

Economic and democratic reforms combined

Figure 9 provides an overall picture of the status of the economic and democratic reforms in the transition countries in 2005. The economic reform ratings are an equally weighted average of all nine EBRD transition indicators (that is, both stages from *Tables 1* and *2*). The democratic reform ratings are calculated from the average of the seven democratic reform components in 2005 as shown in *Table 4*. *Table 6* tabulates these aggregate economic and democratic reform scores and ranks the countries on both dimensions.

These data show that progress in economic and democratic reforms in the transition region varies greatly, ranging from that found in Hungary, Estonia, and Poland at one end of the reform spectrum to Turkmenistan, Belarus, and Uzbekistan at the other end. The three primary sub-regions have relatively distinct reform profiles, particularly in terms of progress in democratization. Moreover, the data shown in *Figure 9* suggests a further differentiation of countries within Eurasia; the three Eurasian non-reformers lag behind virtually all the other countries on both reform dimensions.

There are two notable geographic outliers: Kosovo's reform progress is closer to Eurasian standards, while Ukraine's is closer to Southern Tier CEE standards. In addition, the cohesiveness or homogeneity of these reform profiles differ among the three sub-regions: the Northern Tier CEE countries are much more clustered (i.e., have a relatively homogeneous reform profile), while the Eurasian countries are much more dispersed than either of the two CEE sub-regions (and in fact arguably consist of two sub-groups).

Figure 10 shows the reform picture in 1998. It is starkly different than the 2005 picture. The Northern Tier CEE countries were much less homogeneous in 1998, and there was considerably more overlap in the range in reform progress between the Southern Tier CEE countries and Eurasia than exists today. Since 1998, most of the countries across the three sub-regions moved forward on economic reforms, while on democracy, the gap between CEE and Eurasia widened notably.

Figures 11-18 explore in greater detail the relationship between economic and democratic reforms in the transition region.⁹ *Figures 11-13* show times series trends by sub-region, and two distinct patterns. In CEE, economic and democratic reforms are generally advancing together (*Figures 11* and *12*). Democratic reforms have been farther along in both CEE sub-regions, though economic reforms are catching up, and in the case of the Southern Tier CEE, convergence has occurred.

The pattern in Eurasia, however, has been very different (*Figure 13*). Democratic reforms were farther along than economic reforms in the early part of the transition in Eurasia. However, by the mid-1990s economic reform progress matched democratic reform progress and since then economic reforms have continued to advance while democratic reforms have regressed. In other words, divergence between the two reform dimensions has been the salient trend since 1995 in Eurasia.

Reform trends in Ukraine, Georgia, and Kyrgyz Republic are highlighted in *Figures 14-16*

to underscore the reform patterns where democratic “revolutions” have recently taken place. Of the three countries, Ukraine stands out as having had the most reform gains leading up to the (Orange) revolution and thereafter. In Georgia, democratic reform trends were mixed in 2004, the year following the Rose revolution, though good progress was made in both economic and democratic reforms in 2005. Based on the two sets of Freedom House data, recent reform trends in Kyrgyz Republic are not clear. Freedom House’s *Nations in Transit* data show little forward movement in reforms in Kyrgyz Republic since the Tulip Revolution in the spring 2004. In contrast, Freedom House has Kyrgyz Republic advancing in both political rights and civil liberties in 2005 from its global *Freedom in the World* dataset.

Apparent trends between economic and democratic reforms across the region (as shown in *Figures 14-16*) were also compared with results from econometric tests which attempted to take stock of other possible intervening influences as well as direction of causality. *Figures 17 and 18* show some of the key results of a subset of such tests. These tests also tried to assess the relationship between the two reform dimensions and economic growth.¹⁰

Three basic regressions were developed and tested for four data sets: (1) the full sample of twenty-seven countries¹¹; (2) the Northern Tier CEE countries; (3) Southern Tier CEE; and (4) Eurasia. Each data set was a panel design i.e., cross-country observations were combined with annual time series, from 1989-2004.

The model consists of three basic regressions:

- (1) democratic reforms (at time t) were regressed on democratic reforms three years prior ($t-3$), economic reforms three years prior, economic growth one year prior, GDP per capita in 1990 (a proxy for “initial conditions”), a dummy variable to account for war years, and a dummy variable for time (a proxy for residual influences on the dependent variable);
- (2) economic reforms (at time t) regressed on economic reforms three years prior, democratic reforms three years prior, economic growth one year prior, GDP per capita in 1990, a dummy variable to account for war years, a dummy variable for time; and
- (3) economic growth regressed on democratic reforms three years prior, economic reforms three years prior, GDP per capita 1990, war, time, education (secondary school enrollment), and macro-economic stability (the inflation rate).

Figures 17 and 18 correspond to the salient results of two of the four samples: the full sample and Eurasia. In these figures, the focus is on the inter-relationships between the three key indicators: economic reforms; democratic reforms; and economic growth. One of four possible outcomes for each relationship for each sample was assessed: either the relationship was positive; negative; not statistically significant; or ambiguous. The finding of ambiguity resulted when test results were inconsistent, though not all statistically insignificant.

Overall, the results (complemented with findings from the empirical literature)¹² provide evidence that: (1) economic and democratic reforms are mutually reinforcing in the transition region; (2) even in Eurasia (despite economic and democratic reform divergence there); (3) economic reforms may have a stronger favorable impact on democratic reforms than the reverse; (4) economic reforms in general favorably affect economic growth (though this relationship is more ambiguous in the case of the Eurasian countries than in CEE); (5) democratic reforms favorably affect economic growth indirectly (via economic reforms) if not directly; and (6) while the feedback effects from economic growth to reforms are more ambiguous, there is some evidence that economic growth may actually stifle democratic reforms, and/or economic contraction may facilitate democratization.¹³

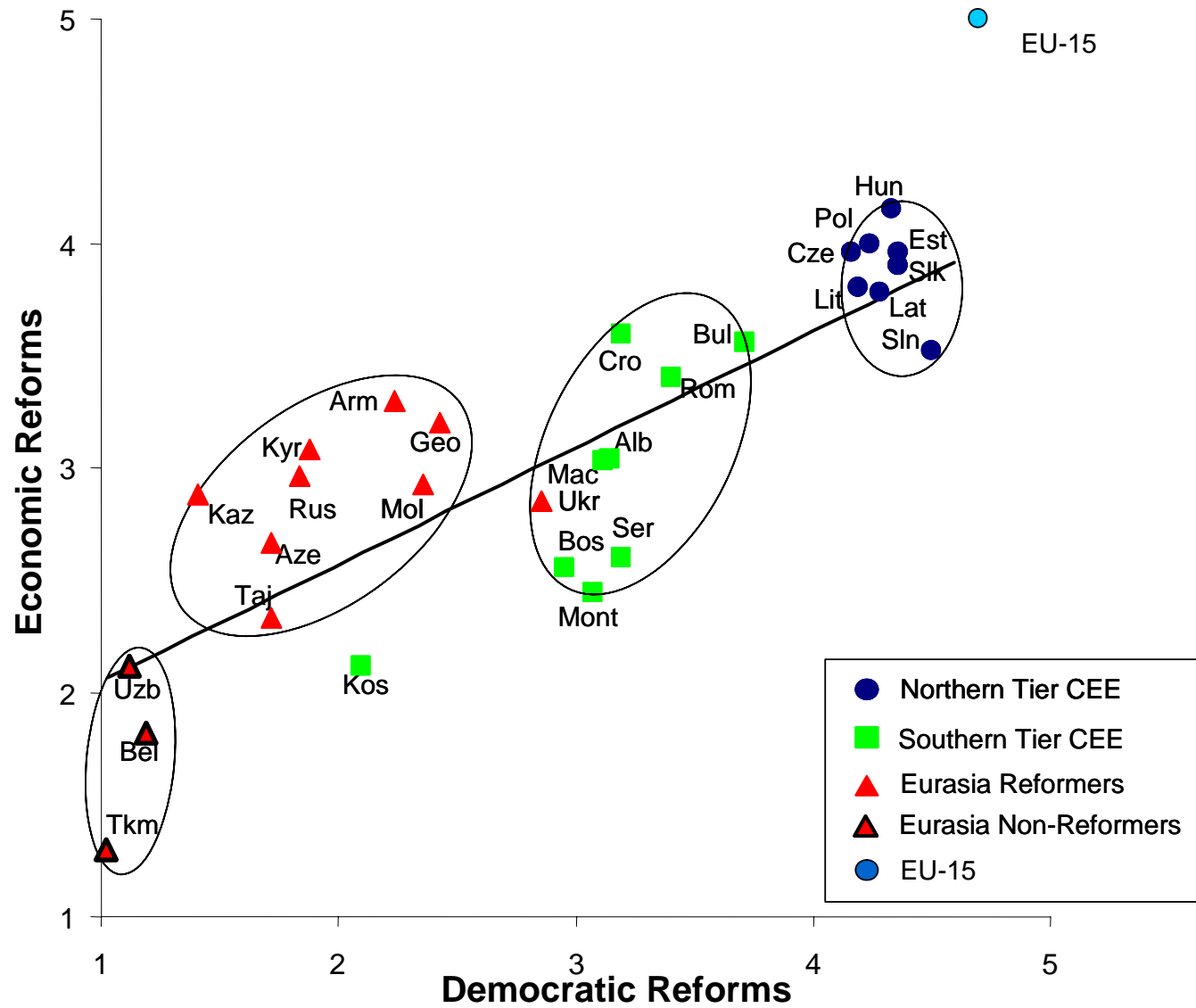
**TABLE 6. ECONOMIC AND DEMOCRATIC REFORMS
IN CENTRAL AND EASTERN EUROPE AND EURASIA: 2005**

	<u>ECONOMIC REFORMS</u>		<u>DEMOCRATIC REFORMS</u>		
	<u>RATING</u> <u>(1 to 5)</u>	<u>RANKING</u>	<u>RATING</u> <u>(1 to 5)</u>	<u>RANKING</u>	
HUNGARY	4.1	1	SLOVENIA	4.5	1
CZECH REPUBLIC	4.0	2	ESTONIA	4.4	2
ESTONIA	4.0	2	SLOVAK REPUBLIC	4.4	2
POLAND	4.0	2	HUNGARY	4.3	4
SLOVAK REPUBLIC	3.9	5	LATVIA	4.3	4
LITHUANIA	3.8	6	POLAND	4.2	6
LATVIA	3.8	6	LITHUANIA	4.2	6
CROATIA	3.6	8	CZECH REPUBLIC	4.2	6
BULGARIA	3.6	8	BULGARIA	3.7	9
SLOVENIA	3.5	10	ROMANIA	3.5	10
ROMANIA	3.4	11	CROATIA	3.2	11
ARMENIA	3.3	12	SERBIA	3.2	11
GEORGIA	3.2	13	MONTENEGRO	3.1	13
KYRGYZ REPUBLIC	3.1	14	MACEDONIA	3.1	13
ALBANIA	3.0	15	ALBANIA	3.1	13
MACEDONIA	3.0	15	BOSNIA AND HERZEGOVINA	3.0	16
RUSSIA	3.0	15	UKRAINE	2.9	17
MOLDOVA	2.9	18	GEORGIA	2.4	18
KAZAKHSTAN	2.9	18	MOLDOVA	2.4	18
UKRAINE	2.9	18	ARMENIA	2.2	20
AZERBAIJAN	2.7	21	KOSOVO	2.1	21
SERBIA	2.6	22	KYRGYZ REPUBLIC	1.9	22
BOSNIA AND HERZEGOVINA	2.6	22	RUSSIA	1.7	23
MONTENEGRO	2.4	24	TAJIKISTAN	1.7	23
TAJIKISTAN	2.3	25	AZERBAIJAN	1.7	23
UZBEKISTAN	2.1	26	KAZAKHSTAN	1.4	26
KOSOVO	2.1	26	UZBEKISTAN	1.1	27
BELARUS	1.8	28	BELARUS	1.2	28
TURKMENISTAN	1.3	29	TURKMENISTAN	1.0	29
	Rating (1 to 5)		Rating (1 to 5)		
CEE & EURASIA	3.1		2.9		
NORTHERN TIER CEE	3.9		4.3		
SOUTHERN TIER CEE	3.1		3.2		
EURASIA	2.6		1.8		
INDUSTRIAL COUNTRIES	5.0		4.8		
NORTHERN TIER CEE AT GRADUATION	3.5		4.3		
ROMANIA & BULGARIA IN 2002	3.4		3.4		

Ratings are based on a 1 to 5 scale, with 5 representing most advanced.
USAID calculations drawing from Freedom House, *Nations in Transit 2005 (2006)*
and EBRD, *Transition Report 2005 (November 2005)*.

Economic and Democratic Reforms in 2005

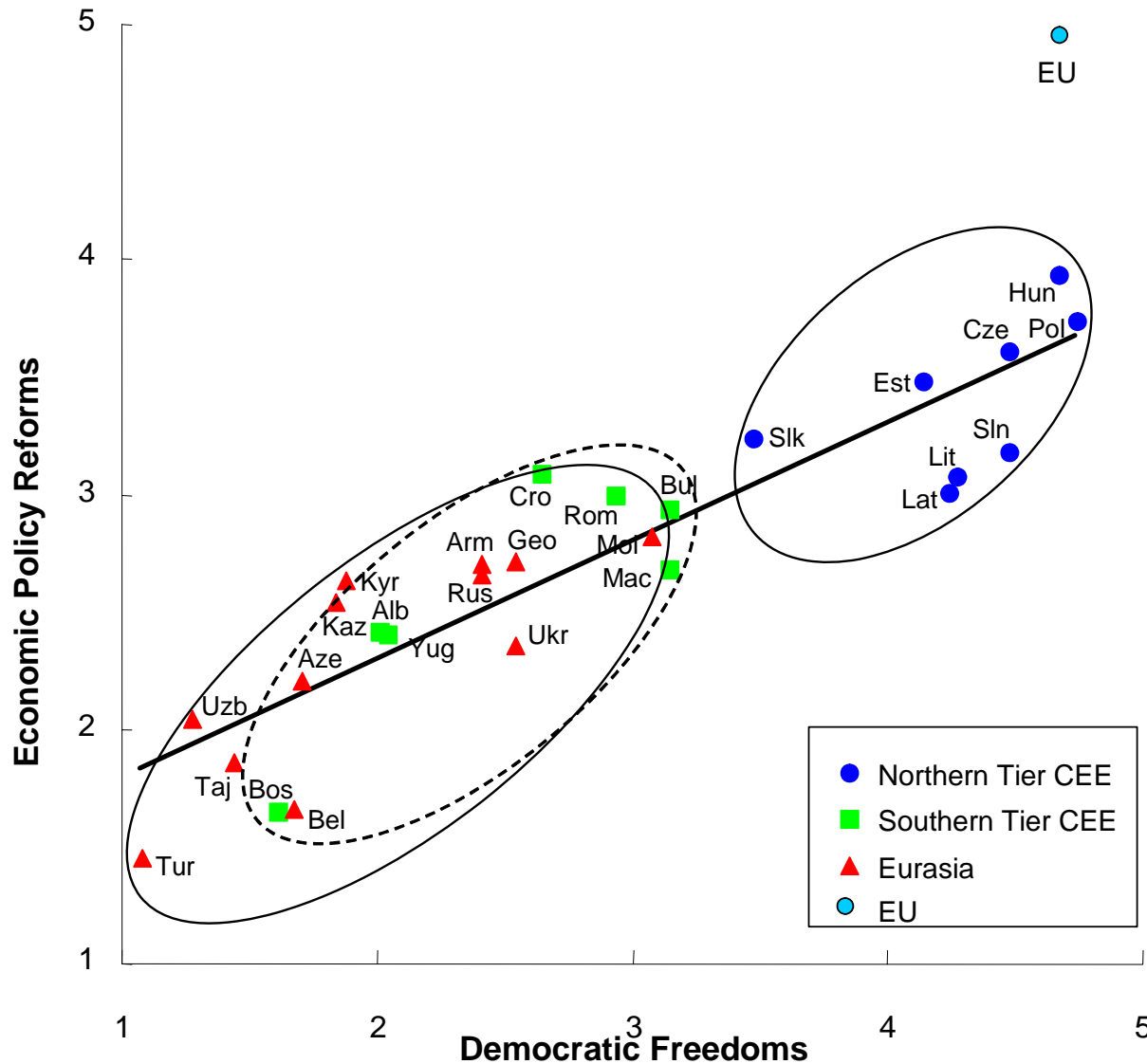
Figure 9



Ratings are based on a 1 to 5 scale, with 5 representing most advanced. Freedom House, *Nations in Transit 2005* (2005), *Freedom in the World 2006* (2005), and EBRD, *Transition Report 2005* (November 2005).

Figure 10

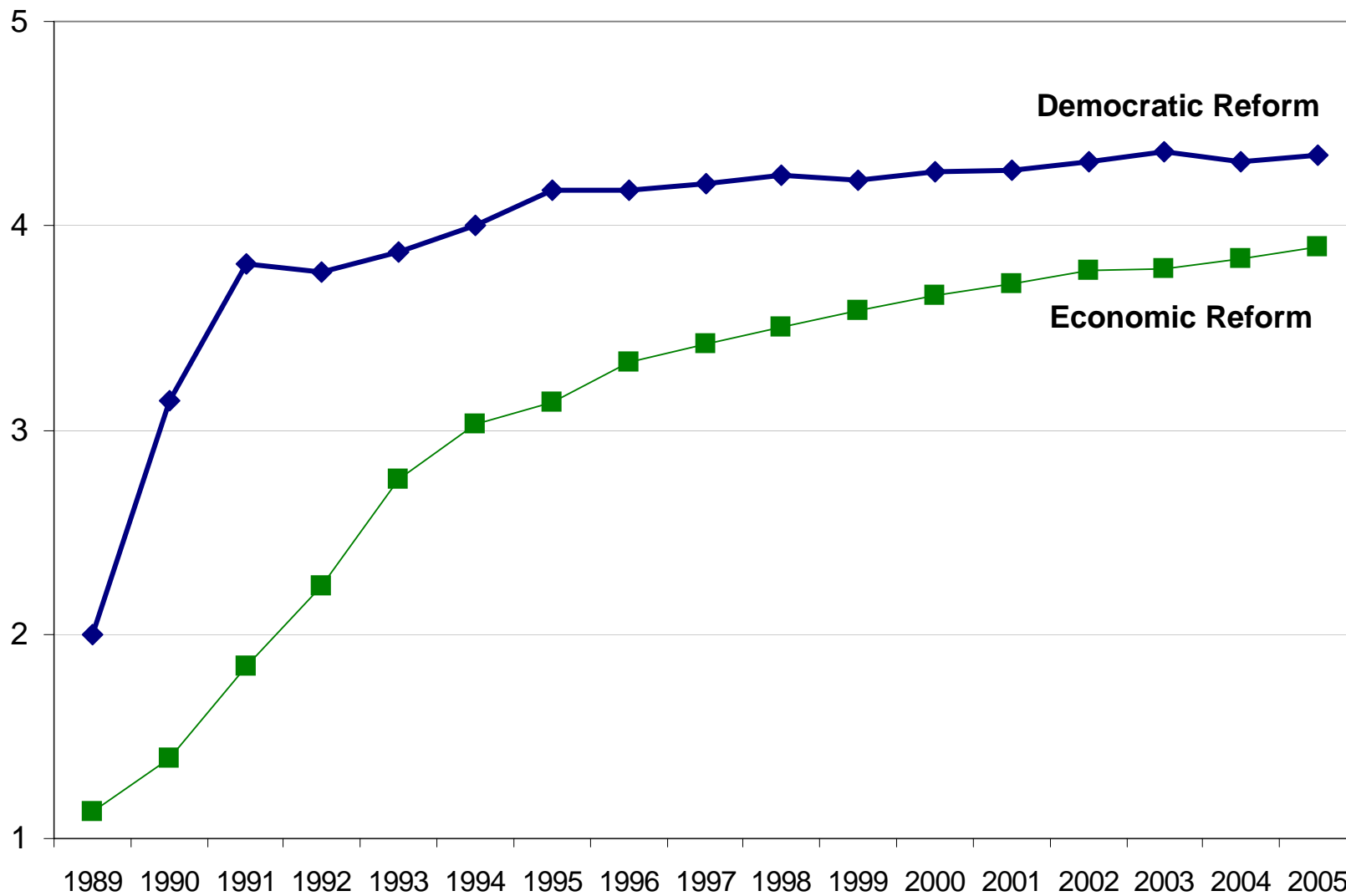
Economic and Democratic Reforms in 1998



Ratings of democratic freedoms are from Freedom House, *Nations in Transit 1998* (October 1998) and Freedom House, *Freedom in the World 1998-1999* (June 1999), and assess reforms through December 1998. With 1 exception, economic policy reform ratings are from EBRD, *Transition Report 1998* (November 1998), and cover events through early September 1998; economic policy reform rating for Yugoslavia is from Freedom House (October 1998). Ratings are based on a 1 to 5 scale, with 5 representing most advanced.

Figure 11

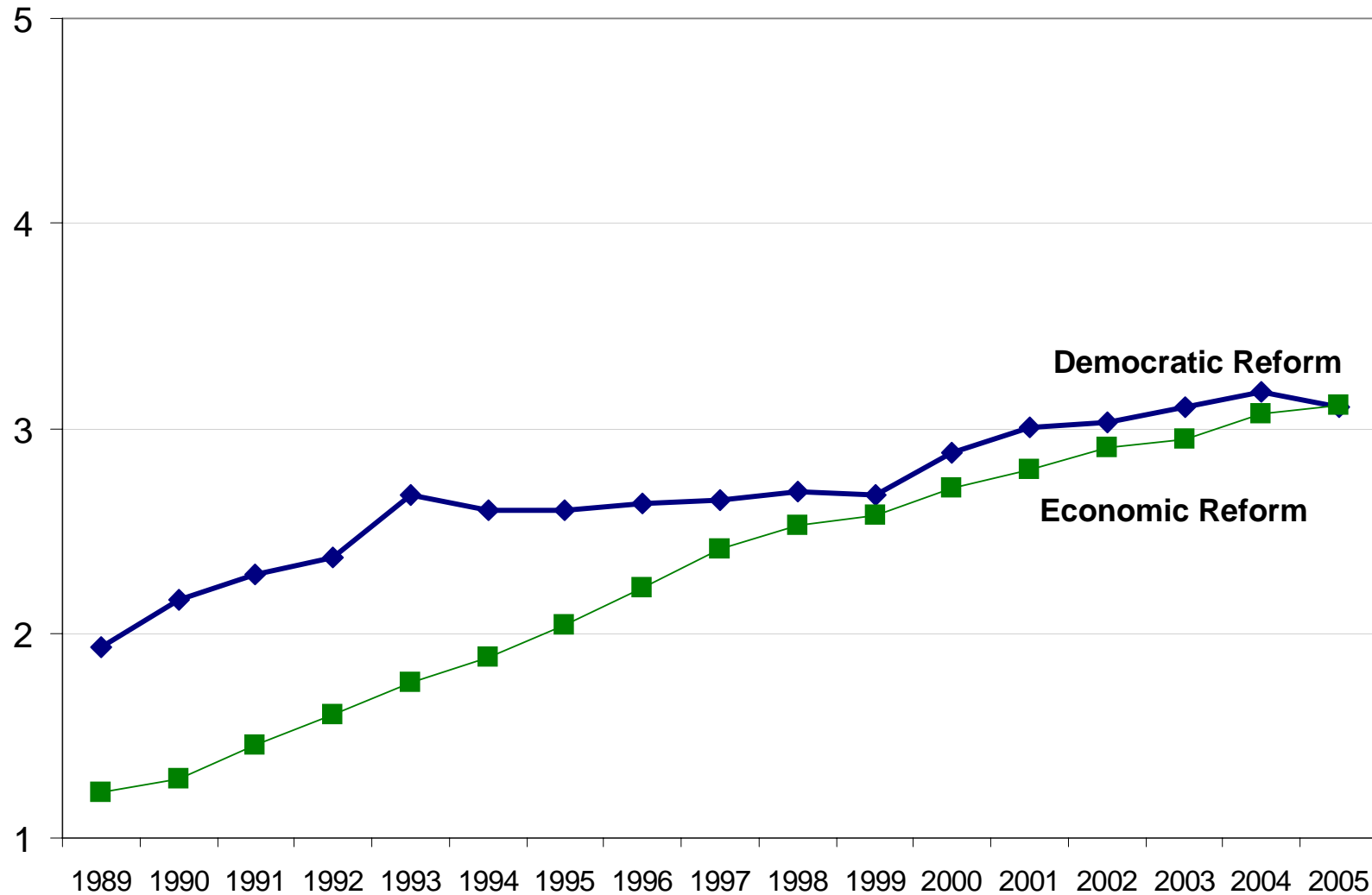
Economic and Democratic Reforms in the Northern Tier CEE



Ratings are based on a 1 to 5 scale, with 5 representing most advanced. USAID calculations drawing from Freedom House, *Nations in Transit 2006* (2006) and EBRD, *Transition Report 2005* (November 2005).

Figure 12

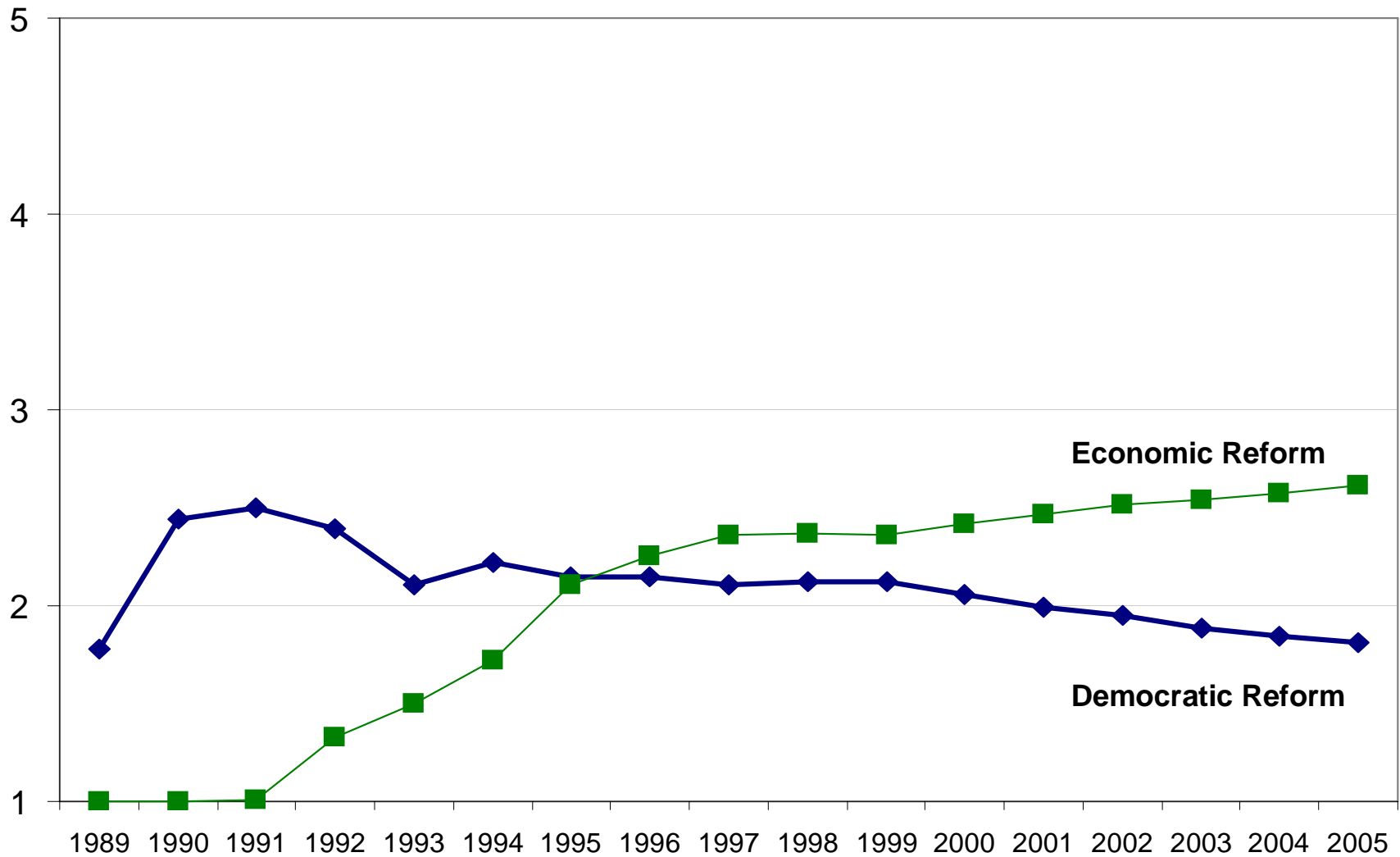
Economic and Democratic Reforms in the Southern Tier CEE



Ratings are based on a 1 to 5 scale, with 5 representing most advanced. USAID calculations drawing from Freedom House, *Nations in Transit 2006 (2006)* and EBRD, *Transition Report 2005 (November 2005)*.

Figure 13

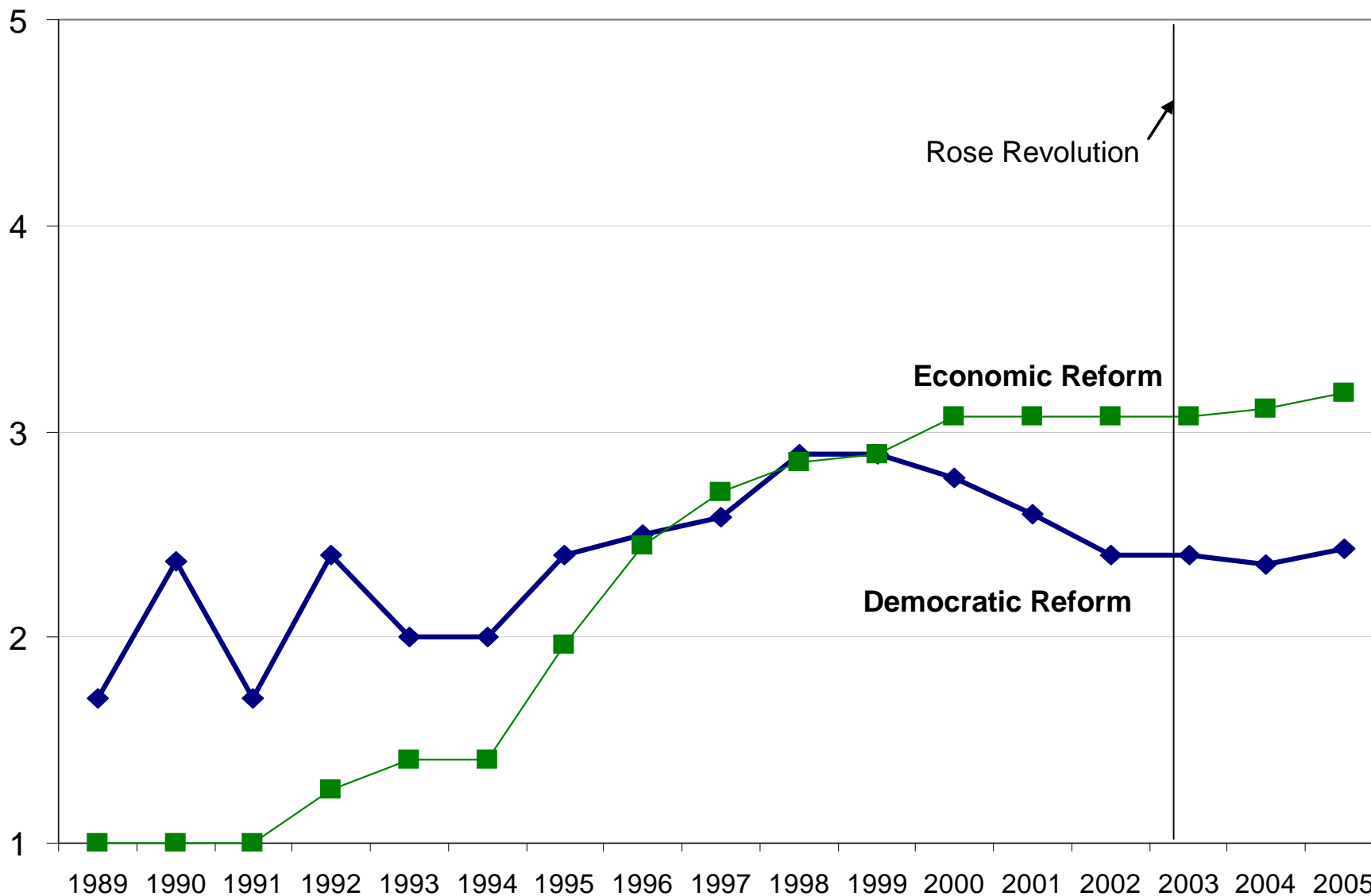
Economic and Democratic Reforms in Eurasia



Ratings are based on a 1 to 5 scale, with 5 representing most advanced. USAID calculations drawing from Freedom House, *Nations in Transit 2006* (2006) and EBRD, *Transition Report 2005* (November 2005).

Figure 14

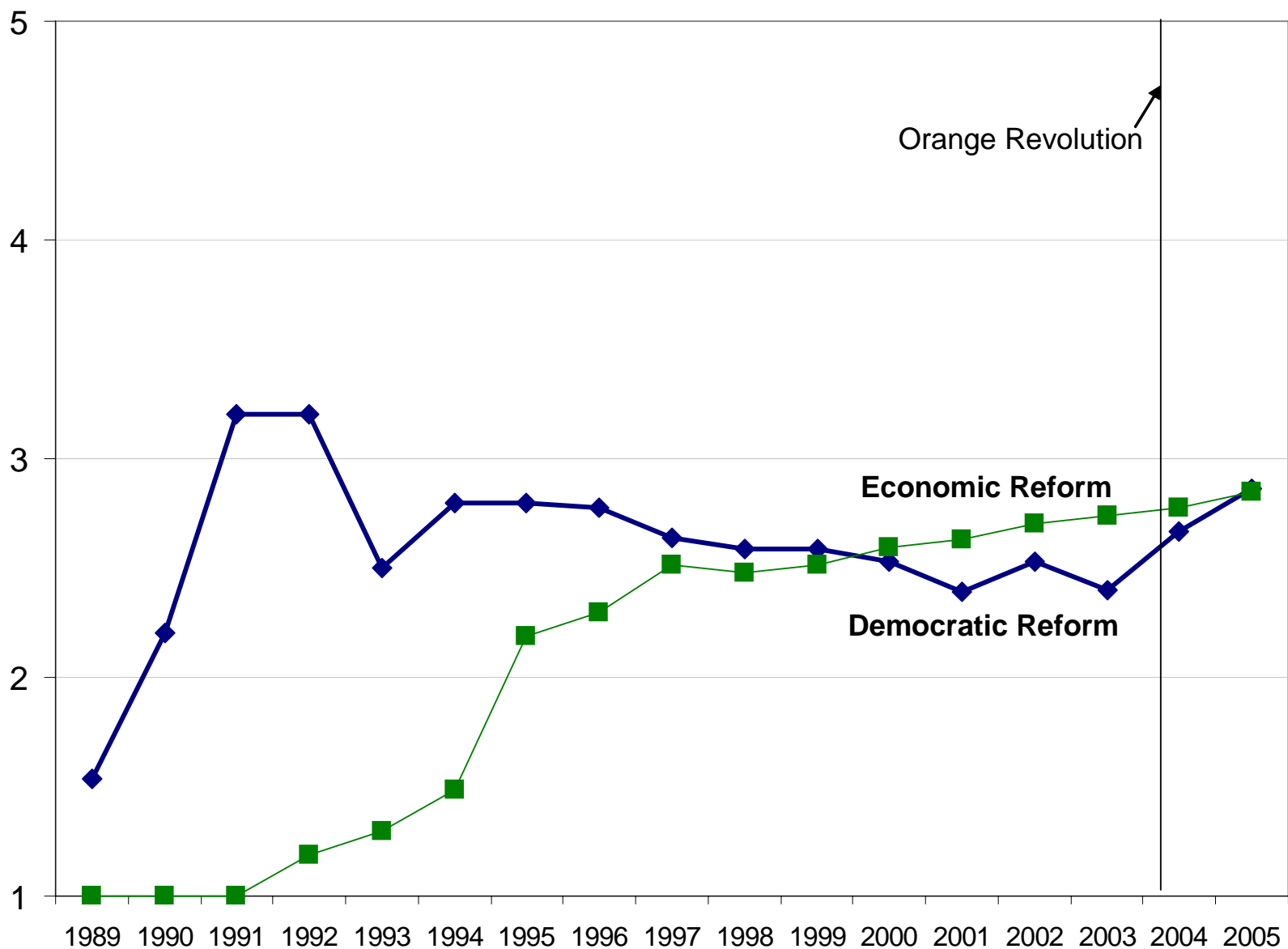
Economic and Democratic Reforms in Georgia



Ratings are based on a 1 to 5 scale, with 5 representing most advanced. USAID calculations drawing from Freedom House, *Nations in Transit 2006* (2006) and EBRD, *Transition Report 2005* (November 2005).

Figure 15

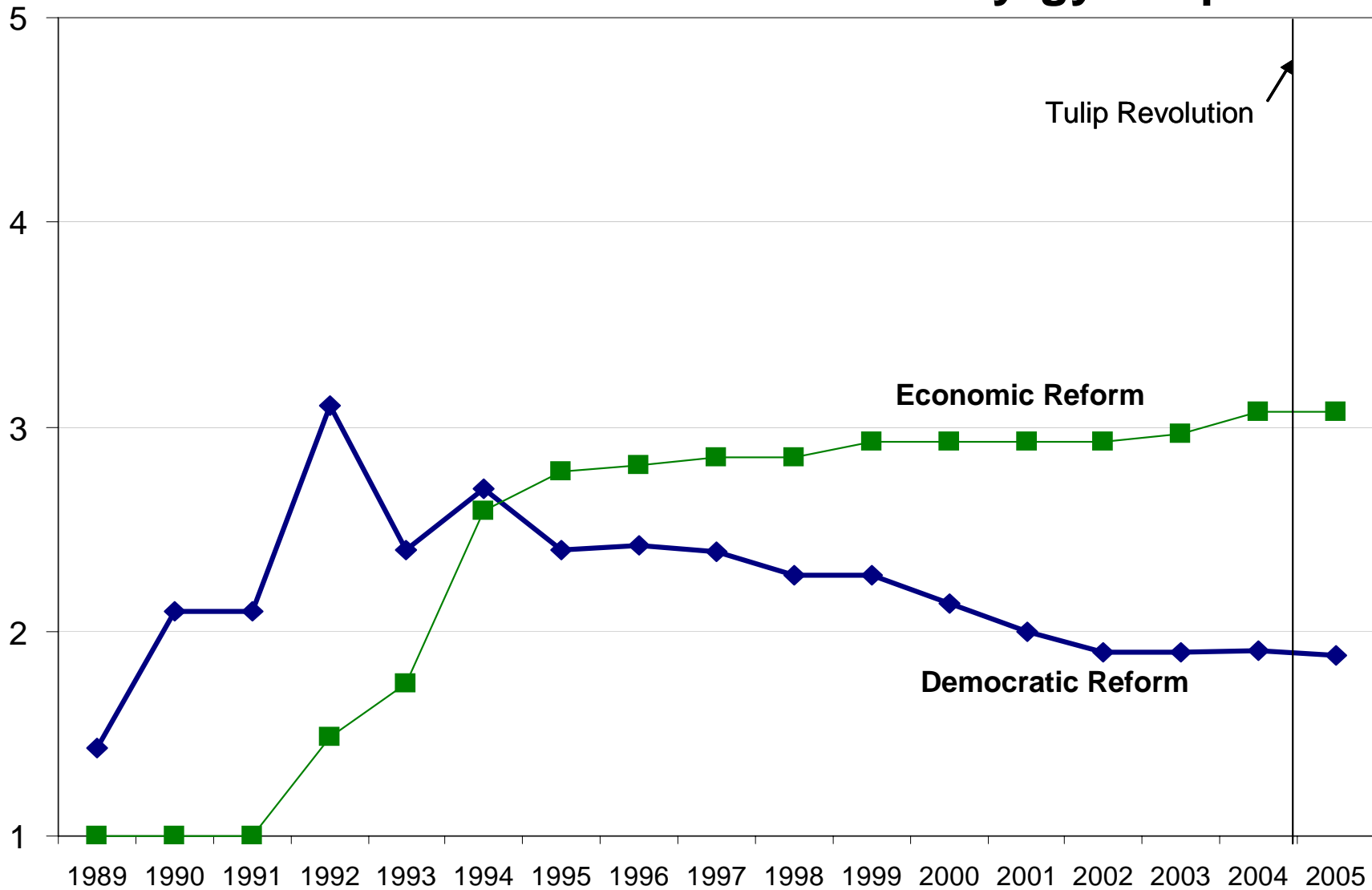
Economic and Democratic Reforms in Ukraine



Ratings are based on a 1 to 5 scale, with 5 representing most advanced. USAID calculations drawing from Freedom House, *Nations in Transit 2006* (2006) and EBRD, *Transition Report 2005* (November 2005).

Figure 16

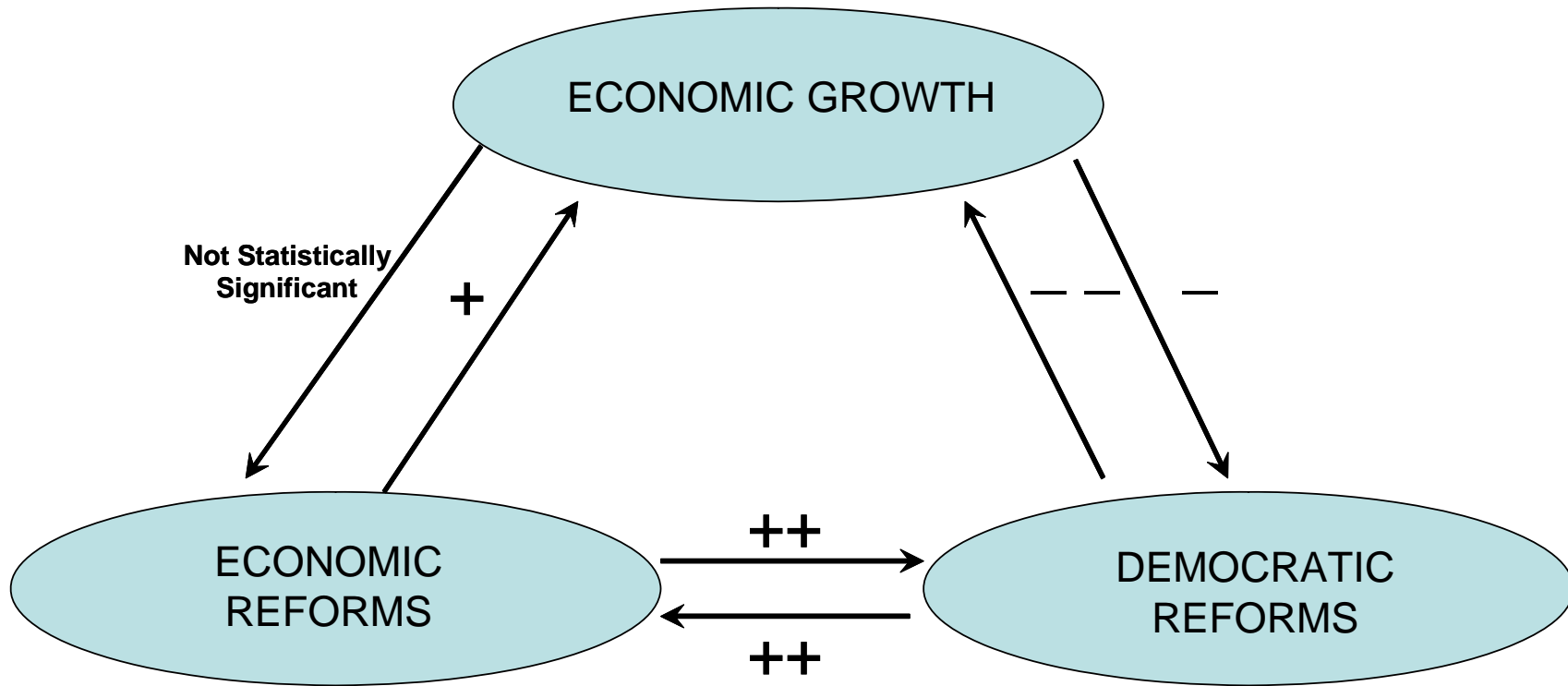
Economic and Democratic Reforms in Kyrgyz Republic



Ratings are based on a 1 to 5 scale, with 5 representing most advanced. USAID calculations drawing from Freedom House, *Nations in Transit 2006* (2006) and EBRD, *Transition Report 2005* (November 2005).

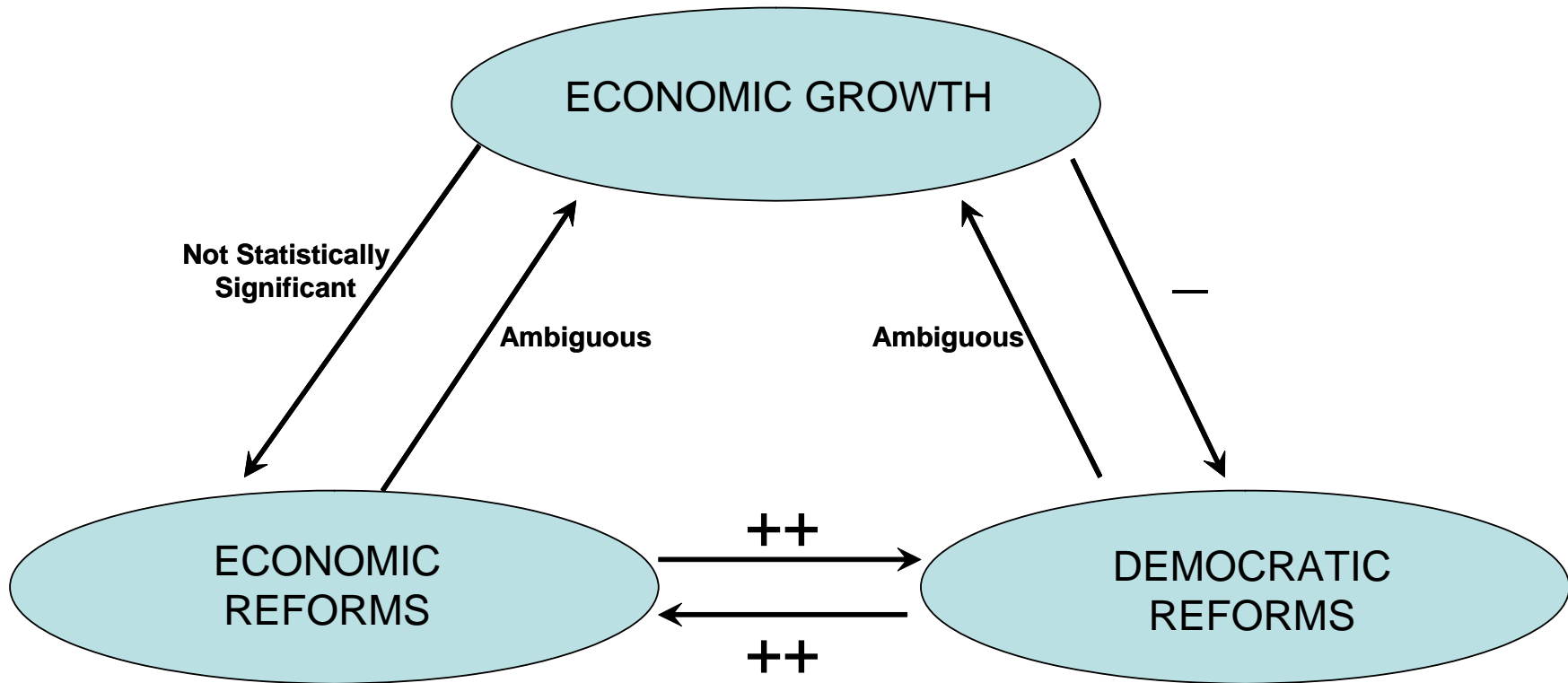
Figure 17

Economic Reforms, Democracy and Growth in CEE & Eurasia



"+ +" or "- -": all 4 tests show a consistent coefficient sign, and at least 3 are statistically significant at 5% level. "+" or "-": at least 2 of 4 tests are statistically significant at 5% level. Findings are from Tables 4-6 of USAID, *Economic Reforms, Democracy, and Growth in Eastern Europe and Eurasia* (October 2005).

Figure 18 **Economic Reforms, Democracy and Growth in Eurasia**



USAID, Europe and Eurasia Program Office, *Economic Reforms, Democracy, and Growth in Eastern Europe and Eurasia* (November 2005). "+ + " or "- -": both tests show a consistent coefficient sign, and are statistically significant at 10% level. Ambiguous: different coefficient signs, but at least 1 test result is statistically significant. "-": at least 1 of 2 tests are statistically significant at the 5% level. Findings are from Tables 4-6 of USAID, *Economic Reforms, Democracy, and Growth in Eastern Europe and Eurasia* (October 2005).