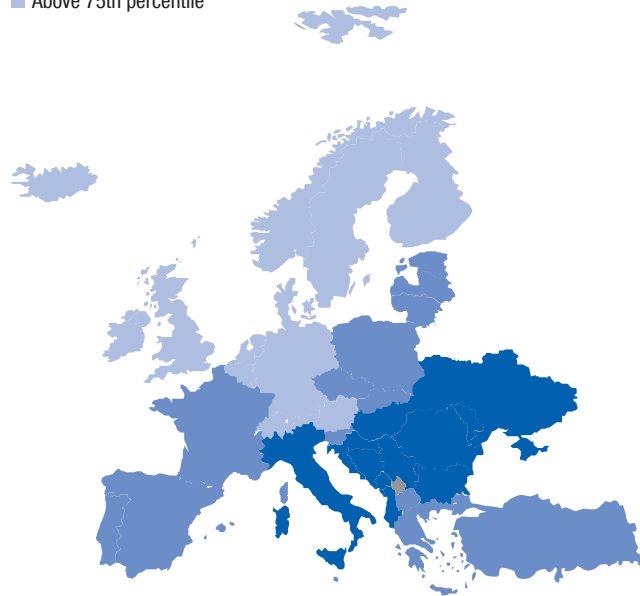
**3. Impartiality of Courts, 2015**

- Below 25th percentile
- Between 25th and 75th percentiles
- Above 75th percentile



**4. Protection of Property Rights, 2015**

- Below 25th percentile
- Between 25th and 75th percentiles
- Above 75th percentile

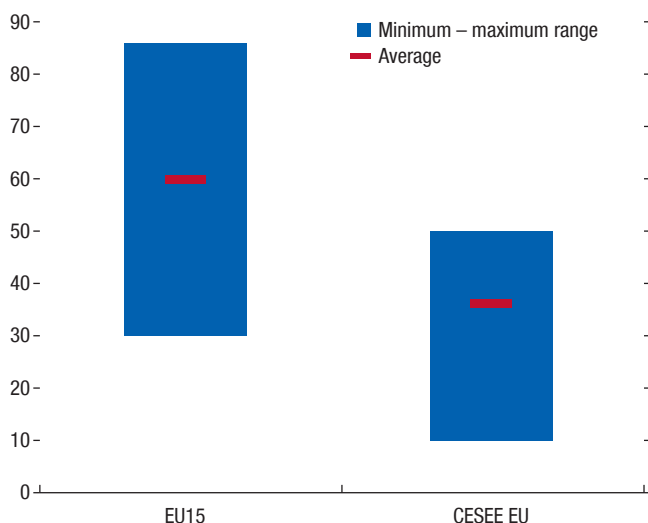


Sources: World Bank, Worldwide Governance Indicators (rule of law); World Economic Forum (protection of property rights, judicial independence, impartiality of courts); and IMF staff calculations.

Note: Data on judicial independence, impartiality of courts, and protection of property rights are not available for Kosovo.

<sup>1</sup>The percentiles are defined based on the worldwide rankings of available countries excluding low-income countries.

**Figure 2.25. Perceived Independence of Courts, 2017<sup>1</sup>**  
(Percent)



Source: Eurobarometer.

Note: EU15 countries are listed in text footnote 1.

<sup>1</sup>Percentage of respondents that ranked independence of courts in their country as fairly or very good.

the regulatory enforcement index compiled by the World Justice Project. This suggests weaker performance in regulatory enforcement in CESEE countries than the performance in establishing the regulatory framework. GRECO (2017) finds that while solid legal and institutional foundations have been established on paper, in many CESEE countries effective implementation is lacking. The Global Integrity Report also estimates a large gap between the regulatory framework and its actual implementation in the region—on average about 30 percentage points—that is similar to the report’s estimates for emerging market economies.

Despite much progress, the pace of improvement appears to have slowed or even reversed since the global financial crisis.

- In general, countries farther behind have recorded larger improvements in judicial indicators since 2001 (Figure 2.26).
- While the perceived rule of law has continued to improve in several CESEE countries in recent years, in about half of them the pace of improvement has slowed or even reversed

since 2007, as shown in the case studies (Figure 2.27). The evolution is worse for the other indicators, especially for judicial impartiality and independence.

- These findings are consistent with those of other authors highlighting a slowdown or reversal of judicial reforms and anticorruption efforts after EU accession (Mungiu-Pippidi 2015; EBRD 2013, 2016). Aslund and Djankov (2014) maintain that several of Bulgaria’s and Hungary’s reforms have proved vulnerable,<sup>12</sup> and the EC recently registered concern about Poland’s judicial independence.

## Main Findings

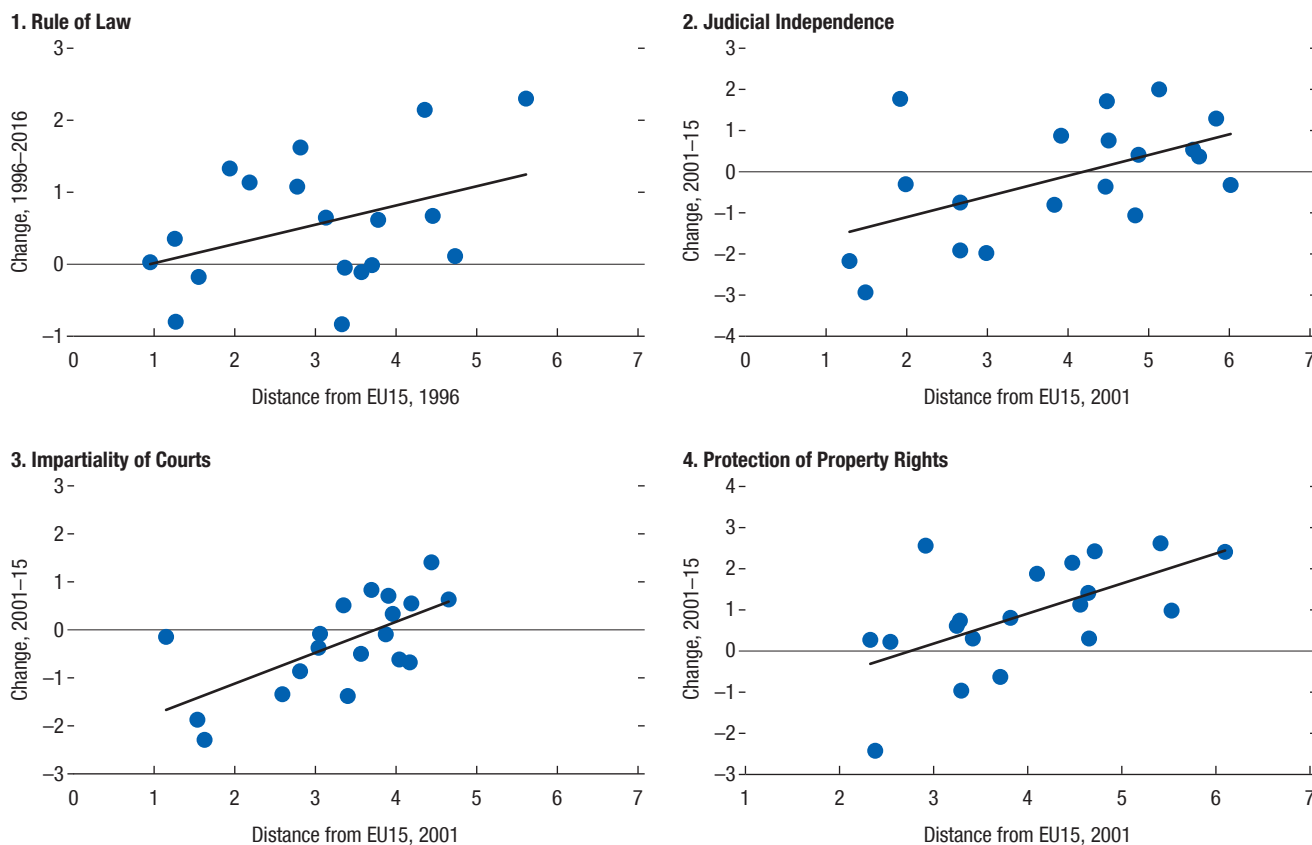
This section presents the main findings from all the strands of analysis carried out in this chapter, including some econometric evidence. It draws from the case studies, the judicial indicators, and regressions covering all advanced and emerging market economies that explore the determinants of judicial independence and protection of property rights in a global setting. Panel regressions were estimated with five-year, nonoverlapping averages using model specifications based on the conceptual framework presented earlier in this chapter (Box 2.4).

This chapter finds empirical support for the importance of the distribution of resources and of opportunities for strengthening judicial systems and the protection of property rights.

- From the case studies, countries that managed to prevent large increases in inequality and the emergence of oligarchic structures attained better institutions (see also Guriev 2017).<sup>13</sup> Policies implemented as part

<sup>12</sup>The State Audit Office of Hungary (2016) reports an improvement in survey-based corruption risk indicators between 2013 and 2015, but indicates that “the ratio of institutions applying anti-corruption procedures still remains low.”

<sup>13</sup>The transition from a centrally planned to a market-based economy generally entailed higher measured inequality. The region’s posttax Gini coefficient, on average, increased by 4 percentage points during the 1990s, though it started at very low levels. Nevertheless, this may overestimate the increase, as the income distribution in

**Figure 2.26. CESEE: Evolution of the Elements of the Rule of Law**

Sources: World Bank, Worldwide Governance Indicators; World Economic Forum; and IMF staff calculations.

Note: EU15 countries are listed in text footnote 1.

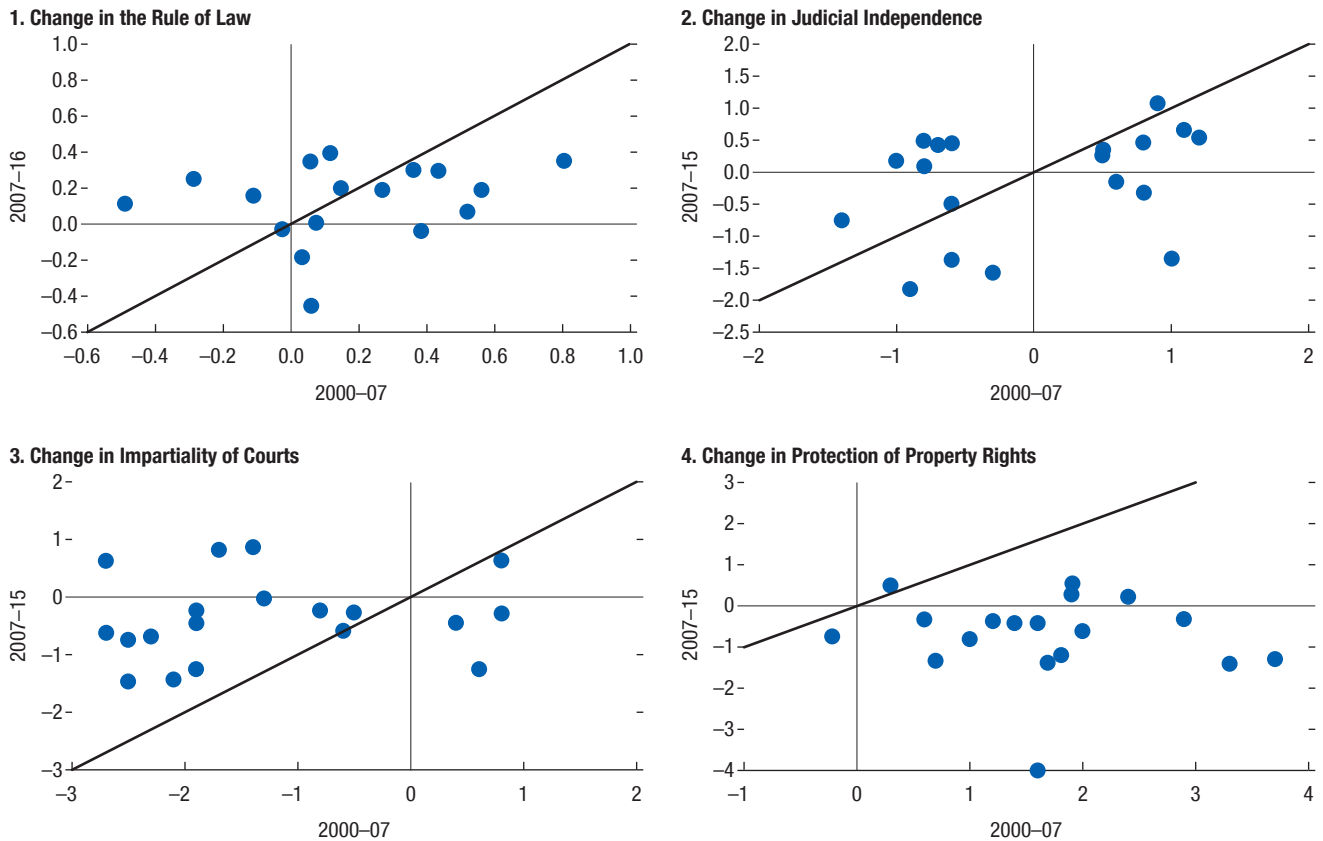
of the transition, such as privatization, deregulation, restructuring of SOEs, and implementation of competition policies, had a considerable impact on income inequality and on preventing the emergence of oligarchic structures, a finding that Djankov (2014b) also highlights. In particular, the way privatization was conducted played a significant role in resource distribution, with implications for institutional quality. For example, most members of Romania's elite used insider knowledge, political power, and control over state resources to solidify their control over the economy during privatization, resulting in a much higher Gini coefficient by the late 1990s and contributing to considerable resistance to judicial reforms

(Gabanyi 2004). In contrast, Estonia's privatization, which aimed to put assets into the hands of those with the incentives and skills to use them effectively, combined with wide participation across society, appears to have been vital for Estonia's success in institution building. In Serbia, members of the business elite managed to increase their control over resources, undermining judicial independence. In Poland and Hungary, far-reaching policies to liberalize trade and commercial activities succeeded in demonopolizing the economy early in the transition, which may have aided judicial independence and control of corruption (Slay 1995).<sup>14</sup> But setbacks also occurred in several countries, as documented in the case studies

command economies likely underestimated the degree of inequality due to price controls and shortages.

<sup>14</sup>OECD (2014) notes that more competition results in less corruption.

Figure 2.27. CESEE: Evolution of Institutions before and after 2007



Sources: World Bank, Worldwide Governance Indicators; World Economic Forum; and IMF staff calculations.

and in the indicators. EBRD (2016) links these to a perceived unfair distribution of earlier reform gains, and Aslund and Djankov (2014) attribute some of the deterioration to the influence of business groups with strong ties to the government. In some cases, the private sector may also influence the independence of the courts directly.

- As in several previous empirical studies, the econometric work for this chapter finds that the Gini coefficient has a negative correlation with judicial institutions, but is not always statistically significant. However, a broader index of resource distribution—which besides income equality also includes equality of access to education and healthcare and the distribution of power among different socioeconomic groups—has a more robust association with higher independence

of the judiciary and better protection of property rights.

The capacity of the public administration is critical to achieving judicial independence and overall effectiveness. In several countries, for example in Kosovo and Poland, rapid changes in the legal framework, an increasing number of court cases, and opportunities for better-paid jobs emerging in the private sector (especially for legal, finance, and economist professions) initially put pressure on the capacity of the judiciary. In almost all the cases studies, the creation of an independent, self-governing body responsible for recruiting and selecting magistrates helped limit political involvement in selecting and disciplining judges. While most countries in the case studies created, de jure, an independent self-governing body, de facto independence varied significantly

across countries. Ensuring the independence of the self-governing body was easier in countries such as Estonia that early on managed to replace most of the communist-era political appointees in important judiciary positions. However, the case studies show that in countries where replacement of judges with integrity problems or political connections was not comprehensive, an antireform alliance formed among judges worried about losing their jobs and political parties that wanted to keep control over the justice system. This appears to have been the case in Romania and Serbia early in the transition, and it delayed the establishment of a de facto independent self-governing body. Where a qualified and professional bureaucracy was established, the effectiveness of the judiciary was fostered and de jure reforms appeared to be implemented more successfully. The variable capturing merit-based procedures to recruit and promote civil servants has a robust association with judicial independence and property rights protection in the regressions.

Transparency and accountability mechanisms feature prominently in the case studies, and they seem to play a particularly important role when the environment is unfavorable to robust institutions. Transparency took many forms. For example, Estonia's publishing of formal coalition agreements contributed to the continuation of reforms despite frequent government changes. In Croatia, the publication of results of surveys on the judicial system enabled public scrutiny and helped catalyze reforms. Romania's civil society organizations used the freedom of information legislation adopted during the EU accession process to expose politicians' dishonest behavior, facilitating judicial reforms. In Ukraine, legal reforms requiring the identification of ultimate beneficiaries made bank owners liable for losses from related-party lending. Freedom of information gets some support in our econometric analysis in line with earlier results (IMF 2005; Borner, Bodmer, and Kobler 2004), and its marginal impact rises when resource distribution or public administration capacity are not conducive to robust institutions. These

findings echo others' findings that transparency, especially related to fiscal issues, including public procurement, increases the effectiveness of laws that otherwise exist only on paper (Mungiu-Pippidi and Dadasov 2017; OECD 2014). To improve the efficiency of the judiciary, GRECO recommends transparency in the recruitment, promotion, and case assignments of judges and in measures of judicial system performance.

In line with the literature, openness tends to be positively associated with judicial independence and protection of property rights. Estonia's experience suggests that substantial reductions in trade tariffs and nontariff barriers, elimination of export restrictions, and guarantees for equal rights for both foreign and domestic investors during the privatization process facilitated institutional reforms by increasing competition and discouraging rent seeking. In Poland, the Balcerowicz Plan replaced import restrictions and foreign trade monopolies with tariffs (IMF 2014), thereby reducing opportunities for rent seeking. Foreign ownership of banks also fostered competitive credit allocation and limited connected lending, for example in Estonia and Poland, strengthening the constituency for more rules-based institutions (Poghosyan and Poghosyan 2010; Bonin, Hasan, and Wachtel 2005; Nikiel and Opiela 2002). In the regressions, lower barriers to trade and the institutional quality of trading partners have a significant positive correlation with judicial independence and the protection of property rights.

The case studies suggest that the European Union and the CoE played different roles as external anchors, depending on the dynamics of domestic factors affecting institutional quality. In countries like Estonia, with strong domestic fundamentals for effective institutions, institutional reforms were largely domestically driven and used EU and CoE standards as benchmarks. In countries where domestic fundamentals were not as conducive to effective institutions, such as, Croatia, Romania, and Serbia, the European Union and the CoE helped overcome political resistance to reforms.



While EU-driven reforms initially were largely *de jure*, they did facilitate improvements in domestic fundamentals as well, and ultimately in the judiciary's *de facto* effectiveness. In Croatia and Serbia, incentives from EU accession coupled with recommendations by CoE monitoring bodies helped establish magistrates' self-governing bodies. However, when the incentives offered by the European Union were viewed as unattractive, as in Serbia in 2005–07, anti-EU political parties blocked reforms. For Croatia and Romania, EU conditionality was instrumental for the adoption of a judicial reform strategy aimed at separating the judiciary and the political branches of government. Also, the European Union and the CoE continue to encourage reforms via, for example, the Cooperation and Verification Mechanism for Bulgaria and Romania. Some previous studies also support the view that the EU “anchor” played a positive role for institutional improvement (IMF 2005; EBRD 2013; Mulas-Granados, Koranchelian, and Segura-Ubiergo 2008), though Mungiu-Pippidi (2015) warns that the EU impact is limited if reforms are implemented as bureaucratic requirements and do not engage civil society and change domestic agents' incentives. In the regression, the EU impact is captured via trading partners' institutional quality, which is found to be significant for judicial independence, but not for property rights protection.

Additional noneconomic factors that appear to matter for judicial effectiveness and property rights protection are

- *Societal fragmentation*: In Bosnia and Herzegovina, Croatia, and Serbia, long wars delayed the transition, and societal fragmentation stifled judicial reforms. Also, fragmentation along rural and urban population lines may have complicated institutional reforms in Poland and contributed to reform reversals in other countries. These results are in line with the literature (Guriev 2017). The negative association of the old-age dependency ratio with institutional quality may reflect

difficulties in solving collective action problems in societies with a large share of retirees who may favor the status quo and oppose reforms with long-term payoffs.<sup>15</sup>

- *The strength of civil society*, which appears to help judicial reforms, as illustrated in Estonia, Poland, and Romania: Some authors (Bakolias 2000; Mungiu-Pippidi 2017; Rodríguez-Ferreira 2013) argue that civil society is critical to supporting effective justice systems, for example by fostering public debate, increasing awareness, and demanding transparency and accountability.
- *Favoritism in politics*, which has a strong negative link to judicial independence and property rights protection in the regressions: Clientelism enables some groups to capture institutions, as found in the case studies. At times, state-owned banks were an important conduit of weak governance. Ukraine's experience suggests that high levels of corruption and entrenched vested interests impede governance and judicial reforms. In Poland, instances of corruption among the judiciary and members of the political elite during 1998–2003 coincided with the perceived deterioration in judicial independence. The power struggles between different groups are deemed a cause for the ups and downs in judicial reforms in most of the case studies. A 2017 GRECO report attributes implementation gaps in many CESEE countries' legal frameworks to remaining corruption and clientelism among those who wish to preserve their grip on power and the status quo. Surveys such as the 2017 EU Justice Scoreboard also point to political pressure as one of the main reasons for perceived lack of judicial independence.

<sup>15</sup>Atoyan and others (2016) find that the exit of young and skilled people from the region over the past 20 years (the largest economic emigration in modern history as a share of home population) removed a voice that could have been critical for improving institutions.

## Conclusion

CESEE countries significantly strengthened the effectiveness of judicial systems and property rights protection, though achievements varied across countries, and progress was not linear. Looking ahead, a number of countries aspire to join the European Union. For these countries, but also for others seeking to improve the effectiveness of their judiciary and institutions, the main policy insights from the case studies, indicators, and econometric analysis are

- The importance of distributional factors in countries' success in judicial reforms calls for careful examination of the distributional impact of policies. The way privatization was implemented, as well as the opening up of the economy, had a critical bearing on whether a few dominant players emerged or more balanced economic structures prevailed. This had attendant implications for judicial effectiveness, especially for independence and impartiality. This calls for careful consideration of the distributional implications of all policies and other drivers of inequality and argues for reforms that can help ensure a level playing field. Strong enforcement of competition rules and lower trade and entry barriers can reduce monopolistic power. Redistributive fiscal policies can be another policy lever, with attention also given to equality of opportunities.
- Selecting and promoting public officials (judicial and otherwise) strictly on merit and strengthening the independence of the civil service can improve institutional quality.
- Countries' experiences suggest that better transparency and accountability can foster reforms. Besides freedom of information legislation, economic policies that can contribute to transparency include fiscal transparency, accountability on the use of public resources, e-government, financial disclosures of public officials, and transparency of ownership structures of financial and nonfinancial corporations. The impact of transparency and accountability seems stronger when other fundamentals were not conducive to high institutional quality, suggesting that this could be an area that presents several entry points for policymakers.
- The European Union and the CoE played a key role as external anchors, though the sustainability of reforms rested more on domestic factors. In countries with domestically driven reforms, EU and CoE legal standards acted as a benchmark for high institutional quality. In countries with a limited domestic drive for institutional reforms, the incentive of EU membership helped overcome some political resistance to reforms, though setbacks were common. EU conditionality helped align domestic legal frameworks to those of the European Union. While this generated *de jure* changes, *de facto* improvements appear to have followed a less linear path. Yet in many cases, EU and CoE standards facilitated improvements in domestic factors conducive to institutional reforms. For example, the adoption of freedom of information laws enabled civil society to be more successful in exposing rent-seeking behavior of government officials. The European Union and the CoE continue to play a catalytic role through technical assistance and enforcement procedures, though their effectiveness after accession may be more limited.
- IMF-supported program cases also indicated that operating on domestic levers can help nudge institutional reforms. The IMF can enhance its analysis of distributional impacts and promote policies that favor a more equal distribution of resources and opportunities. Its technical assistance can help strengthen state capacity in many ways, though other institutions are more active in overall civil service reform. The IMF can contribute to transparency in many ways—for example, via comparative analyses, standard setting, data, fiscal and financial transparency, and

anti-money-laundering initiatives, as well as in increasing accountability mechanisms.

- Many of these factors interacted with each other due to important feedback loops, suggesting that there can be several entry points for policy intervention. “The insight that ‘everything matters’ can be both paralyzing and empowering” (Thaler and Sunstein 2009). Transparency presents many opportunities for nudges to start a virtuous cycle.

These findings are tentative, and more work is needed to understand institutional reforms. Judicial effectiveness and property rights protection, as well as a host of socioeconomic factors that may determine them, are inherently difficult to measure and assess. Complex political economy interactions affect reforms, making it hard to uncover how agreement was reached and maintained. More work is needed to understand factors and policies that affect the balance of power and increase the chances that institutional reforms are undertaken, make a difference in practice, and are sustained.

## Box 2.1. Institutions and Economic Outcomes

Effective institutions, which encompass an effective rule of law, play a key role in promoting more equitable and sustainable growth. A well-documented stylized fact is that societies with high institutional quality tend to be more prosperous. Several authors identify causal effects from institutions to per capita income and underscore that differences in institutional quality can explain cross-country variations in economic development. The World Bank's 2017 *World Development Report* argues that peace, justice, and strong institutions (UN Sustainable Development Goal (SDG) 16) hold “important instrumental value because the attainment of the goal will aid in the attainment of all the other SDGs.” It highlights that “the achievement of all the SDGs will require a solid understanding of governance to enable more effective policies.”

Institutions foster equitable and sustainable growth through several channels. The main ones include

- Ensuring more equal access to opportunities—a level playing field—and appropriate rewards to those who provide labor, capital, and ideas.
- Providing checks and balances that discourage rent-seeking behavior and promote more efficient/fairer use of public resources and better government services. Checks and balances make decision making less dependent on individuals, thereby limiting policies that benefit only particular interest groups.
- Securing a high level of responsiveness to citizens' preferences and demands, which is key for building public trust in government and institutions, thus facilitating consensus around growth-enhancing reforms.

Institutions can affect growth by enhancing commitment and collective action (World Bank 2017). These factors are particularly relevant for investment and efficiency. The first factor, commitment, involves preparing an environment where firms and individuals feel secure to invest resources in productive activities. The second factor, trust and collective action, pertains to the ability to form partnerships and undertake specialization in production and correct potential market failures (World Bank 2017). Recent microeconomic studies provide evidence for these mechanisms and highlight how institutions affect factors of production. We focus on the following three direct channels, recognizing that they are also interrelated:

- *Labor*: Empirical studies have found a strong effect of weak institutions and governance on the emigration of skilled workers (Cooray and Schneider 2016). Similarly, Atoyán and others (2016) argue that better institutions hold the promise of retaining and slowing emigration of skilled workers.
- *Investment*: In the absence of effective protection of property rights, incentives for investment and innovation will be harmed. Micro studies find that firms that feel more secure from the threat of expropriation invest a larger share of their profits in their business (Johnson and others 2002). Institutions also affect foreign direct investment, which in turn affects productivity and technology adoption (Bénassy-Quéré, Coupet, and Mayer 2007; Bevan and Estrin 2004).
- *Efficiency (total factor productivity)*: The theory predicts that institutions affect innovation and productivity through enhanced trust, cooperation, commitment, and contract enforcement (World Bank 2017). The rule of law is critical, as weaknesses in contract enforcement prevent specialization and optimal allocation of labor and capital (North 1990), which stifles total factor productivity. Firms and workers are hesitant to specialize if they are not sure whether all parties will adhere to the agreed contract. As market size grows and products get more complicated, trust, specialization, coordination, and enforcement of contracts matter more (Dixit 2007; World Bank 2017). Better contract enforcement helps firms expand their pool of suppliers by enhancing trust between unknown parties (Johnson and others 2002).

Prepared by Faezeh Raei.

**Box 2.1 (continued)**

Institutions also affect intermediate variables that matter for growth, including but not limited to

- *Government expenditure, revenue, and services:* For a government to collect taxes needed to provide public goods, its citizens must be willing to comply and cooperate. Legitimacy and cooperation are maximized if the rule of law is applied consistently, trust is built, and decision-making processes are inclusive (World Bank 2017). Weak institutions and governance can lead to forgone tax revenue, larger unofficial economy size (IMF 2016a), and government's inability to deliver quality public services (World Bank 2017). Studies show that better public investment management institutions—transparent procurement and project appraisal processes—are associated with more efficient public infrastructure and higher absorption of EU funds (IMF 2016a).
- *Access to credit:* The strength of the legal system in credit protection and collateral execution affects how much financing creditors are willing to extend (Townsend 1979; Aghion and Bolton 1992; Hart and Moore 1994). Similarly, better contract enforcement is associated with higher lending and fewer defaults (Bianco and others 2005). In addition, weak debt enforcement and ineffective insolvency frameworks tend to lower recovery values of problem loans (IMF 2015).
- *Economic resilience:* The ability to withstand negative shocks is affected by institutions because they govern the quality of policies and their implementation (OECD 2016). Better institutions are associated with greater fiscal policy countercyclicality (Frankel, Vegh, and Vuletin 2013) and with more effective monetary policy transmission (Mishra and others 2014). Countries with stronger protection of property rights are found to have lower probability of market crashes (Blau 2017). Better policies and institutions may enable countries to avoid or withstand episodes of debt distress (Kraay and Nehru 2006; IMF 2017a).
- Some credit rating agencies and capital market participants acknowledge the importance of institutions and governance for macroeconomic stability and sovereign risk assessment (for example, Standard and Poor's 2011, 2013; Moody's 2016; Briegel and Bruinshoofd 2016, Bruinshoofd 2016).

Institutions have an important impact on inequality and inclusive growth. Corruption can undermine the state's ability to deliver inclusive economic growth through its adverse effect on macro and financial stability, lower investment, and reduced human capital accumulation and social spending (IMF 2016a, 2017a). Effective institutions enhance cooperation and trust, making it easier to undertake reforms, collect taxes, and provide quality public services, thus helping achieve more sustainable growth (World Bank 2017).

Many cross-country studies suggest a causal relationship from institutions to growth. While it is likely that causality runs both ways (Barro 2015), or that some third factor (such as accumulated physical and human capital) affects both institutions and growth, several cross-country studies provide evidence that institutions matter for long-term growth (Mauro 1995; Hall and Jones 1999; Acemoğlu, Johnson, and Robinson 2001; and Banerjee and Iyer 2005). To overcome the challenge of endogeneity of institutions, these studies focus on differences in strength of certain institutions—for example, property rights that were driven by exogenous factors such as culture or historical events. Acemoğlu, Johnson, and Robinson (2001), for example, used European mortality rates during colonization as an instrument for current institutions and estimated large effects of institutions on income per capita. Nonetheless, disagreements remain. Several papers challenge the measurement of institutions (Hoyland, Moene, and Willumsen 2012; Donchev and Ujhelyi 2014) or argue that the instruments used to identify causal effects are not appropriate (Docquier 2014). A large body of social science literature deals with two-way linkages between economic and political institutions and the sequencing of reforms. Changes in state capacity or partial improvement in property rights could jump-start development and lead to citizens demanding better institutions (Fukuyama and Levy 2010; Fukuyama 2008).

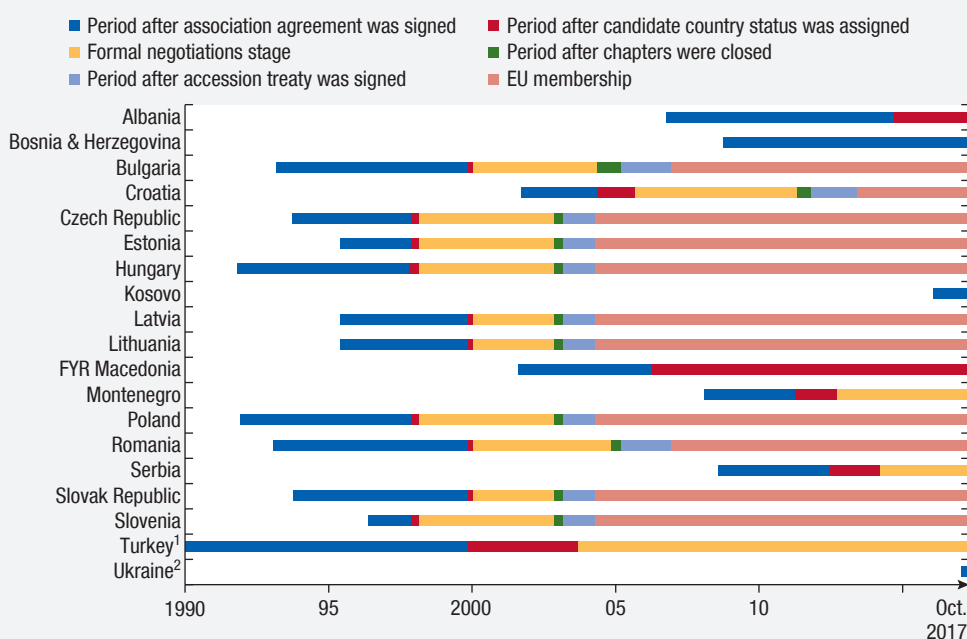


### Box 2.2. The Process of European Union Membership and the Rule of Law

Nineteen countries of Central, Eastern, and Southeastern Europe (CESSEE) are associated with the European Union (EU) in various forms. Eleven are EU members (Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovenia, Slovak Republic), five are candidates (Albania, Macedonia, Montenegro, Serbia, Turkey), and two are potential candidates (Bosnia and Herzegovina, Kosovo) (Figure 2.2.1). Potential candidates have the prospect of joining the European Union, but have not yet been granted candidate-country status, and their relationship with the European Union is governed by the Stabilization and Association Agreements.<sup>1</sup> In 2017, Ukraine entered an association agreement with the European Union.

The EU accession process entails aligning local laws and institutions with EU laws. The rule of law, together with other political, economic, and institutional criteria (the Copenhagen criteria) must be fulfilled by countries in order to join the European Union. The accession process follows a series of formal steps from a preaccession agreement to membership candidacy, the negotiation phase, ratification of the final accession

Figure 2.2.1. CESEE: Timeline of European Union Accession



Source: European Commission.

<sup>1</sup>Turkey signed an Association Agreement with the European Economic Community (predecessor of the EU) on September 12, 1963.

<sup>2</sup>Ukraine fully implemented an Association Agreement with the European Union on September 1, 2017. The Association Agreement was negotiated between 2007 and 2011 and signed in 2014. Substantial parts of the Association Agreement have been applied provisionally since November 1, 2014, and January 1, 2016, for the Deep and Comprehensive Free Trade Area.

Prepared by Faezeh Raei and Vizhdan Boranova.

<sup>1</sup>The Stabilization and Association Agreements set out additional conditions for membership for the Western Balkan countries with the aim to (1) stabilize the countries politically and encourage their swift transition to a market economy, (2) promote regional cooperation, and (3) attain eventual membership in the European Union.

**Box 2.2** *(continued)*

treaty, and, finally, membership. The process requires the adoption of EU laws and preparations to be able to properly apply such laws, known as the *Acquis Communautaire*. The *Acquis* is divided into 35 chapters for negotiations between the European Union and candidate states. Each chapter covers a major aspect of EU policy, such as free movement of goods, capital, and workers; economic policy; energy; transportation; regional and foreign policy; fundamental rights; and the judicial system. Chapter 23 of the *Acquis*, Judiciary and Fundamental Rights, deals with the judicial system.

The Judiciary and Fundamental Rights chapter requires reforming the judicial system to ensure its independence and efficiency. It promotes the establishment of an independent, effective, and impartial judiciary to effectively safeguard the rule of law. In particular, it requires eliminating external influences over the judiciary, putting in place legal guarantees for fair trial procedures, and providing adequate financial resources and training. Relatedly, members are required to deter and fight corruption effectively, since corruption represents a threat to the rule of law.

Specific benchmarks guide transposing the chapter on Judiciary and Fundamental Rights into local law and the country's institutional setup. For most chapters, the European Union sets what are called closing benchmarks, which need to be fulfilled by adopting laws and putting in place institutions. These benchmarks fall into two interlinked categories: (1) independence, accountability, and transparency of the judicial system and protection of property rights; and (2) fighting high-level corruption. Some recommended actions include establishing a judicial inspectorate to monitor the integrity of the judicial system and follow up on complaints; legal provisions for independent staffing of the inspectorate; random assignment of judicial cases to reduce political influence; and merit-based guidelines for the progression of judicial staff. Some recommended actions related to the prevention of high-level corruption include (1) establishing a specialized institution for the prosecution of high-level corruption; (2) independent staffing of such an institution; (3) creating legal provisions for whistle-blowers; (4) implementing a system to verify asset declarations of public officials; (5) investigating inexplicable wealth; and (6) publishing statistics on investigation and conviction cases.

The process of reforming the judiciary in line with the chapter on Judiciary and Fundamental Rights could extend well beyond EU accession. Creating and maintaining an independent and impartial judiciary and administration is a long-term process. For this reason, the European Commission allows some of the required actions to take place after accession by setting interim benchmarks and through continuous monitoring and progress reports. For example, a Cooperation and Verification Mechanism has been in place in Bulgaria and Romania to monitor and guide reforms of the judicial system and fight corruption after those countries joined the European Union in 2007. As European Commission reports indicate, despite progress, efforts are still needed to demonstrate a track record, finalize the adoption of legal codes, and ensure the implementation of court decisions in these countries.

The European Union also has a framework aimed at respecting and strengthening the rule of law in all its members. If the mechanisms established to secure the rule of law at the national level cease to operate effectively, there is a systemic threat to the rule of law and, hence, to the functioning of the European Union (EC 2010). In such situations, the European Commission can act to protect the rule of law by launching infringement procedures and activating Article 7 of the Treaty of the European Union. Given, however, the very high thresholds for activating Article 7, a new framework aimed at preventing the emergence of a systemic threat to the rule of law was enacted in 2014 (EC 2014).

### **Box 2.3. Specific Reforms to the Rule of Law in IMF-Supported Programs: Kosovo and Ukraine**

This box focuses on specific reforms in Kosovo and Ukraine in the context of IMF-supported programs. The reforms have a narrower focus—control of corruption in Ukraine and clearing court backlogs in Kosovo. Their experiences highlight the difficulty in making progress in judicial reforms and the need to learn by doing and adapting to the local context. External actors have the strongest impact when they support domestic reform actors.

#### **Ukraine**

Corruption and oligarchic structures thwart improvements in the rule of law in Ukraine. Multiple data sources suggest that corruption is more prevalent in Ukraine than in other countries of Central, Eastern, and Southeastern Europe (CESSEE) or the European Union (EU) (IMF 2017b). Less-active civil society groups, flawed and minimal privatization, and weak initial reform strategies are often cited as reasons for the lack of progress (Yemelianova 2010; Valdai Discussion Club 2014). Vested interests continue to resist reform, and political fragmentation makes progress more challenging, but civil society is currently quite active and gathering support and is calling attention to corruption.

The IMF-supported program in Ukraine focuses on tackling corruption. Reforms have included (1) the independent National Anti-Corruption Bureau of Ukraine (NABU), (2) comprehensive asset declarations for high-level officials, and (3) a business ombudsman. Over 85 cases have been sent to court by the NABU, financial assets have been seized, and prominent figures have been arrested. However, there have been no major convictions yet. The program includes policies to reduce opportunities for corruption by streamlining business licenses, improving public procurement, bringing energy prices to import parity, overhauling tax administration, cleaning up the banking system, and putting in place an effective anti-money-laundering framework. But additional efforts are needed to address the perception of impunity.

Progress in the reform of state-owned enterprises has been limited, although progress has been made in the banking sector. Weak governance of state-owned enterprises has led to inefficiencies and corruption. Amendments to the privatization law were adopted in January 2016, but no large state-owned enterprises have been privatized. A new law on governance of these enterprises requires independent supervisory boards and adequate auditing principles. Ukraine has oligarch-owned banks, which use deposits to fund dubious related-party transactions (Baum and others 2008). Weaknesses in the rule of law and supervisory powers made it difficult to effectively control the banks, which allowed some owners to earn fictitious profits at the expense of taxpayers and depositors. A break came in 2014–15, when reform-oriented management was appointed at the National Bank of Ukraine (NBU), which saw its independence and powers strengthened (due in part to prior actions under the IMF Extended Fund Facility). Legal reforms required the identification of ultimate beneficiary owners, made bank owners liable for related-party lending losses, and shifted the burden of proof from the NBU to the banks. The NBU has closed nearly 90 of 180 banks since 2014, and the largest private bank was recently nationalized, but firmer efforts to collect related-party loans are needed.

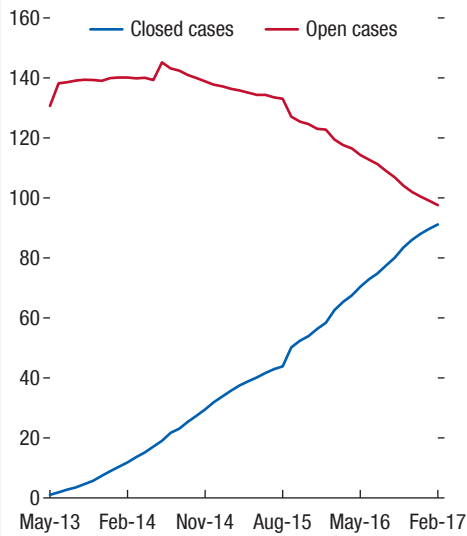
#### **Kosovo**

Although Kosovo has a short history with institution-building, some progress has been made in improving the court system. The most recent IMF-supported program emphasized Kosovo's inefficient court system as a major impediment to bank lending and growth. Kosovo's courts had large case backlogs due to low institutional capacity, weak management, and poor incentives. Creditors could not efficiently obtain and enforce judgments and hence required more collateral and higher lending rates.

Prepared by Ricardo Llaudes, Brett Rayner, Pamela Madrid Angers, and Jason Weiss.

**Box 2.2** (continued)

**Figure 2.3.1. Kosovo: Court Backlog Clearance under USAID Program**  
(Cumulative, thousands of court cases)



Source: US Agency for International Development (USAID) Contract Enforcement Program.

The authorities decided to confront the backlog of open cases (Figure 2.3.1). With help from the US Agency for International Development, the authorities (1) introduced a system of private enforcement agents that helped creditors enforce court judgments and recover assets and reduced the burden on courts; (2) established a centralized registry of bank account holders at the Central Bank of Kosovo, which enables the private enforcement agents to garnish accounts; and (3) improved court case resolution procedures. A large reduction in court cases was achieved. In parallel, private enforcement agents resolved numerous cases and recovered millions of dollars in assets. The progress in contract enforcement likely contributed to the sharp recent decline in lending rates. However, there are remaining gaps in judicial effectiveness, as debtors can sometimes sidestep enforcement actions.

## Box 2.4. Econometric Analysis

We estimate panel regressions with five-year nonoverlapping averages with time dummies and random effects, conduct robustness checks, and attempt to mitigate endogeneity.

### Dependent Variables

The main variables are judicial independence and protection of property rights indices from the World Economic Forum (WEF). For robustness, we also use the protection of property rights index from the Heritage Foundation and an indicator of court impartiality based on WEF data.

### Explanatory Variables

To capture power asymmetries owing to the unequal distribution of resources and opportunities, we employ a composite indicator of resource distribution encompassing socioeconomic groups, education, health, and gender, with some of these aspects regressed separately as well. Also, we use indicators of market dominance, natural resource availability, and corruption in politics—the latter reflecting the prevalence of favoritism in politics. For the ability to solve collective action problems, we use the press freedom index, several measures of transparency and accountability, the old-age dependency ratio, and the urbanization rate. State capacity is represented by the variable covering the extent of established rules and procedures to hire and train government employees. We include trade barriers and trading partners' institutional quality to analyze the role of external factors. We control for GDP per capita. The sample includes 26 advanced and 53 emerging market economies from 1990 to 2014.

The baseline econometric analysis provides support for some variables capturing power asymmetries, transparency, state capacity, and openness, as well as noneconomic factors (Table 2.4.1). We identify a positive association between institutional quality and more equal distribution of resources, higher information freedom, state capacity, lower trade barriers, trading partners' institutional quality, and less corruption in politics. Another relatively new factor that seems to matter is the old-age dependency ratio, which is negatively associated with institutional quality.<sup>1</sup> Perhaps this captures the higher demand for checks and balances in societies with a larger share of working-age population. Gorodnichenko and Roland (2011) emphasize that attitudes in societies change slowly due to culture. These findings are broadly in line with the more recent literature, which finds that many factors contribute to institutional quality (see EBRD 2013; Ganiou Mijiyawa 2013).

Some interaction terms between the explanatory variables matter. The positive impact of information freedom is larger when the quality of public administration is low, resources are more concentrated, or the level of GDP per capita is lower. This suggests that when resource distribution or public administration capacity is not conducive to strengthening institutions, the marginal impact of checks and balances imposed by information freedom on politicians and government officials rises.

The baseline results are fairly robust to various model specifications and alternative measures (see Annex 2.3). Market dominance indicators are strongly associated with both judicial independence and property rights protection, but their presence eliminates the significance of trade barriers. This is possibly because market power indicators and openness operate through the common channel of competition.

Alternative measures for property rights protection, resource distribution, trade openness, and transparency and accountability do not alter the results materially. Some measures of transparency and accountability,

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<sup>1</sup>Straub (2000) used life expectancy in a panel regression and identified a statistically significant positive association with institutional quality.



**Box 2.4 (continued)**

while having the expected sign, are not statistically significant. We could not identify a statistically significant correlation with the urbanization rate and educational attainment (though education opportunities are included in the composite indicator of resources and opportunities distribution). Dropping variables that might be considered as institutions themselves—corruption in politics, state capacity, and transparency and accountability—maintains the significance of variables capturing power asymmetries and openness.

Caveats abound, given difficulties in assessing the effectiveness of judicial systems and protection of property rights and the feedback loops between these institutions and their potential determinants. While we have used the instrumental variable approach by including lagged variables to mitigate the potential reverse causality between institutional quality and economic performance, some residual endogeneity bias is likely to remain. Cross-sectional regressions, however, broadly confirm the panel results. Controlling for GDP per capita addresses concerns that some of the identified associations might reflect the impact of better institutions on the explanatory variables through high income. However, other factors not included in our regressions may drive both the dependent and explanatory variables.

**Table 2.4.1 Factors Affecting Institutional Quality**

	Expected Sign	Judicial Independence			Protection of Property Rights		
		(1)	(2)	(3)	(1)	(2)	(3)
Equal distribution of resources	+	2.225** (1.076)	3.141** (1.283)	1.747* (1.033)	0.143 (0.846)	1.698* (0.991)	-0.405 (0.815)
Freedom of the press	+	0.00968 (0.00625)	0.0484** (0.0235)	0.0425*** (0.0140)	0.0114*** (0.00443)	0.0708*** (0.0167)	0.0545*** (0.0140)
Impartial public administration	+	0.875*** (0.224)	0.865*** (0.232)	1.251*** (0.248)	0.507*** (0.171)	0.462*** (0.179)	1.008*** (0.166)
Lower barriers to trade	+	0.194*** (0.0715)	0.183** (0.0722)	0.196*** (0.0737)	0.573*** (0.0972)	0.561*** (0.0975)	0.576*** (0.103)
Institutional quality of trading partners	+	0.396*** (0.131)	0.356*** (0.131)	0.356*** (0.129)	0.109 (0.106)	0.0284 (0.111)	0.0518 (0.103)
Old-age-dependency ratio	-	-0.0685** (0.0291)	-0.0648** (0.0295)	-0.0676** (0.0289)	-0.0469*** (0.0178)	-0.0458** (0.0179)	-0.0479*** (0.0180)
Control of corruption in politics	+	0.425*** (0.114)	0.407*** (0.113)	0.416*** (0.114)	0.349*** (0.107)	0.303*** (0.107)	0.300*** (0.0998)
GDP per capita, constant purchasing power parity	+	0.578** (0.244)	0.599** (0.244)	0.529** (0.246)	0.840*** (0.190)	0.920*** (0.181)	0.799*** (0.181)
Freedom of the press × equal distribution of resources		...	-0.0612* (0.0342)	...	...	-0.0965*** (0.0342)	...
Freedom of the press × impartial public administration		...	...	-0.0150*** (0.00577)	...	...	-0.0203*** (0.00616)
Constant		-8.770*** (1.770)	-9.316*** (1.811)	-8.768*** (1.814)	-9.853*** (1.313)	-9.316*** (1.811)	-9.961*** (1.249)
Observations		204	204	204	204	204	204
Number of countries		75	75	75	75	75	75
Time effect		Yes	Yes	Yes	Yes	Yes	Yes

Source: IMF staff estimates.

Note: Robust standard errors in parentheses.

\*\*\*  $p < 0.01$ ; \*\*  $p < 0.05$ ; \*  $p < 0.1$ .

## Annex 2.1. Institutions: Literature Review

**Annex Table 2.1.1. Summary of the Theoretical Literature on Institutions**

Theory	Description	References
Economic: Efficient institutions	Societies choose efficient economic institutions that facilitate the maximization of the income of society as a whole. However, the distribution of the resulting income is independent of the distribution of political power. If the existing economic institutions in a country penalize some groups and benefit others, the two groups can engage in negotiations to modify the existing institutions or to create new institutions. This would produce beneficial outcomes for all. Institutions are therefore created when the social benefits of their creation exceed their social costs, so the search for efficiency prevents the existence of inefficient economic institutions. This is more likely to materialize when the economy is large or expanding.	Coase 1960 Demsetz 1967 Williamson 1985 Grossman and Hart 1986
Cultural: Ideological beliefs and behavior	Institutions are different because of cultural differences. There are three main strands of theory. First, different societies have different beliefs and behaviors, which shape collective action and consequently the quality of governments and institutions. One interpretation is that some societies have cultural values favorable to the emergence of efficient institutions, while others do not. Another interpretation is that cultural values favoring trust in strangers serve to facilitate collective action and increase the supply of public goods, including efficient economic institutions. Yet another interpretation is that cultural values that incite intolerance, xenophobia, and closed-mindedness hinder economic development and the emergence of efficient institutions. Second, countries choose their economic institutions based on that society's conception of what is most beneficial for its citizens. Since societies do not have the same concept of what is "good" for their members, economic institutions vary from country to country. This difference is reinforced by the uncertainties about the ex ante knowledge of what constitutes a "good" economic institution. Third, in societies whose primary social institutions legitimize individuals' expression of their own preferences and emphasize the moral equality of individuals, more specific norms of governance are expected to promote legal entitlements, authority undistorted by bribes, and feedback mechanisms of accountability. Cultural differences are expected to be reflected by religious affiliation and cultural profiles of nations.	Banfield 1958 Weber 1930, 1958, 1968 Putnam 1993 Piketty 1995 Landes 1998 Romer 2003 Williamson 2000 Roland 2004 Licht and others 2007
Historical: Past events	Institutions are the consequences of historical events. These events occur at a certain point in time, which subsequently determines the nature of institutions and makes them persist over time. There are two main strands of thought here. First, class coalitions and the way agriculture is organized determine which political institutions will emerge, although organization of agriculture is not predetermined to influence political institutions, and these institutions are just an unintended consequence. Second, the organization of a country's legal system is the result of historical circumstances. More specifically, legal origins have an important impact on the quality of property rights protection, which in turn determines institutions.	Moore 1966 Gaesper and Shleifer 2002
Political economy: Social conflict	Institutions are not chosen by all members of society, but rather by a group of individuals who control political power at a given point in time. The dominance of the group holding political power is the result of social conflict, and this group will therefore set up institutions that maximize personal payoffs, regardless of whether this will increase the income of the society as a whole. Two main strands dominate here. First, individuals who control political power as economic agents pursue their personal interests. Transaction costs associated with monitoring and verifying the agents' behavior generate a gap between the institutions chosen by policymakers for the maximization of their personal payoffs and the institutions that maximize the income of the society as a whole. Second, economic institutions determine not only the level of income, but also income distribution. Consequently, the existence of individuals who do not benefit equally from institutions may result in divergent individual preferences pertaining to institutions. Institutions should therefore be considered endogenous because they depend on political power, which in turn is endogenous as it depends on de jure political power conferred by political institutions and de facto political power conferred by the distribution of resources.	North 1981 Finer 1997 Acemoğlu, Johnson, and Robinson 2005 Acemoğlu 2006
State capacity	This theory claims that in many countries state capacity is not sufficient to adopt and implement economic institutions consistent with best practices that support an efficient functioning of markets. The argument is that policy choices in market regulation (including property rights) and taxation are constrained by past investments in legal and fiscal capacity.	Acemoğlu 2005, 2006 Besley and Persson 2009 Andrews, Pritchett, and Woolcock 2012

**Annex Table 2.1.2. Summary of the Empirical Literature on Institutions**

Theory	Evidence	Studies
Economic	<p>Given that economic institutions are established when the benefits of their creation exceed their costs, institutional quality could be positively associated with larger and/or expanding economies.</p> <p>Variable:</p> <ul style="list-style-type: none"> <li>• <i>GDP per capita</i></li> </ul> <p>Findings:</p> <ul style="list-style-type: none"> <li>• Generally significant and positive association</li> </ul>	<p>Clague and others 1996 La Porta and others 1997 Chong and Zanforlin 2000 Kaufmann and Kraay 2002 Ganiou Mijiyawa 2013</p>
Cultural	<p>Given that cultural differences are approximated by religions and cultural profiles, the quality of institutions could be associated with religious affiliation and nations' cultural profiles. In particular, Protestantism is hypothesized to be better for effective economic institutions. The autonomy of individuals is hypothesized to be positively associated with institutional quality, while hierarchy tends to be negatively associated with it.</p> <p>Variables:</p> <ul style="list-style-type: none"> <li>• <i>Religious affiliation</i>: Proxy for professional ethics, tolerance, and trust</li> <li>• <i>Cultural profiles of nations</i>: Proxy for the extent to which societies prefer change versus maintaining the status quo</li> <li>• <i>Individualism</i>: Instrumented by genetic distance between the population in a given country and that of the United States</li> </ul> <p>Findings:</p> <ul style="list-style-type: none"> <li>• Generally significant and positive association with Protestantism</li> <li>• Generally significant and negative association with Islam and Catholicism</li> <li>• Partial support for authority and hierarchy as well as the English-speaking environment/heritage</li> <li>• Two-way causal effect between culture and institutions</li> </ul>	<p>La Porta and others 1999 Schwartz 1994, 1999 Stulz and Williamson 2003 Borner, Bodmer, and Kobler 2004 Licht, Goldschmidt, and Schwartz 2007 La Porta, Lopez-de-Silanes, and Shleifer 2008 Gorodnichenko and Roland 2011 Ganiou Mijiyawa 2013</p>
Historical	<p>Given that institutions can be shaped by historical events, institutional quality could be associated with legal origin.</p> <p>Variable:</p> <ul style="list-style-type: none"> <li>• <i>Legal origin</i>: Proxy for common law and/or other laws</li> <li>• <i>Tenure of judges</i>: Proxy for autonomy/independence</li> </ul> <p>Findings:</p> <ul style="list-style-type: none"> <li>• Generally significant and positive association with common law</li> <li>• Generally significant and negative association with French and German law as well as socialist legal origin</li> <li>• Partial support for tenure of judges</li> </ul>	<p>La Porta and others 1998, 1999 Chong and Zanforlin 2000 Straub 2000 Acemoğlu, Johnson, and Robinson 2001, 2002 Djankov and others 2002, 2003 Borner, Bodmer, and Kobler 2004 La Porta, Lopez-de-Silanes, and Shleifer 2008 Ganiou Mijiyawa 2013 Alonso and Garcimartin 2013</p>
Social conflict/Political economy	<p>Given that institutions can be determined by social conflict, their quality could be associated with the concentration of political power, income inequality, and abundance of natural resources.</p> <p>Variables:</p> <ul style="list-style-type: none"> <li>• <i>Concentration of political power</i>: Voice and accountability index</li> <li>• <i>Income inequality</i>: Gini index</li> <li>• <i>Abundance of natural resources</i></li> </ul> <p>Findings:</p> <ul style="list-style-type: none"> <li>• Generally significant and negative association with the concentration of political power and abundance of natural resources</li> <li>• Partial support for income inequality</li> </ul>	<p>Straub 2000 Panizza 2001 Borner, Bodmer, and Kobler 2004 Ganiou Mijiyawa 2013</p>
External factors	<p>The European Union makes effective rule of law and control of corruption conditions for accession, helping address governance in the following ways:</p> <ul style="list-style-type: none"> <li>• By overcoming collective action problems</li> <li>• By developing and codifying anticorruption legal norms internationally</li> <li>• By promoting and establishing legal constraints at the national level</li> </ul> <p>Findings:</p> <ul style="list-style-type: none"> <li>• Generally significant and positive impact on the rule of law during the pre-accession phase, at least de jure</li> <li>• Progress seems to slow once the EU membership offer has been made</li> <li>• Once countries have joined, many actually reverse the progress made</li> </ul>	<p>Mungiu-Pippidi 2015 EBRD 2013 Johnson, Taxell, and Zaum 2012 IMF 2005</p>

**Annex Table 2.1.3. Institutions and Economic Outcomes**

Economic Outcomes	Evidence	Studies
Sustainable and inclusive growth	Institutions matter for long-term growth and help achieve growth that is more sustainable and inclusive. Effective institutions, which encompass effective rule of law, ensure a level playing field and provide checks and balances. The latter discourages rent-seeking behavior and promotes more efficient and fairer use of resources. Within the rule of law, the effectiveness of the justice system and protection of property rights are critical functions for economic outcomes.	Mauro 1995 Hall and Jones 1999 Acemoğlu, Johnson, and Robinson 2001 Mahoney 2001 Feld and Voigt 2003, 2005 Banerjee and Iyer 2005 Esposito, Lanau, and Pompe 2014 IMF 2016a, 2017a World Bank 2017
Growth via factors of production	Institutions can affect growth via the factors of production by enhancing commitment, that is, by creating an environment where economic agents feel secure to invest in productive activities. By enhancing trust, contract enforcement, and collective action, institutions promote partnerships, specialization in production, and the solving of market failures. <i>Labor:</i> Weak institutions and governance have a strong effect on the emigration of skilled workers. Better institutions hold the promise of retaining and slowing emigration of skilled workers. <i>Investment:</i> Firms that feel more secure from expropriation invest a larger share of their profits in their business. A well-functioning, independent, and impartial judicial system improves foreign direct investment, the availability and cost of credit, investment, and growth. <i>Efficiency (total factor productivity—TFP):</i> Weaknesses in contract enforcement prevent specialization and optimal allocation of labor and capital, hence hampering TFP. Better contract enforcement can help firms expand their pool of suppliers by enhancing trust and cooperation between unknown parties.	North 1990 Johnson, McMillan, and Woodruff 2002 Bevan and Estrin 2004 Bianco, Jappelli, and Pagano 2005 Laeven and Majnoni 2005 Bénassy-Quéré, Coupet, and Mayer 2007 Dixit 2007 Djankov and others 2008 Atoyan and others 2016 Cooray and Schneider 2016
Growth via intermediate factors	Institutions affect a host of intermediate factors that ultimately matter for growth, including but not limited to <i>Government finances:</i> Institutions help government tax collection efforts by ensuring compliance and cooperation from citizens. Weak institutions and governance can lead to forgone tax revenue, a larger informal economy, and the inability of government to deliver quality public services. Better institutions, particularly in the areas of public investment management—such as transparent procurement and project appraisal processes—are associated with more efficient public infrastructure and higher absorption of EU funds. <i>Access to credit:</i> The strength of the legal system in credit protection and collateral execution affects how much financing creditors are willing to extend to the economy. Better contract enforcement is associated with higher lending and fewer defaults. In addition, weak debt enforcement and ineffective insolvency frameworks tend to lower recovery values of problem loans. <i>Economic resilience:</i> Institutions affect the ability of countries to withstand negative shocks because those institutions govern the quality of policies and their implementation. Better institutions are also associated with greater fiscal policy countercyclicality and with more effective monetary policy transmission. Countries with stronger protection of property rights have lower probability of market crashes. Better policies and institutions may enable countries to avoid or withstand debt distress. Some credit rating agencies and capital market participants acknowledge the importance of institutions and governance for macroeconomic stability and sovereign risk assessment.	Townsend 1979 Aghion and Bolton 1992 Hart and Moore 1994 Bianco, Jappelli, and Pagano 2005 Kraay and Nehru 2006 Standard and Poor's 2011, 2013 Frankel, Vegh, and Vuletin 2013 Mishra and others 2014 IMF 2015, 2016b, 2017a Briegel and Bruinshoofd 2016 Bruinshoofd 2016 Moody's Investor Service 2016 OECD 2016 Blau 2017 World Bank 2017
Causality between growth and institutions	Even though causality between growth and institutions likely runs both ways, several cross-country studies suggest that institutions matter for long-term growth. These studies have used various techniques to establish a causal relationship, including instrumental variables, natural experiments, and more narrative approaches. Nonetheless, disagreements remain. Several studies challenge the measurement of institutions and instruments used for identifying causal effects. A large body of social science literature deals with two-way linkages between economic and political institutions, and the dynamics of sequencing of reforms from one area to another. For example, it is argued that changes in state capacity or even partial improvements in property rights can jump-start development, which in turn could lead to the emergence of a citizen class demanding better institutions.	North 1981, 1990 Mauro 1995 Hall and Jones 1999 Acemoğlu, Johnson, and Robinson 2001 Banerjee and Iyer 2005 Dell 2010 Acemoğlu and Robinson 2012 Hoyland, Moene, and Willumsen 2012 Docquier 2014 Donchev and Ujhelyi 2014 Barro 2015

## Annex 2.2. Indicators and Sources

In line with the IMF Board paper on the “Use of Third-Party Indicators (TPIs) in Fund Reports” (IMF 2017c), this annex describes the indicators used and their sources. Specific descriptions of indicators used are described in Annex Table 2.2.1.

### The World Bank’s Worldwide Governance Indicators

The Worldwide Governance Indicators draw on four different types of source data: surveys of households and firms, including the Afrobarometer surveys, the Gallup World Poll, and Global Competitiveness Report surveys; commercial business information providers, including the Economist Intelligence Unit, Global Insight, and Political Risk Services; nongovernmental organizations, including Global Integrity, Freedom House, and Reporters Without Borders; and public sector organizations, including the Country Policy and Institutional Assessments of the World Bank and regional development banks, the European Bank for Reconstruction and Development Transition Reports, and the French Ministry of Finance Institutional Profiles Database.

### World Economic Forum Global Competitiveness Index

The Global Competitiveness Index is a composite index based on data largely obtained from an opinion survey asking business executives to evaluate aspects of their economy. The survey is conducted with the help of a network of 160 partner institutes that follow detailed sampling guidelines to ensure that the sample of respondents is the most representative possible and comparable. To improve comparability, 4 of 10 questionnaires are filled out by executives who have previously taken part in the survey. Official statistics are also used.

### World Bank Doing Business Index

The Doing Business Index looks at domestic small and medium companies and measures the regulations applying to them through their life cycle. To provide different perspectives on the data, the index presents data both for individual indicators and for two aggregate measures: the distance to frontier score and the ease of doing business ranking. Doing Business uses a simple averaging approach for weighting component indicators, calculating rankings, and determining the distance to frontier score.

### European Commission for the Efficiency of Justice (*Commission européenne pour l’efficacité de la justice*—CEPEJ)

The CEPEJ maintains a comprehensive database with data on judicial systems of Council of Europe member states for 2010, 2012, and 2014. The data are based on reports submitted by country authorities. Since 2008, the CEPEJ has implemented a peer evaluation process for the systems for judicial data collection and reporting in Council of Europe members. The CEPEJ data cover topics such as the budget of judicial systems and legal aid, professionals, courts and users, and the efficiency of the justice system.

### Group of States Against Corruption (GRECO)

GRECO’s objective is to improve the capacity of its 49 member states to fight corruption by monitoring their compliance with the Council of Europe’s anticorruption standards and their effective implementation. GRECO uses a dynamic process of mutual evaluation and peer pressure. Its country-by-country evaluations identify deficiencies in national anti-corruption frameworks and make recommendations on addressing shortcomings, thus prompting the necessary legislative, institutional, and practical



reforms. GRECO also produces evaluation reports that cover justice systems.

## **Varieties of Democracy Institute (V-Dem)**

The V-Dem Project is a collaborative international effort that unites thousands of social scientists working in the sphere of democracy and governance. It is coordinated by the University of Gothenburg's V-Dem Institute and the University of Notre Dame's Kellogg Institute. Approximately half of the indicators in the V-Dem data set are based on factual information obtainable from official documents such as constitutions and government records. The other half consists of more subjective assessments on topics like political practices and compliance with de jure rules. On such issues, typically, five experts per country provide ratings. These experts are generally

academics or professionals working in government, media, or public affairs. They are also generally nationals of and/or residents in the country and have documented knowledge of both that country and a specific substantive area.

## **International Country Risk Guide (ICRG)**

The ICRG provides ratings based on indicators for countries that forecast political, financial, and economic risk. A separate index is created for each of the subcategories. This data set is produced by the PRS Group of Syracuse, New York. Political risk assessments are based on a compiler's judgement, while financial and economic ratings are based on macro-financial data. Weights assigned to each variable and subcategory are predetermined and identical for every country.

Annex Table 2.2.1. Description of Third-party Indicators

Indicator	Source	Country Coverage	Notes
1. Justice system and protection of property rights			
Rule of law	World Bank, World Governance Indicators	Global	Captures perceptions of the extent to which agents have confidence in and abide by the rules of society, and in particular the quality of contract enforcement, property rights, the police, and the courts, and the likelihood of crime and violence. It is constructed from surveys of firms and individuals, and from assessments by commercial risk rating agencies, nongovernmental agencies, multilateral aid agencies, and other public sector organizations.
Rule of law	World Justice Project	Global	Measures how the rule of law is experienced and perceived by the public based on household and expert surveys. Performance is measured using indicators across eight primary factors (constraint on government powers, absence of corruption, open government, fundamental rights, order and security, regulatory enforcement, civil justice, and criminal justice), each of which is scored and ranked globally and against regional and income peers.
Judicial independence	World Economic Forum, Global Competitiveness Index	Global	Measured through opinion surveys of company executives and based on the following question: In your country, how independent is the judicial system from influences of the government, individuals, or companies? (1 = not independent at all; 7 = entirely independent).
Judicial independence	Eurobarometer	EU countries	Based on a series of public opinion surveys conducted by the European Commission. It is conducted in two formats: (1) a standard survey, a cross-national longitudinal study, and (2) flash Eurobarometer, ad hoc thematic telephone interviews.
Structural independence	EU Justice Scoreboard	EU countries	An overview of how justice systems are organized to safeguard judicial independence in certain types of situations where independence may be at risk. Focuses on some of the main aspects of the judges' status: appointment of judges, evaluation of judges, transfer of judges without their consent, and dismissal of judges.
Impartiality of courts	World Economic Forum, Global Competitiveness Index	Global	Measured through opinion surveys of company executives and based on two indicators: (1) <i>Efficiency of the legal framework in settling disputes</i> , based on the question of how efficient the legal and judicial systems are for settling disputes among companies (1 = extremely inefficient; 7 = extremely efficient); and (2) <i>Efficiency of the legal framework in challenging regulations</i> , based on the question of how easy it is for private businesses to challenge government actions and/or regulations through the legal system (1 = extremely difficult; 7 = extremely easy).
Protection of property rights	World Economic Forum, Global Competitiveness Index	Global	Measured through opinion surveys of company executives and based on the following question: To what extent are property rights, including financial assets, protected? (1 = not at all; 7 = to a great extent).
Clearance rate	European Commission for the Efficiency of Justice ( <i>Commission européenne pour l'efficacité de la justice</i> - CEPEJ)	Council of Europe countries	Measured as a ratio between resolved cases and incoming cases.
Disposition time	European Commission for the Efficiency of Justice ( <i>Commission européenne pour l'efficacité de la justice</i> - CEPEJ)	Council of Europe countries	Calculated as the length of court proceedings, based on a ratio between pending and resolved cases.
2. Distribution of resources and opportunities			
Equal distribution of resources	Varieties of Democracy Institute (V-Dem)	Global	Measured as an index by taking the point estimates from a Bayesian factor analysis model of the indicators for particularistic or public goods, means tested versus universalistic welfare policies, educational equality, health equality, power distributed by socioeconomic position, power distributed by social group, and power distributed by gender.
Educational equality	Varieties of Democracy Institute (V-Dem)	Global	Measures the extent to which education can be achieved through the Gini coefficient of educational inequality, based on the following question: How unequal is the level of education achieved by the population aged 15 years and older? The Gini coefficient is estimated from average education data using the method as suggested by Thomas, Wang, and Fan (2000).
Health equality	Varieties of Democracy Institute (V-Dem)	Global	Based on the following question: To what extent is high-quality basic healthcare guaranteed to all, sufficient to enable them to exercise their basic political rights as adult citizens?
Market dominance	World Economic Forum, Global Competitiveness Index	Global	Measured through opinion surveys of company executives and based on the following question: How do you characterize corporate activity? (1 = dominated by a few business groups; 7 = spread among many firms).
Effectiveness of anti-monopoly policy	World Economic Forum, Global Competitiveness Index	Global	Measured through opinion surveys of company executives and based on the following question: How effective are anti-monopoly policies at ensuring fair competition? (1 = not effective at all; 7 = extremely effective).

**Annex Table 2.2.1. Description of Third-party Indicators (continued)**

Indicator	Source	Country Coverage	Notes
3. Transparency and accountability			
Government censorship	Varieties of Democracy Institute (V-Dem)	Global	Based on the following question: Does the government directly or indirectly attempt to censor the print or broadcast media? (0 = attempts to censor are direct and routine; 4 = the government rarely attempts to censor major media).
Justification of policies	Varieties of Democracy Institute (V-Dem)	Global	Based on the following question: When important policy changes are being considered (that is, before a decision has been made), to what extent do political elites give public and reasoned justifications for their positions? (0 = no justification; 3 = sophisticated justification).
Press freedom	Reporters Without Borders	Global	This is a snapshot of the media freedom situation based on an evaluation of pluralism, independence of the media, the quality of the legislative framework, and the safety of journalists in each country.
4. State capacity			
Rigorous and impartial public administration	Varieties of Democracy Institute (V-Dem)	Global	Based on the following question: How do public officials handle the cases of ordinary people? (0 = the law is not respected by public officials; 4 = the law is generally fully respected by the public officials).
Quality of the bureaucracy	International Country Risk Guide	Global	Measures institutional strength and the quality of the bureaucracy. High scores are given to countries where the bureaucracy has the strength and expertise to govern without drastic changes in policy or interruptions in government services. Countries that lack the cushioning effect of a strong bureaucracy receive low scores because a change in government tends to be traumatic in terms of policy formulation and day-to-day administrative functions.
5. External environment			
Regulatory barriers to trade	Varieties of Democracy Institute (V-Dem)	Global	Based on (1) <i>Nontariff trade barriers</i> : To what extent do tariff and nontariff barriers significantly reduce the ability of imported goods to compete in the domestic market? and (2) <i>Compliance cost of importing and exporting</i> : This includes data on the time required to import and export.
Institutional quality of trading partners	International Monetary Fund	Global	Calculated as a weighted average of trading partners with respect to judicial independence and property rights.
6. Political power			
Strength of civil society	Varieties of Democracy Institute (V-Dem)	Global	The questions cover the following: (1) Do policymakers routinely consult major civil society organizations (CSOs)? (2) How large is the public's involvement in CSOs? (3) Are women prevented from participating? (4) Are legislative candidate nominations within party organizations highly decentralized or made through party primaries? The index is formed by taking the point estimates from a Bayesian factor analysis model of the indicators for candidate selection—national/local, CSO consultation, CSO participatory environment, and women's participation in CSOs.
Corruption in politics	Varieties of Democracy Institute (V-Dem)	Global	The index includes measures of six distinct types of corruption that cover both different areas and levels of the polity realm, distinguishing between executive, legislative, and judicial corruption. Within the executive realm, the measures also distinguish between corruption mostly pertaining to bribery and corruption due to embezzlement. Finally, the measures differentiate between corruption in the highest echelons of the executive, on the one hand, and in the public sector at large, on the other. The measures thus tap into several distinctive types of corruption: both “petty” and “grand,” both bribery and theft, and both corruption aimed at influencing lawmaking and corruption affecting the implementation of laws.

## Annex 2.3. Econometric Analysis: Additional Results

This annex presents three sets of robustness checks. First, some of the explanatory variables that could be considered measures of institutional quality themselves are removed from the regressions. Second, we examine additional variables, such as market dominance. Finally, we attempt to address endogeneity issues.

Following Acemoğlu and others (2003), who argue that historically determined components of institutions are slow-moving and can be considered exogenous, we do not include individual effects. The Breusch-Pagan test is employed to determine whether random effects should be included, with results broadly in favor of random effects. This serves as a benchmark for robustness checks.

Some of the explanatory variables in the baseline regressions—freedom of the press, impartiality of public administration, and corruption in politics—could also be considered as measures of institutional quality themselves. To address this concern, we remove each of these, one by one and all of them at the same time, from the set of explanatory variables, and reestimate the model. Variables capturing power asymmetries and openness remain significant (Annex Table 2.3.1). We also continue to find a statistically significant association with institutional quality of trading partners, old-age dependency, and per capita income.

We tried adding corporate market dominance, as it could be a source of power asymmetries. Hence, excluding this measure could result in an omitted variable bias. We find a positive and significant association between market dominance and judicial independence and property rights protection (Annex Table 2.3.2). However, when openness and corporate market dominance are jointly included, openness is not always statistically significant, though the signs are as expected. This likely reflects the fact that openness affects competition, as does market dominance.

Finally, we try to mitigate endogeneity concerns by using lags of variables as instruments in a generalized methods of moments (GMM) framework. Since including lags of variables as instruments may not satisfactorily address endogeneity, we also try cross-sectional regressions, and regress the most recent five-year period for the dependent variables on longer lags (average over 1990–2000) of explanatory variables. We find that measures of resource distribution, openness, and the old-age dependency ratio remain associated with the expected sign with judicial independence and protection of property rights, even though they are not always statistically significant (Annex Table 2.3.3). Other explanatory variables (for example, impartiality of public administration and transparency) have the expected sign as in the baseline in most alternative specifications, but lose significance.

**Annex Table 2.3.1 Factors Affecting Institutional Quality: Dropping Variables**

	Judicial Independence				Protection of Property Rights			
	(1)	(2)	(3)	(4)	(1)	(2)	(3)	(4)
Equal distribution of resources	2.225** (1.076)	2.627** (1.217)	3.731*** (1.113)	2.666** (1.158)	0.143 (0.846)	-0.284 (0.735)	0.932 (0.814)	0.405 (0.930)
Freedom of the press	0.00968 (0.00625)	... ...	0.00245 (0.00669)	0.00446 (0.00609)	0.0114*** (0.00443)	... ...	0.00678 (0.00525)	0.00651 (0.00488)
Impartial public administration	0.875*** (0.224)	0.563*** (0.186)	... ...	0.741*** (0.224)	0.507*** (0.171)	0.410** (0.165)	... ...	0.436** (0.205)
Lower barriers to trade	0.194*** (0.0715)	0.114* (0.0689)	0.271*** (0.0776)	0.193** (0.0887)	0.573*** (0.0972)	0.353*** (0.0905)	0.631*** (0.0911)	0.563*** (0.116)
Institutional quality of trading partners	0.396*** (0.131)	0.412*** (0.143)	0.389*** (0.146)	0.425*** (0.128)	0.109 (0.106)	0.139 (0.118)	0.0943 (0.116)	0.180* (0.0992)
Old-age-dependency ratio	-0.0685** (0.0291)	-0.0594*** (0.0223)	-0.0534* (0.0274)	-0.0520* (0.0309)	-0.0469*** (0.0178)	-0.0427*** (0.0162)	-0.0386** (0.0186)	-0.0359* (0.0206)
Control of corruption in politics	0.425*** (0.114)	0.373*** (0.0922)	0.511*** (0.117)	... ...	0.349*** (0.107)	0.250*** (0.0886)	0.407*** (0.101)	... ...
GDP per capita, constant purchasing power parity	0.578** (0.244)	0.690*** (0.232)	0.639*** (0.230)	0.849*** (0.257)	0.840*** (0.190)	1.180*** (0.212)	0.882*** (0.202)	1.058*** (0.200)
Constant	-8.770*** (1.770)	-8.276*** (1.722)	-8.916*** (1.668)	-10.44*** (1.695)	-9.853*** (1.313)	-10.44*** (1.420)	-9.978*** (1.428)	-11.40*** (1.284)
Observations	204	246	204	217	204	246	204	217
Number of countries	75	75	75	81	75	75	75	81
Time effect	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes

Source: IMF staff estimates.

Note: Robust standard errors in parentheses.

\*\*\*  $p < 0.01$ ; \*\*  $p < 0.05$ ; \*  $p < 0.1$ .

Annex Table 2.3.2. Factors Affecting Institutional Quality: Adding Market Dominance

	Judicial Independence					Protection of Property Rights				
	(1)	(2)	(3)	(4)	(5)	(1)	(2)	(3)	(4)	(5)
Equal distribution of resources	2.225** (1.076)	3.281*** (1.160)	3.398*** (1.199)	3.410*** (1.151)	3.452*** (1.193)	0.143 (0.846)	0.553 (0.847)	0.653 (0.790)	0.847 (0.790)	0.808 (0.767)
Freedom of the press	0.00968 (0.00625)	0.00652 (0.00644)	0.00577 (0.00664)	0.00632 (0.00637)	0.00553 (0.00653)	0.0114*** (0.00443)	0.00973* (0.00524)	0.00691 (0.00558)	0.00857 (0.00539)	0.00544 (0.00553)
Impartial public administration	0.875*** (0.224)	0.499* (0.274)	0.507* (0.277)	0.544** (0.274)	0.528* (0.281)	0.507*** (0.171)	0.394** (0.180)	0.322** (0.156)	0.541*** (0.176)	0.405** (0.164)
Lower barriers to trade	0.194*** (0.0715)	0.115 (0.126)	0.0606 (0.135)	...	...	0.573*** (0.0972)	0.347*** (0.124)	0.237* (0.132)	...	...
Institutional quality of trading partners	0.396*** (0.131)	0.378** (0.149)	0.358** (0.157)	0.405*** (0.148)	0.369** (0.156)	0.109 (0.106)	0.148 (0.103)	0.114 (0.0969)	0.232** (0.0972)	0.161* (0.0924)
Old-age-dependency ratio	-0.0685** (0.0291)	-0.0768*** (0.0220)	-0.0704*** (0.0242)	-0.0764*** (0.0217)	-0.0697*** (0.0236)	-0.0469*** (0.0178)	-0.0455*** (0.0142)	-0.0309** (0.0140)	-0.0465*** (0.0151)	-0.0292** (0.0139)
Control of corruption in politics	0.425*** (0.114)	0.570*** (0.139)	0.511*** (0.138)	0.567*** (0.141)	0.506*** (0.139)	0.349*** (0.107)	0.433*** (0.0876)	0.290*** (0.0982)	0.442*** (0.101)	0.273*** (0.0954)
GDP per capita, constant purchasing power parity	0.578** (0.244)	0.295 (0.255)	0.323 (0.259)	0.304 (0.255)	0.324 (0.261)	0.840*** (0.190)	0.426** (0.174)	0.383** (0.166)	0.479*** (0.180)	0.394** (0.180)
Market dominance	...	0.523*** (0.174)	...	0.546*** (0.170)	...	...	0.470*** (0.138)	...	0.517*** (0.144)	...
Anti-monopoly policies	...	...	0.518*** (0.190)	-	0.543*** (0.174)	...	...	0.742*** (0.167)	...	0.836*** (0.150)
Constant	-8.770*** (1.770)	-7.372*** (1.865)	-7.247*** (1.930)	-7.171*** (1.877)	-7.105*** (1.925)	-9.853*** (1.313)	-5.423*** (1.117)	-4.938*** (1.053)	-4.927*** (1.296)	-4.435*** (1.230)
Observations	204	139	139	139	139	204	139	139	139	139
Number of countries	75	75	75	75	75	75	75	75	75	75
Time effect	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes

Source: IMF staff estimates.

Note: Robust standard errors in parentheses.

\*\*\*  $p < 0.01$ ; \*\*  $p < 0.05$ ; \*  $p < 0.1$ .



**Annex Table 2.3.3. Factors Affecting Institutional Quality: Endogeneity**

	Judicial Independence				Protection of Property Rights			
	(1)	(2)	(3)	(4)	(1)	(2)	(3)	(4)
Equal distribution of resources	2.225** (1.076)	2.151 (1.349)	4.177*** (1.297)	3.551* (1.952)	0.143 (0.846)	0.358 (0.959)	5.568*** (1.533)	1.041 (1.500)
Freedom of the press	0.00968 (0.00625)	0.0211*** (0.00682)	0.00945 (0.00650)	... ...	0.0114*** (0.00443)	0.0173*** (0.00517)	0.0113 (0.00766)	... ...
Impartial public administration	0.875*** (0.224)	0.834** (0.353)	0.488 (0.301)	1.340*** (0.257)	0.507*** (0.171)	0.662** (0.285)	-0.362 (0.382)	1.106*** (0.194)
Lower barriers to trade	0.194*** (0.0715)	0.402** (0.191)	0.0798 (0.0975)	... ...	0.573*** (0.0972)	0.531*** (0.152)	0.323*** (0.117)	... ...
Institutional quality of trading partners	0.396*** (0.131)	0.112 (0.133)	-0.293*** (0.0950)	... ...	0.109 (0.106)	0.0920 (0.108)	-0.350*** (0.113)	... ...
Old-age-dependency ratio	-0.0685** (0.0291)	-0.0690*** (0.0203)	-0.0823*** (0.0186)	-0.0838 (0.0557)	-0.0469*** (0.0178)	-0.0428*** (0.0130)	-0.0621*** (0.0213)	-0.0374 (0.0427)
Control of corruption in politics	0.425*** (0.114)	0.877*** (0.154)	0.377*** (0.125)	... ...	0.349*** (0.107)	0.538*** (0.104)	0.523*** (0.142)	... ...
GDP per capita, constant purchasing power parity	0.578** (0.244)	0.413 (0.269)	-0.159 (0.225)	... ...	0.840*** (0.190)	0.439** (0.198)	-0.177 (0.288)	... ...
Judicial independence, lagged	... ...	... ...	0.694*** (0.0827)	... ...	... ...	... ...	... ...	... ...
Protection of property rights, lagged	... ...	... ...	... ...	... ...	... ...	... ...	0.553*** (0.126)	... ...
Observations	204	129	175	84	204	129	175	84
Number of countries	75	70	70	84	75	70	70	84
Time effect	Yes	Yes	Yes	Yes	Yes	Yes	Yes	no

Source: IMF staff estimates.

Note: Robust standard errors in parentheses.

\*\*\*  $p < 0.01$ ; \*\*  $p < 0.05$ ; \*  $p < 0.1$ .

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