

Monitoring Country Progress in Central and Eastern Europe & Eurasia

October 2001

Executive Summary

I. Introduction

This paper presents USAID/E&E's system for monitoring country progress with a focus on developing criteria towards graduation from USAID assistance. Country progress is analyzed in a sequence of steps for twenty-seven countries of the transition region. First, we look at the progress towards economic reforms and democratization. Progress on both fronts must reach a certain threshold before we can begin to consider graduation. Next, we look at indications of sustainability; that is, macroeconomic performance and social conditions. Economic reforms need to translate into solid macroeconomic performance if they are to be sustained. Trends in social conditions need to be tracked as well to give us a pulse on the possibilities of "reform fatigue," and, more fundamentally, human capital deterioration.

II. Findings

a. Economic Trends. Recent trends in economic reforms and macroeconomic conditions in the transition region have been very favorable. Economic reforms advanced more on an annual basis in 2000 than they have since at least 1996 when we started tracking such progress. Economic reform gains in 2001 have been nearly as significant. The reform gains have been widely shared between CEE and Eurasia and widely distributed among both first and second stage economic reforms. Moreover, an examination of economic reform trends since 1997 reveals little evidence that the 1998 Russian financial crisis and the 1999 Kosovo conflict had any significant long-lasting adverse spill-over effects on the pace of reforms in neighboring countries.

On average, the transition economies grew by 6.1 percent in 2000, far surpassing annual growth rates in all the previous transition years. 2001 estimates show somewhat slower, though still reasonably robust and broadly shared economic growth across the transition region: 4.0 percent overall; highest in Eurasia (4.4 percent), followed by Southern Tier (3.9 percent) and the Northern Tier CEE (3.2 percent). While the transition economies have not been immune to the worldwide economic slowdown in 2001, most seem to be weathering the adverse global conditions better than other emerging market economies.

b. Social Conditions Revisited. New data and analyses of social conditions reveal a picture that, while still grim for many persons in the region, is not quite as dismal as depicted in previous *Monitoring Country Progress* reports. First, new estimates of poverty, mostly for 1998-1999, show poverty rates varying widely not only by country but also by poverty threshold. A lower poverty threshold (of \$2.15 per day) shows the poverty rate to be 12 percent of the population region-wide, significantly lower than poverty rates at similar thresholds in the developing world. Second, efforts to include unofficial economic activity into official GDP estimates reveal that the drop in economic activity since the transition began (and the hardship implied from this decline), is

significantly less, most notably in several Eurasian countries, than official GDP estimates suggest. Third, while new data on inequality continue to support that inequality has increased dramatically overall in the transition region, they also reveal that the pace of the increase has slowed considerably in most countries, and that the inequality gap between subregions narrows when consumption measures are used in lieu of income.

c. CEE-Eurasia Distinctions. However, significant distinctions between the CEE countries, particularly the Northern Tier CEE, and Eurasia remain. In important respects, different transition paths continue to persist. Overall, the findings of this report lend support to USAID graduation decisions. The eight countries of the Northern Tier CEE, and the only "graduates" of the transition region from USAID assistance, continue to be in a transition stage far advanced from the rest.

i. Reform progress. Three key observations surface from an examination of the *Summary Figure*: (1) the Northern Tier CEE countries continue to be far out front of the rest of the transition countries in progress towards economic and democratic reforms; (2) while the reform gap between the Northern Tier and Southern Tier CEE countries remains large, it is narrowing; and (3) the transition paths between the Eurasian countries and CEE continue to diverge in at least one key dimension. Specifically, while the links between progress in economic and democratic reforms in the CEE countries are strong and continue to grow, 2000-2001 reform trends in Eurasia are characterized, in striking contrast, by both impressive gains in economic reforms with equally "impressive" backsliding in democratization.

This latter observation provides further support to longer-term trends in democratization, namely: the gap in democratic freedoms between the CEE and Eurasian countries is large and continues to grow. Since the transition began in CEE (i.e., since 1989), fourteen of the fifteen CEE countries (all but Bosnia-Herzegovina) have advanced in democratic reforms, many no doubt at a historically unprecedented pace. Of all the Eurasian countries, in contrast, only Georgia, Moldova, and Armenia are today further along in democratic freedoms than they were when the Soviet Union collapsed (in 1991). Nevertheless, with the probable exception of Turkmenistan, all the countries of the former Soviet Union have greater democratic freedoms today than those that existed during the much more repressive Soviet times of the mid-1980s.

ii. Integration into the world economy. The sources of economic growth, and hence the sustainability of such growth, vary widely among the countries. Robust export growth in 2000 contributed to rapidly expanding economies throughout the region. However, for most of the Eurasian countries, growing export revenues have derived largely from a substantial reliance on the Russian economy (which grew robustly in 2000 at 7.5% and may expand by 4% in 2001) and heavy dependence on natural resource exports (most of which had significant price increases in 1999-2000, followed by more recent modest declines in 2001). The economies of the CEE countries, in contrast, are much more closely linked to Western Europe, and generally much more diversified in terms of export markets and export products. Worldwide comparisons suggest, however,

that even the Northern Tier CEE countries have considerable scope for more integration into the world economy.

The Northern Tier CEE countries have considerably larger trade sectors as a share of GDP than the rest of the transition countries, though they are still much smaller than those of most of the EU countries. The Northern Tier CEE countries also continue to receive the lion's share of foreign direct investment (FDI): on a per capita basis since 1989, nine times more than in Eurasia, and roughly three times more than in the Southern Tier CEE countries. Virtually all the relatively autarchic economies are also the poorest economies. All but one (Albania) are in Eurasia.

iii. Social conditions. Unemployment rates are highest and particularly troublesome in the Southern Tier CEE, 21 percent on average in 2000. However, unemployment rates remain stubbornly problematic in the Northern Tier CEE as well, rising to 12.8 percent in 2000. In important respects, lower open unemployment rates in Eurasia continue to reflect a lag in enterprise restructuring and the labor shedding that necessarily accompanies it. One consequence of this has been a greater fall in real wages in much of Eurasia. Wage arrears and hidden unemployment also characterize and distinguish labor market adjustments in Eurasia.

The Northern Tier CEE per capita income average, while less than half the EU average, is almost twice that found in the Southern Tier CEE and Eurasia. Income is much more evenly distributed in the Northern Tier, comparable now to inequality found in the EU. Income inequality in a handful of Eurasian countries may approach those levels found among the most unequal economies worldwide.

At \$2.15 per day, the poverty rate is 1 percent in the Northern Tier CEE, 6 percent in the Southern Tier CEE, and 17 percent in Eurasia. Infant and child mortality rates have fallen in all three subregions over the transition. However, these rates were the lowest in the Northern Tier at the outset of the transition and have fallen the most there since then. Average life expectancy in the Northern Tier countries has increased to 73 years during the transition; life expectancy has fallen in the Southern Tier CEE countries to 71 years and in Eurasia even more, to 67 years. Secondary school enrollment has increased in the Northern Tier (where it is highest) and decreased in Eurasia and the Southern Tier (where it is lowest).

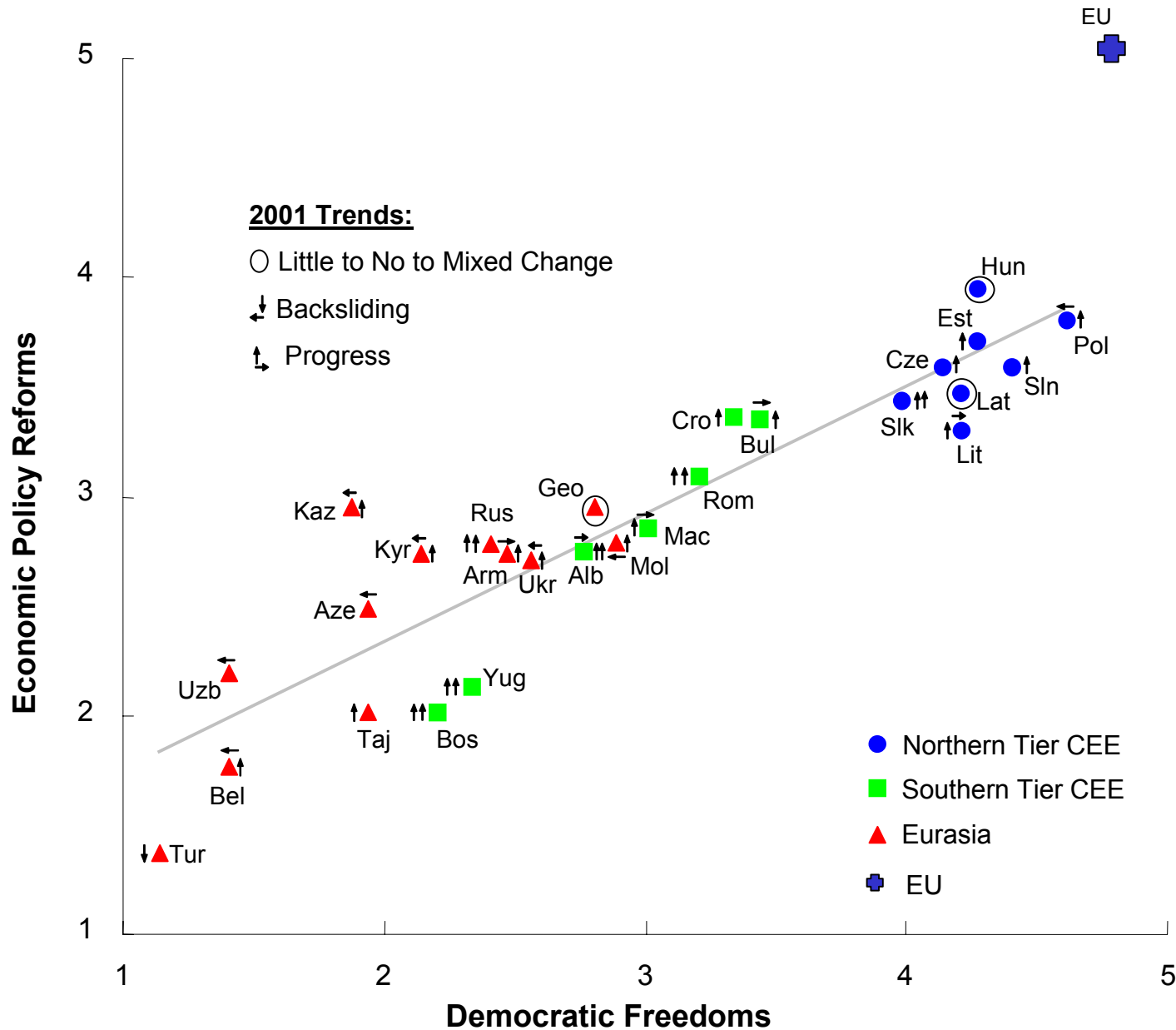
III. Concluding remarks

Decisions on the magnitude and duration of U.S. assistance to the E&E region are made on the basis of several factors: (1) progress the country has made toward a sustainable transition to a market-based democracy; (2) strategic importance of the country to the United States; (3) importance of the recipient country to U.S. citizens; and (4) effectiveness of particular assistance activities.

This paper presents an approach to analyzing the first factor. Particular country levels will likely be shaped in part by whether a given country falls into one of several

categories, based on the analysis of country performance indicators. Countries ranked near the top of the list are obvious candidates for “graduation.” On virtually all scores, these are the Northern Tier CEE leaders which have now graduated from USAID bilateral assistance, though continue to receive limited regional funding. Other countries would seem to fall into one of three categories: (1) those where assistance is least likely to be effective, in which case it may make sense to close those programs down altogether or to keep highly targeted funding at minimal levels until commitment to reform increases; (2) those where the possibilities for substantial reform now appear likely and hence where the return on our investment may be particularly high; or (3) those which possess both transition and developing country characteristics, where our foreign assistance investment is needed albeit over a longer time horizon than perhaps originally envisioned or hoped.

Economic Policy Reforms and Democratic Freedoms in Central & Eastern Europe and Eurasia in 2000-2001



2000 Ratings of democratic freedoms are from Freedom House, *Nations in Transit 2000-2001* (2001), and assess reforms through October 2000. With one exception, economic policy reform ratings are from EBRD, *Transition Report 2000* (November 2000), and cover events through September 2000; economic policy reform rating for Yugoslavia is from Freedom House, *Nations in Transit 2000-2001* (2001). 2001 trends are drawn primarily from EBRD (*draft Transition Report*, October 2001, and *Transition Report Update*, April 2001) and Economist Intelligence Unit, *Country Reports*, most recent. Economic policy reforms include price liberalization, trade and foreign exchange, privatization, legal, banking and capital markets, enterprise restructuring (credit and subsidy policy), infrastructure, and environmental policy reforms. Democratic freedoms include political rights (free and fair elections; openness of the political system to competing political parties and to minority group representation; governance and public administration) and civil liberties (free media and judiciary; freedom to develop NGOs and trade unions; equality of opportunity and freedom from corruption). Ratings are based on a 1 to 5 scale, with 5 representing most advanced.