

Introduction

This paper presents USAID/E&E's system for monitoring country progress in the twenty-nine transition country region.¹ It is the ninth update of the original January 1997 report. As in past editions, transition progress is tracked along four primary dimensions: (1) economic reforms; (2) democratization; (3) economic performance (which includes economic structure and macroeconomic conditions); and (4) human capital (or social conditions). An important objective of this report and the *Monitoring Country Progress (MCP)* system is to provide criteria for graduation of transition countries from U.S. government assistance, and, more generally, to provide guidelines in optimizing the allocation of USG resources in the region.²

Salient findings for each of the four primary dimensions are articulated in the main body of the report below. Three appendices follow: *Appendix 1* provides elaboration of indicator definitions and sources; *Appendix 2* defines the transition country classification schemes that are used in the report; and *Appendix 3* includes a visual "gap analysis" for each of the twenty-nine countries.

Findings

Economic reforms

Progress in economic reforms is measured by the EBRD's transition indicators (*Tables 1 & 2* and *Figure 1*) and the World Bank's *Doing Business* indicators (*Table 3* and *Figure 2*). The former indicators attempt to measure macro policy reforms; the latter group of indicators attempts to address micro business environment reforms.

Nine indicators are drawn from the EBRD and grouped into two stages of reform. The first stage reforms consist of liberalization of prices, external trade and foreign currency reforms, and privatization of small-scale and large-scale units (*Table 1*).³ The second stage reforms consist of enterprise restructuring (credit and subsidy policy), competition policy, financial sector reforms (including banking and capital markets), and reforms in infrastructure (*Table 2*). In general, whereas much of the first stage reforms focus on liberalizing the economy from government intervention or ownership, second stage reforms concentrate in large part on building a government's capacity to govern; that is, reconstructing a leaner and more efficient government capable of enforcing the rules and providing the public goods needed for a vibrant market economy to work.

Progress in 2005 in economic reforms was comparable to the pace of reforms in recent years. Eighteen of twenty-nine transition countries advanced in 2005 in at least one reform dimension. Serbia made the greatest advancement, moving forward on four indicators: trade liberalization; large-scale privatization; enterprise governance; and bank reform. Armenia advanced in three areas: large-scale privatization; competition policy; and bank reform. Seven other countries advanced in two dimensions.

In contrast, Russia backslid on large-scale privatization (though it also moved forward on banking reform). This was the only measurable backsliding in economic reform throughout the transition region in 2005 by EBRD's count. Nevertheless, given that it occurred in Russia, it is

notable. As stated by the EBRD, “Russia has largely stalled with reform, having once been the standard bearer for the CIS....As a result of increased state interventions in a range of key economic areas, the privatization process in Russia suffered a significant setback over the last year.”⁴

In general, progress in second stage economic reforms exceeded first stage economic reform gains in the transition region, in no small part because first stage reforms are complete or close to being complete in the large majority of transition countries. Most of the forward movement in first stage reforms occurred in Eurasia, much of such gains occurred in large-scale privatization. Most of the gains in second stage reforms occurred in the Northern Tier CEE countries, much of this in enterprise governance and financial sector reforms. Hence, in contrast to trends in recent years, the Southern Tier CEE countries did not lead the three sub-regions in progress in economic reforms in 2005.

Figure 1 highlights the pace of economic reforms (first and second stage combined) in the three primary transition regions since 1989. It also disaggregates Eurasia into reforming and non-reforming countries.⁵ The trends show slower progress in recent years in the Northern Tier CEE and in Eurasia, as compared to the early 1990s. Economic reform progress among the Eurasian non-reformers has stagnated since 1995. Economic reform progress among the Southern Tier CEE countries on average has appeared to be much more linear or stable over time. However, the overall Southern Tier CEE trend masks large individual country variations in the sub-region: some countries moved forward impressively early on only to stall more recently (such as Romania at least through 2003); other countries, in no small part due to wars, did not start the economic reform process until the mid-to-late 1990s (Bosnia-Herzegovina and Serbia & Montenegro are the salient cases).

Figure 1 also shows that the Northern Tier CEE countries are well out front and have remained well out front of the rest of the countries in progress in economic reforms since the transition began. However, notwithstanding the 2005 trends, the economic reform gap between the Northern Tier and Southern Tier CEE countries is smaller today than it was in the mid 1990s. The Eurasian countries do not seem to be closing the economic reform gap vis-à-vis Central and Eastern Europe.

Table 3 and *Figure 2* highlight microeconomic reform trends; i.e., indicators which attempt to capture the business environment. Data are from the World Bank’s *Doing Business* (third) annual report, which includes 155 countries and ten aspects of the business environment in 2005: starting a business; dealing with licenses; hiring and firing workers; registering property; getting credit; protecting investors; paying taxes; trading across borders; enforcing contracts; and closing a business.⁶ The transition countries’ rank on average is roughly the worldwide average (i.e., seventy-five out of 155 countries). The range of results in the transition region is very large: Lithuania and Estonia have among the most business friendly environments worldwide by these measures (ranking fifteen and sixteen, respectively); enterprises in Uzbekistan confront some of the highest business environment obstacles worldwide (i.e., Uzbekistan ranks 138, close to Egypt, 141, not far from the Congo, 155, characterized by having the worst overall business environment). Five of the top ten reformers worldwide in 2004 (i.e., countries which made the greatest gains across the ten dimensions) are in the transition region.

Serbia & Montenegro ranked first on this score, advancing in eight out of ten areas. Georgia was second alongside Vietnam, advancing in five areas. Slovakia, Romania, and Latvia all advanced in four areas (*Figure 3*).

There is general correspondence between these *Doing Business* micro economic reform results with the macro reform results of the EBRD: the Northern Tier CEE countries are farthest along; most of the Eurasian countries lag behind the CEE countries (*Figure 4*). Croatia is the salient outlier. According to the *Doing Business* scores, of all the transition countries only Uzbekistan and Ukraine rank lower than Croatia on microeconomic reform progress. The EBRD measures, in contrast, show much greater relative economic reform progress for Croatia, ranking eighth out of twenty-nine overall by EBRD's count.

TABLE 1. FIRST STAGE ECONOMIC POLICY REFORMS IN 2005							1ST STAGE		
	TRADE		SMALL SCALE		LARGE SCALE		PRICE	1ST STAGE	
	LIBERALIZATION		PRIVATIZATION		PRIVATIZATION		LIBERALIZATION	AVERAGE	
CZECH REPUBLIC	5.0		5.0		4.0		5.0	4.8	
ESTONIA	5.0		5.0		4.0		5.0	4.8	
HUNGARY	5.0		5.0		4.0		5.0	4.8	
LITHUANIA	5.0		5.0		4.0	↑	5.0	4.8 ↑	
SLOVAK REPUBLIC	5.0		5.0		4.0		5.0	4.8	
LATVIA	5.0		5.0		3.7		5.0	4.7	
POLAND	5.0		5.0		3.3		5.0	4.6	
ARMENIA	5.0		4.0		3.7	↑	5.0	4.4 ↑	
BULGARIA	5.0		3.7		4.0		5.0	4.4	
GEORGIA	5.0		4.0		3.7	↑	5.0	4.4 ↑	
KYRGYZ REPUBLIC	5.0		4.0		3.7		5.0	4.4	
ROMANIA	5.0		3.7		3.7		5.0	4.3	
CROATIA	5.0		5.0		3.3		4.0	4.3	
ALBANIA	5.0		4.0		3.0		5.0	4.3	
SLOVENIA	5.0		5.0		3.0		4.0	4.3	
MACEDONIA	5.0		4.0		3.3		4.0	4.1	
MOLDOVA	5.0		3.7		3.0		3.7	3.8	
KAZAKHSTAN	3.3		4.0		3.0		4.0	3.6	
RUSSIA	3.3		4.0		3.0	↓	4.0	3.6 ↓	
UKRAINE	3.3	↑	4.0		3.0		4.0	3.6 ↑	
MONTENEGRO	3.7		3.0		3.3	↑	4.0	3.5	
SERBIA	3.7	↑	3.3		2.7	↑	4.0	3.4 ↑	
AZERBAIJAN	4.0	↑	3.7		2.0		4.0	3.4 ↑	
BOSNIA AND HERZEGOVINA	3.7		3.0		2.7	↑	4.0	3.3 ↑	
TAJKISTAN	3.3		4.0	↑	2.3		3.7	3.3 ↑	
KOSOVO	3.7		3.0	↑	1.0		4.0	2.9	
UZBEKISTAN	2.0	↑	3.0		2.7		2.7	2.6 ↑	
BELARUS	2.3		2.3		1.0		2.7	2.1	
TURKMENISTAN	1.0		2.0		1.0		2.7	1.7	
CEE & EURASIA	4.2		4.0		3.1	↑	4.3	3.9	
NORTHERN TIER CEE	5.0		5.0		3.8	↑	4.9	4.7	
SOUTHERN TIER CEE	4.6		3.8		3.2	↑	4.4	4.0	
EURASIA	3.6	↑	3.6	↑	2.7	↑	3.9	3.4 ↑	
INDUSTRIAL COUNTRIES	5.0		5.0		5.0		5.0	5.0	
ROMANIA & BULGARIA 2002	4.5		3.7		3.5		5.0	4.2	
NORTH. TIER CEE AT GRADUATION	4.8		4.9		3.5		4.5	4.4	

Ratings are based on a 1 to 5 scale, with 5 being most advanced. A "↑" indicates an advancement from September 2004 to September 2005.

EBRD, *Transition Report 2005* (November 2005).

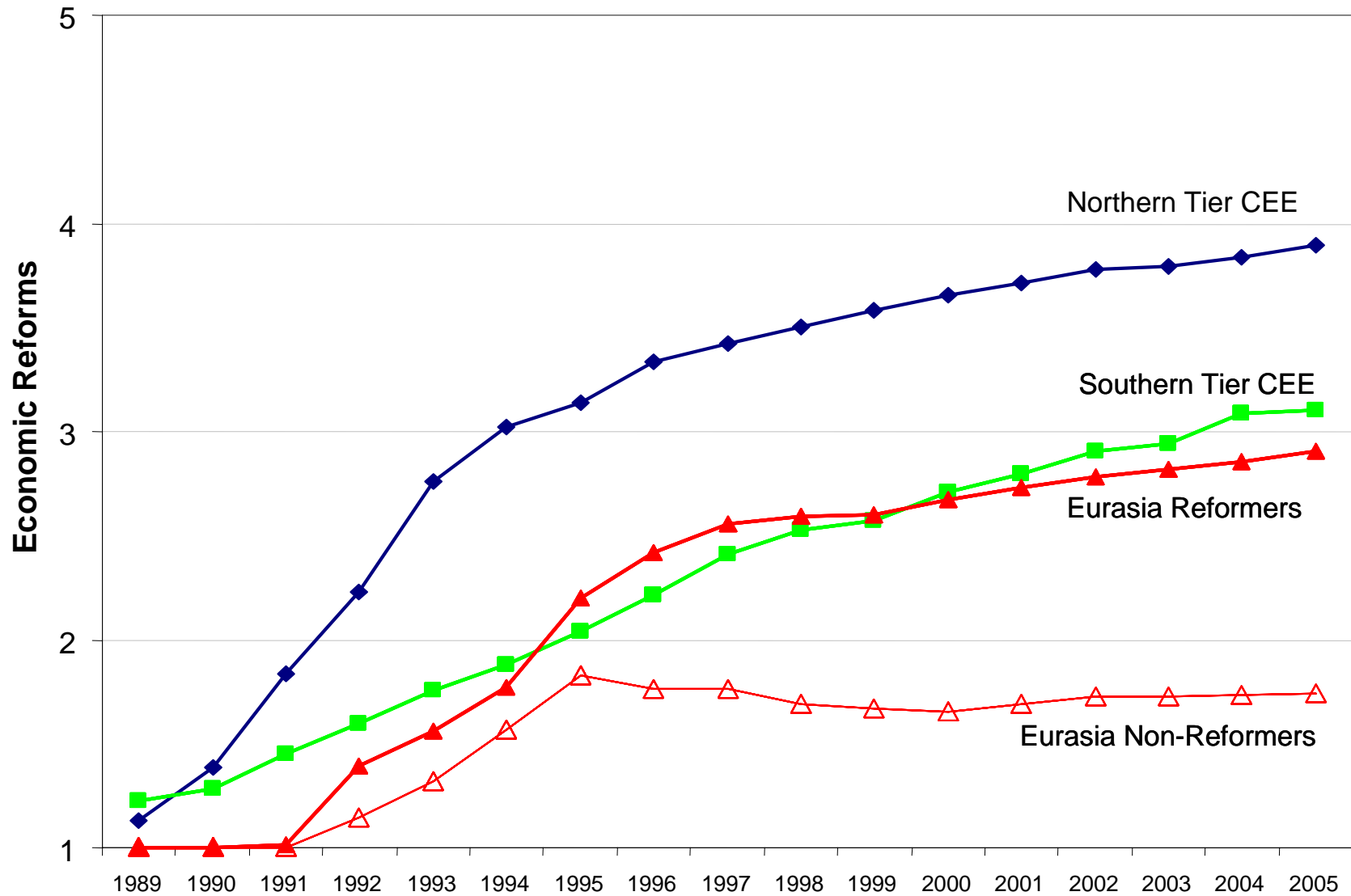
TABLE 2. SECOND STAGE ECONOMIC POLICY REFORMS IN 2005												
	ENTERPRISE		COMPETITION		BANK		CAPITAL		INFRASTRUCTURE		2ND STAGE	
	GOVERNANCE		POLICY		REFORM		MKT. REFORM		REFORM		AVERAGE	
HUNGARY	3.7	↑	3.0		4.0		4.0	↑	3.7		3.7	↑
POLAND	3.7	↑	3.0		3.7	↑	3.7		3.3		3.5	↑
CZECH REPUBLIC	3.3		3.0		4.0	↑	3.7	↑	3.3		3.5	↑
ESTONIA	3.7	↑	2.7		4.0		3.3		3.3		3.4	↑
SLOVAK REPUBLIC	3.7	↑	3.0		3.7		2.7		3.0		3.2	↑
LATVIA	3.0		2.7		3.7		3.0		3.0		3.1	
LITHUANIA	3.0		3.0		3.7	↑	3.0		2.7		3.1	↑
CROATIA	3.0		2.3		4.0		2.7		3.0		3.0	
SLOVENIA	3.0		2.7		3.3		2.7		3.0		2.9	
BULGARIA	2.7		2.7	↑	3.7		2.3		3.0		2.9	↑
ROMANIA	2.3	↑	2.3		3.0		2.0		3.3		2.6	↑
RUSSIA	2.3		2.3		2.3	↑	2.7		2.7		2.5	↑
ARMENIA	2.3		2.3	↑	2.7	↑	2.0		2.3		2.3	↑
KAZAKHSTAN	2.0		2.0		3.0		2.3		2.3		2.3	
UKRAINE	2.0		2.3		2.7	↑	2.3		2.0		2.3	↑
GEORGIA	2.3	↑	2.0		2.7		1.7		2.3		2.2	↑
MOLDOVA	2.0	↑	2.0		2.7		2.0		2.3	↑	2.2	↑
MACEDONIA	2.3		2.0		2.7		2.0		2.0		2.2	
ALBANIA	2.0		2.0		2.7		1.7		2.0		2.1	
AZERBAIJAN	2.3		2.0		2.3		1.7		2.0		2.1	
SERBIA	2.3	↑	1.0		2.7	↑	2.0		2.0		2.0	↑
KYRGYZ REPUBLIC	2.0		2.0		2.3		2.0		1.7		2.0	
BOSNIA AND HERZ.	2.0		1.0		2.7		1.7		2.3		1.9	
UZBEKISTAN	1.7		1.7		1.7		2.0		1.7		1.7	
BELARUS	1.0		2.0		1.7		2.0		1.3		1.6	
MONTENEGRO	2.0		1.0		2.3		1.7		1.0		1.6	
TAJIKISTAN	1.7		1.7		2.0		1.0		1.3		1.5	
KOSOVO	1.7		1.7	↑	2.0		1.0		1.0		1.5	
TURKMENISTAN	1.0		1.0		1.0		1.0		1.0		1.0	
CEE & EURASIA	2.4	↑	2.1		2.9	↑	2.3		2.3		2.4	↑
NORTHERN TIER CEE	3.4	↑	2.9		3.8	↑	3.3	↑	3.2		3.3	↑
SOUTHERN TIER CEE	2.3		1.9	↑	3.0		2.0		2.4		2.3	↑
EURASIA	1.9	↑	1.9		2.3	↑	1.9		1.9		2.0	↑
INDUSTRIAL COUNTRIES	5.0		5.0		5.0		5.0		5.0		5.0	
ROMANIA & BULG. 2002	2.2		2.3		3.0		2.2		2.9		2.5	
NORTHERN TIER CEE AT GRADUATION	2.9		2.6		3.2		2.8		2.7		2.8	

Ratings are based on a 1 to 5 scale, with 5 being most advanced. A "↑" indicates an advancement from September 2004 to September 2005.

EBRD, *Transition Report 2005* (November 2005).

Economic Reform

Figure 1



Ratings are based on a 1 to 5 scale, with 5 representing most advanced. EBRD, *Transition Report 2005* (November 2005 and earlier editions). Eurasia non-reformers include Uzbekistan, Belarus & Turkmenistan.

TABLE 3: DOING BUSINESS IN 2005

	<u>STARTING A BUSINESS</u>		<u>CLOSING A BUSINESS</u>		DIFFICULTY OF HIRING (0-100)**	DIFFICULTY OF FIRING (0-100)**	DOING BUSINESS RANK*
	TIME (DAYS)	COST	TIME (YEARS)	COST			
		(% INCOME PER CAPITA)		(% ESTATE)			
LITHUANIA	26	3	1	7	33	40	15
ESTONIA	35	6	3	9	33	40	16
LATVIA	18	4	1	4	67	70	26
SLOVAKIA	25	5	5	18	17	40	37
CZECH REPUBLIC	40	10	9	14	33	20	41
ARMENIA	25	6	2	4	17	70	46
HUNGARY	38	22	2	14	11	20	52
POLAND	31	22	1	22	11	40	54
BULGARIA	32	10	3	9	61	10	62
SLOVENIA	60	10	4	14	61	50	63
ROMANIA	11	5	5	9	67	50	78
RUSSIA	33	5	4	9	0	30	79
MACEDONIA	48	11	4	28	61	40	81
MOLDOVA	30	17	3	9	33	70	83
KYRGYZ REPUBLIC	21	10	4	4	33	40	84
KAZAKHSTAN	24	9	3	18	0	10	86
BOSNIA & HERZ.	54	41	3	9	56	30	87
SERBIA & MONT	15	6	3	23	44	40	92
AZERBAIJAN	115	13	3	8	33	40	98
GEORGIA	21	14	3	4	0	70	100
BELARUS	79	23	6	22	0	40	106
ALBANIA	41	31	4	38	44	20	117
CROATIA	49	13	3	14	61	50	118
UKRAINE	34	11	3	42	44	80	124
UZBEKISTAN	35	16	4	4	33	30	138
CEE & EURASIA	38	13	3	14	34	42	75
NORTHERN TIER CEE	34	10	3	13	33	40	38
SOUTHERN TIER CEE	36	17	4	19	56	34	91
EURASIA	42	12	3	12	19	48	94

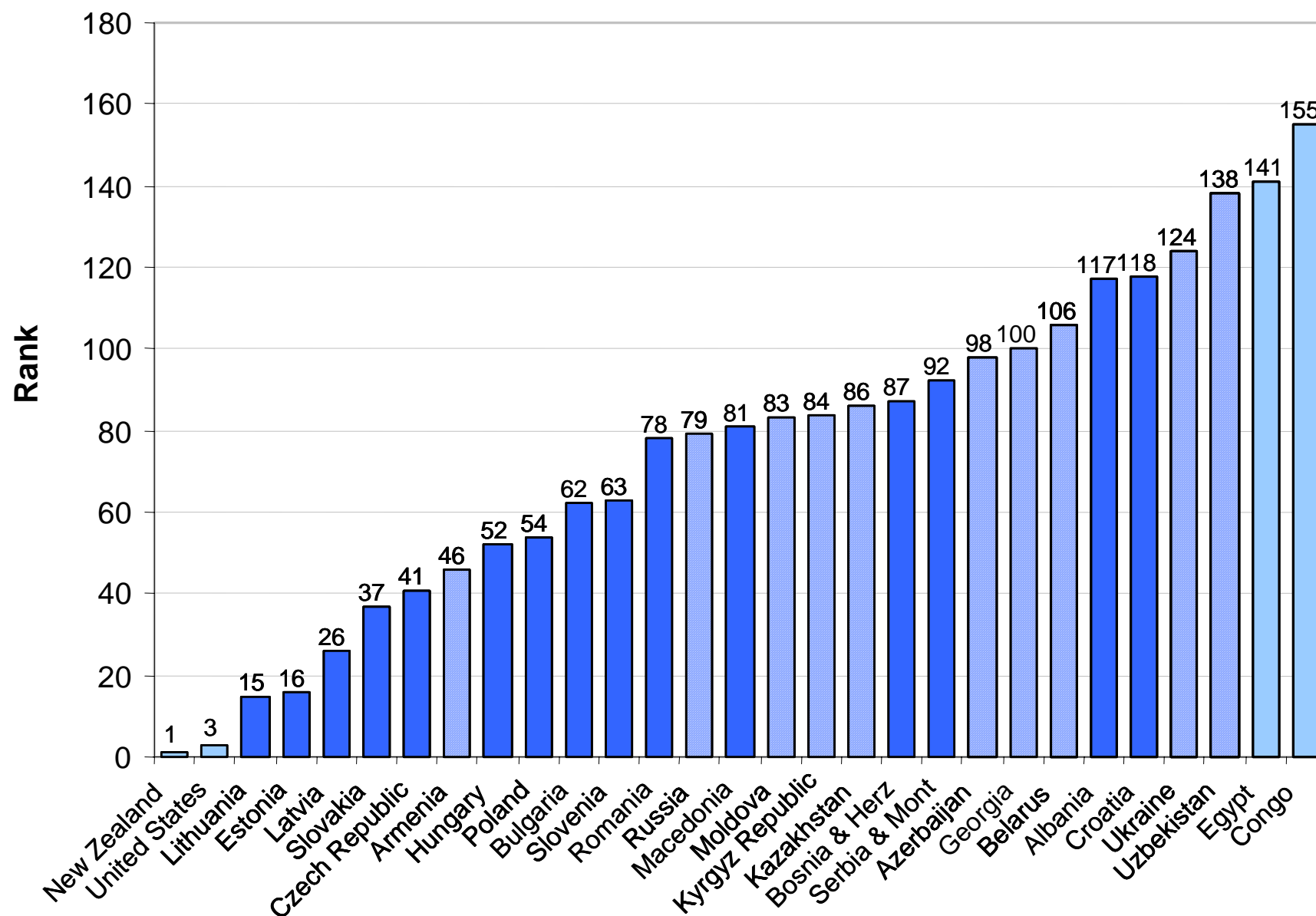
World Bank, *Doing Business in 2006* (September 2005).

* Worldwide scores range from 1 to 155 and include 10 topics: starting a business, dealing with licenses, hiring and firing workers, registering a property, getting credit, protecting investors, paying taxes, trading across borders, enforcing contracts, closing a business.

** The higher the score, the more difficult to hire (or fire).

Figure 2

Business Environment in 2005



World Bank, *Doing Business in 2006* (September 2005). Worldwide scores range from 1 to 155 and include 10 topics: starting a business, dealing with licenses, hiring and firing workers, registering a property, getting credit, protecting investors, paying taxes, trading across borders, enforcing contracts, closing a business.

Figure 3 **Greatest Reform Progress in Business Environment in 2004**

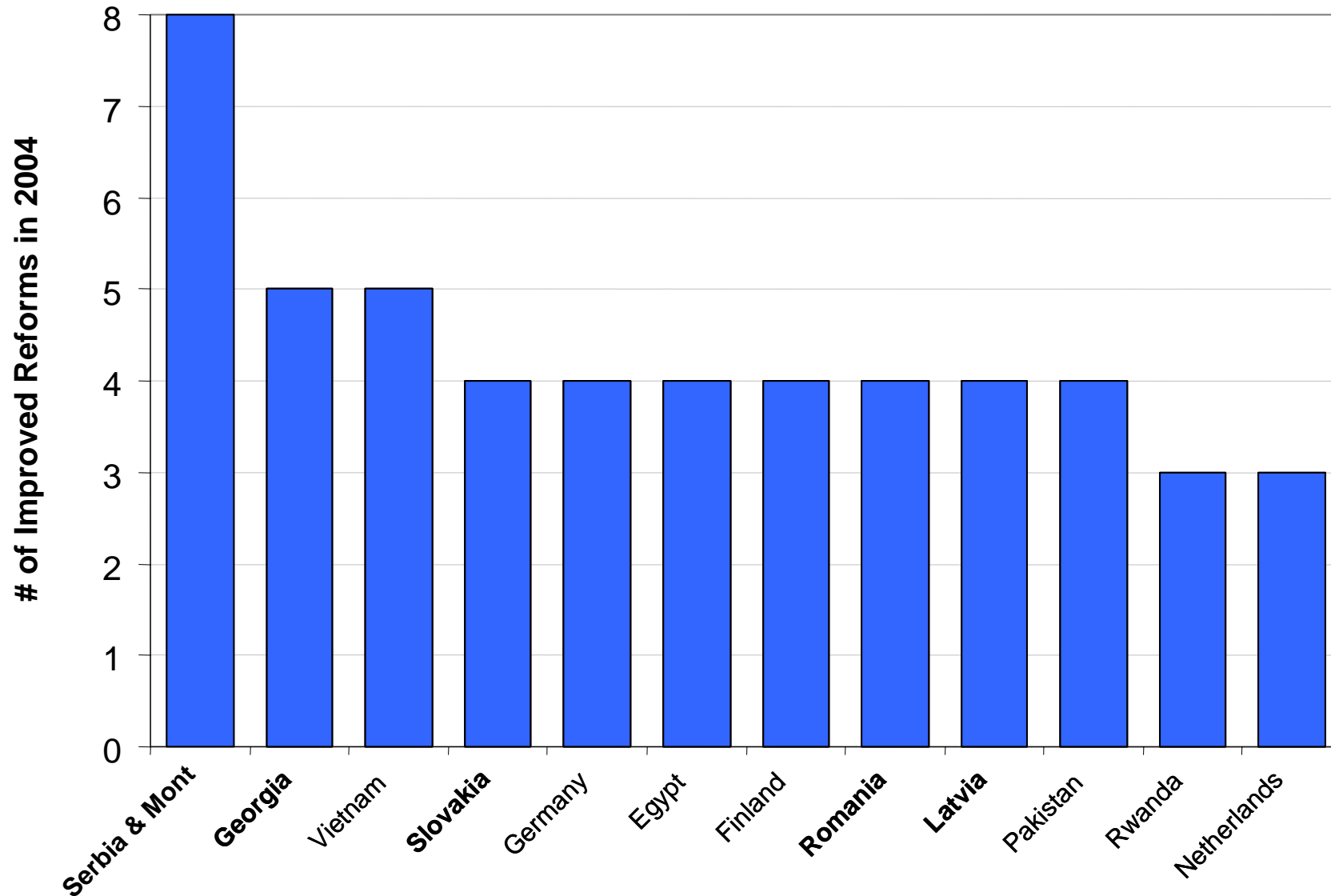
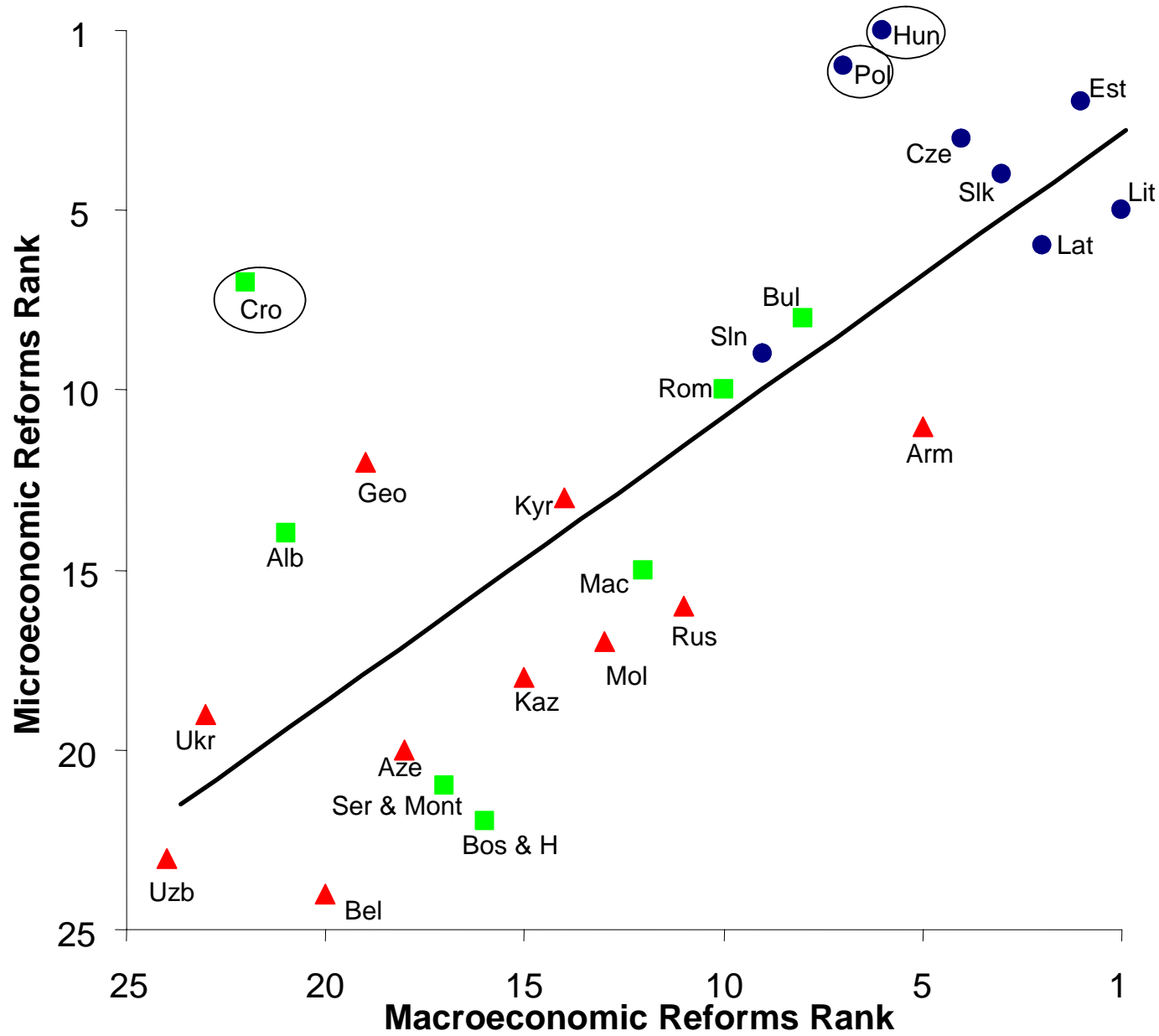


Figure 4

Economic Reforms Compared



EBRD, *Transition Report* (October 2005); World Bank, *Doing Business in 2006* (2006).