PAR PUBLIC ADMINISTRATION REVIEW

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The Effectiveness of Administrative Reform in New Democracies

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Public Administration Review,
Vol. 72, Iss. 3, pp. 324–333. © 2012 by
The American Society for Public Administration.
DOI: 10.1111/j.1540-6210.2012.02483.x.

Practitioners and scholars of postcommunist politics disagree on the accomplishments of administrative reforms in new Eastern European democracies. The transformation of the public sector after 1989 has aimed to consolidate the democratic process and enhance economic development. Skeptics, however, argue that administrative reforms face serious challenges in the context of economic liberalization, insufficient capacity for modernization, and cultural legacies of the past. The authors judge reform effectiveness by testing the impact of civil service reform on government transparency and foreign direct investment. The results of the empirical analysis confirm that once reform is adopted, administrations become more effective at reducing corruption and attracting investment. Despite the delays and difficulties of implementation, the adoption of reform is important in and of itself, and countries can expect positive results sooner than skeptics predict.

A pillar of effective democratic governance is the existence of efficient public administration that adheres to professional standards and integrity. Since the collapse of communism in 1989, all of the countries in Central and Eastern Europe (CEE) have undergone civil service reforms aiming to transform their highly politicized and inefficient bureaucracies into modern professional administrations. The massive political, economic, and social transformation required the establishment of a new type of public service, one with the professional skills needed to carry out new policies and protect citizen rights. The importance of this task notwithstanding, there has been a dearth of empirical studies systematically assessing the effectiveness of civil service reforms (see Anderson, Reid, and Ryterman 2003; Evans and Rauch 1999; Rauch and Evans 2000; Recanatini, Prati, and Tabellini 2005). This study seeks to uncover the long-term outcomes of administrative transformation in new democracies.

Scholars of postcommunist politics observe both achievements and weaknesses in the process of administrative reform in CEE. Change was intended to make bureaucracy more efficient, transparent, and responsive to the needs of the public, but success was not guaranteed. In the context of simultaneous political and economic transformation, reforming the state bureaucracy was postponed in many countries. Moreover, implementing institutional reform became difficult because of insufficient resources. Legislation for the establishment of a professional and depoliticized bureaucracy was introduced, but legacies from the past instilled a reluctance to change. Furthermore, front-runners such as Hungary and Poland rolled back the requirements for impartiality in their laws, thus effectively letting politicization back in. This prompted some analysts to claim that civil service laws had practically failed in depoliticizing the CEE civil service systems (Meyer-Sahling 2006, 2009). The move toward greater professionalization has also been hampered in cases such as the abolition of civil service authorities in Poland and Slovakia and the late and weakly implemented reform in the Czech Republic. Given the contradictory record of achievement and frustration, has the recent administrative transformation in Eastern Europe produced any tangible positive results?

We explore reform effectiveness in CEE according to two criteria: direct and indirect. First, we assess the reforms by looking for changes in the behavior of state bureaucracies, as indicated by lower levels of corruption. Then we turn to the indirect effect of civil service reform by examining the behavior of foreign investors who have to deal with national bureaucracies. To empirically test our hypotheses, we pool data from six postcommunist countries—Bulgaria, Croatia, the Czech Republic, Macedonia, Romania, and Slovakia—between 1996 and 2007. This sample allows for a rigorous test, as the selected countries adopted reforms relatively late and therefore are considered laggards in institutional rebuilding.

The results of such an investigation may have implications for both the theory and practice of democratic government. Theoretically, the findings are expected to contribute to the debate about the success of institutional reform in the context of democratic transition. Empirical evidence for effectiveness will help practitioners sustain anticorruption policies and improve the investment climate in their countries. If administrative change turns out to be conducive to economic growth, the case for more robust and stricter implementation will emerge as even more important. Indeed, our empirical findings support the proposition that reform lowers corruption. We also find that once the CEE countries began to transform their civil service, they became more attractive to foreign investors. This suggests that the adoption of a framework for institutional modernization enhances government transparency and economic prosperity.

> [O]ur empirical findings support the proposition that reform lowers corruption.

The article is organized as follows: We start with a discussion of the context in which administrative reform was introduced in the former communist states after 1989. The section blends together legacies from the totalitarian past and transitional specifics that made the transformation of bureaucracy complex and unique. Next, we discuss the nature of the reforms and the challenges they face. We proceed with our hypotheses on reform effectiveness and the construction of models to test the impact of reform on corruption and foreign investment. Then, we report the results, discuss their implications, and propose avenues for future research.

The Context of Civil Service Reform after Communism

Civil service reform in CEE was introduced in the context of a unique and simultaneous political, economic, and social transition. Experts agree that, with a few exceptions, the transformation of public administrations in the region was postponed with respect to other reforms. New electoral legislation and new constitutions were passed quickly after 1989 (Noutcheva and Bechev 2008), but other institutional reforms were "constrained" by politics (Haynes and Husan 2002). Similarly, the task of judicial reform was perceived as more important than the depoliticization of bureaucracies full of servants who were "excessively servile to the Communist party" (Magalhaes 1999). In some countries, it took more than a decade for legal changes in civil servants' status to get approved. Clearly, the adoption and implementation of reform in Eastern Europe have carried the marks of the unique postcommunist transition. State institutions inherited from the previous regime were deeply politicized and weak (Schamis 2002). Ironically, although marketization called for less government involvement, efficient and competent bureaucracies were required to secure property rights and enforce contracts. Yet institutional reform occurred only when self-interested political elites found it congruent with their priorities.

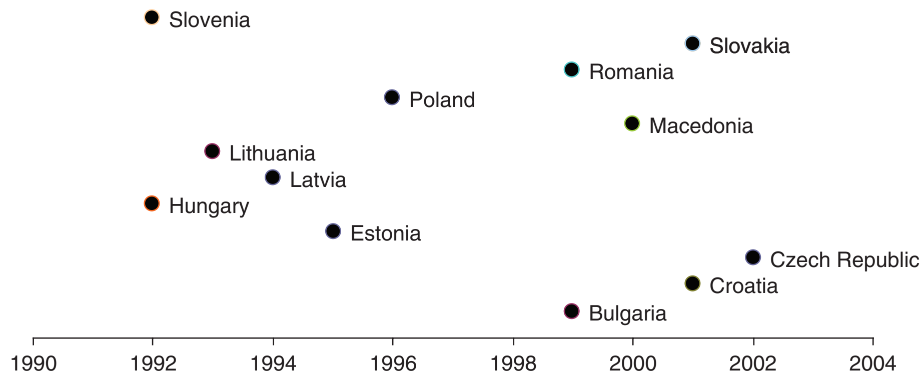
Globally, administrative change in CEE coincided with a reform movement in the Western Hemisphere dominated by the ideas of New Public Management (NPM). Yet the NPM trend remained foreign to reform efforts in the postcommunist countries (Dimitrova 2005; Gajduschek 2007; Goetz 2001), which chose to reform their administrations along the lines of the classical Weberian model of centralized hierarchy. Scholars offer several explanations for why the CEE administrative reforms remained so "curiously clear of the NPM approach" (Nunberg 1999, 264). According to Goetz (2001), the movement toward more managerial freedom and businesslike practices simply was not feasible in the context of postcommunism. Other authors point to strong national and organizational cultural preferences for the classical traditions (Nunberg 1999). Another group sees the orientation toward the Weberian model as rooted in the lack of relevant information about the latest developments in advanced democracies (Bossaert and Demmke 2003). Finally, the European Union (EU) also endorsed the classical type of professional nonpartisan bureaucracy for countries aspiring to membership.[1]

What Reform?

Although the new Eastern European laws vary in their particular features, the literature agrees on the existence of a common core in the design of the civil service models. Oriented along Weberian rational-legal lines, the reform efforts pursued two major goals—depoliticization and professionalization of the state bureaucracy (Gajduschek 2007; Goetz 2001; Meyer-Sahling 2004).[2]

Depoliticization aims at curtailing political control over the appointment of administrators. In CEE, the creation of a nonpartisan public service was considered a break with the socialist legacy of the superiority of party bureaucracy over state administration (Goetz 2001). Depoliticization also sought to discourage the patronage practice of distributing state posts in exchange for loyalty, which had led to turnover of administrators and a lack of institutional continuation. The threat that politicization of the bureaucracy might continue was real in the context of a peaceful transition and a surviving *nomenklatura* (a select class of people from which top-level government appointees were drawn). Parties of all stripes have tried to maximize their access to state resources, for example, by staffing administrations with politically loyal people (Verheijen and Rabrenovic 2007). To curb politicization, almost all countries adopted legal constraints on politicians' freedom to make discretionary appointments. The policies varied from full depoliticization of top-level civil servants, as in Poland (relaxed later), to the designation of a political layer in the administration, as in Hungary and Bulgaria (Verheijen and Rabrenovic 2007). In the countries that were most successful in limiting politicization (Latvia and Lithuania), politicians saw administrators as collaborators in the reform instead of subjects to it (World Bank 2006).[3]

Professionalization, the second goal of the reforms, is associated with the establishment of a competent civil service that maintains professional integrity in the formulation and implementation of public policies. The rationale behind the establishment of a professional civil service is that it allows the administration to develop expertise over time. It was expected that the combination of political neutrality and expertise would limit personnel turnover when new parties came to power. The socialist state administration had little policy-making authority, and professionalism was not considered as important as allegiance. As Goetz and Wollmann (2001) note, the socialist state bureaucracies were "over-politicized" in personnel terms and "under-politicized" in policy terms. To stimulate professionalism, the new civil service laws established systems of merit recruitment and promotion, servants' rights and obligations, professional codes, and systematic training of civil servants. The area of open competition has been praised (Meyer-Sahling 2009) for achieving high compliance with European administrative principles. By 2003, virtually all of the CEE countries had codes of conduct for public officials that were systematically improved in quality and scope.



Sources: Grzymala-Busse (2007, 87) and United Nations Public Administration Network.

Figure 1 Adoption of Civil Service Laws in Postcommunist Countries

The institutional isomorphism observed in the common goals of the administrative reform movement in CEE can be explained by both "normative pressures" and "coercive pressures" (DiMaggio and Powell 1983). The reforms had a powerful normative impetus that was often popularly formulated as a desire to "break with the past" and to "return to Europe." The existence of a strong international organization in close proximity, namely the EU, has served as a normative example and a source of coercive influence. Vachudova (2005) identifies two types of leverage exercised by the EU on countries aspiring to membership: passive (setting an example) and active (setting a standard to be met). Beginning in 1997, the EU enforced a new requirement that candidate states develop the administrative capacity to implement and enforce *acquis communautaire*, the entirety of the EU laws and regulations. Candidate countries had to pass legislation establishing a neutral professional civil service that was protected from political intrusion.

Although all postcommunist states underwent civil service reforms, as figure 1 shows, there was considerable variation in the timing of reform introduction. Hungary, widely considered a front-runner in institutional reconstruction, passed its civil service law as early as 1992 (Gajduschek 2007; Goetz 2001; Meyer-Sahling 2004). Estonia and Lithuania adopted new legislation by the mid-1990s, and Bulgaria and Romania in 1999. Surprisingly, some of the leaders in the transition, such as the Czech Republic, were very slow to introduce reform.

Why Administrative Reform May Not Be Effective

The proponents of public sector modernization in CEE shared a belief in its future positive role in the process of democratization. World experience had shown that formal institutions of oversight can be successful promoters of bureaucratic accountability (Grzymala-Busse 2007). Therefore, a neutral merit-based civil service system, the opposite of the communist *nomenklatura,* should enhance fair competition and honest policy making (Gajduschek 2007). Also, the adoption of administrative measures enabling public control over state resources would help strengthen the national economy (Center for the Study of Democracy 2006). Thus, there were good reasons to believe that the competent management of public affairs would result in efficiency and growth.

Skeptics, however, argue that a positive outcome of the foregoing transformative changes is not inevitable in CEE. Observers warn that even in Hungary, a pioneer in the adoption of administrative reform, the passage of civil service legislation was "not sufficient to prevent the politicization of the state" (Meyer-Sahling 2006). Bureaucratic politicization and patronage in Hungary resumed after 1994 because of a trust deficit in government–bureaucracy relations. A return of politicization has been observed in another early reformer, Poland. In 2005, the new center-right government in that country "unleashed" political influence by transforming some senior civil service posts into political appointee positions (Meyer-Sahling 2009). A high level of political polarization was also noted in Slovenia (World Bank 2006).

Second, experts on postcommunist transition identify incongruities between the new institutional configurations and informal everyday practice (Goetz and Wollmann 2001; Nunberg 1999). Relevant to this issue are the inertia of running administrative procedures in the old way and the conscious reluctance of some bureaucrats to change their behavior for the good. Nunberg (1999) attributes this to precommunist and communist legacies that led to a trend of "structural conservatism" instead of genuine reform. Many officials, socialized during the old regime, may find it difficult to transform into modern administrators who are ready to work with politicians of all stripes (Goetz 2001). As Nunberg notes, "The 'new civil servant,' it turns out, is more likely a rehabilitated version of the old bureaucrat" (1999, 208).

The third source of doubt can be found in the design of the new administration laws, particularly loopholes allowing for continued political control.[4] Because of them, recruitment can still operate through informal channels rather than competition (Bossaert and Demmke 2003).[5] In some instances, early institutional choices resulted in "dysfunctional mechanisms" that, at least temporarily, postponed implementation (Nunberg 1999). Other scholars warn that the new rules did not clearly differentiate political appointees' posts from those of civil servants (Meyer-Sahling 2004). "Vagueness" of the provisions contributes to the survival of communist-era features and may hinder the positive effects of transformation (Nunberg 1999, 207).

Finally, skepticism also comes from the realization that the implementation of public service reforms may face insurmountable challenges in times of democratic transition. As policy analysts emphasize, effective policies need to incorporate stringent regulations, provide adequate funding, and secure consistent enforcement (Mazmanian and Sabatier 1989). It seems that most concerns in CEE focus on the insufficient capability to implement reform. It proved difficult to develop material capacities for administrative change when the hardships of marketization were so severe. Low wages in the public sector and shortages of resources for training and equipment hampered the establishment of a capable and responsible bureaucracy (Gajduschek 2007; Nunberg 1999).

Toward Testable Hypotheses

Our central argument builds on the expectation that civil service reform, based on the principles of probity and neutral competence, discourages corrupt behavior and creates an attractive environment for investment. While the effects of having a professional and depoliticized civil service may be multiple, we focus on two—namely, corruption and foreign direct investment. The mechanisms of the proposed effects are discussed next.

The Impact of Reform on Corruption

Corruption has been broadly defined in the literature as the misuse of public office for private gain. While malfeasance may exist on different levels, we consider here the extent of illegal activity originating from the privileged position of central public authority. Under this scenario (see Philip 2002, 57), a public official violates the rules and norms of conduct in order to benefit a third party, who gains privileged access to goods and services. As a result, the official is rewarded for what he or she did (or failed to do), and the public interest is harmed. This conceptual definition of corruption includes activities of illegal exchange leading to personal enrichment, appointment, or promotion of civil servants. In the pursuit of these benefits, public officials provide individual benefactors and organized interest groups with privileged access to public contracts and administrative support for requested policies. What might prevent such activities is a carefully designed set of incentives to constrain illegal behavior, facilitate transparency in bureaucrats' interactions with the public, and reward professional integrity.

Because of the multifaceted character of the postcommunist transition, public employees were tempted by numerous opportunities for easy gains from illicit payments. Privatization at an unprecedented scale was carried out in the absence of a national bourgeoisie, and members of the former *nomenklatura* found themselves in an advantageous position of transferring property rights through network connections (Holmes 1997). Along with the well-known ones, new forms of extortion and bribing developed (Coulloudon 2002), including bribery of the public officials managing privatization, nontransparent public procurement in favor of "friendly" firms, and the courting of group interests through disproportionate distribution of foreign aid and EU subsidies.

Among the various goals pursued through the reform of the state administration, transparent and accountable government stands out in stark contrast to the past. Moreover, all postcommunist states have introduced in their civil service statutes codes of conduct for the civil servants. As Bossaert and Demmke (2003) argue, these codes serve a twofold purpose: to promote rules for loyal, honest, and impartial conduct among public officials and to fight violations of these rules. In the Czech Republic, for example, some categories of civil servants are even prohibited from joining political parties. In addition, many CEE countries have set out ethical rules and requirements in separate legal acts, known as codes of ethics. They regulate the interaction between civil servants and the private sector, the acceptance of or prohibition against gifts, the occupation of a second job, and resignation from public office (Bossaert and Demmke 2003).

The modernization of the structure of the civil service, the reinforcement of its material and institutional capacity, and the introduction of new bodies with control functions are all relevant factors in the formulation and implementation of clean and fair policies. The depoliticization of bureaucrats contributes to administrative decisions that are free of political rent seeking. Autonomous civil servants are more likely to formulate policies and deliver services to the public when their reappointment or promotion is not under the pressure of pleasing private interests. As Philip argues (2002, 67), the weaker the institution of public office, the more difficult it is to distinguish cases of corrupt activities. Therefore, the introduction of clear norms becomes crucial for identifying unacceptable behavior. Administrative reforms in CEE also aimed at bringing more professionalism to the public office, which previously was filled on the principle of party loyalty. The emphasis on professionalism is expected to lead to a more effective government, but also to more efficiency and less temptation to steal from the state. An adequately trained and paid civil service increases the state's ability to cope with corrupt practices. Both scholars and policy makers argue that well-paid bureaucrats are less corrupt (Hankiss 2002; Xin and Rudel 2004).[6]

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How soon after the adoption of civil service reform can one expect behavioral changes to occur? As it relates to corruption, scholars worry that backlashes and incongruent culture may delay actual implementation (Meyer-Sahling 2004; Nunberg 1999). Yet others suggest that some positive effects of administrative reform should be felt early after adoption. Studying the intensity of anticorruption policy measures in the postcommunist world, Steves and Rousso (2003) find that in the period from 1999 to 2002, when most of the new civil service laws were adopted, bribery and kickbacks in the administrations decreased. Using 2005 data from the World Bank, Anderson and Gray (2006) also conclude that the introduction of institutional change, including reinforcing meritocracy in the civil service, helped reduce corruption in a relatively short time. That civil service reform might have had an early impact on bureaucrats' behavior is indicated by evidence of improved administrative professionalization. Gajduschek (2007) argues that in Hungary, reform has led to more professionalization of the civil service, where numerous well-educated individuals find employment. In the 1990s, the rapid increase of graduates with diplomas in law and economics provided the administration with much-needed skilled professionals. This trend, Gajduschek claims, is generalizable to the rest of CEE. The magnitude of this influence in the short term might not be as strong as intended, but the very adoption of civil service laws is a sign of what Grzymala-Busse calls "heightened vigilance" (2007, 159). Therefore, it is hypothesized,

> Hypothesis 1: Reform of the civil service directed toward more professionalism and less political intrusion will result in less corruption.

The Impact of Reform on Foreign Direct Investment Inflows

We develop our expectations for a link between administration reform and foreign direct investment (FDI) by drawing insights from new institutional economics. Combining arguments from economics and strategic management, this theoretical perspective has proven useful in explaining the inflow of FDI in transitional economies. Previous scholarship has established that in CEE, institutional arrangements such as bilateral investment treaties, corporate governance reform, and profit repatriation rules attract foreign investment (Grosse and Trevino 2005). While these regimes enhance the inflow of funds, we believe that the adoption of civil service reform is crucial in creating a stable environment for entrepreneurs.

The utility of the new institutional economics approach is the emphasis on the role of institutions. Despite some cross-national similarities, it seems that the institutional factor is most powerful in Eastern Europe (Grosse and Trevino 2005). Our argument is twofold: In order to attract foreign investors, postcommunist governments adopt legislation to recognize and facilitate FDI. Scholarship has shown that more aggressive strategies for the institutionalization of FDI attract more investment (Bandelj 2008). Yet those who are looking for a place to invest would appreciate the efforts of some governments more than others. At the heart of their decision lies the notion of minimum transaction costs.

FDI, like any other business transaction, is associated with costs resulting from market imperfections (Grosse and Trevino 2005). In new markets that are just opening for free exchange based on competition, these costs might be even higher because of the high level of uncertainty in the transitional context. There, the legislative framework may stay "dazzling and contradictory" for quite some time, with unclearly specified property rights and rules of interactions between administrative officials and business entities (Katsamunska 2008; Marinescu 2003). Following North's assertion (1990) that efficient markets rely on institutions that sustain free competition, we note the importance of institutional reform in lessening the extra costs of underdeveloped financial systems, unclear business regulation, and an obsolete postsocialist bureaucracy. The very act of launching an institutional reform sends a signal to foreign investors that governments want to commit to the principles of market competition and establish enabling structures and policy frameworks.

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To facilitate the development of a stable investment environment, CEE reformers emphasized the principles of "openness, accessibility, political neutrality, impartiality, responsibility, responsiveness (to citizens), loyalty, legality… and integrity" (Borissova 1999). Over the course of reform, the need to meet requirements for "high moral standards" and efficiency has been linked to both improved governance and the ability of the state to attract FDI (Marinescu 2003; Setnikar-Cankar n.d.). Thus, administrative reform was recognized as an important contributor to macroeconomic certainty and stability (Borissova 1999). All of these measures speak strongly about a transition toward a more competitive market, one that not only welcomes the inflow of investment but also guarantees a climate of open and fair transactions.

To summarize, we expect that public administration reform in the CEE countries has a positive effect on their ability to attract FDI. As previous research has posited, investment in the region has been both "market seeking and efficiency seeking" (Bevan and Estrin 2004). While the former principle considers labor costs and resources, the latter is driven by considerations lowering transaction costs. The transition to a depoliticized merit-based civil service is expected to reduce these costs and favorably affect FDI location decisions.

> Hypothesis 2: Civil service reform will ease the way to do business and thus make Central and Eastern European countries more attractive to foreign capital.

Explaining the Effects of Administrative Reform

To test the hypothesized effects empirically, we use data from six postcommunist countries—Bulgaria, Croatia, the Czech Republic, Macedonia, Romania, and Slovakia—between 1996 and 2007. These countries are all in a process of transition from a totalitarian system with a centrally planned economy to a modern, market-based democracy. Thus, they share a range of similar political, economic, and social characteristics. All of these countries adopted administrative reforms. Although the reforms were shaped by the particular context, they shared a common core—the development of a merit-based and politically independent civil service. Country selection was further determined by data considerations: from the pool of all CEE countries, we left in the sample only those for which levels of corruption and FDI had been documented both before and after reform. Therefore, we analyze data from rather late reformers (see figure 1).

This sample allows for even more rigorous testing of the effects of reforms. Finding a difference in the expected direction for the group of reform laggards, for which the effects are more doubtful, would strengthen our confidence in the proposed impact. It is also worth noting that most of the countries in the sample have not experienced major reversals or backsliding. Two cases merit special attention: the Czech Republic and Slovakia. The latter was loudly criticized for abolishing its central administrative authority in 2006. The Czech Republic was not only the last country in CEE to adopt a civil service law, but also the only one that has not enforced it, except for several provisions.[7] Yet, on average, the countries in our sample have moved in a positive direction, and "the general trend has been encouraging" (Verheijen and Rabrenovic 2007).

Because the countries adopted their civil service acts at different times, we can exploit the effects of reform by using state-level aggregates in a panel data set. We design two basic regression models for

Table 1 Summary Statistics

Variable	Mean	Std. Dev.	Min	Max
Dependent Variables:				
CPI (Corruption, Transparency International)	3.746	.681	2.6	5.4
WB (Corruption, World Bank)	–.080	.371	–1.06	.58
Foreign direct investment	5.576	3.815	0	17
Institutional Reform Variable:				
Civil service	.639	.484	0	1
Other Independent Variables:				
Regulation	3.481	0.795	1	4
Democracy	11.333	9.723	3	30
Ln (GDP per capita)	9.244	.378	8.698	10.022
Ln (GDP)	23.516	1.115	21.742	25.068
Openness	59	13.932	31	93
Wages (US$)	326.790	216.873	88.271	933.562

Note: The table contains summary statistics for the sample of six postcommunist countries from 1996 through 2007.

Sources: *Institutional reform* was coded by the authors based on Grzymala-Busse (2007) and country reports of the United Nations Public Administrations Network (http://www.unpan.org). *CPI* and *WB* were collected from Transparency International (http://www.transparency.org) and the World Bank (http://www.worldbank.org). *FDI, Openness, GDP,* and *GDP per capita* were measured using World Development Indicators Online (http://www.worldbank.org). *Democracy* measures are from Gerring and Thacker's (2004) data set (http://www.bu.edu.sthacker). *Regulation* is the Heritage Foundation/*Wall Street Journal* Regulation Index (http://www.heritage.org/research/features/index). Data on *Wages* come from the International Labour Organization (http://www.laborsta.ilo.org).

each of the hypothesized effects. To isolate the impact of reform, we incorporate sets of control variables suggested by existing research. Table 1 contains summary statistics for the sample of six countries. The models are described here.

Civil service reform and corruption. The main specification of the models estimating the effect of reform on the level of corruption is as follows:

$$Corruption = f\begin{pmatrix}\beta_0 + \beta_1 \times reform + \beta_2 \times regulation + \beta_3 \times democracy \\ + \beta_4 \times Ln(GDP/pop) + \beta_5 \times openness\end{pmatrix},$$

where the dependent variable is a country's yearly level of corruption. For more robust results, we use two measures: the Corruption Transparency International (CPI) index and the World Bank corruption index (WB), which range from 0 to 10 and from –2.5 to +2.5, respectively.[8] Higher values correspond to more transparency, and lower values denote more corrupt policies.[9] Other instruments, such as the Business Environment and Enterprise Performance Survey (BEEPS), also offer data on corruption but cover just a few years for the sampled countries. Because we seek to analyze a longer series of pre- and postreform observations, these indicators are less useful.[10]

Our main explanatory variable, *reform,* is coded as 1 for the years after the adoption of civil service laws and 0 for the years before.[11] Admittedly, this is a crude measure that focuses on the adoption and not the substance of reforms. Yet the new civil service laws share a common core of principles, and this convergence allows us to employ a more uniform measure.[12]

To isolate the impact of civil service reform, we include four control variables.[13] *Regulation* accounts for the regulatory burden faced by businesses. Extortion and corruption are widespread when businesspeople have to pay various overlapping charges and licensing depends on the submission of too many documents to bureaucrats (Kaufmann and Siegelbaum 1997). We measure regulatory burden using the regulatory index of the Heritage Foundation, which ranges from 1 (less regulation) to 5 (more regulation). Because higher values of the dependent variable correspond to more transparent policies, we expect a strong inverse correlation with *regulation.* Prior research also indicates a relationship between the level of corruption and the length of *democracy.* Following Gerring and Thacker (2004), we control for the countries' democratic experience (in years) between 1900 and 1995. We expect that states with longer democratic histories will have lower levels of corruption. In other words, a positive-signed coefficient is anticipated. *Openness* accounts for the extent to which a country has liberalized its foreign trade. Scholars have argued that the more active a country's interactions with other states, the higher the cost of border bribery and extortion (Sandholtz and Gray 2003). This variable is measured as imports and exports as a percentage of gross domestic product (GDP). Finally, we introduce *GDP* to control for national economic development. Higher levels of wealth are associated with less illegal enrichment because of improved financial capacity of the state to purchase equipment and to offer better pay to bureaucrats (Gerring and Thacker 2004; Hankiss 2002; Xin and Rudel 2004). Similarly, elites in poorer countries are more likely to raise funds for party activities through illegal means. We measure national wealth using the natural log of per capita GDP in 2005 U.S. dollars. Finally, we include a dummy variable for the Czech Republic because of the limited implementation of the adopted civil service law.

Civil service reform and FDI. To assess the effect of civil service reform on foreign capital inflow, we estimate the following model:

$$FDI = f\begin{pmatrix}\beta_0 + \beta_1 \times reform + \beta_2 \times openness + \beta_3 \times Ln(GDP) \\ + \beta_4 \times democracy + \beta_5 \times corruption + \beta_6 \times wages\end{pmatrix},$$

where the dependent variable is a country's yearly FDI inflow, measured as a percentage of GDP.[14] *Reform,* again, is our main explanatory variable, coded 1 for the years after civil service reform. We use a one-year lag to account for the time lag between the reform and the reaction of business.

In this model, we incorporate six controls. The first, o*penness,* is an indicator of the host country's liberal regime of trade (as measured in the corruption model). Openness is considered favorable for foreign capital, in the sense that FDI is attracted by a state's policies of liberalized access to markets (Janicki and Wunnava 2004). *GDP,* the natural log of a country's GDP in current dollars, is a proxy for the size of the national market. The larger the market, the bigger the profit for investors and the larger the FDI inflow (Bevan and Estrin 2004; Grosse and Trevino 2005). *Democracy* taps the effect of democratic experience—namely, investors feel safer in environments with stronger democratic transitions. We operationalize democracy in the same way as in the corruption model and expect a positive correlation with FDI.

The last two control variables represent factors identified by existing scholarship as discouraging FDI. *Corruption,* operationalized as the WB index on corruption, accounts for the lack of predictable and transparent investing climate that may turn away foreign capital. Thus, we expect corruption to have a negative effect on the amount of investment.[15] Finally, with *wages,* we control for the possible impact of labor costs in investment decision making. As suggested in previous work, places with cheaper production costs are more attractive to investment because the expected profit will be higher (Bevan and Estrin 2004; Janicki and Wunnava 2004; Landsbury, Pain, and Smidkova 1996). The measure used here is the average annual wage in the manufacturing sector in U.S. dollars. We expect a negative correlation between wages and foreign investment. As in the corruption model, we control for the Czech Republic.

Results

To test the proposed relationship between civil service reforms and the level of corruption and FDI in CEE countries, we estimate a series of linear regression models. Because the data are organized by country and by year, it is highly likely that the observations within and across countries are related, violating the independence of observations assumption underlying linear regression. To account for this, we employ standard errors that allow observations to be specified within panels by country and by year. In addition, we employ models with a common AR(1) parameter to account for autocorrelation of the disturbances.

The results for alternative measures of corruption are reported in table 2, columns 1 and 2. Our data provide strong support for the first hypothesis that civil service reform reduces the level of corruption in CEE. The key predictor, civil service reform, is statistically significant in both models for corruption. When using the CPI, the coefficient of the reform variable is positive and statistically significant at the 0.01 level. When running the model with the WB index, the effect of reform is also substantial, as indicated by the estimated coefficient, which is positive and significant at the 0.05 level. In both models, the chi-square statistics indicate a good fit. The R^2 shows that the variables in the models explain 74 percent to 79 percent of the variation in corruption.

As predicted in theory, the regulatory burden is a major driver of corrupt practices. The coefficient of *regulation* has the expected negative sign and is statistically significant at the 0.01 level in both models of corruption. The more paperwork is required to open a new business, the less transparent the process, and the more opportunities for opaque practices. Also, richer countries are less corrupt, as suggested by the positive coefficient of GDP, albeit statistically significant in the WB model only. A country's trade *openness* and years of *democracy* turn out to be significant in one of the models. *Czech Republic* does not seem to have a distinctive effect.

We also find evidence in support of our second hypotheses regarding the expected economic impact of civil service reform (reported in table 2, column 5). The registered economic effect is positive and significant at the 0.05 level. This indicates that foreign entrepreneurs are less likely to commit resources to long-term projects in countries with unpredictable and incompetent bureaucracies. Conversely, the presence of professional administrations recruited on the basis of merit instead of political loyalty decreases the costs of doing business in these countries and constitutes a necessary addition to market-oriented reforms. Not surprisingly, trade openness is important to foreign capital, as indicated by the positive and statistically significant coefficient of this variable. Our results are also consistent with previous work on the importance of labor cost. The negative and statistically significant coefficient of *wages* suggests that countries with cheap labor attract more foreign investment than those with expensive labor. The length of democracy is found to affect the allocation of foreign capital: countries with a history of respect for political rights and economic freedoms are considered safer for business. Unlike our results for corruption, the FDI model estimates suggest that the lack of implementation of civil service provisions in the Czech Republic might have made a difference.

Another explanation of the variation in the levels of corruption and FDI is the impact of the European Union. One could

Table 2 Regression Coefficients for the Effects of Civil Service Reform

	Corruption				FDI	
Predictor Variable	(1)	(2)	(3)	(4)	(5)	(6)
Reform	.204***	.055**	.204***	.054**	2.192**	2.029**
	(.079)	(.028)	(.082)	(.028)	(1.028)	(1.045)
Regulation	–.582***	–.120***	–.601***	–.115***		
	(.065)	(.023)	(.066)	(.026)		
Ln (GDP/pop)	–.066	.979***	–.167	.991***		
	(.371)	(.121)	(.348)	(.119)		
Ln (GDP)					.708	.673
					(.772)	(.753)
Openness	.011**	–.0036	.012**	–.004	.186***	.193***
	(.005)	(.0029)	(.005)	(.003)	(.067)	(.069)
Democracy	.022*	–.010	.023*	–.0095	.371**	.413**
	(.013)	(.007)	(.012)	(.008)	(.157)	(.194)
Wages					–.011***	–.011***
					(.004)	(.004)
Corruption (WB)					1.177	.637
					(3.008)	(3.034)
EU			–.049	.028		1.019
			(.130)	(.055)		(1.835)
Czech Republic	–.289	.014	–.308	.001	–8.882**	–9.786**
	(.249)	(.115)	(.234)	(.136)	(3.942)	(4.656)
Constant	5.271	–8.382***	6.253**	–8.539***	–22.162	–22.857
	(3.289)	(.976)	(3.081)	(.988)	(21.145)	(21.292)
N	43	54	43	54	64	64
Wald χ^2	863.49***	652.57***	1064.78***	682.01***	38.85***	39.82***
R^2	.79	.74	.78	.74	.18	.18

Note: The entries are coefficients from linear regression estimations with a common AR(1) parameter; panel corrected standard errors in parentheses. In models 1 and 3, the dependent variable, *CPI*, is perceived corruption as reported by Transparency International. In models 2 and 4, the dependent variable, *WB*, is perceived corruption as reported by the World Bank. In models 5 and 6, the dependent variable, *FDI*, is the country's FDI inflow, measured as a percentage of GDP.
* $p < .10$; ** $p < .05$; *** $p < .01$.

argue that corruption levels in the CEE countries dropped not because of the reform of their administrations but also because of the increased monitoring of EU candidate states. Similarly, the registered increase in FDI might be because investors anticipated the accession of these countries. To check these possibilities, we include a new variable, *EU,* which is operationalized differently in the two models. In the corruption model, the variable taps the impact of EU monitoring, coded 1 for the years after submission of the application for membership until the conclusion of an accession treaty, and 0 for the years before and after that. According to the *conditionality* literature, when the external control is removed, countries have less incentive to stick to their pre-accession commitments and are more likely to defect on them (Haughton 2007). Because the EU discontinues monitoring after the treaty for membership is signed, the variable goes back to 0 in the post-accession period. Only for Bulgaria and Romania did the monitoring continue after accession, and our variable reflects this. The results are reported in table 2, columns 3 and 4, for the two measures of corruption. The *EU* coefficients are not statistically significant, indicating that the data do not offer sufficient evidence for an EU-independent impact, while the effect of reform is still confirmed.

We also test whether investment growth is affected by anticipated EU membership. In the FDI model, the *EU* variable is coded 1 for the years after a country applies for membership and accession becomes a prospect, and 0 for the years before that. The results (column 6) do not support such a proposition. The sign of the coefficient indicates a positive correlation, but the estimate fails to achieve statistical significance. The main explanatory variable, *reform,* retains its sign and significance level. This suggests that the results derived from the original models are robust.[16]

Conclusion

The principal finding of this analysis is that the existence of civil service reform is systematically associated with lower levels of public sector corruption in postcommunist countries. The civil service laws introduced a range of disciplinary measures seeking to constrain irresponsible behavior in the public sector and increase accountability. These laws introduced the meritocratic principle of recruitment and the prospect of long-term careers based on individual competence and performance, which, in turn, was expected to discredit the short-term benefits of corrupt practices. We hypothesized that administrative reform facilitates transparent governance and found empirical evidence to support this expectation.

> The principal finding of this analysis is that the existence of civil service reform is systematically associated with lower levels of public sector corruption in postcommunist countries.

The second finding concerns the expected economic effects of administrative reforms in CEE countries. The two main goals of reform, professionalization and depoliticization, promise to create more competent and predictable bureaucracies and thus ease doing business in these countries. Our results show a sharp and steady increase in the amount of FDI in the period after the reforms. Countries such as Bulgaria, for example, saw an almost 6 percent increase in the amount of FDI compared to the prereform level. Therefore, changes in administrative climate and practices can be associated with a shift in a country's economic status, as foreign entrepreneurs are more likely to invest in places where the costs of dealing with domestic bureaucracy are lower.

Furthermore, we documented these effects using a sample of countries not usually thought of as very accomplished in their institutional reforms. The finding that administrative reforms have fostered transparency and FDI inflows in countries generally considered to be reform laggards is encouraging news for policy makers. This result recognizes the efforts of democratically minded domestic elites and international institutions to stimulate institutional change. Even when adopted late in the transition process, reform can still produce positive effects.

This study contributes to at least two bodies of literature. First, it contributes to the public administration research by improving our understanding of the effects of administrative reform. While we construct our argument about the influence of civil service reform only with regard to the effects on corruption and foreign investment, the impact of this transformation might be much broader. Second, this research contributes to the literature on corruption in transition environments by showing that the modernization of state bureaucracies is important from the moment of adoption. While problems with implementation may cast a shadow over the prospect for speedy success, one need not be overly pessimistic. Our findings suggest that, once adopted, the new civil service laws started to produce behavioral change, although perhaps not of the magnitude experts had hoped for.

How generalizable are these findings from Eastern Europe to other countries undergoing democratic transformation? Depoliticization may be difficult to implement, as transitional elites everywhere strive for opportunities to get rid of nonloyal bureaucrats and reward supporters. The attempt at professionalization may also yield similar patterns across regions, as manifested by Goetz's (2001) "'enclaves' of professionalism" in Eastern and Southern Europe and Latin America. Despite contextual differences, such as varying levels of education, administrative inheritance, and regime type, other countries in transition can draw valuable lessons from the experience of the postcommunist reformers. We urge scholars to replicate our approach in other settings, exploring the same and other effects of administrative reform and looking for cross-regional patterns and distinctions.

Acknowledgments

We would like to thank Allan Rosenbaum for his valuable insights and Agatha Caraballo for her assistance with the data collection. Earlier versions of this article were presented at the research colloquium of Florida International University's Department of Public Administration and the 2009 Midwest Political Science Association meeting. We are grateful for the helpful feedback received from our colleagues and *PAR*'s anonymous reviewers.

Notes

1. All countries in the sample have been pursuing EU membership, although their status of integration varies. Two joined the EU during the first wave of eastward

enlargement in 2004 (Czech Republic and Slovakia), two joined in 2007 (Bulgaria and Romania), and two are still in negotiations (Croatia and Macedonia).

2. The new civil service laws, on average, covered about half of the public sector employees in CEE. According to Sigma country reports, 47.1 percent of the Bulgarian administration is part of the civil service; in Lithuania the share covered is 52 percent, and in Poland it is 50 percent.
3. In Lithuania, for example, the limit of politically appointed public officials was drawn at the deputy minister level (Meyer-Sahling 2009).
4. For instance, the Croatian civil service law fails to mention the obligation of political neutrality. Another example comes from Bulgaria, where the legislation established merit-based recruitment procedures, but administrative decisions on recruitment were denied judicial review before the amendments of 2005.
5. For a contradictory view, see Gajduschek (2007).
6. For a slightly different perspective, see Gorodnichenko and Sabirianova Peter (2007) and Van Rijckeghem and Weder (1997).
7. The Czech Republic's delay of administrative rebuilding has been attributed largely to the lack of external and internal drivers of change. By the time the EU administrative capacity requirement was imposed (after 1997), accession had already been secured (Dimitrova 2005). At the domestic level, there has been reluctance on the part of politicians to ensure continuity and stability of the civil service, as job security was regarded as contradicting the market-oriented spirit of transition (World Bank 2006).
8. Both measures are based on perceptions, and as such, they have been criticized as reflecting attitudes rather than actual corruption (for further discussion, see Sik 2002) and praised as enabling cross-national evaluation and comparison (Kaufmann, Kraay, and Mastruzzi 2005; Persson 2002).
9. In 1996, within our sample, Macedonia was the most corrupt (WB index = –1.06, 1996), while the Czech Republic had the cleanest policies (CPI = 5.4 and WB index = –0.58). Yet the Czech Republic is the only country with a negative temporal trend in corruption.
10. The 1999 values of the CPI, WB index, and BEEPS are highly correlated across our countries.
11. Such binary measures have been widely used in social sciences to study policy innovations, such as the effects of banking deregulation on new business incorporations (Black and Strahan 2002), the adoption and timing of economic development strategies in U.S. cities (Kwon, Berry, and Feiock 2009), and state lottery introduction (Berry and Berry 1990).
12. We believe that the development of a more precise measure accounting for the evolution of the civil service legislation is needed, as this would enable a more accurate evaluation of the effects of reform.
13. Corruption is a complex phenomenon that is affected by numerous causes. Prior research on political corruption has suggested a variety of controls. Because of the limited number of cases in our models, we include only those with strong theoretical rationales. In making these decisions, we also consider multicollinearity, in particular high-order correlation between per capita GDP and political freedom and between regulation and presidential regime. To increase the robustness of our findings, we tried alternative specifications with freedom and presidential regime.
14. FDI levels in our sample vary from a high of 17 percent of GDP in Slovakia (2002) to 0 percent in Macedonia (1996). In the former country, the increase was sudden—one year after the adoption of civil service reform, FDI jumped from 8 percent to 17 percent. In Bulgaria, FDI increased after the passage of the new administration law from 6 percent to 8 percent and reached 16 percent by 2006. The Czech Republic is the only country in the sample that saw a decrease in the amount of FDI in comparison to prereform levels.
15. We also considered regulation as a possible hindrance to FDI, but for reasons of high correlation with the corruption variable (r = –0.77 for the CPI index, r = –0.75 for WB index), we dropped it from the model.
16. One might argue that the effect of civil service reforms cannot be separated from the effects of anticorruption reforms. We explored this possibility by running alternative models for corruption and FDI with other relevant reforms—namely, access to public information laws, national anticorruption strategies, and asset disclosure laws. The results showed that none of these had a significant independent effect. The results of these additional tests are available from the authors upon request.

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