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# Assessing Democracy, Market Economy and Political Management: The Bertelsmann Transformation Index and Southeastern Europe

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# Assessing Democracy, Market Economy and Political Management: The Bertelsmann Transformation Index and Southeastern Europe

## Summary

Indicator-based governance assessments support the precise description of differences and similarities among countries. But they also simplify a much more complex empirical reality by focusing on its quantifiable aspects and by aggregating its different components and interrelations into abstract numbers.

To initiate a reflective debate about the utility of such indicators, this paper presents a new indicator project that links numerical ratings and rankings with comparative studies, the Bertelsmann Transformation Index (BTI). The BTI is a global ranking that examines the political management of societal change in 119 countries on the way to a market-based democracy. The paper explains why such an assessment may be useful for Southeastern Europe, a region situated between the legacies of war-ridden authoritarian regimes and the future of membership in the European Union. We argue that EU accession and international agreements on questions of contested statehood are important for Southeastern Europe but should not distract attention from the quality of democracy and market economy in each country of the region. We then discuss the conceptualization of democracy, market economy and governance in order to derive criteria and questions for the BTI. The BTI's methodology of measurement and aggregation is explained in detail.

These sections show that the BTI differs from other indices by focusing on the management performance of political actors, by using broader, more demanding concepts of democracy and market economy and by relying mostly on self-collected empirical evidence. In contrast to numerical ratings on the one hand or purely qualitative comparisons of countries on the other hand, the BTI allows readers to simultaneously compare countries and to familiarize themselves with the state of affairs in individual countries. Run by non-governmental organizations, the BTI does not depend on political mandating or the consensus requirements of international organizations. The BTI and similar assessments may initiate public discourses on better governance and encourage governments to engage in peer review mechanisms and evidence-based policy making.

## 1. Introduction

Assessing states and their performance through indicators has become a growth industry. A recent overview publication by the United Nations Development Programme and the European Commission lists 33 different sources of publicly available governance indicators, ranging from representative opinion surveys to expert polls and composite quantitative indicators.<sup>1</sup> An earlier survey counted 178 different initiatives that took efforts to measure democracy, human rights and governance.<sup>2</sup> To construct its biannual synthetical governance indicators, the World Bank Institute has been able to draw on a growing number of data sources, from 13 different sources in 1999 to 37 different data sources from 31 different organizations in 2005.<sup>3</sup>

Variety of performance indicators

This development is not only driven by the recognition that the political institutions of any country in the world can and have to be placed in relation to ideal types of liberal democracy and market economy, given the absence of viable alternatives for providing a similar degree of prosperity and freedom. An equally powerful driver has been globalization, by creating a demand and supply of information that allows to compare distant countries quickly and easily. Moreover, to address the challenges of globalization, states have assigned resources and tasks to international organizations and agencies. Situated in a non-hierarchical environment of sovereign nation states, the UN, the World Bank, the OECD and other international actors have come to rely on indicator-based cross-national comparisons as instruments to effect policy changes in their member states and to legitimize their own activities.

In the Western industrialized countries, the changing role of the state has been a third factor. It has paved the way from old public administration and redistribution towards “new public management” and “regulatory policy-making”. The reorganization of public administration according to principles of corporate management and the delegation of regulatory functions to independent agencies have necessitated comparable performance indicators and performance assessments based on objective standards.

Performance management

For Southeast European countries aspiring to join the European Union, the EU’s approach of a merit-based accession is a fourth factor facilitating indicator-based performance assessments since the EU has committed itself to make membership contingent upon a state’s individual performance.

Viewed from the perspective of domestic actors, a rating or ranking of their country in comparison with other countries can be a useful tool to stimulate domestic debates about governance improvements. It can also facilitate lesson drawing and policy transfer across borders, increase the transparency of government performance and support convergence towards best practice. Domestic citizens or non-governmental organisations who seek to hold governments accountable may be supported by cross-national comparisons if other domestic mechanisms of public accountability are weak.

Political implications

While numerical indicators support the precise description of differences and similarities among countries, they also simplify a much more complex empirical reality by focusing on its quantifiable aspects and by aggregating its different components and

Methodological problems

interrelations into abstract numbers. These analytical tasks are inevitable parts of measurement and entail numerous methodological problems that need to be addressed by concepts and methods in order to ensure a maximum of objectivity, reliability and validity.<sup>4</sup> Even if an indicator is considered to be sufficiently objective, reliable and valid, its utility will ultimately depend on the needs and perceptions of its (potential) users. Given the increase of governance and democracy indicators, this utility will increasingly be determined in comparison with other indicators that may provide more useful, alternative assessments of what the indicator is designed to measure.

Analytical expertise

To initiate a reflective debate about the utility of such indicators, it is important that projects to construct indicators set out their concepts and methodologies and demonstrate the specificity of their approach. We believe that this debate should be conducted among area specialists with a comparative interest, rather than being confined to methodological journals. This is why we have chosen Southeastern Europe as a special regional focus to present the results of a new indicator project that links numerical ratings and rankings with comparative studies, the Bertelsmann Transformation Index (BTI).

Bertelsmann  
Transformation Index

The BTI has been developed by a group of scholars and practitioners in the fields of development and democratization who are collaborating in a project managed by the Bertelsmann Foundation and its academic partner, the Center for Applied Policy Research.<sup>5</sup> The index examines the political management of societal change in 119 countries on the way to a market-based democracy. The index is based on detailed and systematic country analyses that are summarized in numerical ratings and aggregated into two rankings and trend indicators. One ranking—the Status Index—locates where a country stands on the way to a constitutional democracy and a socially responsible market economy as compared to all other countries examined. A second ranking—the Management Index—classifies the quality of political management in global comparison. Two trend indicators inform about the current direction of development in terms of democracy and market economy in each of the examined countries.

Western Balkans  
in focus

Within Southeastern Europe, special attention is paid to Albania, Bosnia-Herzegovina, Croatia, the Former Yugoslav Republic of Macedonia and Serbia and Montenegro. These countries have been selected because two distinguishing features place them in a particular transitional period. While they were able to break with their past regimes and end the wars surrounding the dissolution of Yugoslavia, they are still struggling with some legacies of those times, seeking to overcome deficiencies of their democracies or market economies. While the great majority of their citizens and leaders intend to join the EU, the EU considers them as not yet ready for membership and has labeled them “Western Balkan” countries.

This transitional situation assigns a particular role to political elites and their management, the focus of the BTI. Our grouping of the five Western Balkan countries, however, neither intends to neglect the significant differences among them, nor does it disregard the similarities between them and other Southeast European or European countries. One quality criterion for indicators should be their ability to identify the relative scope and significance of differences and similarities among countries.

This introductory article provides a theoretical framework for the assessment. A second paper places the region in a global comparative perspective.<sup>6</sup> We start by arguing that EU accession and international agreements on questions of contested statehood are important for Southeastern Europe but should not distract attention from the quality of democracy and market economy in each country of the region. We then discuss the conceptualization of democracy, market economy and governance in order to derive criteria and questions that are used for the BTI. This is followed by a section explaining the methodology of the BTI.

Proceeding

## 2. The primacy of democracy and market economy in Southeastern Europe

In the course of the last decade, democracy and market economy have been consolidating in Southeastern Europe. In Serbia, a broad and sustained protest movement was able to oust the regime of Slobodan Milosevic from power in October 2000 and to achieve a democratic breakthrough. In Croatia, the parliamentary elections of January 2000 and subsequent constitutional changes swept away the power structures underpinning Franjo Tudjman's rule. Since then parliamentary and presidential elections have been held in both countries. In Bulgaria and Romania, the successors of the former state socialist parties, which had dominated government until then, lost the elections in 1997 and 1996.

Democratic consolidation

Albania's and Macedonia's major competing political forces switched between government and opposition in 1992 and 1997 and, respectively, in 1998 and 2002. Thus, the two countries passed the 'double turnover test' that was seen as an indicator of democratic consolidation.<sup>7</sup> Democratic institutions also survived major crises threatening the existence of the two states: the breakdown of public order in Albania in 1997 and the clashes between ethnic Albanian fighters and the Macedonian army in 2001. In 2002, state-level elections in Bosnia were for the first time organized solely by the Bosnian Electoral Commission instead of the OSCE, indicating the maturation of Bosnia's democracy.

All countries of the region have established private property and markets as the frameworks of production and exchange. The private sector generates more than half of the gross domestic product, nearly all small-scale firms have been privatized and the privatization of large-scale enterprises is in progress; commercial banks have been restructured and independent central banks now control monetary and exchange rate policies; prices for most commodities have been liberalized and free trade agreements interlink all countries of the region.

Market consolidation

Since the institutions of democracy and market economy seem to have become consolidated, one may argue that public and scholarly attention should now focus on the remaining and new challenges for the region: settling unsolved statehood and ethnopolitical conflicts and preparing for accession to the European Union. Statehood and ethnopolitical conflicts persist over the future legal and territorial status of Kosovo, the preservation of the State Union of Serbia and Montenegro, the relations between state and entities in Bosnia-Herzegovina and the inter-ethnic power-sharing arrangements in Macedonia. If the conflicting parties and the international community will negotiate agreements to these conflicts, one can assume that more stable states and constitutional frameworks will emerge. These will then, as can be argued, remove the last obstacles to democratic consolidation and foster the improvement of democracy and market economy.

EU perspective

A similar argument can be made for EU accession. Bulgaria and Romania have signed their accession treaty and Croatia has entered accession negotiations. Croatia and Macedonia have concluded Stabilization and Association Agreements to establish a free trade area and closer links with the EU and its member states, and the remaining countries are negotiating such agreements. The preparation for EU membership and membership itself will “Europeanize” the Balkan countries and strengthen their administrative-legal framework of democracy and market economy, thereby improving democratic quality and economic performance.

While we do not want to downplay the stabilizing impact EU accession and constitutional-territorial settlements will have on democracy and market economy in the region, we believe that the quality of democracy and market economy is equally and perhaps more important for the region, as a priority on the political agenda, a field of study and a focus of external assistance. We claim that high-quality democracy and market economy should not be seen as a consequence, but rather as an indispensable component and precondition of sustainable conflict settlements and successful applications for EU membership. This contention shall be substantiated by the following four arguments.

Public disaffection

First, contrary to the prima facie impression of institutional consolidation, democracies in the Balkans are threatened by the disaffection of citizens and the rise of populist and radical political forces. Opinion polls document a high degree of disappointment about the functioning of democracy in most Balkan countries.<sup>8</sup> Although elections are held and political freedoms are granted, all political elites are seen as corrupt, self-interested and ineffective. One reason for this popular perception seems to be that changes in government do not entail real policy changes. A type of democracy is emerging that is dominated by the “passing of power back and forth between competing elites who are largely isolated from the citizenry but willing to play by widely accepted rules.”<sup>9</sup> This “feckless pluralism”<sup>10</sup> may lead to “the destruction of the representative nature of democracy combined with the continued presence of its institutional shell.”<sup>11</sup>

Widespread disaffection with democracy may also turn into support for populist and radical political alternatives. In Serbia for example, the Serbian Radical Party became the most popular parliamentary party in the elections of December 2003, and its presidential candidate was supported by a quarter of the electorate in June 2004. In the ethnically divided societies of Bosnia and Macedonia, citizens repeatedly supported nationalist parties that advocated the interests of their ethnic kin group and challenged the constitutional framework of inter-ethnic coexistence. These political forces are unlikely to reinstate an authoritarian system, but they can curtail or weaken the civil liberties, political rights and rule of law that constitute liberal democracy.

Eroding social basis of market economy

Second, while all governments of the region have successfully established macro economic stability, the social and political basis of market economy is eroded by the rise of the informal economy, state capture and social marginalization.<sup>12</sup> Registered unemployment is high and characterized by high shares of long-term unemployment. Most unemployed depend on the informal economy, family networks and subsistence production.<sup>13</sup> The criminalization and corruption associated with the shadow economy have led many people to believe that economic wealth is usually accumulated by illegal means. Such a popular perception is nurtured by the

cultural legacy of collectivism and egalitarianism still present in the region. Substantial groups of society have lost their previous social status or fear a loss of their social status and thus mistrust any political or economic reforms. The violent clashes in Kosovo in March 2004 manifested not only political frustration about the unsolved status of the region, but also a dissatisfaction with the dismal socio-economic situation.<sup>14</sup>

Third, the quasi-protectorates established by the international community in Bosnia and Kosovo have certainly laid the foundations for democratic institutions and procedures, but their long term effect is more ambiguous. Critics have charged that the interventions of the High Representative in Bosnia tend to undermine the democratic accountability of domestic politicians.<sup>15</sup> Relying on the protector and supervisory institutions of the international community, local politicians are inclined to shirk their own political responsibility. Kosovo's unsolved status and the tutelage role of the UN administration provide rationales for Kosovo Albanian politicians to explain and justify the violation of democratic standards in Kosovo. In Bosnia and Kosovo, accountable self-government is still impaired and the functioning of democracy will have to be improved if the two entities aspire for EU membership.

Impaired accountability

Fourth, it is uncertain whether the perspective of EU membership is sufficiently credible to provide an external anchor for domestic liberal reformers building a constituency for market-based democracy.<sup>16</sup> Triggered by the failed referenda in France and the Netherlands, the looming crisis of the Union has strengthened those interests that prefer to postpone further enlargements. Intra-EU views and power constellations tend to determine the sequencing and timing of the accession process, ignoring the legitimation needs of domestic political elites. Liberal, western-oriented political actors in the Balkan countries usually refer to the European perspective in order to justify costly and conflict-prone reforms. These actors, however, can not rely on safe electoral majorities firmly aligned with a programme of liberal democracy and market economy. Moreover, the reformers' time horizon for delivering on their promises is limited, as the rising electoral support for populists has shown. If the European perspective becomes more remote and uncertain for the Western Balkan countries, the achievements of democratic and economic reforms are likely to be questioned.

Uncertain EU anchor

Thus, there are several reasons to assume that the quality of democracy and market economy is more worrisome than the broad picture of institutional consolidation suggests. European integration and new international status agreements are likely to support the improvement of democracy and market economy but will not be the encompassing solution to the problems observable. Rather, domestic political elites continue to play the key role for preserving and developing democracy and market economy in the Balkans. They matter for consolidating representative democracy, rule-based economic activities, accountable governments and a steady course towards EU membership.

Reasons to worry

### 3. Conceptualizing democracy, market economy and governance

#### 3.1. Democracy

##### Approaches to democracy

Theories of democracy and research on democratization have reflected the emergence and remarkable persistence of new democracies across the world by asking how well democracy works and how to differentiate the new variety of democracies. Three main approaches of conceptualizing the functioning of democracy may be distinguished in the literature.

##### Parsimonious or broad definitions

A first approach is to adopt a parsimonious definition of democracy as a regime characterized by electoral competition and political participation rights, following Robert Dahl's notion of polyarchy.<sup>17</sup> A regime fulfilling these two conditions may violate civil rights or lack effective judicial review, but is considered a democracy. How such a democracy functions is conceived and studied as the quality of democracy.<sup>18</sup> While universal, adult suffrage, free and fair elections, more than one political party and alternative sources of information are constitutive elements of democracy, the extent to which competition is fair and participation rights are ensured denotes a quality of democracy. The respect of civil rights and the horizontal accountability of rulers also tell about a high or low quality of democracy, but are exogenous to the concept of democracy as such.

A second approach suggests a broader definition of democracy by arguing that Dahl's notion of polyarchy presupposes the existence of other components to become effective.<sup>19</sup> Democracy is conceived as consisting of five interdependent "partial regimes: a democratic electoral regime, political rights of participation, civil rights, horizontal accountability, and the guarantee that the effective power to govern lies in the hands of democratically elected representatives."<sup>20</sup> This approach seeks to incorporate the first approach by considering a democratic electoral regime including the right to vote as the necessary condition for the existence of democracy or, to put it differently, as the decisive feature distinguishing democracy from authoritarian regimes.

##### Defective democracies

But such a democracy is qualified as "defective" as long as one or several of the other partial regimes do not function effectively. Various subtypes of defective democracies are identified, depending on which partial regime is considered defective. If all partial regimes function effectively, the second approach qualifies democracy as "constitutional", stable or liberal, thereby emphasizing the embedded nature of modern democracy. Thus, much of what is seen as a quality of democracy by the first approach is conceived here as an inherent element of constitutional democracy. Advocates of this approach, however, claim that a constitutional democracy does not represent a perfect democracy and that the quality of constitutional democracy may still vary and can be assessed.

##### Functional approach

A third approach attempts to avoid the normative and potentially discriminatory implications associated with democracy by focusing on good governance. Such a functional approach has been taken mainly by international agencies which have defined governance as "the exercise of economic, political and administrative authority to manage a country's affairs at all levels."<sup>21</sup> According to the World Bank, good governance is "epitomized by predictable, open and enlightened policy-making; a bureaucracy imbued with a professional ethos; an executive arm

of government accountable for its actions; a strong civil society participating in public affairs; and all behaving under the rule of law.”<sup>22</sup>

This conceptualization highlights the quality of policy-making and the political process, but does not explicitly require democratic elections. While this distinguishes good governance from democracy concepts, the components of good governance in the World Bank definition clearly overlap with attributes of democratic quality or constitutional democracy. Components such as “open policy-making” and “civil society participating in public affairs” obviously strongly suggest democratic mechanisms and may at the same time be understood as more demanding than a minimum version of electoral democracy.

The second and third approach have guided the conceptual design of the BTI. The index takes constitutional democracy as its normative point of reference and evaluates the governance performance of political elites. This focus seems to be particularly well suited to monitor the deficiencies of democracy and the crucial role of domestic political elites in Southeastern Europe. In the remainder of this section, we set out how the concept of constitutional democracy is reflected in the criteria and questions used to construct the BTI’s democracy assessment (see table 1 below).

BTI’s democracy concept

First, the criterion **Political Participation** asks whether and how well the core element of constitutional democracy, free and fair elections, and the freedoms of opinion, association, assembly and free media function. In addition, this criterion asks whether democratically elected rulers have the effective power to govern.

Second, the separation of legislative, executive and judicial powers with checks and balances – “horizontal accountability”<sup>23</sup> – and the protection of civil rights are monitored by the **Rule of Law** criterion. Constructing the rule of law as a distinct and constituent criterion assigns greater importance to functioning accountability mechanisms than democracy assessments that focus on free elections and universal suffrage. Moreover, this emphasis on the rule of law pays particular attention to the weakness of checks and balances that has been identified as a salient feature of Southeast European political systems.<sup>24</sup>

Democracy criteria

Third, two criteria, **Institutional Stability** and **Political and Social Integration** take into account whether and to what extent democratic institutions are consolidated in terms of popular attitudes, behaviour of political actors and patterns of political representation. These criteria and questions reflect insights from research on the consolidation of democracy,<sup>25</sup> but they also check attributes of the quality of democracy. They also allow to monitor citizens’ disaffection with democracy that is observable in most Balkan countries.

Fourth, basic state identity and coherence are viewed as prerequisites of democratic development. In the tradition of modernization theory, nation building, secularization and the institutionalization of a state monopoly on the use of force are assumed to precede the emergence of viable and sustainable democracy. The **Stateness** criterion monitors whether a political system is characterized by unsettled conflicts related to these processes. Integrating stateness conflicts and rule of law problems into the measurement of democracy allows to take into account those problems of Balkan democracies that are associated with weak states.<sup>26</sup>

**Table 1: The democracy criteria**

1.	<b>Stateness:</b> There is clarity about the nation's existence as a state, with adequately established and differentiated power structures.
1.1.	To what extent does the state's monopoly on the use of force cover the entire territory?
1.2.	Is there fundamental agreement about which people qualify as citizens of the state?
1.3.	Are the state's legitimacy and its legal order defined without interference by religious dogmas ("separation of church and state")?
1.4.	Do working administrative structures exist?
2.	<b>Political Participation:</b> The populace decides who rules, and it has other political freedoms.
2.1.	To what extent are rulers determined by general, free and fair elections?
2.2.	Do democratically elected rulers have the effective power to govern, or are there veto powers and political enclaves?
2.3.	To what extent can independent political and/or civic groups associate and assemble freely ("freedom of choice")?
2.4.	To what extent can citizens, organizations and the mass media express opinions freely?
3.	<b>Rule of Law:</b> State powers check and balance one another and ensure civil rights.
3.1.	To what extent are state powers independent and interdependent?
3.2.	Does an independent judiciary exist?
3.3.	Are there legal or political penalties for officeholders who abuse their positions?
3.4.	To what extent do civil liberties exist and to what extent can citizens seek redress for violations of these liberties? Freedoms in question include human rights, rights to justice, bans on discrimination and freedom of religion.
4.	<b>Institutional Stability:</b> Democratic institutions are capable of performing, and they are adequately accepted.
4.1.	Are democratic institutions, including the administrative system and system of justice, capable of performing?
4.2.	To what extent are democratic institutions accepted or supported by the relevant actors?
5.	<b>Political and Social Integration:</b> Stable patterns of representation exist for mediating between society and the state; there is also a consolidated civic culture.
5.1.	To what extent is there a stable, moderate, socially-rooted party system to articulate and aggregate societal interests?
5.2.	To what extent is there a network of cooperative associations or interest groups to mediate between society and the political system?
5.3.	How strong is the citizens' consent to democratic norms and procedures?
5.4.	To what extent have social self-organization and the construction of social capital advanced?

### 3.2. Market economy

A socially responsible market economy is the other normative point of reference for the BTI exercise. Whereas a narrow definition of a market economy focuses primarily on free markets and property rights, the concept of a socially responsible market economy complements this definition by the principles of social justice and responsibility. This notion is informed by studies of new institutional economics and the literature on the nexus between social justice and development.<sup>27</sup> As for constitutional democracy, the concept of a socially responsible market economy is operationalized in criteria and questions.

Social justice

First, the criterion **Level of Socioeconomic Development** monitors whether and how the economic system and policy reduce or prevent poverty and social exclusion. Second, the BTI assesses whether and how a country's **Welfare Regime** compensates for the main social risks of market economies and provides for an equality of opportunity. Third, the **Sustainability** criterion observes whether economic development is environmentally sustainable and underpinned by investment in education, research and infrastructure.

The market economy concept of the BTI is further operationalized in four criteria measuring the quality of the institutional framework (competition, property rights) and the performance (macroeconomic stability, growth).

Market economy criteria

**Table 2: The market economy criteria**

6.	<b>Level of Socioeconomic Development:</b> In principle, the country's level of development permits adequate freedom of choice for all citizens. To what extent can one assume that fundamental social exclusions due to poverty, education or gender are a marginal phenomenon?
7.	<b>Organization of the Market and Competition:</b> There are clear rules of the game for stable market-based competition. 7.1. To what level have the fundamentals of market-based competition developed? 7.2. Are monopolies avoided or combated? 7.3. To what extent has the liberalization of foreign trade evolved? 7.4. Are the foundations laid for a banking system and a capital market?
8.	<b>Stability of Currency and Prices:</b> There are institutional or political precautions to control inflation sustainably, together with an appropriate foreign-exchange policy 8.1. Does the country pursue a consistent inflation policy and an appropriate foreign-exchange policy? Is there an independent central bank? 8.2. Do government authorities give signals to preserve macroeconomic stability, especially in fiscal and debt policy?
9.	<b>Private Property:</b> There are adequate conditions to support a functional private sector. 9.1. Do government authorities ensure well-defined rights of private property and regulate the acquisition of property? 9.2. Are private companies permitted, and are state companies undergoing a process of privatization in conformity with market principles?

10. **Welfare Regime:** Viable arrangements to provide adjustments compensate for the social effects of the capitalist economic system.

10.1. Do social safety nets exist to compensate for poverty and other risks such as old age, illness, unemployment or disability?

10.2. To what extent does equality of opportunities exist?

11. **Economic Performance:** The strength of the economy points to solid growth. What quantitative performance do the macroeconomic indicators show?

12. **Sustainability:** Economic growth is balanced, ecologically compatible and oriented to the future.

12.1. To what extent are environmental concerns taken into account macro- and micro-economically?

12.2. To what extent are there solid institutions for basic and continuing education as well as for research and development? Is there a modern infrastructure?

### 3.3. Governance

A crucial factor

The debate among social scientists and practitioners about the meaning and scope of the term governance has produced numerous different conceptualizations.<sup>28</sup> Up to now there has not been a convincing theoretical integration of these proposals that could constitute a 'root concept' similar to Robert Dahl's polyarchy concept in the democracy literature. The governance concepts of international agencies are designed to underpin their particular policy purposes. Moreover, they have to take into account the limitations of their mandates, that is not to intervene into the domestic politics of their member countries. This restriction is particularly problematic because comparative research has demonstrated that there are causal chains between the quality of politics, political institutions, governance and policy outcomes.

Notions of governance developed in the literature on public administration and public policy draw on developments in advanced, wealthy western states that have little in common with the challenges for countries on the way to democracy and market economy.<sup>29</sup>

Broad notions of governance

Authors of governance indicators for developing and transition countries rely on broad notions of governance. Kaufmann, Kraay and Mastruzzi, for example, define governance as "the traditions and institutions by which authority in a country is exercised. This includes (1) the process by which governments are selected, monitored and replaced, (2) the capacity of the government to effectively formulate and implement sound policies, and (3) the respect of citizens and the state for the institutions that govern economic and social interactions among them."<sup>30</sup> Hyden, Court and Mease suggest an even broader, less government-centric notion: "Governance refers to the formation and stewardship of the formal and informal rules that regulate the public realm, the arena in which states as well as economic and societal actors interact to make decisions."<sup>31</sup>

The BTI concept of governance is narrower than these notions, since it is focused on the leading political actors and their governing activities. The BTI tries to

measure the management performance of a country's political leadership with respect to developing a constitutional democracy and a socially responsible market economy. One may label this an actor-centered concept, which is also signaled by the use of the term "management". Governance is viewed as the responsibility, capacity and performance of leading political actors. The role of executives and governments is seen as highly important, but is conceived in a functional sense, in view of their contribution to management. Such a functional understanding of political leadership implies that non-governmental actors are also taken into account if they play an important role for governing a country.

BTI's approach

This conceptual design seeks to overcome the limitations of "non-political" governance notions and the vagueness of encompassing systemic governance notions. The BTI's actor-centered concept of governance has also been facilitated by the wider scope of the entire measurement exercise. Some of those BTI criteria, which measure the state of development towards democracy and market economy, cover elements of systemic governance concepts such as accountability, effectiveness, fairness, openness, participation, predictability and transparency. This enables the BTI to conceptualize management as composed of four criteria that reflect key findings of the literature on governance and policy reforms.

Functional understanding

First, the experience with successful development and transitions has shown the importance of state capacity. Effective states can initiate economic modernization and were able to drive an economic catch-up process by channeling export revenues into education, research and development, as exemplified by successful Asian countries.<sup>32</sup> Conversely, "state weakness" has been seen as a key reason for the crisis of democracy in the Balkans.<sup>33</sup> Unconstrained executive authority is required to initiate economic reforms, overcome the resistance of status-quo oriented groups and impose social burdens on the population in order to achieve long-term improvements.<sup>34</sup> For these reasons, the BTI monitors whether governments seek to achieve strategic goals, manage their resources efficiently and act effectively. These management qualities are operationalized in two criteria: **Steering Capability** and **Resource Efficiency**. Individual questions under these criteria draw on the list of government capabilities used by Weaver and Rockman to study whether and how institutions matter for public policies.<sup>35</sup>

State capacity

Second, effectively acting and efficiently organized states were only able to sustain development and reforms if they were backed by a broad support from society. The "embedded autonomy" of these states ensured that their governments were not captured by particularist economic and political elites and that the ruling elites did not consume the country's wealth.<sup>36</sup> This finding of historical-institutionalist research on successful development corresponds with insights from the political economy of policy reforms. This literature has argued that higher constraints to executive authority forced governments to engage in a dialogue with society and form broader coalitions that, in turn, often enabled a political leadership to sustain unpopular reforms. To consolidate policy reforms, governments would thus require representative institutions that widen the social basis of reform.<sup>37</sup>

A higher effective number of veto points restricts the decisiveness, but increases the resoluteness of policy making.<sup>38</sup> Institutional devices that weaken executive authority such as more frequent elections and shorter executive tenures contribute to improve competition among political actors and thus reduce the blockade

Role of the society

power of vested interests.<sup>39</sup> In the light of these studies, Knack, Kugler and Manning have suggested to conceive governance as consisting of executive capacity and executive accountability.<sup>40</sup>

The utility of consultation, compromise and consensus can also be explained by the interaction of social capital, government policies and policy outcomes. Political elites who cooperate with society may better use a country's social capital of civic engagement for collective goals.<sup>41</sup> Furthermore, comparative research on transitions to democracy has shown that negotiated agreements among major social groups and political actors were key to successful transitions.<sup>42</sup> The **Consensus-Building** criterion has been constructed in view of these findings.

Third, political elites who learned from abroad and effectively integrated financial and technical assistance into their own strategy of development have been more successful than elites who misused foreign aid as rents or as a compensation for their failed policies.<sup>43</sup> Regional and goodneighbourly cooperation also represent important areas of policy learning that can be used to guide a transition and development process. This explains why **International Cooperation** forms part of the BTI's governance concept.

Democracy and effectiveness

Especially the **Consensus-Building** criterion reflects that this governance concept is not only about effectiveness but also refers to democratic elements. It is assumed that a democratic environment and democratic forms of participation improve the likelihood of effective management. Conversely, the lack of democratic consensus-building in most autocracies limits the effectiveness and sustainability of economic reforms in such systems.

It should be noted that these criteria do not operationalize governance as a catalogue of reform measures required to establish constitutional democracy and socially responsible market economy. This indeterminacy is necessitated by the empirical diversity of development and democratization trajectories and strategies. Yet the emphasis on capacities rather than distinct reform moves also allows to assess the potential of a political leadership.

**Table 3: The management criteria**

13. <b>Steering Capability:</b> The political leadership manages reforms effectively and can achieve its policy priorities.
13.1. Does the political leadership set and maintain strategic priorities?
13.2. Does the government implement its reform policy effectively?
13.3. Does the political leadership act flexibly? Are leading political actors capable of learning and policy innovation?
14. <b>Resource efficiency:</b> The government makes optimum use of available resources.
14.1. Does the government make efficient use of available economic and human resources?
14.2. Can the government coordinate conflicting interest into a coherent policy?
14.3. Can the government curb corruption successfully?

15. **Consensus-Building:** The political leadership establishes a broad consensus about reform with other actors in society, without sacrificing its reform goals.

15.1. Do the major political actors agree on a market economy and democracy as strategic, long-term aims?

15.2. Can the reformers exclude or co-opt anti-democratic veto actors?

15.3. Can the political leadership manage political cleavages so that they do not escalate into irreconcilable conflicts?

15.4. Does the political leadership develop social capital among citizens and social groups?

15.5. Does the political leadership enable the participation of civil society in the political process?

15.5. Can the political elite bring about reconciliation between the victims and perpetrators of past injustices?

16. **International Cooperation:** The country's political actors are willing to cooperate with outside supporters and organizations.

16.1. Does the political leadership use the support of international partners to improve its domestic reform policies?

16.2. Does the government act as a credible and reliable partner in its relations with the international community?

16.3. Is the political leadership willing to cooperate with neighboring countries in regional and international organizations?

### 3.4. Democratization and development

The theoretical concepts of constitutional democracy, socially responsible market economy and actor-centered governance do not imply an optimal institutional model. Rather, these definitions simply delineate certain functions that can be embodied in a variety of functionally equivalent institutions.

A constitutional democracy and a socially responsible market economy represent goals, but not necessarily immediate priorities in complex processes of development. In the BTI perspective, the aims of development, democratic transition and consolidation are identical. Development comprises political and economic transformation, while a democratization or a preceding authoritarian period do not constitute necessary preconditions of development. Development and democratization processes are not sequential. They can overlap both temporally and in terms of the problems to overcome. This broad understanding of development and democratization allows to study developing and transition countries in a single sample and by means of only one set of questions.

The BTI rests on the assumption that a constitutional democracy and a socially responsible market economy are empirically and functionally interlinked. To express this linkage, the term "market-based democracy" is used. Whereas features of a constitutional democracy are found most often in those countries exhibiting elements of a socially responsible market economy, the opposite is true for autocracies, where economic freedoms are frequently restricted. This may be explained by the fact that the constitutive liberties of economic citizenship and the participa-

Linkage democracy and market economy

tory rights of political citizenship have required and reinforced each other in the history of modern democracy.

Market economy  
and democracy

Furthermore, the institutions of market economy and democracy also appear to be interlinked. In the majority of countries, social differentiation triggered by the forces of marketization has led to the emergence of democracy. On the one hand, democratic rules to legitimize decisions and facilitate accountability have helped to prevent socioeconomic conflicts from damaging the viability and legitimacy of the economic system. Modern democracies, on the other hand, require a sufficient and stable resource base which can only be provided by production processes organized as a market economy.

Although many arguments militate for a close interrelation of market economy and democracy, this does not presage any “natural” sequence of development. Asian states such as China and Singapore illustrate that the path to a market economy can be combined with authoritarian regimes over long periods of time. For those few countries that achieved spectacular economic development in the course of the last 50 years, the autocratic or democratic nature of the political system did not matter, since the average growth of total income was nearly identical for autocracies and democracies.<sup>44</sup> Benchmarking countries against market-based democracy does not imply that observable social changes and political reforms necessarily and continually approach the aim of market-based democracy. Development is conceived as path-dependent, not as historically efficient. Stagnation and relapses into authoritarianism are just as much a possibility as detours and asynchronicity in development.

#### 4. The methodology of the Bertelsmann Transformation Index

Consequences for the BTI

The conceptual choices explained in the previous section have several consequences for the measurement and index construction.<sup>45</sup> The complexity of concepts and criteria, the large number of countries and the aim of cross-national comparability suggest organizing the measurement as an expert poll based on in-depth country analyses rather than as a survey or as an exclusively numerical rating. The measurement is therefore underpinned by country reports written by social scientists with detailed country experience and knowhow. The purpose of these country reports is to substantiate and explain the ratings given to a country, sketching a holistic, contextualized view of the country’s situation and perspectives. The present issue of Southeast European and Black Sea Studies contains updated and annotated versions of these country reports.

**Selection of countries.** Since constitutional democracy and socially responsible market economy are used as benchmarks to rate countries, the BTI criteria are unlikely to sufficiently discriminate between countries that are already market-based democracies. As such countries would cluster at the top of the rankings, the board of scholars and practitioners supervising the BTI (“BTI Board”) decided to exclude countries from the sample that can be considered as consolidated democracies and highly developed market economies, formally identified by their donor status in the OECD.<sup>46</sup>

**Assessment.** The country experts assessed the 16 criteria according to a coding manual that contains the 47 questions listed in tables 1-3 together with eight

questions to assess the trend of development and the level of structural difficulty (see below). The manual explains all questions and proposes the wordings of four different, graded answers per question. These “evaluation levels” cover the scope of possible assessments and could be used as building blocks for formulating the analysis, while not being mandatory components. For the Status Index, the experts assessed the state of democracy and market economy in January 2005. For the Management Index, experts took into account the period from January 2003 to January 2005.

Each country report was reviewed twice, by an anonymous second country expert, mostly from the country itself, and by an expert with a broad, comparativist knowledge of the region. The main purpose of the first review was to improve the validity and objectivity of the verbal assessment. The second review mainly served to ensure that all criteria and questions were addressed by the author of the country report. The country reports were revised on the basis of these reviews.

Double review

The numerical ratings are based on the four evaluation levels, but are further differentiated into 10 different levels, with 1 representing the worst, and 10 representing the best rating. Raters thus were able to provide a more nuanced rating. The ratings were derived from two independent sources. The first and the second country expert each suggested scores for all 47 (+8) questions.

To facilitate the rating and reduce bias, the country experts were provided with exemplary country reports and ratings that allowed them to assess “their” country in comparison with a “benchmark country” from their region of the world. The ratings and analyses of these benchmark countries had been adjusted and calibrated across world regions.

Two regional experts discussed these ratings and agreed upon a rating that reflected the differences among countries of the same world region. These regionally calibrated ratings were reviewed by the BTI Board that recalibrated them in a cross-regional comparison and established a consensus on the final ratings. The calibration discussions aimed at minimizing country and regional bias. The need for intra- and interregional calibration implies that the final ratings may no longer correspond fully to the rating expressed by the wording of the country reports.

Ensuring comparability

**Aggregation.** The aggregation of scores into composite indicators is based on two assumptions. First, the high degree of scale differentiation (ten levels) allows to consider the ordinal rating scale as an approximation of an interval scale. Second, in designing questions and criteria, care was taken to divide the concepts into criteria of equal importance and to disaggregate criteria into questions of similar relevance. Since no compelling conceptual reasons were identified that would have justified a differentiation among criteria and questions according to their importance, the BTI Board decided to assign equal weights to (1) all criteria within the three concepts and (2) all questions within the 16 criteria. This conceptual choice can be empirically justified by a principal component analysis that shows that more than 77 (68) per cent of the variance measured by the composite concepts (and the individual criteria) can be explained by single underlying factors. This finding of highly correlated criteria and question ratings implies that assigning different weights to individual questions/ criteria would not introduce systematic bias to the composite scores.<sup>47</sup>

Creating valid indicators

These assumptions permit the calculation of arithmetical means as the main procedure to obtain the Status Index and the Management Index. As explained in section 3.4., the BTI assumes that market economy and democracy are functionally inter-related. This justifies why the average ratings for market economy and democracy are added to form one single index, the Status Index. In effect, this procedure assigns equal weights to the democracy and the market economy components (not, however, to the constituent criteria ratings). The empirical results of the BTI measurement confirm the assumed interrelation of market economy and democracy by a high (.749) and significant ( $p < 0.01$ ) correlation between the average ratings for democracy and market economy, even if we control for the influence of income levels. One intended effect of this aggregation procedure is that the BTI is biased in favour of states that take democratic and economic reforms simultaneously.

The Management Index is determined as a separate index, following from the conceptual distinction between constitutional democracy and socially responsible market economy on the one hand, the performance of political actors on the other. In order to construct this index, one has to consider that the underlying actor-centered concept of governance analytically separates the management performance of political actors from the structural constraints these actors are faced with. It is, however, intuitively evident that structural difficulties such as poverty, lack of education or protracted conflicts may severely restrict the management performance. As this would lead to a systematic underestimation of good management under difficult structural circumstances in relation to an equally good management of comparatively easier tasks, the measurement should take into account the structural constraints of development and democratization.

Level of difficulty

Hence their impact is analyzed and classified as a **Level of Difficulty**. The difficulty level reflects the levels of income and education achieved by a state, the intensity of conflicts, the existence of civil-society traditions and a state's institutional capacity. A low level of economic and educational development, the presence of serious conflicts, a lack of civil-society traditions and weak state capacity represent a high level of difficulty for a political leadership. The **Level of Difficulty** is calculated from qualitative ratings and quantitative data as shown in table 4 below.

**Table 4: Construction of the Level of difficulty**

1. Structural constraints on governance rated by country experts
2. Traditions of a civil society rated by country experts
3. Intensity of ethnic, religious or social conflict rated by country experts
4. Gross national income per capita, World Development Indicators, 2003, purchasing power parities
5. Level/inclusiveness of education, Human Development Report, UN Education Index
6. State capacity, Mean of BTI ratings for stateness and rule of law

=> **Level of difficulty**  
(Unweighted mean of individual scores)

In a second step, the average rating for the four management criteria is multiplied with the **Level of Difficulty**. This is justified by the fact that structural problems such as high poverty, a history of violent conflict or the absence of civil society traditions are likely to affect all aspects of governance. The **Level of Difficulty** may range between 1.0 (least difficult) and 1.25 (most difficult). The effect of such a range is that the political leadership's performance continues to play a decisive role in the Management Index, while, as sensitivity tests have shown, the influence of differential structural conditions is not neglected. The third and final step is to rescale the resulting product to a scale with a maximum value of ten.<sup>48</sup>

In addition to the Status and Management Index, the BTI provides trend indicators showing the direction and intensity of democratic and economic development. These indicators are based on five questions – two on stateness and democracy, three on socioeconomic development, institutional reform and economic performance – that are rated by the country experts and then aggregated by averaging. To maximize their validity and to simplify the presentation of the BTI, the trend indicators denote only progress, continuity or decline.<sup>49</sup>

Trend indicators

Aggregating indices and indicators according to the procedures described here might, in theory, allow effective authoritarian states to compensate their lack of democratic structures by high scores for economic reforms and good management. However, such a compensation effect is limited by the design of the questions and evaluation levels which envisage ceilings for the scores autocracies may be given. Thus, a state like Singapore that combines autocratic government with a highly developed market economy can only attain an intermediate position in the status and management rankings.

The Management Index and the Status Index are displayed as rankings showing the index values and the ranks for all 116 countries studied.<sup>50</sup> The index values are provided with two decimals which means that the third decimals are rounded. That is, differences between index values that are smaller than 0.01 are not taken into account for the ranking. In addition to the rankings, the disaggregated criteria ratings are published. These ratings provide a detailed profile of each country's performance and enable readers to reconstruct the ranking of a country.

## 5. Conclusion

This article has outlined the concept and methodology of the BTI, a new index that, we believe, constitutes a useful tool to assess the quality of democracy, market economy and governance in Southeast European countries. The BTI differs from other indices by focusing on the management performance of political actors, by using broader, more demanding concepts of democracy and market economy and by relying mostly on self-collected empirical evidence. In contrast to numerical ratings on the one hand or purely qualitative comparisons of countries on the other hand, the BTI allows readers to simultaneously compare countries and to familiarize themselves with the state of affairs in individual countries.

We also think that the BTI addresses an important lacuna of research. Comprehensive studies of democratization and market reforms in the region have mainly focused on single country cases. An exception is the annual study "Nations in Transit" conducted by the US-based non-governmental organization Freedom

Freedom House

House.<sup>51</sup> The Freedom House study provides ratings and assessments for the state of democratization in 27 Central and East European countries. Six categories (electoral process; civil society; governance; independent media; constitutional, legislative and judicial framework; corruption) are evaluated and aggregated into a “Democracy Score”. Each category is further detailed in checklists of 6-10 questions that guide the country reporting and rating. In contrast with the BTL, Freedom House does not rate governments per se and uses a broader notion of governance, comprising “the stability of the governmental system, as well as legislative and executive transparency; the ability of legislative bodies to fulfill their law-making and investigative responsibilities; decentralization of power; the responsibilities, election, and management of local governmental bodies; civil service reform; and the freedom of the civil service from excessive political interference and corruption.”<sup>52</sup>

#### Copenhagen Criteria

Governance assessments by international agencies have so far been done mainly for policy advise purposes, not with the aim of a systematic, analytically oriented cross-national comparison. The most influential agency assessments have certainly been the reports prepared by the EU Commission to monitor the progress made by Western Balkan countries on the way toward EU association and membership.<sup>53</sup> The Commission derives its assessment framework from the eligibility criteria for EU accession defined by the EU member states in Copenhagen in 1993 (stable democratic institutions; a functioning and competitive market economy; and the capacity to implement the EU legislation). The reports are divided accordingly in a political assessment, an economic assessment and an analysis of the country’s ability to fulfill its contractual commitments regarding the EU. As the Copenhagen criteria for accession are fairly broad, the Commission has specified them by analysing, e.g. in the case of the political assessment, the functioning of the main political institutions.

#### Objectiveness

While the reports provide detailed and well-informed empirical evidence, they do not disclose the standards or reference points used to assess democracy or to distinguish between serious democratic defects and the frictions occurring in everyday politics. Although grades of assessment have evolved over time, such as “made progress”, “limited progress”, “further progress is needed”, it is unclear how individual observations add up to a summary assessment. One reason for this vagueness is the Commission’s limited discretion to provide detailed rules where EU member states represent a plurality of institutional arrangements and claim the exclusive power to take decisions on agreements with candidate countries. The Commission reports are, in this respect, consultative documents, not systematic derivations of EU judgments.

The World Bank tried to test the feasibility of constructing governance “scorecards” for Southeast European states, based on its so-called “second generation governance indicators.”<sup>54</sup> These quantitative indicators have been designed to provide transparently generated and institutionally specific information on governance deficiencies and for targeting institutional reforms. They differ from older and less specific indicators that measured, for example, the degree of corruption. The feasibility test, however, showed that it was rather difficult to obtain data from each Balkan country and to achieve a consensus within the framework of the Stability Pact Anti-Corruption Initiative (SPAI) on monitoring governance via peer review mechanisms. In this respect, the project failed “due to a combination of dissatis-

faction among participants with the proposed indicators, the scorecard peer monitoring approach or with the SPAI itself.”<sup>55</sup>

Governance indicators provided by non-governmental organizations are less dependent on such settings with their consensus requirements. They may initiate public discourses on better governance and encourage governments to engage in peer review mechanisms and evidence-based policy making.

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