MONITORING COUNTRY PROGRESS IN CENTRAL AND EASTERN EUROPE & EURASIA

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I. Introduction

The objective of U.S. assistance to Central and Eastern Europe (CEE) and to the Eurasian countries of the former Soviet Union is to help move these countries far enough along the road to becoming market-based democracies that they can complete the journey themselves. Early expectations were that the duration of assistance to the region would be brief. After ten plus years, while there are many successes, particularly in the Northern Tier CEE countries, remaining transition challenges are formidable and fluid. The collapse of the Russian financial system in August of 1998, for example, underscored the complexity of the transition task, and ongoing conflicts in the Balkans demonstrate how fragile stability can be in this post-Cold War period.

These challenges make it all the more essential to closely monitor both the impact of the U.S. assistance programs themselves to maximize their effectiveness, as well as the progress of the countries more generally to determine whether continued assistance is necessary or justified. Program impact monitoring is done by both field missions and Washington-based operating units through a system of setting results targets and annually monitoring progress toward them, and through less frequent special field evaluations. This paper presents USAID/E&E's system for monitoring country progress in twenty-seven countries of the region.[1]

Country progress monitoring is done in part to determine whether the assistance program can be terminated either because: (a) the country is well launched on its way to a successful transition and cessation of assistance will no longer jeopardize that transition (i.e., graduation); or (b) the country is making so little progress that significant resources will have little impact. Monitoring is done annually and results are shared with the State Department Coordinators for U.S. assistance to each of the two regions.

Section II below highlights the methodology. This is followed in *Section III* by analyses in each of the major areas examined: (a) economic policy reforms; (b) democratization; (c) macroeconomic performance; and (d) social conditions. *Section IV* briefly concludes. *Appendix I* elaborates on the rating schemes of the economic policy reform and democratization indicators.

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[1] While USAID programs are largely complete in the Northern Tier CEE region, monitoring country progress among the USAID "graduates" provides a basis for comparison with the remaining transition countries, and enables us to track possible backsliding among the leaders as well.

II. Methodology

Market-oriented reforms and democratization have been the two pillars of USAID's program in the transition countries.[2] This has been combined with a more recent and growing focus on social aspects of the transition.[3] The primary challenge of this analysis thus is essentially to assess the progress across these fronts, with a particular focus on the sustainability of reforms.

Country progress is analyzed in a sequence of steps drawing from standard, well-established data sources that are external to USAID. 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.

Economic policy reforms are assessed by drawing from EBRD's annual rating scheme of transition indicators, and supplemented by a similar scheme from Freedom House.[4] Progress in democratic freedoms is determined from Freedom House's annual worldwide rating of civil liberties and political rights, and from an effort on its part to further disaggregate and better target the measurement of such freedoms in the transition region.[5]

Next, we look at indications of sustainability. Economic reforms need to translate into solid macroeconomic performance. We might expect improved performance to follow reform implementation with some lag. In time, however, evidence of good macroeconomic performance would give us more confidence that the reformed economy is on a sustainable path.

Furthermore, it is important to underscore that acceptable progress in the reforms must precede good macroeconomic performance. A cross-country snapshot might show one economy outperforming another in part because painful reforms have been avoided in the former. Yet, this is hardly sustainable.

The macroeconomic performance indicators also provide a check on the comprehensiveness of the economic reform indicators. For example, fiscal reform is not adequately addressed in the current mix of economic reform indicators. Yet, insufficient fiscal reform is likely to surface in the form of rising fiscal deficits, and this *is* being tracked as an economic performance indicator.

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[2] USAID assistance to the transition countries is funded through the Support for East European Democracy Act (SEED) and the Freedom Support Act (FSA), the latter applying to the Eurasian countries. The SEED Act has two goals: the promotion of democracy and a market-oriented economy. The FSA objectives are broader in scope, including the transition goals of the SEED Act as well as those focused more directly on humanitarian, social, environmental, and trade and investment conditions.

[3] See USAID/E&E, *From Transition to Partnership: A Strategic Framework for USAID Programs in Europe and Eurasia* (December 1999); and the E&E Bureau's social transition strategy: USAID/E&E, *Transition With a Human Face: Broadening the Benefits of Economic and Political Reform in Central and Eastern Europe and the New Independent States* (August 1999).

[4] See EBRD, *Transition Report 2000* (November 2000), and Freedom House, *Nations in Transit 2001* (forthcoming).

[5] See Freedom House, *Freedom in the World 2000-2001* (May 2001), and *Nations in Transit 2001* (forthcoming).

Another means to measure the sustainability of reforms is to assess trends in the quality of living conditions. This is largely addressing the concern of "reform fatigue." It is not enough to have a healthy economy and significant political freedoms if households continue to struggle and living conditions deteriorate. In this scenario, support for reforms also deteriorates. So, too, eventually does human capital and, from that, the productive capacity of the economy.

Country progress is assessed throughout this report with population-weighted measures of progress of three subregions among the transition economies as well as with comparators outside the region. The Northern Tier Central and Eastern Europe (CEE) subregion consists of Poland, Hungary, Slovenia, the Czech Republic, Slovakia, Estonia, Latvia, and Lithuania; the Southern Tier CEE countries consist of Romania, Bulgaria, Croatia, the FYR Macedonia, Albania, Bosnia-Herzegovina, and Yugoslavia; and the Eurasian states consist of the countries formed from the dissolution of Soviet Union less Latvia, Lithuania, and Estonia.

For many indicators, proposed graduation benchmarks are assigned. Some are more arbitrary than others and need to be held to debate. Should a country fail to meet a benchmark, this should signal a "yellow flag" in the mind of the analyst; an aspect that may need to be examined more thoroughly if graduation is being considered on the basis of other evidence. The number of benchmarks a country needs to achieve should vary according to context.

An important step of the process is the holding of annual reviews—alternating the focus between the CEE and Eurasian countries—with area specialists from U.S. government agencies. Soliciting such expert opinion serves as a reality check on the data and our interpretation of it.

Finally, it merits explicitly recognizing that what is occurring in the region is unprecedented, and that there is little if any theoretical and/or empirical basis for devising precise thresholds of reform sustainability. Further, it is reasonable to assume that there is more than one acceptable transition route, or, what may amount to the same, many possible varieties of sustainable market-oriented democracies. This exercise, in short, is likely to be as much art as it is science, and it is important to place the results in this context.

III. Analysis

A. Economic Policy Reforms

Sufficient progress in economic policy reforms must entail achieving an adequate threshold of reform that is sustainable over time. To assess this, twelve economic policy reform indicators, drawn from the EBRD and grouped into two stages of reform, are tracked for twenty-six of the twenty-seven transition countries.[6] The indicators, which cover events through September 2000, are measured on a one-to-five scale, with gradations in between.[7] A "five" represents standards and performance norms typical of advanced industrial economies. In general, depending on the particular indicator, a "3" or a "4" may very well be the threshold that we seek. Descriptions of the rating categories are provided in *Appendix I*.

These indicators focus on critical reform aspects of economic liberalization, structural reform, and institution building in the transition process. Such reforms provide much of the overall enabling environment that is required for the emergence of a vibrant and sustainable market economy. Moreover, strong complementarities exist among them all. This means that possibilities for synergism derive from implementation of the total policy package. The other side to this is the possibility that insufficient progress in one reform aspect may undermine the potential gains from progress of another. As is highlighted below, this latter possibility has become an important characteristic of the reform profile among some of the transition laggards.

First Stage Reforms (*Table 1*). The first stage reforms consist of liberalization of prices, external trade and currency arrangements, privatization of small-scale units, and the establishment of key commercial laws. ***Price liberalization*** focuses on the decontrolling of wages and product market prices, including key infrastructure products such as utilities and energy, and the phasing out of state procurement at non-market prices. ***Trade and foreign exchange reforms*** focus on the removal of trade restrictions (export tariffs, quantitative and administrative import and export restrictions), progress towards membership in the WTO, and improving access to foreign exchange (current and capital account convertibility). ***Small-scale privatization*** includes small firms, small farms and plots of land, and housing. The ***legal reforms for investment*** focus on three laws: bankruptcy, pledge or collateral, and company law.

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[6] Economic reform progress in Yugoslavia is measured from Freedom House's rating scheme in its *Nations in Transit 2001* (forthcoming). Freedom House's scheme is similar to that of the EBRD's, and includes three broad aspects: (1) progress towards privatization (the scope and type of privatization; the extent of public awareness and support); (2) the development of macroeconomic policy and reform of the state (reforms in tax and public expenditure, banking and capital markets, and exchange rate policy); and (3) microeconomic policy to encourage enterprise development (commercial law development, judicial reform, price liberalization, competition policy, trade and investment reform, and energy sector reform). See *Monitoring Country Progress*, No. 4 (October 1998) for a comparison of the two schemes.

[7] In earlier *Transition Reports*, the EBRD assigned a 4* to the highest threshold and provided a separate description of the criteria to achieve that level of progress. For simplicity, their "4*" (which is now a 4+) becomes our "5". All other "+"s and "-"s are measured by adding or subtracting a "0.3", respectively.

Alongside the growth of new firms, privatization is an essential aspect of restructuring the economy into one that is private-sector driven. Price liberalization provides the appropriate incentives through market-based prices to better maximize efficiency. Trade and foreign exchange reforms provide further discipline for the private sector through global competition, as well as providing domestic firms with a greater capacity to compete. Consistent, nondiscriminatory, and transparent legal rules for investment are critical to developing an enabling environment for enterprise restructuring and growth, and improved corporate governance.

These first stage reforms require relatively little institution building and tend to be the easiest to do. However, as underscored by trends in Eurasia since the onset of the global financial crisis in mid-1997, progress in these reform areas can also be prone to setbacks. These dynamics, in fact, help explain why the spread between economic reform progress among the transition leaders and laggards remains the greatest in trade and foreign exchange reforms.

In the CEE countries, the first stage reforms have generally been adopted rapidly and quite thoroughly. All the CEE countries (for which data are available)[8] have implemented a comprehensive program of price liberalization; other than rents, transport and public utilities, prices are generally set by the market. With the salient exception of Bosnia-Herzegovina (where privatization just began in the second half of 1999), most CEE countries have essentially completed small-scale privatization. Bosnia-Herzegovina continued some reform momentum in small-scale privatization in 2000, and Bulgaria and Latvia made further gains as well. Latvia is now one of nine CEE countries (Croatia, plus all the Northern Tier CEE countries) with standards for and performance of small-scale private enterprise that are typical of advanced industrial economies.

Virtually all quantitative and administrative trade restrictions (apart from agriculture) have been removed in all the CEE countries but Bosnia-Herzegovina (and Yugoslavia). Moreover, notable gains in trade and/or foreign exchange liberalization in 2000 occurred in Croatia, Estonia, Albania, Lithuania, and, to a lesser extent, in Bosnia-Herzegovina. In fact, according to the EBRD's September 2000 scores, ten CEE countries (Hungary, Poland, Slovenia, the Czech Republic, Slovakia, Latvia, Bulgaria, and more recently, Croatia, Estonia, and Albania) have achieved policy standards in trade and foreign exchange systems that are comparable to those of the advanced industrial economies. All ten countries are now members of the World Trade Organization (WTO). Croatia and Albania became members in the fall 2000. On May 31, 2001, Lithuania became the newest transition country member of the WTO.

Advancements in legal reforms in CEE continue to lag behind the other first stage reforms. For only six of the CEE countries--four in the Northern Tier (Hungary, Slovenia, Latvia, and Lithuania) and two in the Southern Tier (Croatia and Bulgaria)--

[8] As noted above, Yugoslavia is not included in EBRD's rating scheme and hence is not included in the following analysis.

does comprehensive legislation exist in at least two of the three areas of commercial law that have been the focus of the EBRD survey: collateral; bankruptcy; and company law.

Legal reform results in the CEE countries in 2000 were also much more mixed and volatile than those of other first stage reforms. Notable progress occurred in Albania, and Bosnia-Herzegovina, and, to a lesser extent, Estonia and Latvia. However, Poland, the Czech Republic (as in 1999), Slovakia, and Macedonia saw some "backsliding" in this measure. This backsliding may partly reflect growing realizations of the limitations in the scope of the laws as more active efforts are made to apply them.[9] In notable contrast to virtually all other economic reform measures, progress in the extensiveness of legal reforms is now only slightly more advanced in the Northern Tier CEE countries than it is in the Southern Tier CEE and Eurasian countries.

In general, while there continues to be a large gap in first stage reform progress between the Northern Tier CEE leaders and the Eurasian countries, this past year witnessed some narrowing of the spread. This trend contrasts with that of the previous two years, and partly reflects the dissipation of the adverse spillover effects from the 1998 Russian financial crisis. In other words, some of the reform backtracking that occurred in Eurasia in 1998-1999, such as the re-introduction of price controls and/or trade and foreign exchange restrictions, turned out to be largely temporary measures to cope with close economic ties to a Russia in crisis. Russia in 2000 regained its 1997 level of price liberalization with the abolition of most of the temporary restrictions on domestic flows of goods and services introduced after the crisis in August 1998. Restrictions on trade and foreign exchange in Russia in 2000 were also reduced considerably, though these gains were partly offset by the re-introduction of oil export quotas. Moldova and Georgia further liberalized domestic prices; Georgia, Kazakhstan, Tajikistan, and Belarus lowered trade and foreign exchange restrictions.

Georgia made the greatest first stage reform gains in 2000 in Eurasia, followed by Kazakhstan and Tajikistan. Azerbaijan, Moldova, and Belarus had mixed results, gaining in one reform aspect while backtracking in another.

Of the Eurasian countries, Georgia has now advanced the furthest in first stage reforms, and is more advanced than the Southern Tier CEE countries on average. Kazakhstan and Kyrgyzstan are close behind. Moldova and Armenia, previously near the top, have slipped some in the ranking. For the three Eurasian leaders, privatization of small companies with tradable ownership rights is complete. Substantial progress on price liberalization, including energy prices, has been made. Virtually all quantitative and administrative trade restrictions have been removed in Georgia and Kyrgyzstan. Both are now WTO members; Georgia joined in 2000. Kazakhstan's trade and foreign exchange system is not quite as liberalized, though most trade restrictions have been removed. Of the three leaders, Kazakhstan is the most advanced in legal reforms. There,

[9] The legal reform scores are derived from a survey of the views of local lawyers and academics. With the exception of the environmental reform scores, all the other economic reform indicators derive directly from EBRD staff assessments. The differences in methodology may also partly contribute to more mixed and volatile results in the legal reforms.

comprehensive commercial law legislation exists in a majority of key areas surveyed by the EBRD. In Kyrgyzstan and Georgia, new or amended legislation has recently been enacted in most areas, though further refinement is needed.

Belarus and Turkmenistan continue to lag behind all other transition countries in first stage reforms, and far behind most. Moreover, Belarus backtracked further in 2000 in first stage reforms on balance even though there is very little "room" for further backsliding. In both countries, government control of prices is extensive. Trade and foreign exchange restrictions are significant. Legal rules are limited in scope and inconsistent. Overall commitment to reform continues to be very weak.

Second Stage Reforms (*Table 2*). The most challenging economic reforms are found in the second stage. In general terms, 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 the 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.

Not surprisingly, progress in the second stage reforms has been slower than that of the first stage reforms. Building institutions and effective regulatory entities by nature is an incremental, long-term process. An important part of this is developing market-oriented behavior (or informal institutions) that is compatible with the new formal institutions.[10]

Furthermore, these second stage reforms require more preparation to build political consensus. They typically generate greater political resistance and uncover stronger vested interests. In fact (and somewhat ironically), some of these vested interests were created in the early stages of reform and liberalization.

We draw from the EBRD to track eight specific reforms that we classify as part of the second stage. ***Large-scale privatization reforms*** refer to the transfer of major public sector assets to the private sector, but also the extent of outside ownership and effective corporate governance of such privatized entities. ***Enterprise restructuring reforms*** address effective corporate governance in large part through government actions to tighten credit and subsidy policy at the firm level, enforce bankruptcy legislation, and break up dominant firms. Such reforms, in other words, provide some of the financial discipline needed for vibrant growth of the private sector.

Closely related to these reforms is ***competition policy***, which focuses on the development of legislation and institutions to facilitate the entry of firms, existing or potential, into existing markets. This includes the promotion of a competitive environment through enforcement actions to reduce the abuse of market power by dominant (or non-competitive) firms. More competitive market structures contribute to more efficient firms.

[10] These informal institutions are what the EBRD refers to as social capital or basic codes of conduct, trust, and co-operative behavior. See EBRD, *Transition Report 1999* (November 1999), p. 5.

Banking reform includes progress towards the establishment of bank solvency, well-functioning bank competition coupled with interest rate liberalization, financial deepening and extensiveness of private sector lending, and effective prudential supervision, with movement of laws and regulations towards BIS standards. ***Non-bank financial reforms*** include the development and deepening of securities exchanges, investment funds, private insurance and pensions funds, leasing companies, and associated regulatory framework, with movement of laws and regulations towards IOSCO standards.

The financial system undergirds the market economy. The private sector cannot grow and develop without a sound financial sector. It provides the capital to grow. It provides the discipline for good corporate governance. Nor can there exist a stable macroeconomic framework without a sound financial system, given its importance in overall monetary management. Moreover, an unstable financial sector can lead to crisis, and, in fact, most of the significant economic setbacks that have occurred in the transition economies have been largely triggered by financial crisis. Russia is the most recent example, though economic crises in Bulgaria and Albania in 1996-1997 and backsliding in the Czech Republic in 1997 apply as well.

The degree to which ***investment-related legal reforms*** are successfully ***implemented*** is a focus as well. This follows from tracking as part of the first stage reforms, the extensiveness of such reforms—in particular, bankruptcy, collateral, and company law. Here the focus is how clear these rules are (and the degree to which they do not discriminate between domestic and foreign investors), and how well they are administered and supported judicially.

Environmental policy reforms combine two components: (a) the degree of adherence to six key international environmental treaties, and (b) progress in preparing and implementing national environmental action plans.[11] Progress in environmental reforms contributes directly to progress in other economic reform areas and to productivity gains more broadly.

Finally, the ***restructuring of infrastructure*** includes progress assessed in three aspects of infrastructure reform (tariff reform, commercialization, and regulatory and institutional development) in five infrastructure sectors (telecommunications, electric power, railways, roads, and water and wastewater). Tariff reform includes setting prices that reflect costs, eliminating cross-subsidies, and improving collection rates. Commercialization includes corporatization and the introduction of hard budget constraints and competitiveness pressures, including various forms of private sector participation. Regulatory and institutional development includes the establishment and enforcement of laws that protect consumers (from monopoly power) as well as investors (by promoting fair competition).

[11] This is a revision from last year's environmental reform indicator that included two additional components (for which updated data are not available): progress in air and water standards; and an assessment of the extent to which environmental financial incentive mechanisms are used. Environmental reform gains noted in *Table 2* are based only on the change of the two components common to the 1999 and 2000 ratings.

The physical infrastructure plays a central role in the productivity of an economy. In general, the transition countries face very significant infrastructure investment requirements (with very limited means to meet them) due to previous policies that grossly distorted incentives. During central planning, some services, such as water and power, were oversupplied and at prices well below costs (both in an economic and environmental sense), while services such as telecommunications were largely undersupplied.

As has been noted in previous reports, all the transition countries lag considerably behind the industrial market economies in progress in second stage reforms. Nevertheless, the most striking trend in these reforms in 2000 is the impressive gains, widely shared across the three subregions. In fact, nineteen transition countries made measurable progress on balance in second stage reforms in 2000. The most significant and broadest gains occurred in Croatia, Bulgaria, and Lithuania, followed by Georgia and Ukraine. Only one transition country, Turkmenistan, which already lags far behind all the other countries, experienced backsliding in 2000 in second stage reforms.

Four Northern Tier CEE countries come closest to attaining industrial market economy standards in second stage reforms: Hungary, followed by Poland, Estonia, and the Czech Republic. All four countries made second stage gains in 2000, though progress in Estonia was mixed, moving forward in infrastructure reforms and back in legal reforms effectiveness. Poland's progress was the most impressive of the four leaders.

In at least three of these four leaders (Poland is the possible exception), more than 50 percent of large-scale state-owned enterprise assets have been privatized in schemes that have generated substantial outsider ownership. In all four countries, there have been significant and sustained actions to harden budget constraints and to promote corporate governance effectively. On competition policy, there has been a substantial reduction of restrictions on firms to enter markets, and some enforcement actions to reduce abuse of market power. Substantial progress has been made in the establishment of bank solvency and of a framework for prudential bank supervision and regulation. Banking reforms are furthest along in Hungary and include significant movement of banking laws and regulations towards Bank of International Settlements (BIS) standards and substantial financial deepening. Estonia is close behind in such progress. With further gains in 2000, Hungary and Poland now have securities laws and regulations that come close to IOSCO standards, and relatively well-functioning non-bank financial institutions and effective regulation. In all four countries, commercial laws are reasonably clear and, at least in the case of Poland and Hungary, administrative and judicial support of the law is reasonably adequate.

As with the first stage reforms, overall progress in second stage reforms in the Southern Tier CEE countries is closer to Eurasian standards than to Northern Tier CEE norms. However, diversity in progress is very large within the Southern Tier. Second stage reform progress in Bosnia-Herzegovina lags far behind all other CEE countries (except perhaps Yugoslavia) and is comparable to that in Belarus and Tajikistan. In contrast, second stage reform progress in Bulgaria is now comparable to a handful of Northern Tier CEE countries, including Lithuania and Latvia. Croatia and Romania are not far behind.

Kazakhstan is now slightly out front of all the Eurasian countries in second stage reforms, with progress comparable to that found in Macedonia. Second stage progress lags only slightly more in Russia, Georgia, Moldova, and Ukraine. Among these Eurasian "leaders," anywhere from more than 25 percent to 50 percent of large-scale state-owned enterprise assets have been privatized or are in the process of being sold, but often with major unresolved issues regarding corporate governance. On enterprise restructuring, there has been moderately tight credit and subsidy policy, but weak enforcement of bankruptcy legislation and little action taken to break up dominant firms. Competition policy legislation and institutions have been set up, and there has been some reduction of entry restrictions or some enforcement action on dominant firms. In bank reforms, significant liberalization of interest rates and credit allocation has taken place, but there has not yet been much progress in the establishment of bank solvency and of a framework for prudential supervision and regulation. Among this group, Russia continues to lag the most in bank reforms.

The effectiveness of commercial legal rules ranges widely among these five Eurasian countries. Progress in Kazakhstan in this domain approaches that found in the Northern Tier CEE countries where legal reforms are reasonably clear, and administrative and judicial support of the law is reasonably adequate. In Russia, while commercial legal rules are reasonably clear, administration or judicial support of the law remains inadequate. Progress lags further in Georgia, Moldova, and Ukraine. There, commercial legal rules are generally unclear and sometimes contradictory and few if any meaningful procedures are in place to make commercial laws operational and enforceable.

Turkmenistan remains farthest behind all the transition countries in second stage reforms. Progress in such reforms in Tajikistan and Belarus is not much more advanced. No notable progress in the privatization of medium and large enterprises occurred in 2000 in any of these three countries; in none of these countries has more than 25 percent of large-scale state-owned enterprise assets been privatized. This is reflected in small private sector shares in these economies, particularly Belarus (where only 20 percent of output is derived from the private sector) and Turkmenistan (only 25 percent).

In Turkmenistan and Belarus in particular, few reforms have been implemented to promote corporate governance, and soft budget constraints prevail. In Turkmenistan, widespread market entry restrictions for firms exist, and competition legislation and institution do not exist. In Tajikistan and Belarus, at least some competition policy legislation and institutions have been established and reduction of entry restrictions for firms has occurred. Very little progress has been made in financial reforms (banks and non-banks) in all three laggards, and banking sectors remain controlled by government. Overall, in all three countries, little progress in commercialization, regulation, and decentralization has been achieved in infrastructure reform.

Trends in Economic Reforms from 1998-2000. *Table 3* enables us to look at economic reform trends over the medium term, from 1998 to 2000, a period which covers two jolting crises for the region, the Russian financial crisis of 1998 and the Kosovo conflict in 1999. We look at the data first across countries, by subregion, then by reform areas.

Perhaps the most striking trend from these data is the significant reform slippage in Russia since 1997, both in absolute terms but particularly relative to the transition progress most elsewhere. In fact, a salient characteristic of the reform trends in Eurasia is the wide diversity in outcomes over this period. While Russia, far and away, saw the greatest reform backtracking (of all the transition countries), three other Eurasian countries also regressed on balance: Belarus, Turkmenistan, and Uzbekistan. By these measures, Armenia managed only to "tread water", moving forward in some areas, but back in others to balance it out. In contrast, Azerbaijan, Kazakhstan, and Tajikistan are among the transition leaders in terms of reform progress since 1997. Georgia and Ukraine made notable gains as well. Russia's backtracking has primarily occurred in financial sector reforms and in the liberalization of trade and foreign exchange. Overall, the data support the contention that the adverse spillover from the Russian crisis in terms of reform progress elsewhere was short-lived and/or minimal. Similarly, the backsliding in Belarus, Turkmenistan, and Uzbekistan has likely been driven more by internal politics (and by the absence of political will) than by external macroeconomic forces. Reforms in these countries had been lagging and/or backtracking well before the Russian crisis.

By subregion, the most impressive reform gains in this three-year period have occurred in the Southern Tier CEE. Bulgaria has advanced the most of all the transition countries, and has made significant gains in both first stage and second stage reforms. All other Southern Tier CEE countries have made notable gains as well, particularly Macedonia (in both first and second stage reforms) and Bosnia-Herzegovina (though almost exclusively in first stage reforms).[12] Croatia has advanced the least of the subregion since 1997. However, as noted above, reform gains in Croatia in 2000 were significant. These data reinforce trends observed in previous analyses,[13] namely, the greatest gains in economic policy reforms since at least the mid-90s have occurred among some of the "middle-tier" reformers. Key characteristics of this group include sufficient political will, significant "room" for further reform progress, and a strong pull towards memberships into Western institutions, the EU most prominently. These data also suggest that the concerns about possible reform backsliding in the subregion due to the 1999 Kosovo crisis proved largely to be unfounded. In fact, early estimates had forecast the economies of Bulgaria and Macedonia to be hardest hit as a result of the crisis and hence possibly more vulnerable to reform backsliding. While reforms in Macedonia were largely "put on hold" for much of 1999, both countries, as noted above, have remained very much on track in making transition reform progress.

Overall economic reform progress among the Northern Tier CEE countries from 1998 to 2000 has been modest, particularly for the reform leaders, Hungary, Poland, and Estonia. The Czech Republic actually regressed some in reform progress by this count; much of

[12] Again, excluding Yugoslavia for which data are not available.
[13] See *Monitoring Country Progress*, No. 6 (May 2000), p. 12.

this may have stemmed from a growing recognition of the inadequacy of the commercial law framework and the failure to adequately implement and enforce key laws. The other Northern Tier CEE countries made greater gains, particularly Latvia, followed by Lithuania. In general, progress has been converging among this group of eight countries.

Finally, from *Table 3*, what medium term assessments of relative progress across the reform areas can be made? The population weighted regional averages of the table reflect in large part the significant, largely negative, changes in Russia. Disentangling Russia from the aggregate statistics (i.e., weighing each country equally in each reform area) provides the following summary observations. First, while some backsliding since 1997 occurred in all but one of the ten reform areas examined (i.e., in all but small-scale privatization), countries that made gains outnumbered those that backtracked in each of the ten areas. Second, the greatest gains have occurred in liberalizing trade and foreign exchange (with the salient exception of Russia, and, to a lesser extent, Uzbekistan and Kazakhstan), and extending the commercial law framework. There were also notable gains in some countries towards efforts to implement and increase the effectiveness of the commercial law framework, though alongside this occurred significant backsliding in others countries.

Third, the least progress in economic reforms since 1997 has occurred in enterprise restructuring reforms, large-scale privatization, and price liberalization. Gains in banking reforms have been relatively small as well. Most countries had completed or nearly completed the liberalization of domestic prices by 1998, which largely explains the minimal change since then. In contrast, enterprise restructuring reforms (i.e., implementing hard budget constraints) and bank reforms continue to lag behind most all other reform areas. These areas continue to be among the most challenging for the transition region as a whole. Finally, while significant gains in large-scale privatization had been made prior to 1998, the pace of change has slowed considerably since then.

Table 1. First Stage of Economic Policy Reforms

	Small Scale Privatization	Trade and Foreign Exchange	Price Liberalization	Legal Reforms (Extensiveness)	1st Stage Average
Hungary	5.0	5.0	3.3	4.0	4.3
Slovenia	5.0	5.0	3.3 ↑	4.0	4.3
Croatia	5.0	5.0 ↑	3.0	4.0	4.3 ↑
Latvia	5.0 ↑	5.0	3.0	4.0 ↑	4.3 ↑
Poland	5.0	5.0	3.3	3.7 ↓	4.2 ↓
Estonia	5.0	5.0 ↑	3.0	3.7 ↑	4.2 ↑
Czech Republic	5.0	5.0	3.0	3.0 ↓	4.0 ↓
Lithuania	5.0	4.0	3.0	4.0	4.0
Slovakia	5.0	5.0	3.0	3.0 ↓	4.0 ↓
Bulgaria	3.7 ↑	5.0	3.0	4.0	3.9 ↑
Albania	4.0	5.0 ↑	3.0	3.3 ↑	3.8 ↑
Georgia	4.0	5.0 ↑	3.3 ↑	3.0 ↑	3.8 ↑
FYR Macedonia	4.0	4.0	3.0	3.3 ↓	3.6 ↓
Kazakhstan	4.0	3.3 ↑	3.0	4.0 ↑	3.6 ↑
Kyrgyzstan	4.0	4.0	3.0	3.3	3.6
Armenia	3.3	4.0	3.0	3.7	3.5
Romania	3.7	4.0	3.0	3.3	3.5
Moldova	3.3	4.0	3.3 ↑	3.0 ↓	3.4 ↓
Russia	4.0	2.3	3.0 ↑	3.7	3.2
Ukraine	3.3	3.0	3.0	3.3 ↑	3.2 ↑
Azerbaijan	3.3 ↑	3.3	3.0	3.0 ↓	3.2
Tajikistan	3.3 ↑	3.3 ↑	3.0	2.0	2.9 ↑
Bosnia-Herzegovina	2.3 ↑	3.0 ↑	3.0	3.0 ↑	2.8 ↑
Uzbekistan	3.0	1.0	2.0	3.0 ↑	2.3 ↑
Turkmenistan	2.0	1.0	2.0	...	1.7
Belarus	2.0	1.7 ↑	1.7	1.0 ↓	1.6 ↓
CEE & Eurasia	3.9	3.2 ↑	2.9 ↑	3.4 ↑	3.3
Northern Tier CEE	5.0	5.0 ↑	3.2	3.6 ↓	4.2
Southern Tier CEE	3.7	4.3 ↑	3.0	3.5 ↑	3.6 ↑
Eurasia	3.6	2.5 ↑	2.9 ↑	3.3 ↑	3.1 ↑
Industrial Countries	5.0	5.0	5.0	5.0	5.0
Benchmarks	4.0	4.0	3.0	4.0	3.8

Note: On a 1 to 5 scale, with 5 being most advanced. A "↑" indicates an advancement from September 1999 through September 2000. Unless specified, all regional averages in the main body of this report are population-weighted.

EBRD, *Transition Report 2000* (November 2000).

Table 2. Second Stage of Economic Policy Reforms

	Large Scale Privatization	Enterprise Restruct.	Competition Policy	Banking Sector	Capital Markets	Legal Reform (effectiveness)	Environment Policy	Infra-structure	2nd Stage Average
Hungary	4.0	3.3	3.0	4.0	3.7 ↑	3.7	4.5	3.7	3.7
Poland	3.3	3.0	3.0	3.3	3.7 ↑	4.0 ↑	4.5	3.7 ↑	3.6 ↑
Estonia	4.0	3.0	2.7	3.7	3.0	3.3 ↓	4.0	4.0 ↑	3.5
Czech Republic	4.0	3.3 ↑	3.0	3.3	3.0	3.3 ↑	4.0	2.9	3.4 ↑
Slovenia	3.0 ↓	2.7	2.7 ↑	3.3	2.7 ↓	3.7 ↓	4.5 ↑	3.1 ↑	3.2 ↑
Slovakia	4.0	3.0	3.0	3.0 ↑	2.3	3.0	4.5 ↑	2.2	3.1 ↑
Lithuania	3.0	2.7	2.7 ↑	3.0	3.0 ↑	3.3 ↑	4.0	2.9 ↑	3.1 ↑
Bulgaria	3.7 ↑	2.3	2.3 ↑	3.0 ↑	2.0	3.7	4.5	2.9 ↑	3.1 ↑
Latvia	3.0	2.7	2.3 ↓	3.0	2.3	3.7 ↑	4.5	2.9	3.1 ↑
Croatia	3.0	2.7	2.3 ↑	3.3 ↑	2.3	3.3 ↑	4.5 ↑	2.7 ↑	3.0 ↑
Romania	3.0 ↑	2.0	2.3 ↑	2.7	2.0	3.7	4.0	3.2 ↑	2.9 ↑
FYR Macedonia	3.0	2.3 ↑	2.0 ↑	3.0	1.7	2.3 ↓	4.5 ↑	1.9	2.6 ↑
Kazakhstan	3.0	2.0	2.0	2.3	2.3 ↑	3.7 ↑	3.5 ↑	2.2	2.6 ↑
Russia	3.3	2.0 ↑	2.3	1.7	1.7	3.0 ↑	4.0	2.3	2.5 ↑
Georgia	3.3	2.0	2.0	2.3	1.7 ↑	2.0	4.0 ↑	2.7 ↑	2.5 ↑
Moldova	3.0	2.0	2.0	2.3	2.0	2.0 ↓	4.0 ↑	2.3	2.5
Ukraine	2.7 ↑	2.0	2.3 ↑	2.0	2.0	2.0	4.5 ↑	2.1 ↑	2.5 ↑
Kyrgyzstan	3.0	2.0	2.0	2.3	2.0	3.0	3.0 ↑	1.6 ↑	2.4 ↑
Armenia	3.0	2.0	1.0 ↓	2.3	2.0	2.0	4.0 ↑	2.4 ↑	2.3
Albania	2.0	2.0	1.7 ↓	2.3 ↑	1.7	1.7	4.0 ↑	2.2 ↑	2.2 ↑
Uzbekistan	2.7	1.7 ↓	2.0	1.7	2.0	2.3	3.5	1.5 ↑	2.2
Azerbaijan	1.7	2.0	2.0 ↑	2.0	1.7	2.0	4.0 ↑	1.8 ↑	2.1 ↑
Belarus	1.0	1.0	2.0	1.0	2.0	2.3 ↑	4.0 ↑	1.4	1.8 ↑
Bosnia-Herzegovina	2.0	1.7	1.0	2.3	1.0	1.0	1.5	2.1 ↑	1.6 ↑
Tajikistan	2.3	1.7	1.7 ↑	1.0	1.0	1.7 ↓	2.0	1.1	1.6
Turkmenistan	1.7	1.0 ↓	1.0	1.0	1.0	...	2.0	1.1	1.2 ↓
CEE & Eurasia	3.1 ↑	2.1 ↑	2.3 ↑	2.2	2.1 ↑	2.9 ↑	4.0 ↑	2.4 ↑	2.6 ↑
Northern Tier CEE	3.5 ↓	3.1 ↑	2.9	3.4	3.4 ↑	3.7 ↑	4.4 ↑	3.4 ↑	3.5 ↑
Southern Tier CEE	3.0 ↑	2.1	2.1 ↑	2.8 ↑	1.9	3.2	3.9 ↑	2.9 ↑	2.7 ↑
Eurasia	2.9	1.9 ↑	2.2 ↑	1.8	1.8	2.6 ↑	3.9 ↑	2.1 ↑	2.4 ↑
Industrial Countries	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0
Benchmarks	4.0	3.0	4.0	3.0	4.0	4.0	4.0	3.0	3.6

Note: On a 1 to 5 scale, with 5 being most advanced. A "↑" indicates an advancement from September 1999 through September 2000.

EBRD, *Transition Report 2000* (November 2000).

Table 3. Change in Economic Policy Reforms: 1998-2000

	1st Stage				2nd Stage						Total
	SSP	PL	TFE	LR (ex)	LSP	ER	CP	BR	CM	LR(ef)	Change
Bulgaria	0.7	0.0	1.0	1.0	0.7	0.0	0.3	0.3	0.0	0.7	4.7
Azerbaijan	0.3	0.0	1.0	0.7	-0.3	0.0	1.0	0.0	0.7	1.0	4.3
Kazakhstan	0.7	0.0	-0.7	2.0	0.0	0.0	0.0	0.0	0.3	1.7	4.0
FYR Macedonia	0.0	0.0	0.0	1.3	0.0	0.3	1.0	0.0	0.7	0.3	3.7
Tajikistan	1.3	0.3	1.3	0.0	0.3	0.7	0.7	0.0	0.0	-1.3	3.3
Latvia	1.0	0.0	1.0	0.7	0.0	0.0	-0.3	0.0	0.0	0.7	3.0
Bosnia - Herzegovina	0.3	0.0	1.0	1.0	0.0	0.0	0.0	0.3	0.0	0.0	2.7
Lithuania	1.0	0.0	0.0	0.0	0.0	0.0	0.3	0.0	0.7	0.3	2.3
Romania	0.7	0.0	0.0	0.3	0.3	0.0	0.3	0.0	0.0	0.7	2.3
Georgia	0.0	0.3	1.0	0.0	0.0	0.0	0.0	0.0	0.7	0.0	2.0
Ukraine	0.0	0.0	0.0	1.3	0.3	0.0	0.3	0.0	0.0	0.0	2.0
Albania	0.0	0.0	1.0	1.3	0.0	0.0	-0.3	0.3	0.0	-0.3	2.0
Slovakia	0.0	0.0	1.0	0.0	0.0	0.3	0.0	0.3	0.0	0.0	1.7
Croatia	0.0	0.0	1.0	0.0	0.0	0.0	0.3	0.7	0.0	-0.7	1.3
Slovenia	0.0	0.3	0.0	1.0	-0.3	0.0	0.7	0.3	-0.3	-0.3	1.3
Kyrgyzstan	0.0	0.0	0.0	0.3	0.0	0.0	0.0	-0.3	0.0	1.0	1.0
Moldova	0.3	0.3	0.0	0.0	0.0	0.0	0.0	0.3	0.0	0.0	1.0
Estonia	0.0	0.0	1.0	-0.3	0.0	0.0	0.0	0.3	0.0	-0.7	0.3
Hungary	0.0	0.0	0.0	0.0	0.0	0.3	0.0	0.0	0.3	-0.3	0.3
Poland	0.0	0.3	0.0	-0.3	0.0	0.0	0.0	0.3	0.3	-0.3	0.3
Armenia	0.3	0.0	0.0	0.7	0.0	0.0	-1.0	0.0	1.0	-1.0	0.0
Uzbekistan	0.0	-0.7	-0.7	0.7	0.0	-0.3	0.0	0.0	0.0	0.3	-0.7
Turkmenistan	0.0	0.0	0.0	…	-0.3	-0.7	0.0	0.0	0.0	…	-1.0
Czech Republic	0.0	0.0	0.0	-1.0	0.0	0.3	0.0	0.3	0.0	-0.7	-1.0
Belarus	0.0	-1.3	0.7	-1.0	0.0	0.0	0.0	0.0	0.0	0.3	-1.3
Russia	0.0	0.0	-1.7	0.3	0.0	0.0	0.0	-0.7	-1.3	0.0	-3.3
					(Weighted) Average Change						
CEE & Eurasia	0.11	-0.03	-0.56	0.45	0.05	0.00	0.08	-0.18	-0.41	0.13	-0.04
Northern Tier CEE	0.08	0.18	0.12	-0.27	-0.01	0.12	0.02	0.26	0.24	-0.30	0.05
Southern Tier CEE	0.36	0.00	0.27	0.59	0.22	-0.03	0.20	0.12	-0.06	0.37	0.20
Eurasia	0.08	-0.09	-0.87	0.51	0.05	-0.03	0.08	-0.35	-0.63	0.11	-0.11
Benchmark											0 or greater

Note: The sub-headings refer to the following economic reforms: (SSP) small-scale privatization; (PL) price liberalization; (TFE) trade and foreign exchange reforms;(LR ex) legal reforms extensiveness; (LSP) large-scale privatization; (ER) enterprise restructuring; (CP) competition policy; (BR) bank reforms; (CM) capital market reforms; and (LRef) legal reforms effectiveness. The change is based on a rating from 1 to 5, e.g., a "1.3" score in this table might represent an advancement from 2.0 to 3.3 for the three years 1998 to 2000. Environment policy and infrastructure reform are excluded. Changes for Bosnia-Herzegovina and Tajikistan are from 1999 to 2000.

EBRD, *Transition Report 2000* (November 2000), and previous editions of the EBRD report.

B. Democratization

Progress towards democracy building is primarily assessed from indicators drawn from Freedom House. First, the status and the change from 1989 through end-year 2000 in political rights and civil liberties are examined. Second, 1999-2000 democratic trends are further disaggregated and reviewed. Third, drawing from Freedom House, Transparency International, and a recent World Bank/EBRD study, measures of corruption are analyzed and compared. As with the economic reforms, sufficient progress in democratization must entail both an adequate threshold as well as no significant deterioration.

Political Rights and Civil Liberties. Six primary criteria go into the determination of ***political freedoms***: (1) the extent to which elections for head of government are free and fair; (2) the extent to which elections for legislative representatives are free and fair; (3) the ability of voters to endow their freely elected representatives with real power; (4) the openness of the system to competing political parties; (5) the freedom of citizens from domination by the military, foreign powers, totalitarian parties, and other powerful groups; and (6) the extent to which minority groups have reasonable self-determination and self-government.

Greater political liberties are part of the end objective of a sustainable transition as well as a means to facilitate the economic reforms needed to achieve the transition. The evidence strongly suggests that the most effective route is one that is facilitated, sooner rather than later, by an open and competitive political system at all levels of government.[14] This system can only be sustained by broad-based participation from a genuinely empowered electorate.

Ten primary criteria go into the determination of ***civil liberties***: (1) freedom of media, literature, and other cultural expressions; (2) existence of open public discussion and free private discussion including religious expression; (3) freedom of assembly and demonstration; (4) freedom of political or quasi-political organization (which includes political parties, civic associations, and ad hoc issue groups); (5) equality of citizens under law with access to independent, nondiscriminatory judiciary; (6) protection from political terror and freedom from war or insurgency situations; (7) existence of free trade unions, professional organizations, businesses or cooperatives, and religious institutions; (8) existence of personal social freedoms, which include gender equality, property rights, freedom of movement, choice of residence, and choice of marriage and size of family; (9) equality of opportunity; and (10) freedom from extreme government indifference and corruption.

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[14] The EBRD provides evidence that political competition, as with economic competition, is key to transition progress. In fact, in contrast to conventional wisdom derived from past experience in other parts of the world, economic progress in the transition region is shown to be more closely associated with frequent political regime turnovers than with the stability or continuity from a strong executive and/or minimal political regime change. Political regime turnovers mitigate the influence of vested interests. See EBRD, *Transition Report 1999* (November 1999), Chapter 5: The Politics of Economic Reform.

Civil liberties are the freedoms to develop views, institutions, and personal autonomy apart from the state. The development of civil liberties, like political liberties, is an end objective in itself. The merits of such liberties as freedom of assembly and open public discussions, and freedom from political terror and war are self-evident.

However, greater civil liberties can also serve as a crucial counterweight or check on governments in societies where political rights are lacking and vested interests are strong. This counterweight can be found among NGOs (such as free trade unions, professional organizations, and religious institutions) as well as a free media. An independent, nondiscriminatory judiciary is critical for similar reasons.

In addition, civil liberties tend to link quite closely with economic progress. Many civil liberties--such as greater equality of opportunity, freedom from corruption, the existence of personal social freedoms such as gender equality, property rights, freedom of movement--contribute to a more productive economy as well as a more just one. Similarly, through the political process, pressures from civil society can help push economic reforms along.

Table 4 below highlights Freedom House's assessments of political rights and civil liberties from 1989 through 2000. The range in progress in democratization across the countries is great. At one extreme, are the eight Northern Tier CEE countries where political rights and civil liberties are roughly comparable to those found in many countries of Western Europe (such as France, Germany, Italy, and the UK). Three of these transition countries--the Czech Republic, Hungary, and Slovenia--have maintained this level of freedom since at least 1993. Poland and Lithuania achieved this level in 1995, Estonia in 1996, Latvia in 1997, and Slovakia in 1999. Of these eight countries, only Latvia, Estonia, and Slovakia experienced a temporary relapse in democratic freedoms since 1989 as so measured.

Among these leaders, democracy and freedom prevail. Elections are free and fair, at the national and sub-national levels. Those elected rule. There are competitive political parties, and the opposition has an important role and power. By and large, minority groups have self-determination.[15] In general, there remain deficiencies in some aspects of civil liberties, though most such freedoms exist. The media are generally free. The judiciary is generally independent and nondiscriminatory. NGOs and trade unions are free and able to exist. Personal social freedoms exist, as does freedom from extreme government indifference and corruption.

In contrast, Turkmenistan is among a handful of countries worldwide rated by Freedom House to have the fewest political rights and civil liberties in 2000; one of only eleven

[15] Valerie Bunce of Cornell University argues at least implicitly that "electoral inclusion" of minority groups is not adequately captured in the Freedom House scores and hence concludes that "full-scale democracies" (those that are both fully inclusive and fully free) are fewer than the group of eight scored by Freedom House. In particular, this presumably more rigorous standard would exclude Estonia and possibly Latvia. See V. Bunce, "The Political Economy of Post-Socialism," *Slavic Review*, Vol. 58, No. 4 (Winter 1999), pp. 756-793.

(down from thirteen countries in 1999) out of 192 countries to receive the poorest score. Democratic freedoms in Uzbekistan, Tajikistan, and Belarus are not much greater than those in Turkmenistan.

In Turkmenistan and Uzbekistan, basic political rights are nonexistent. In the other democratic laggards, the regimes may allow some minimal manifestation of political rights such as competitive local elections or some sort of representation or partial autonomy for minorities. An independent civic life, including a free media, is effectively suppressed in Turkmenistan. In the other lagging countries, citizens are severely restricted in expression and association.

Table 4 also shows that the large gap in democratic freedoms between the CEE and Eurasian countries continues to grow. This is evident from the table whether one looks at the most recent trends in 2000, or a medium-term timeframe (from 1998-2000, i.e., since the Russian financial crisis), or trends since communism's collapse.

In 2000, all measurable gains in the transition region in political rights and/or civil liberties occurred among the Southern Tier CEE countries. Croatia and Yugoslavia took great strides forward in this domain; Bosnia-Herzegovina advanced as well, to a lesser extent. The only backsliding in democratic reforms in CEE in 2000 occurred in Macedonia. In Eurasia in contrast, five countries experienced an erosion of democratic freedoms in 2000 (Georgia, Ukraine, Russia, Kyrgyzstan, and Azerbaijan), while none moved forward.

Both Croatia and Yugoslavia advanced significantly in political rights and civil liberties in 2000. In Croatia, the death of the autocratic ruler, Franjo Tudjman, in late 1999 set the stage for victories in parliament and presidential elections in early 2000 for a reform-minded government. From this, according to Freedom House, came broad-based gains in democracy including a significant deepening of the rule of law, more independent media, greater vibrancy within civil society, as well as improvements in governance, accountability, and transparency with the new political coalition. In Yugoslavia, democratic freedoms grew following the war in Kosovo as opposition to President Slobodan Milosevic's tight rule gained momentum, and culminated in an electoral victory in September 2000 over Milosevic. This victory, in turn, has generated considerable momentum for further gains in democratic reforms, particularly, improvements in governance and transparency, and a more effective civil society with greater press freedoms. This has included a dramatic overhaul of the broadcast media by the new Kostunica government.

Bosnia-Herzegovina advanced in civil liberties in 2000 while Macedonia regressed in political rights. The flawed September 2000 local elections in Macedonia were widely viewed as a step back in Macedonia's democratization process. More generally, the conduct of politics in Macedonia deteriorated in 2000.

By Freedom House's broad indexes (of *Table 4*), Russia, Ukraine, Georgia, and Kyrgyzstan all experienced a significant decline in political rights in 2000, while

Azerbaijan saw substantial erosion of civil liberties. Kyrgyzstan slipped to Freedom House's "Not Free" category in 2000, reflecting presidential and parliamentary elections that were neither free nor fair, and, more generally, further consolidation of power within the executive branch. In Russia and Ukraine, government harassment of independent media grew; in Russia, this surfaced in the serious irregularities that took place in the country's March 2000 presidential election. In Georgia, the re-election of President Shevardnadze in the spring 2000 was characterized by serious irregularities, and substantial governance problems in the face of an ongoing fiscal crisis persisted. Azerbaijan's election in November 2000 was characterized by voter fraud and severe pressure from government on civic groups and the media unsympathetic to the ruling regime. Similarly, freedom of association decreased as police pressures against protesters increased.

The growing CEE-Eurasian gap in democratization is also evident from trends since 1997 shown in *Table 4*. From 1998-2000, significant gains in democratic reforms occurred in CEE, particularly in the Southern Tier CEE, but also Slovakia. Only one CEE country, Albania, backslid on balance. To contrast, only two Eurasian countries, Moldova and Armenia, moved forward in democratic reforms on balance since 1997, while five countries regressed, Russia and Kyrgyzstan, most notably.

Finally, the most striking comparison in democratization trends between the CEE and Eurasian countries appears when one looks at the entire transition period. Since the transition began in CEE (i.e., since 1989), fourteen of the fifteen CEE countries have advanced in democratic reforms, many no doubt at a historically unprecedented pace. Of the CEE countries, only Bosnia-Herzegovina has not advanced by these scores. However, since the transition began in Eurasia (i.e., since 1991), nine of the twelve Eurasian countries have regressed in democratic freedoms. By this score, of all the Eurasian countries, only Georgia, Moldova, and Armenia are today further along in democratic freedoms than they were when the Soviet Union collapsed.[16]

Democratization Disaggregated. In its forthcoming *Nations in Transit 2000-2001* (2001), Freedom House further disaggregates regional democratization trends (*Table 5*). Six components of democracy building are rated on a one-to-seven scale in each country. The ratings represent events through October 2000 and are compared with progress in the summer 1999. These ratings are slightly less current than the political rights and civil liberties scores of *Table 4* (which attempt to depict events through end-year 2000). However, they presumably provide a more complete and accurate picture of the various aspects of democratization germane to the region.

The ***political process*** focuses on the extent to which elections are free, fair, competitive, and participatory. ***Civil society*** assesses the status of nongovernmental organizations; the number and nature of NGOs, and the degree of participation. ***Independent media*** attempts to measure freedom from government control (such as legal protection, editorial

[16] The trend is notably more favorable for the Eurasian countries if the starting point is 1989. This is because democratic freedoms had been increasing prior to the collapse of the Soviet Union during President Gorbachev's "glasnost" reforms.

independence, and the extent of privatization) and the financial viability of private media. ***Governance and public administration*** focuses on legislative and executive effectiveness, and on government decentralization, including the independence and effectiveness of local and regional government. ***Rule of law*** examines constitutional reforms, the development and independence of the judiciary, and the rights of ethnic minorities. Finally, the scope of ***corruption*** (official corruption in civil service; public-private sector links; anti-corruption laws and decrees adopted and enforced) is also assessed.

As expected, general trends between the two Freedom House rating schemes coincide. First, the country rankings are very similar between the two schemes. In each, the Northern Tier CEE countries are all out in front in democratization, while the Central Asian Republics alongside Belarus and Azerbaijan remain the laggards. However, the disaggregated scores of *Table 5* reveal both a greater differentiation of progress within the Northern Tier CEE countries and a larger gap between the Northern Tier leaders and the rest.

Second, the growing gap in democratic reform progress is further reinforced in the disaggregated ratings. According to the data of *Table 5*, the Northern Tier CEE countries, on balance, have maintained the level of democratic freedoms that existed since mid-1999, though there has been some slippage in fighting corruption and developing a free media in the Czech Republic and possibly in Hungary as well.[17] The Southern Tier CEE countries have made the greatest gains in 2000, moving forward on average in five of the six democratic reform areas. Gains in media freedom have been particularly impressive in the Southern Tier. Croatia and Yugoslavia made the greatest broad-based gains in democratic reforms of all the transition countries in 2000. Five Southern Tier CEE countries advanced in democratic reforms in 2000, while Macedonia and Romania experienced some erosion, according to these data.

In contrast, the Eurasian countries experienced broad-based backtracking in democratization in 2000, moving back on average in five of the six reform areas. According to these data, seven Eurasian countries (Georgia, Ukraine, Russia, Kyrgyzstan, Kazakhstan, Belarus, and Turkmenistan) had democratic freedoms erode in 2000. Of the Eurasian countries, only Tajikistan moved forward in these reforms on balance.

For the transition region as a whole (as well as for each of the three subregions), the greatest progress to date has occurred in civil society (or NGO) development, followed closely by reforms in the political process (i.e., reforms towards competitive and free elections). The least progress continues to be in efforts to reduce corruption. Of the six democratic reform areas, the largest gap in progress between the Northern Tier CEE countries and Eurasia is in efforts to develop a free media.

Corruption. *Tables 6* and *7* attempt to shed additional light on the scope and nature of corruption in the region. *Table 6* examines perceptions of corruption, drawing from

[17] Freedom House's *Press Freedom Survey 2001* shows press freedoms in Hungary increasing in 2000 in contrast to the trend displayed in *Table 5*.

Transparency International's *2000 Corruption Perceptions Index* (*CPI*). Ninety countries are included in the worldwide sample, twenty of which are from the transition region.[18] The index scores countries in terms of the degree to which corruption is perceived to exist among public officials and politicians. It is a composite index, drawing on seventeen different polls and surveys from ten independent institutions (including the World Bank, the Wall Street Journal, and Freedom House) carried out among business people, the general public, and country analysts. Scores can range from ten (highly clean) to zero (highly corrupt).

As shown in *Table 6*, corruption in a handful of Eurasian countries is perceived to be among the highest worldwide. In fact, drawing from Transparency International's full data set, one finds that on average corruption is perceived to be highest in Eurasia, followed by Sub-Saharan Africa. Corruption in the CEE region on average is perceived to be of comparable magnitude to that found in Latin America and the Caribbean, but much greater than what exists among the OECD countries.[19]

These averages, however, mask wide diversity. First, the data suggest that the level of corruption in the Southern Tier CEE countries is much closer to that found in Eurasia than that in the Northern Tier. *Table 6* also reveals that corruption is perceived to range very widely within the three transition subregions, particularly in Eurasia and the Southern Tier CEE countries. In Eurasia, the range is from Belarus (ranked 43rd out of 90 countries worldwide) to Azerbaijan (87th); in the Southern Tier, from Croatia (51st) to Yugoslavia (89th). Only in Nigeria in 2000 was corruption perceived to be greater than what it was in Yugoslavia under Milosevic.

Corruption in the Northern Tier CEE countries on average is roughly comparable to that found in Italy.[20] Of the Northern Tier CEE countries, corruption is perceived to be lowest in Estonia (ranked 27th worldwide), and highest in Latvia (57th).

A handful of the transition country scores in the *2000 CPI* differ significantly from those in the *1999 CPI*, and presumably not because there were dramatic changes in the magnitude of corruption from one year to the next.[21] *Table 7* attempts to examine more rigorously efforts to measure corruption by doing two things. First, it draws from a recent World Bank/EBRD study by Hellman, Jones, and Kaufmann (September 2000) that attempts to unbundle or differentiate types of corruption.[22] Secondly, it compares results from this study with those from Transparency International (in *Table 6*) and

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[18] Seven transition countries are excluded from the *2000 CPI*: Georgia, Albania, Macedonia, Kyrgyzstan, Bosnia-Herzegovina, Turkmenistan, and Tajikistan.

[19] This ranking is broadly consistent with a worldwide survey cited in the World Bank's *World Development Report 1997* (and shown in *Monitoring Country Progress*, No. 4 (October 1998), *Appendix II: Transition Paths*). The World Bank survey found that dissatisfaction with corruption among businesses was highest in Eurasia, followed by Sub-Saharan Africa, CEE, Latin American and the Caribbean, and (trailing far behind) the high income members of the OECD.

[20] Of all the OECD countries, only in Turkey is corruption higher than it is in Italy by this count.

[21] *Table 6* of *Monitoring Country Progress*, No. 6 (May 2000) shows the *1999 CPI* scores.

[22] J. Hellman, G. Jones, and D. Kaufmann, *Seize the State, Seize the Day: State Capture, Corruption, and Influence in Transition*, Policy Research Working Paper 2444, World Bank and EBRD (September 2000).

Freedom House (in *Table 5*) to get a better feel for the robustness of the corruption measures.

Two types of corruption from Hellman, Jones, and Kaufmann (2000) are included in *Table 7*. Administrative corruption refers to petty forms of bribery, and is defined as private payments to public officials to distort the prescribed implementation of official rules and policies. State capture, in contrast, refers to efforts on the part of enterprises to purchase advantages directly from the state, and is defined as actually shaping the formation of the basic rules of the game (i.e., laws, rules, decrees, and regulations) through illicit and non-transparent private payments to public officials. "Captor" firms tend to be new-start firms trying to compete against influential incumbents in an environment of a weak state (i.e., where public goods are under-provided and the "playing field" for the private sector is highly uneven).[23]

The beneficiaries from administrative corruption are primarily corrupt public officials, and the cost to the economy is essentially a tax, which decreases efficiency and distorts the allocation of resources. In contrast, it is the firms that are influencing the state (and shaping the rules) which stand to gain the most from state capture, though corrupt public officials benefit as well. State capture is undertaken because the rules of the game are not fair and/or clear. Yet, this contributes to a further erosion of the rule of law. Hence, state capture is likely more intractable and much costlier economy-wide than is administrative corruption.

The data used to calculate administrative corruption and state capture are from the 1999 Business Environment and Enterprise Performance Survey (BEEPS).[24] For administrative corruption, firms were asked, on average, what percent of revenues do firms like yours typically pay per annum in unofficial payments to public officials: 0%; less than 1 percent; 1-1.99 percent; 2-9.99 percent; 10-12 percent; 13-25 percent; or over 25 percent. The categories were imputed at 0 percent; 1 percent; 2 percent; 6 percent; 11 percent; 19 percent; or 25 percent and the mean calculated. The state capture measure is an index calculated as the unweighted average of six component indices. Specifically, firms were asked to assess the extent to which six types of activities have had a direct impact on their business: (1) the sale of parliamentary votes on laws to private interests; (2) the sale of presidential decrees to private interests; (3) central bank mishandling of funds; (4) the sale of court decisions in criminal cases; (5) the sale of court decisions in commercial cases; and (6) illicit contributions paid by private interests to political parties

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[23] Hellman et.al. (2000) also examines the relationship between these influential incumbent firms and the state. In this relationship, influence refers to a firm's ability to shape the formation of basic rules of the game *without* recourse to private payments to public officials. "Influential" firms, hence, are generally distinct from "captor" firms, and tend to be large, "pre-existing," and often with ownership ties to the state.

[24] The BEEPS is the first stage of a world-wide survey of firms on the obstacles in the business environment conducted by the World Bank in co-operation with the EBRD, the Inter-American Development Bank, and the Harvard Institute for International Development. Some of the data from the BEEPS were first published in the EBRD's *Transition Report* (November 1999). For elaboration of the survey's methodology and main results, see Hellman, Jones, Kaufmann, and Schankerman, *Measuring Governance and State Capture: The Role of Bureaucrats and Firms in Shaping the Business Environment* World Bank Working Paper 2312 (2000).

and campaigns. Firms were asked whether corruption in each of these six dimensions had no impact; minor impact; significant impact; or very significant impact on their business. *Table 7* reports the proportion of firms claiming significant or very significant impact of state capture.

Some of the general trends highlighted by these two measures of corruption are predictable and consistent with the measures drawn from Transparency International and Freedom House. Corruption is considerably lower in the Northern Tier CEE countries on balance, and highest in Eurasia. This is particularly evident in the case of state capture. Roughly 12 percent of the firms surveyed in the Northern Tier CEE countries are significantly affected by state capture. It is closer to 27 percent in Eurasia. However, as with other corruption scores, the range across the countries is very significant as well (and averages can mask substantial diversity). The percentage of firms significantly affected by state capture ranges from 6 to 7 percent in Uzbekistan, Armenia, Hungary, and Slovenia to approximately 49 percent in Azerbaijan and Moldova. Illicit payments as a percent of firm revenues (i.e., administrative corruption) range from around 1 percent in Croatia, Belarus, Latvia, and Slovenia to more than 5 percent in Azerbaijan and Kyrgyzstan.

To facilitate broad comparisons of the four measures of corruption, results of each were grouped into three ordinal categories: low; medium; and high corruption (*Table 7*). These groupings show that of the twenty-two countries for which data are available, there is consistency in the corruption measures for a handful of countries where corruption is determined to be among the lowest (specifically, in Slovenia, Estonia, Poland, and Hungary), as well as where corruption is measured to be among the highest (specifically, Azerbaijan, Kyrgyzstan, Ukraine, and Moldova). Results for all other countries are mixed. The most striking comparisons between corruption measures are in the cases of Latvia, Uzbekistan, and Armenia where different corruption measures for the same country range from low to high.

Part of the explanation as to why there is not greater consistency no doubt stems from different definitions and different types of corruption being measured. Hence, unbundling types of corruption can shed light. In particular (and with exceptions; corruption in Belarus is the salient one), administrative corruption seems to correlate well with progress in transition reforms: the reform leaders generally have (relatively) low administrative corruption; many "middle tier" or "partial" reformers (primarily in the Southern Tier), have medium-range corruption; the reform laggards have high administrative corruption.

However, as suggested by Hellman, et. al. (2000), an inverted "U" shape or nonlinear relationship may better describe the relationship between reform progress and state capture. Specifically, state capture is relatively low among the reform leaders of the Northern Tier (except Latvia); ranges from medium to high among the middle-tier or partial reformers; but is also low among some of the laggards (Uzbekistan and Belarus are the salient cases).[25] Low state capture among the laggards might be explained by the dominance of authoritarian political regimes over relatively small private sectors. Given this imbalance of power, there is little scope (and few available firms) to "capture" the state.

[25] More data would shed more light on this working hypothesis: state capture scores do not exist for other reform laggards, Turkmenistan, Tajikistan, Bosnia-Herzegovina, and Yugoslavia.

Table 4. Political Rights and Civil Liberties[1]

	1989[2]		1997		1998		1999		2000[3]		1998-00 Change[4]		1990-00 Change	
	PR	CL	PR	CL	PR	CL	PR	CL	PR	CL	PR	CL	PR	CL
Hungary	4	3	1	2	1	2	1	2	1	2	0	0	+ 3	+ 1
Poland	4	3	1	2	1	2	1	2	1	2	0	0	+ 3	+ 1
Slovenia	5	4	1	2	1	2	1	2	1	2	0	0	+ 4	+ 2
Estonia	6	5	1	2	1	2	1	2	1	2	0	0	+ 5	+ 3
Latvia	6	5	1	2	1	2	1	2	1	2	0	0	+ 5	+ 3
Lithuania	6	5	1	2	1	2	1	2	1	2	0	0	+ 5	+ 3
Czech Republic	6	6	1	2	1	2	1	2	1	2	0	0	+ 5	+ 4
Slovakia	6	6	2	4	2	2	1	2	1	2	+ 1	+ 2	+ 5	+ 4
Romania	6	5	2	2	2	2	2	2	2	2	0	0	+ 4	+ 3
Bulgaria	6	5	2	3	2	3	2	3	2	3	0	0	+ 4	+ 2
Croatia	5	4	4	4	4	4	4	4	2 ↑↑	3 ↑	+ 2	+ 1	+ 3	+ 1
Moldova	6	5	3	4	2	4	2	4	2	4	+ 1	0	+ 4	+ 1
FYR Macedonia	5	4	4	3	3	3	3	3	4 ↓	3	0	0	+ 1	+ 1
Georgia	6	5	3	4	3	4	3	4	4 ↓	4	− 1	0	+ 2	+ 1
Ukraine	6	5	3	4	3	4	3	4	4 ↓	4	− 1	0	+ 2	+ 1
Armenia	6	5	5	4	4	4	4	4	4	4	+ 1	0	+ 2	+ 1
Yugoslavia	5	4	6	6	6	6	5	5	4 ↑	4 ↑	+ 2	+ 2	+ 1	0
Albania	6	5	4	4	4	5	4	5	4	5	0	− 1	+ 2	0
Bosnia-Herzegovina	5	4	5	5	5	5	5	5	5	4 ↑	0	+ 1	0	0
Russia	6	5	3	4	4	4	4	5	5 ↓	5	− 2	− 1	+ 1	0
Kyrgyzstan	6	5	4	4	5	5	5	5	6 ↓	5	− 2	− 1	0	0
Azerbaijan	6	5	6	4	6	4	6	4	6	5 ↓	0	− 1	0	0
Kazakhstan	6	5	6	5	6	5	6	5	6	5	0	0	0	0
Belarus	6	5	6	6	6	6	6	6	6	6	0	0	0	− 1
Tajikistan	6	5	6	6	6	6	6	6	6	6	0	0	0	− 1
Uzbekistan	6	5	7	6	7	6	7	6	7	6	0	0	− 1	− 1
Turkmenistan	6	5	7	7	7	7	7	7	7	7	0	0	− 1	− 2

	1989		1997		1998		1999		2000[3]		1998-00 Change		1990-99 Change	
	PR	CL	PR	CL	PR	CL	PR	CL	PR	CL	PR	CL	PR	CL
CEE & Eurasia	5.8	4.9	3.3	3.9	3.6	3.9	3.6	4.2	4.1	4.2	− 0.4	− 0.3	+ 1.7	+ 0.8
Northern Tier CEE	4.7	3.9	1.1	2.1	1.1	2.0	1.0	2.0	1.0	2.0	+ 0.1	0.0	+ 3.7	+ 1.9
Southern Tier CEE	6.3	5.9	3.3	3.4	3.3	3.5	3.1	2.9	2.8	3.0	+ 0.5	+ 0.5	+ 3.5	+ 2.9
Eurasia	6.0	5.0	3.9	4.4	4.4	4.4	4.4	4.9	5.1	5.0	− 0.7	− 0.6	+ 0.9	+ 0.0
European Union[5]									1.0	1.5				
OECD[6]									1.2	1.7				
Benchmarks									1.0	2.0	> 0.0	> 0.0		

Notes: (1) Ratings from 1 to 7, with 1 representing greatest development of political rights/civil liberties. (2) The 1989 scores for the Soviet Union, Czechoslovakia and communist Yugoslavia are used for the countries that were part of these larger entities in 1989. (3) An ↑ (↓) indicates an increase(decrease) in democratization in 2000 as measured by a change in a political rights or civil liberties score. (4) A "+ (-)" refers to an increase(decrease) in freedoms. (5) All 15 EU members score "1" in Political Rights. In Civil Liberties 8 of the 15 members score a "1"; 6 score a "2" (Belgium, France, Germany, Italy, Spain and the UK); and Greece scores a "3". (6) All but three OECD members score a "1" in Political Rights; the exceptions are Turkey ("4"), Mexico ("3"), and Korea ("2"). For Civil Liberties, 15 members score a "1"; 11 score a "2" (Belgium, Czech Republic, France, Germany, Hungary, Italy, Japan, Korea, Poland, Spain, and the UK); Greece scores a "3"; Mexico scores a "4"; Turkey scores a "5".

Freedom House, *Freedom in the World 2001* (and previous editions).

Table 5. Democratization Disaggregated in 2000

Country	Political Process	Civil Society	Independent Media	Govt/Public Administration	Rule of Law	Corruption	Average	Change (1999-00)
Poland	1.3	1.3	1.5	1.8	1.5	2.3	1.6	...
Slovenia	1.8 ⇧	1.8	1.8	2.5 ⇩	1.5	2.0	1.9	...
Estonia	1.8	2.3 ⇧	1.8	2.3	2.0	2.8 ⇧⇧	2.1	⇧
Hungary	1.3	1.3	2.3 ⇩	3.0 ⇩⇩	2.0 ⇩	3.0 ⇩⇩	2.1	⇩
Latvia	1.8	2.0 ⇧	1.8	2.3 ⇧	2.0	3.5	2.2	⇧
Lithuania	1.8	1.8 ⇧	1.8	2.5	1.8 ⇧	3.8	2.2	⇧
Czech Republic	1.8	1.5	2.0 ⇩	2.0	2.5 ⇩	3.8 ⇩⇩	2.3	⇩
Slovakia	2.3 ⇧	2.0 ⇧	2.0 ⇧	2.8 ⇧	2.3 ⇧	3.8	2.5	⇧
Bulgaria	2.0 ⇧	3.5 ⇧	3.3 ⇧	3.5 ⇧	3.5	4.8	3.4	⇧
Croatia	3.3 ⇧⇧	2.8 ⇧⇧	3.5 ⇧⇧	3.5 ⇧⇧	3.8 ⇧⇧	4.5 ⇧⇧	3.5	⇧⇧
Romania	3.0 ⇩	3.0	3.5	3.8 ⇩	4.3	4.5 ⇩	3.7	⇩
FYR Macedonia	3.8 ⇩	3.8 ⇩	3.8	3.8 ⇩⇩	4.3	5.0	4.0	⇩
Georgia	4.5 ⇩⇩	4.0 ⇩	3.5 ⇧	4.8 ⇩⇩	4.0 ⇧⇧	5.3 ⇩	4.3	⇩
Moldova	3.3	3.8	4.3 ⇩	4.5	4.0	6.0	4.3	...
Albania	4.0 ⇧	4.0	4.3 ⇧	4.3 ⇧⇧	4.5 ⇧⇧	5.5 ⇧⇧	4.4	⇧
Ukraine	4.0 ⇩⇩	3.8 ⇧	5.3 ⇩	4.8	4.5	6.0	4.7	⇩
Armenia	5.5 ⇩	3.5	4.8	4.5	5.0	5.8	4.8	...
Russia	4.3 ⇩	4.0 ⇩	5.3 ⇩⇩	5.0 ⇩⇩	4.5 ⇩	6.3	4.9	⇩
Yugoslavia	4.8 ⇧⇧	4.0 ⇧⇧	4.5 ⇧⇧	5.3 ⇧	5.5 ⇧	6.3	5.0	⇧⇧
Bosnia-Herzegovina	4.8 ⇧	4.5	4.5 ⇧⇧	6.0	5.5 ⇧⇧	5.8 ⇧	5.2	⇧
Kyrgyzstan	5.8 ⇩⇩	4.5	5.0	5.3 ⇩	5.3 ⇩	6.0	5.3	⇩
Tajikistan	5.3 ⇧	5.0 ⇧	5.5 ⇧	6.0 ⇧	5.8	6.0	5.6	⇧
Azerbaijan	5.8 ⇩	4.5 ⇧	5.8 ⇩	6.3	5.3 ⇧	6.3 ⇩	5.6	...
Kazakhstan	6.3 ⇩	5.0	6.0 ⇩⇩	5.0	5.8 ⇩	6.3 ⇩	5.7	⇩
Belarus	6.8	6.5 ⇩⇩	6.8	6.3	6.8 ⇩	5.3	6.4	⇩
Uzbekistan	6.8 ⇩	6.5	6.8 ⇩	6.0 ⇧	6.5	6.0	6.4	...
Turkmenistan	7.0	7.0	7.0	6.8	7.0 ⇩	6.3 ⇩	6.8	⇩

	Political Process	**Civil Society**	**Independent Media**	**Govt/Public Administration**	**Rule of Law**	**Corruption**	**Average**	**Change (1999-00)**
CEE & Eurasia	4.0 ⇩	3.7	4.6 ⇩	4.5 ⇩	4.3 ⇩	5.4 ⇩	4.4	⇩
Northern Tier CEE	1.5	1.4	1.7 ⇩	2.1	1.8	2.8 ⇩	1.9	...
Southern Tier CEE	3.4 ⇧	3.4 ⇧	3.8 ⇧⇧	4.2	4.5 ⇧	5.0 ⇧	4.1	⇧
Eurasia	4.8 ⇩	4.4 ⇩	5.5 ⇩	5.2 ⇩	4.9 ⇩	6.1	5.1	⇩

Note: On a scale from 1 to 7, with 1 representing most advanced--or, in the case of corruption, most free.
A "↑" indicates an increase in democratization since 1999; a "↓" signifies a decrease. One arrow represents a change greater than 0.1 and less than 0.5; two arrows represents change greater than 0.5.

Data depict trends from July 1999 through October 2000.
Freedom House, *Nations in Transit 2000-2001* (2001).

Table 6. Transparency International's 2000 Corruption Perceptions Index

	Score	Worldwide Rank		Score	Worldwide Rank
Estonia	5.7	27	Finland	10.0	1
Slovenia	5.5	28	USA	7.8	14
Hungary	5.2	32	Germany	7.6	17
Czech Republic	4.3	42	Botswana	6.0	26
Poland	4.1	43	Taiwan	5.5	28
Lithuania	4.1	43	Costa Rica	5.4	30
Belarus	4.1	43	Greece	4.9	35
Croatia	3.7	51	Italy	4.6	39
Slovakia	3.5	52	Peru	4.4	41
Bulgaria	3.5	52	Mexico	3.3	59
Latvia	3.4	57	Zimbabwe	3.0	65
Kazakhstan	3.0	65	India	2.8	69
Romania	2.9	68	Vietnam	2.5	76
Moldova	2.6	74	Kenya	2.1	82
Armenia	2.5	76	Indonesia	1.7	85
Uzbekistan	2.4	79	Nigeria	1.2	90
Russia	2.1	82			
Ukraine	1.5	87	EU	7.6	
Azerbaijan	1.5	87			
Yugoslavia	1.3	89			
CEE & Eurasia (n=20)	3.3				
N.Tier CEE (n=8)	4.5				
S.Tier CEE (n=4)	2.9				
Eurasia (n=8)	2.5				

The TI Corruption Perceptions Index (CPI) scores countries in terms of the degree to which corruption is perceived to exist among public officials and politicians. The 2000 CPI ranks 90 countries. It is a composite index, drawing on 16 different polls and surveys from 10 independent institutions (including Freedom House, World Bank, and Wall Street Journal) carried out among business people, the general public, and country analysts. Scores can range from 10 (highly clean) to 0 (highly corrupt). Transition country ratings are given equal weight in the regional averages.

Transparency International, *2000 Corruption Perceptions Index* (September 2000).

Table 7. Corruption Unbundled (and Measures Compared)

Country	Administrative Corruption (Payments) (payments as % of revenue)	Administrative Corruption (Rank)	State Capture (%) (% of firms affected)	State Capture (Rank)	Admin. Corruption	State Capture	TI's CPI	Freedom House
Slovenia	1.4	3	7	2	Low	Low	Low	Low
Estonia	1.6	5	10	6	Low	Low	Low	Low
Poland	1.6	5	12	9	Low	Low	Low	Low
Hungary	1.7	7	7	2	Low	Low	Low	Low
Belarus	1.3	2	8	5	Low	Low	Low	Medium
Czech Republic	2.5	9	11	7	Medium	Low	Low	Low
Lithuania	2.8	11	11	7	Medium	Low	Low	Low
Croatia	1.1	1	27	15	Low	Medium	Medium	Low
Kazakhstan	3.1	13	12	9	Medium	Low	Medium	High
Latvia	1.4	3	30	18	Low	High	Medium	Low
Uzbekistan	4.4	18	6	1	High	Low	High	High
Armenia	4.6	20	7	2	High	Low	High	Medium
Romania	3.2	14	21	12	Medium	Medium	Medium	Low
Slovakia	2.5	9	24	13	Medium	Medium	Medium	Low
Bulgaria	2.1	8	28	16	Medium	High	Medium	Medium
Russia	2.8	11	32	19	Medium	High	High	High
Albania	4.0	15	16	11	High	Medium	-----	Medium
Georgia	4.3	17	24	13	High	Medium	-----	Medium
Moldova	4.0	15	37	21	High	High	High	High
Ukraine	4.4	18	32	19	High	High	High	High
Kyrgyzstan	5.3	21	29	17	High	High	-----	High
Azerbaijan	5.7	22	41	22	High	High	High	High
Yugoslavia	-----	-----	-----	-----	-----	-----	High	High
FYR Macedonia	-----	-----	-----	-----	-----	-----	-----	Medium
Bosnia-Herzegovina	-----	-----	-----	-----	-----	-----	-----	Medium
Turkmenistan	-----	-----	-----	-----	-----	-----	-----	High
Tajikistan	-----	-----	-----	-----	-----	-----	-----	High
CEE & Eurasia	3.0		24.0					
Northern Tier CEE	1.9		12.4					
Southern Tier CEE	2.8		22.7					
Eurasia	3.4		27.4					

Administrative corruption is defined as private payments to public officials to distort the prescribed implementation of official rules and policies, I.e., petty forms of bribery. For administrative corruption, firms were asked, on average, what percent of revenues do firms like yours typically pay per annum in unofficial payments to public officials: 0%; less than 1%; 1 - 1.99%; 2 - 9.99%; 10 - 12%; 13 - 25%; over 25%. The categories were imputed at 0%; 1%; 2%; 6%; 11%; 19%; 25% and the mean calculated.

State capture is defined as shaping the formation of the basic rules of the game (i.e., laws, rules, decrees, and regulations) through illicit and non-transparent private payments to public officials. The state capture measure is an index calculated as the unweighted average of six component indices. Specifically, firms were asked to assess the extent to which six types of activities have had a direct impact on their business: (1) the sale of Parliamentary votes on laws to private interests; (2) the sale of Presidential decrees to private interests; (3) Central Bank mishandling of funds; (4) the sale of court decisions in criminal cases; (5) the sale of court decisions in commercial cases; and (6) illicit contributions paid by private interests to political parties and campaigns.

Firms were asked whether corruption in each of these six dimensions had no impact; minor impact; significant impact; very significant impact on their business. The table reports the proportion of firms reporting significant or very significant impact of state capture. The data used to calculate administrative corruption and state capture are from the 1999 Business Environment and Enterprise Performance Survey, a firm-level survey commissioned jointly by the EBRD and the World Bank.

J. Hellman, G. Jones, and D. Kaufmann, *Seize the State, Seize the Day: State Capture, Corruption, and Influence in Transition*, Policy Research Working Paper 2444, World Bank and EBRD (September 2000), Transparency International, *2000 CPI* (September 2000), and Freedom House, *Nations in Transit 2000-2001* (2001).

C. Summary of Economic Reforms & Democratization

Table 8 and *Figure 1* provide an overall picture of the status of the economic policy reforms and democratic freedoms in the transition countries in 2000. With one country exception, the economic policy reform ratings represent an equally weighted average of all twelve EBRD policy indicators (that is, from both stages).[26] The democratic freedom ratings are calculated from Freedom House, *Nations in Transit 2000-2001* (forthcoming). Specifically, the six democratization components of *Table 5* are averaged for each country, and then compressed into a one-to-five scale with five representing the most advanced (or most free) to better align with the economic policy reform scale.

The results reinforce several observations made in previous *Monitoring Country Progress* reports. First, 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. *Figure 1* suggests that there are broadly two groups of transition countries differentiated by reform progress, a "well-defined" or closely clustered Northern Tier CEE group and the rest (which are characterized by very large differences in reform progress among them). Second, *Table 8* shows that while the average ratings of economic policy reforms and democratic freedoms are very close for the transition region as a whole ("2.9" for economic reforms vs. "2.7" for democratization), the range in progress is significantly greater in the case of democratic reforms. The reform leaders have democratic freedoms roughly on a par with some Western democracies, while the democratic laggard, Turkmenistan, scores among the least democratic countries worldwide. In economic policy reforms, however, even the Northern Tier CEE countries still have far to go to reach the standards in the industrial market economies. This is particularly evident in the second stage economic reforms.

Third, taking stock of the changes in reform progress in 2000, one finds that the Northern Tier CEE countries continue to move towards convergence in reforms. The three Baltic countries moved forward in both reform dimensions in 2000. Hungary and the Czech Republic slipped a notch in democratization. The remaining Northern Tier countries moved forward in either economic or democratic reforms, but not both. This trend towards convergence reflects in large part that these countries have been approaching a reform "ceiling" (in democratization in particular), and/or that the remaining reforms (particularly in economic policy) are the hardest to achieve.

The fourth observation follows partly from the third. While the reform gap between the Northern and Southern Tier CEE countries remains large, it nevertheless continues to narrow. That is, of the three subregions, the greatest reform gains in 2000 occurred in the Southern Tier where a majority of countries (specifically, Croatia, Bulgaria, Albania, and Bosnia-Herzegovina) made progress in both economic and democratic reforms. Of all the transition countries, perhaps the most impressive and broad-based gains in 2000 occurred in Croatia. Bulgaria and Albania made very notable strides forward as well.

[26] As previously noted, the economic reform score for Yugoslavia is drawn from Freedom House, *Nations in Transit 2000-2001* (forthcoming).

Yugoslavia advanced significantly in democratic reforms in 1999 and 2000, and is now poised to begin catching-up in economic reforms.

Finally, the 2000 reform data highlight the continuing divergence in transition paths between the Eurasian countries and CEE. This divergence can be viewed on several different dimensions, not just reform progress, but also macroeconomic performance, structural trends in the economies, and social conditions.[27] What is striking about the 2000 reform data is the juxtaposition between impressive gains in Eurasia in economic reforms with equally "impressive" backsliding in democratization, and how starkly that contrasts with the close and growing links between economic and democratic reforms among the CEE countries. In fact, in 2000, one-half of the Eurasian countries made gains in economic reforms while simultaneously backsliding in democratization: Georgia; Russia; Ukraine; Kazakhstan; Kyrgyzstan; and Belarus. All seven of the transition countries that experienced economic reforms advancing alongside gains in democratization in 2000 were in CEE: Estonia; Latvia; Lithuania; Bulgaria; Croatia; Albania; and Bosnia-Herzegovina.

Figure 2 shows the reform dimension of the transition paths for four select countries since 1991: Poland, Slovakia, Russia, and Belarus.[28] Two broad reform paths can be discerned between the CEE and Eurasian countries. The first distinction is the very different “starting points” between the two groups (and very similar starting points within each pair). The CEE countries started the transition much further ahead in both economic and democratic reforms.

Since 1991, Poland and Slovakia both have made very impressive and steady gains in economic reforms, and more modest gains in democratization.[29] Today, Poland and Slovakia are again at similar levels of reform progress. The salient difference in paths between the two is that Slovakia experienced some temporary backsliding in democratization while Poland did not. As noted previously, the relatively modest gains in democratization during this period, and a slowing of progress in economic reforms more recently reflect both success (democratic freedoms are approaching a limit by worldwide standards) and growing challenges (that come with the implementation of more difficult economic reforms).

Contrast this with the reform trends in the two Eurasian countries of Belarus and Russia. While Russia’s path may be the more typical for the Eurasian countries overall, both still have common threads that diverge significantly from those of the CEE countries.

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[27] *Appendix II: Transition Paths* of *Monitoring Country Progress*, No. 4 (October 1998) provides some elaboration on these dimensions.

[28] The method to measure reform progress in *Figure 2* was, out of necessity, simplified from that of *Figure 1* to capture estimates of earlier years. Democratic Freedoms were calculated from Freedom House’s civil liberties and political rights indices (*Table 4*). Fewer economic reforms indicators were used to calculate the overall rating since some (in particular, legal reforms, infrastructure, and environmental reforms) are not available from the EBRD for earlier years.

[29] If 1989 is the starting point, the gains in democratization for both are much more impressive, particularly for Slovakia.

Specifically, both made steady, and particularly in the case of Russia, impressive gains in economic reforms to or through the mid-1990s. In the case of Belarus, economic reform progress peaked in 1995; for Russia, it was in 1997. By 1997, it looked as if Russia might catch the CEE countries in economic reform progress. However, since then, backsliding on balance has characterized economic reforms in both countries. In contrast to the CEE countries, earlier economic reform gains in these Eurasian countries proved to be unsustainable. Moreover, the backsliding in democratic reforms since 1991 has been significant for both, even though Russia was able to maintain a level of democratization for several years in the mid-1990s.

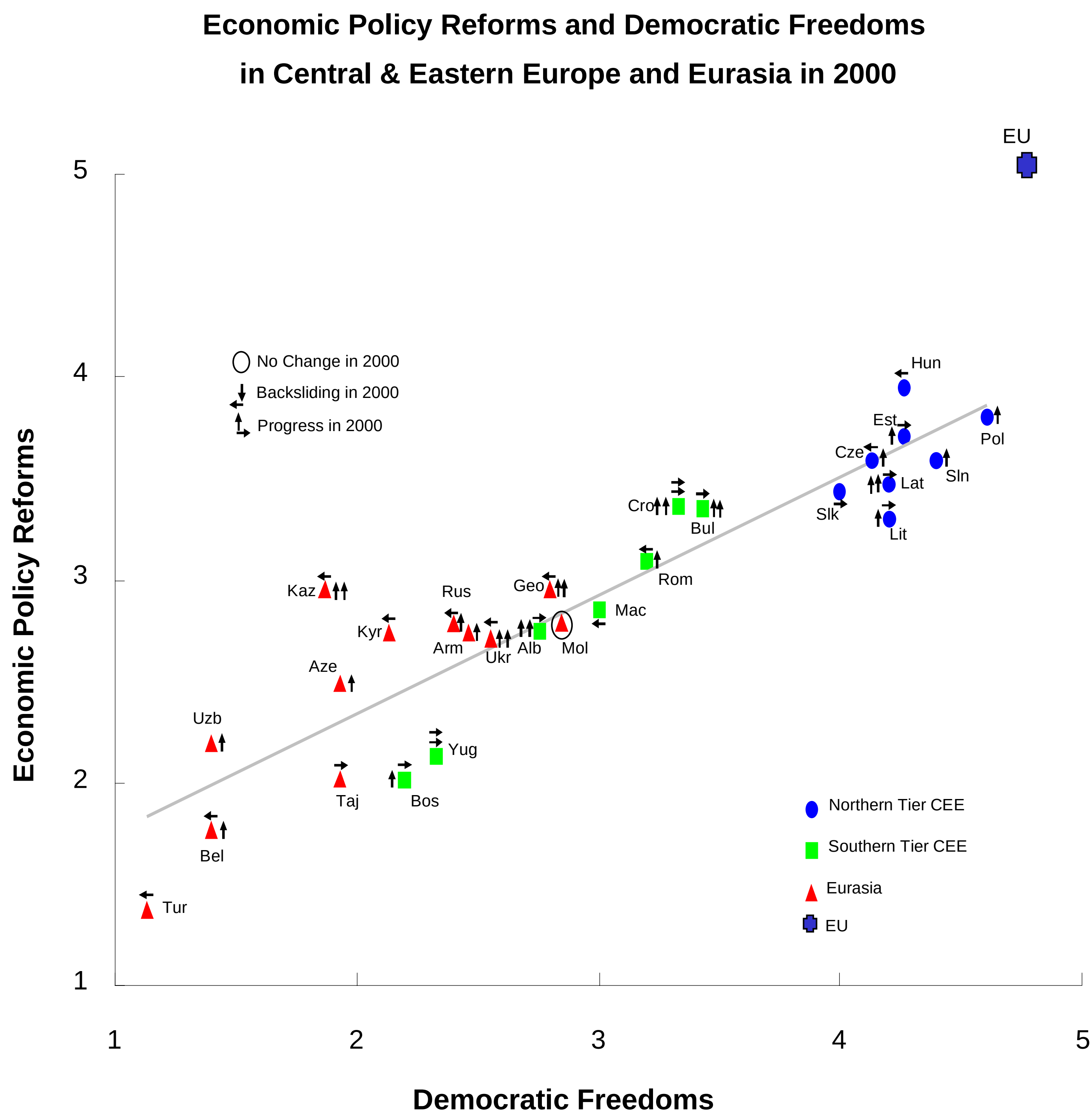
Table 8. Economic Policy Reforms and Democratic Freedoms in Central & Eastern Europe and Eurasia: 2000

Economic Policy			Democratic Freedoms		
Country	**Rating (1 to 5)**	**Ranking**	**Country**	**Rating (1 to 5)**	**Ranking**
Hungary	3.9	1	Poland	4.6	1
Poland	3.8	2	Slovenia	4.4	2
Estonia	3.7	3	Hungary	4.3	3
Slovenia	3.6	4	Estonia	4.3	3
Czech Republic	3.6	4	Lithuania	4.2	5
Latvia	3.5	6	Latvia	4.2	5
Slovakia	3.4	7	Czech Republic	4.1	7
Lithuania	3.4	7	Slovakia	4.0	8
Croatia	3.4	7	Bulgaria	3.4	9
Bulgaria	3.3	10	Croatia	3.3	10
Romania	3.1	11	Romania	3.2	11
Kazakhstan	2.9	12	FYR Macedonia	3.0	12
Georgia	2.9	12	Moldova	2.8	13
FYR Macedonia	2.8	14	Georgia	2.8	13
Moldova	2.8	14	Albania	2.7	15
Russia	2.8	14	Ukraine	2.5	16
Albania	2.7	17	Armenia	2.5	16
Kyrgyzstan	2.7	17	Russia	2.4	18
Armenia	2.7	17	Yugoslavia	2.3	19
Ukraine	2.7	17	Bosnia-Herzegovina	2.2	20
Azerbaijan	2.5	21	Kyrgyzstan	2.1	21
Uzbekistan	2.2	22	Azerbaijan	1.9	22
Yugoslavia	2.1	23	Tajikistan	1.9	22
Tajikistan	2.0	24	Kazakhstan	1.9	22
Bosnia-Herzegovina	2.0	24	Belarus	1.4	25
Belarus	1.8	26	Uzbekistan	1.4	25
Turkmenistan	1.4	27	Turkmenistan	1.1	27

	Economic Policy Rating (1 to 5)	Democratic Freedoms Rating (1 to 5)
CEE & Eurasia	2.9	2.7
Northern Tier CEE	3.7	4.4
Southern Tier CEE	2.8	3.1
Eurasia	2.6	2.2
European Union	5.0	4.8
OECD	--	4.6

Ratings of democratic freedoms are from Freedom House, *Nations in Transit 2000 - 2001* (2001), and assess reforms through October 2000. With 1 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). Ratings are based on a 1 to 5 scale, with 5 representing most advanced.

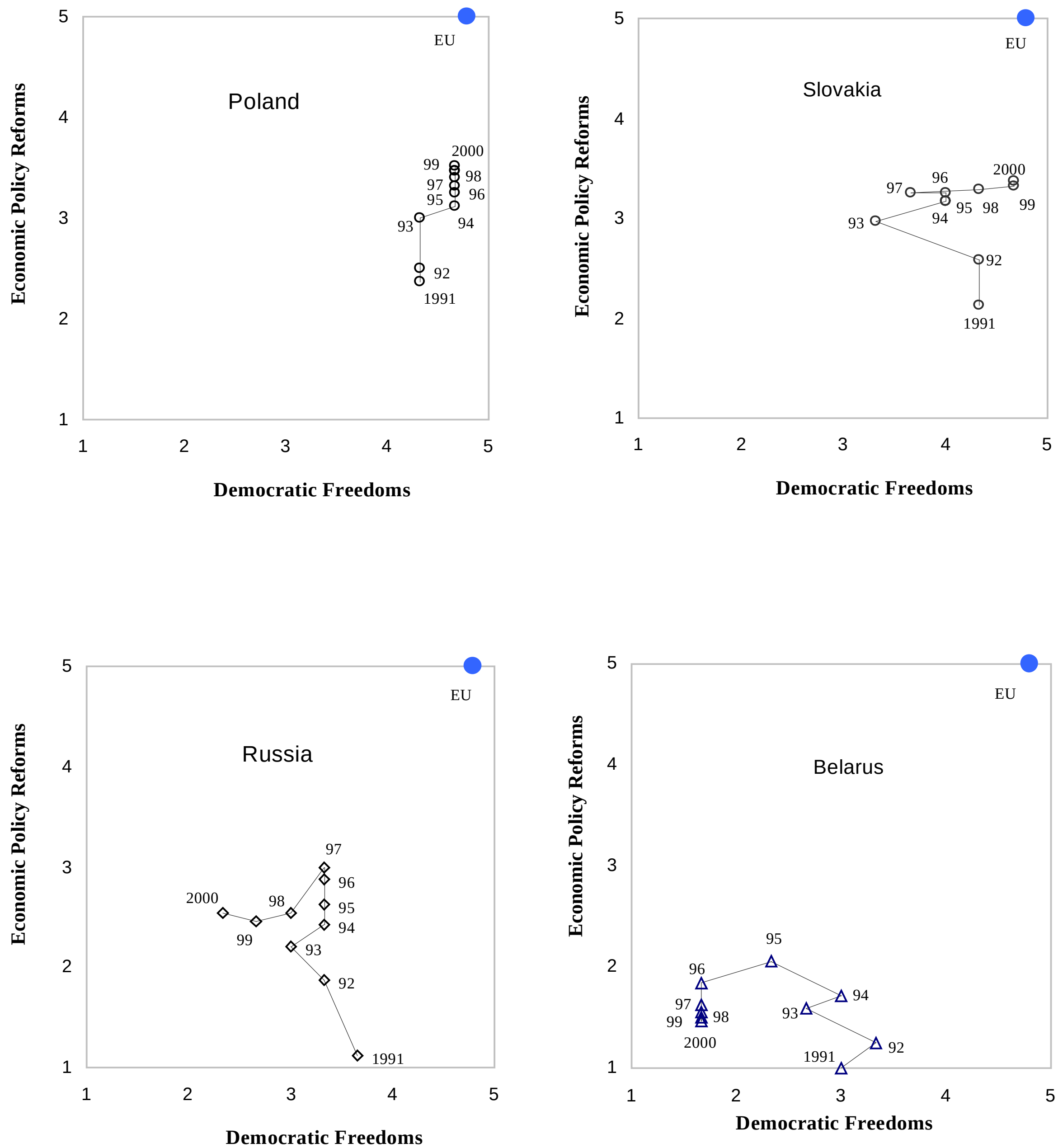
Figure 1.



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). 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.

Figure 2.

Economic Policy Reforms and Democratic Freedoms in Central & Eastern Europe and Eurasia: Selected Countries, 1991 to 2000



Ratings based on a 1 to 5 scale, with 5 representing the most advanced.
EBRD, *Transition Report 2000* (November 2000); Freedom House, *Freedom in the World* (various years).

D. Sustainability

In this section, we weigh the economic and democratic reforms against the macroeconomic and microeconomic evidence. Economic policy reforms need to translate into good macroeconomic performance. Yet, this is not enough. The benefits at the macro level must also be reasonably well distributed and need to translate into social conditions that at the least are not significantly deteriorating. Otherwise, the reforms may stall for lack of support, fiscal sustainability may be jeopardized, and, even more fundamentally, overall productivity may be slowed.

The quality of these data is an important issue, and numerous caveats apply. Credible cross-country comparisons are oftentimes difficult because the quality of data still varies widely throughout the transition region. In general, data for the CEE countries tend to be better than those for the Eurasian countries. Accurate time-series assessments can be difficult as well. Earlier year calculation methods sometime differ from those in latter years. Data for previous years, hence, are also sometimes subject to revisions. In the economic domain, it is widely recognized that unofficial economic activity is very significant, and that efforts to include these activities into official GDP figures fall short. Nor are the important and very substantial qualitative changes adequately reflected in the figures. Recent data that shed light on social conditions are often hard to find as well. Moreover, discrepancies between data from different sources in some of the social indicators can be significant. For example, World Bank data on various social indicators, including measures of mortality and education enrollments, can be significantly at odds with UN data for some transition countries. In general, these caveats underscore the importance of drawing from a variety of evidence, and particularly from a variety of indicators, to shape one's analyses and conclusions.

1. Macroeconomic Performance.

Tables 9 through *16* highlight macroeconomic performance. Overall, the data reveal exceptionally favorable macroeconomic trends in 2000 for the transition region. Salient among these trends are ***economic growth*** rates (*Table 9*). On average, the transition economies grew by 6.1 percent in 2000, far surpassing annual growth rates in all the previous transition years.[30] In fact, there have been only two previous years since 1989 when region-wide economic growth was even positive: in 1997, it was 1.9 percent and in 1999, 2 percent. The expansion in economic activity in 2000 was broadly shared across the subregions, highest in Eurasia (6.8 percent), but followed by strong growth in both the Southern Tier CEE (5.1 percent) and the Northern Tier CEE (4.1 percent). For the first year since the transition began, no transition country in 2000 witnessed a contraction in real GDP.

[30] The IMF in its *World Economic Outlook* (May 2001) estimates that average 2000 economic growth for the transition region was 5.8% while the EBRD in its April 2001 *Transition Report Update* finds it to be 5.4%. Presumably, the primary reason for the difference between our calculation and those of the IMF and

Assessing economic growth over the medium term (i.e., three years or more) gives us a better sense of the sustainability of economic growth, which in turn is fundamental to sustaining reforms. Here the picture changes quite a bit from a one-year snapshot in 2000. Of the three subregions, medium-term economic growth has been highest and generally far more sustainable in the Northern Tier CEE. Since 1994, average annual growth in the subregion has been relatively robust, averaging more than 4 percent annually and ranging from 2.7 percent in 1999 to 5.5 percent in 1997. Moreover, since 1994, annual economic growth in the Northern Tier CEE countries has exceeded economic growth in the EU.

Economic performance prospects in the Northern Tier remain closely tied to economic activity in the EU. A significant majority of Northern Tier exports go to the EU. Hence, when economic growth picked up in the EU from 2.6 percent in 1999 to 3.4 percent in 2000, so did Northern Tier CEE exports and economic growth (from 2.7 percent to 4.1 percent). Economic growth in the Baltic countries in 2000 was also fueled by still relatively close ties to a rapidly expanding Russian economy.

Highest sustained economic growth among the Northern Tier CEE countries has occurred in the three reform leaders of Poland, Slovenia, and Hungary. Poland's economy has been expanding at an impressive clip since 1993, from roughly 4 - 7 percent annually. Economic growth in Slovenia has been at least 3.5 percent annually since 1994. Hungary's impressive economic growth rate has been more recent; its economy has been expanding by at least 4.5 percent annually since 1997.

Four Northern Tier CEE countries (the Baltics and the Czech Republic) experienced notable rebounds in 2000 from stagnation in 1999. The Czech Republic's economy emerged from a three-year recession and grew by 3 percent in 2000. Contracting economies in Estonia (-1.1 percent) and Lithuania (-4.2 percent), and slow growth in Latvia (1.1 percent) in 1999 gave way to moderate to high growth in 2000, from 2.7 percent in Lithuania to roughly 6.5 percent in Latvia and Estonia. Slovakia's high growth from 1994 to 1998 (of close to 6 percent annually) has given way to 2 percent growth in 1999-2000.

EBRD is that we weigh country economic growth rates by population, while the IMF and EBRD use GDP weights.

Perhaps the most impressive improvement in economic performance since 1999 has occurred in the Southern Tier CEE countries. Overall, the subregion rebounded from an economic contraction in 1999 of nearly 4 percent to an expansion in 2000 in economic activity of 5 percent. This impressive turnaround stems in large part from recovery from the 1999 Kosovo conflict. A key part of that recovery has been the resumption of export growth to EU markets in 2000. All the countries of the subregion experienced an increase in economic growth from 1999 to 2000. The turnaround in Yugoslavia has been the most dramatic, from a nearly 20 percent contraction in 1999 to an 11 percent expansion in 2000. Macedonia and Bulgaria, which suffered significant economic slowdowns in 1999 due largely to impediments to access to export markets from the conflict, saw economic growth double from around 2.5 percent in 1999 to 5 percent in 2000. Romania's economy emerged from a three-year recession, and grew by almost 2 percent in 2000. The mild economic contraction in Croatia in 1999 was followed by 3.5 percent growth in 2000.

Bosnia-Herzegovina and Albania have been the only Southern Tier CEE countries able to sustain robust economic growth rates. In fact, for a number of years, both countries have been among the fastest growing economies of the all transition countries. Except for 1999 (when the pyramid schemes collapsed), Albania's economy has grown at least 7 percent annually since 1993. Bosnia-Herzegovina's performance has been even more impressive: from 1995-1997, its economy averaged an annual economic growth rate in excess of 50 percent. This was followed by 10 percent growth rate on average over the past three years (1998-2000).

These high growth rates in Albania and Bosnia-Herzegovina seem to be anomalous on at least two scores. First, the economies appear to be almost immune to economic events outside the borders. Economic growth rates in 1999, for example, remained robust (8.6 percent in Bosnia-Herzegovina and 7.3 percent in Albania) despite war in a neighboring country. Second, high economic growth rates have so far been sustained in the context of relatively little reform progress.

An examination of *Table 9* reveals that this latter observation is not confined to these two countries. The highest three-year economic growth average (for 1998-2000) goes to Turkmenistan, which (by our count in *Table 8*) has made the least progress in economic reforms. In fact, the top seven economic growth performers in the past three years are all among those countries where economic reforms have lagged the most. In addition to Turkmenistan, this includes Belarus (26th in economic reform progress), Tajikistan and Bosnia-Herzegovina (both 24th), Azerbaijan (21st), and Albania and Armenia (both 17th). If there is a link between high growth and slow reform progress, it may very well be that high growth has enabled these countries to avoid moving forward on reforms, and has occurred despite little reform progress because of the existence of some other (arguably less sustainable) contributing factors (such as the stimulus from energy exports in a bull market, or from a "rebound" response to a previous collapse in economic output).[31]

[31] Another, not insignificant issue among these countries is the reliability of the statistics. For several of these (war-torn) countries, the early collapse in output was likely accompanied with a collapse of their

Economic growth in Eurasia in 2000 was 6.8 percent, far surpassing annual growth performances for the subregion since the transition began. 1999 economic growth for Eurasia (at 2.9 percent) comes closest to this record. No Eurasian economy contracted in 2000.[32]

Russia's performance continues to significantly influence both the (population-weighted) regional averages, as well as real economic events in much of Eurasia. Russia's economy contributes close to 70 percent of all economic activity in Eurasia. Ukraine's economy is a distant second, only 11 percent of Eurasian GDP. Moreover, while economic links to Russia have decreased substantially from early transition years for the rest of Eurasia, these ties are still significant.[33] Available evidence suggests that economic growth in 2000 in much of Eurasia was fueled by growing exports, and many of these exports went to Russia. In fact, in contrast to Russia's largely import-substitution growth of 1999 (when Russian imports shrank by more than 20 percent), Russian imports in 2000 increased by 16 percent. Russia' economic growth in 2000, in other words, was largely driven by an increase in domestic demand which in turn contributed to the growth of exports elsewhere. Russian exports also grew in 2000, by 6 percent, facilitated by higher oil prices (noted below) and gains in competitiveness due to the real exchange rate depreciation in 1998-1999. Real GDP growth in Russia in 2000 (at 7.5 percent) was more than twice the rate of growth in 1999 (3.2 percent).

Trends in the prices of commodity exports for the Eurasian countries also continued to factor prominently in economic growth in 2000. The price of oil increased by close to 60 percent in 2000, coming on the heels of nearly a 40 percent increase in 1999. Natural gas prices increased by 80 percent in 2000. Energy exports play a very important role for Turkmenistan, Azerbaijan, Kazakhstan, and Russia.[34] The prices of most metals (important to Kazakhstan, Kyrgyzstan, and Russia) and some agricultural raw materials also increased. Cotton, in particular, is a key export for Uzbekistan, Tajikistan, and Turkmenistan, and its price increased by more than 10 percent in 2000.[35]

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statistical systems. Data from other countries of this group, Belarus and Turkmenistan in particular, seem highly suspect to overt manipulation by government authorities.

[32] The EBRD estimates zero growth for Moldova's economy in 2000 while the IMF calculates that it grew by 1.9%.

[33] The proportion of exports to Russia has decreased substantially for a number of Eurasian countries, particularly Kazakhstan (from 43% of total exports in 1994 to 24% in 2000), Uzbekistan (from 40% in 1994 to 19% in 1998), Ukraine (40% in 1994 to 21% in 1999), Armenia (35% in 1994 to 15% in 1999), and Kyrgyzstan (30% in 1994 to 16% in 1998). Closest economic ties with Russia are maintained by Belarus and Moldova. In fact, export shares to Russia had been increasing for both of these countries prior to the Russian financial crisis, but have since decreased. Fifty-one percent of Moldovan exports went to Russia in 1994. This increased to 58% in 1997, but decreased to 41% in 1999. Belarus had 47% of its exports going to Russia in 1994. This increased to 66% in 1998, but fell back to 48% by 2000.

[34] In recent years, roughly one-half of Turkmenistan's exports have been energy (oil and gas). For Azerbaijan, it is closer to one-third; for Russia and Kazakhstan, at least 20%.

[35] More than one-half of Uzbekistan's exports in recent years have been textiles (cotton and wool); in Tajikistan, about 40%, and Turkmenistan close to 30%. Roughly one-third of exports in Russia, Kazakhstan, and Kyrgyzstan are metals.

The natural resource exporters were among the fastest growers in 2000 in Eurasia. Turkmenistan (energy and cotton) had an economy that grew 17.6 percent in 2000; Azerbaijan (energy), 10.3 percent; Kazakhstan (energy and metals), 9.4 percent; and Russia (energy and metals), 7.5 percent. Of the commodity exporters, only Uzbekistan's economy (dependent on cotton exports) witnessed a slowdown in economic growth from 1999 (4.3 percent) to 2000 (1.5 percent).

However, even most of the energy importing Eurasian countries, which were adversely affected by the increases in prices, experienced strong economic growth in 2000, including Tajikistan (8.3 percent), Armenia (6 percent), Ukraine (6 percent), and Kyrgyzstan (5 percent). Economic growth in Ukraine in 2000 was particularly notable: this was the first year since the transition began that Ukraine's economy expanded.

Annual ***inflation*** rates much above the single-digit range erode business confidence, and the ability and incentive to invest and expand at the enterprise level. *Table 10* shows that while inflation for the transition region in 2000 as a whole, at 24 percent, is about as low as it has been since the mid-1990s (and hence since the transition began), it's still too high in most countries. Most of these countries are in Eurasia. Seven of the nine transition countries in 2000 that have inflation rates of near 20 percent or greater are in Eurasia. Yugoslavia (60 percent) and Romania (46 percent) are the CEE exceptions. Moreover, most of the CEE countries saw some increase in inflation from 1999, though in most instances, the increase was small. Nevertheless, roughly half of the transition countries have been able to hold inflation in the past two years to close to single-digits levels.

From 1994-1999, inflation rates among the Northern Tier CEE countries had been steadily declining, falling on average about 4-5 percentage points annually to an annual rate in 1999 of 7 percent. 2000 saw a departure in this trend; inflation rates increased slightly for the region as a whole (to 8 percent) and in all the countries but Lithuania. Much of this increase was likely due to temporary shocks, such as higher-priced energy imports and drought. Inflation rates ranged from one percent in Lithuania to 12 percent in Slovakia. Inflation increased in the majority of Southern Tier CEE countries as well, and generally for reasons similar to those in the Northern Tier CEE, i.e., rising energy and food prices. Rates ranged widely, however, from zero percent in Albania to 60 percent in Yugoslavia.

In contrast to inflation trends in the CEE countries, inflation in Eurasia fell from 1999 to 2000 in most countries. The subregion average fell from 65 percent in 1999 to 26 percent in 2000, closer to the rates experienced in 1997 and 1998. Greatest drops occurred in Russia (from 86 percent in 1999 to 21 percent in 2000), Georgia (from 19 percent to 4 percent), and Turkmenistan (from 24 percent to 8 percent). 1999, hence, may have been the exceptional year for the region, with inflation increasing from the higher price imports stemming from depreciation of currencies, one spillover from the Russian crisis of 1998. Azerbaijan continues to be able to sustain one of the lowest inflation rates of all the transition countries; prices have actually contracted on balance since 1997. Inflation has been very low in Armenia as well, around zero since 1999. Of all the transition countries, inflation was far and away the highest in Belarus in 2000 (169 percent). Belarus had the highest inflation rate of all the countries in 1998 and 1999 as well.

Budget deficits (*Table 11*) that remain high erode productivity and sustainable economic growth in a number of ways. Financing deficits can fuel inflation (if governments resort to printing money) and/or contribute to "crowding out" private investors to loanable funds (as the cost of borrowing rises with the demand). More fundamentally, as witnessed in Russia, persistently high budget deficits can undermine investor confidence, sparking volatility in capital flows, higher borrowing costs in international markets and higher external imbalances.

Overall, fiscal balances have improved substantially during the transition, from a population-weighted average fiscal deficit of roughly 15 percent of GDP in 1992 to a range of 5-7 percent from 1994-1998, to 3 percent in 1999, and 0.7 percent in 2000. The improvements in the fiscal balances in 2000 occurred across the subregions and were greatly facilitated by growing tax revenues stemming from growing economies. Only in a handful of countries did fiscal balances deteriorate in 2000: in the Czech Republic, Moldova, Romania, Croatia, and Armenia.

Some of the most impressive improvements in 2000 fiscal balances occurred in Eurasia countries able to reap considerable tax gains from rising prices of commodity exports. Salient among these are the four major energy exporters of Eurasia (Russia, Kazakhstan, Azerbaijan, and Turkmenistan) that have had favorable trends in fiscal balances since energy prices began increasing in 1999. Russia had a fiscal surplus of 2.5 percent of GDP in 2000, from a deficit of 1 percent in 1999, and far higher deficits in recent years past (of 8-9 percent from 1996-1998). Turkmenistan's fiscal deficit of 2.7 percent of GDP in 1998 was followed by a small surplus in 1999 (0.9 percent) and another surplus in 2000 (0.2 percent). Kazakhstan's fiscal deficit has decreased substantially from 7-8 percent of GDP in 1997-1998 to roughly 5 percent in 1999 and 0.8 percent in 2000. Azerbaijan's deficit of 5.4 percent of GDP in 1999 was cut in half to 2.6 percent in 2000.

Despite the recent favorable trends in fiscal balances, there remain seven countries that have maintained fiscal deficits in excess of 5 percent of GDP over the past three years. These are deficits, in other words, that may be unsustainably high. Four countries are in CEE (Albania, Bosnia-Herzegovina, Yugoslavia, and Lithuania) and three are in Eurasia (Kyrgyzstan, Georgia, and Armenia). Three of these countries, nevertheless, witnessed significant fiscal deficit reductions from 1999: Lithuania (from a deficit of 8.6 percent of GDP in 1999 to 3.3 percent in 2000); Yugoslavia (from 8.4 percent to 3.7 percent); and Kyrgyzstan (from 12.8 percent to 7.2 percent). Far and away, the highest three-year deficits have been maintained in Kyrgyzstan and Albania (from 1998-2000, 10.4 percent and 10.2 percent of GDP, respectively). High deficits in highly indebted countries are particularly troublesome. In Eurasia, this primarily applies to Kyrgyzstan, Georgia, Moldova, and Armenia; in CEE, Yugoslavia and Bosnia-Herzegovina.

In general, the primary fiscal challenges differ between CEE and Eurasia. In CEE, particularly for the ten CEE countries on track to EU accession (that is, the Northern Tier

CEE countries plus Romania and Bulgaria), the primary fiscal challenge is how to maintain manageable fiscal deficits while at the same time meeting very ambitious expenditure requirements implicit in EU membership. On the one hand, EU membership requires fiscal discipline to achieve macroeconomic convergence with other members. A key Maastricht financial criterion for joining the EU is that fiscal deficits are not to exceed 3% of GDP. In 2000, four of the ten CEE accession countries failed to meet this criterion: Romania; Hungary; Slovakia; and the Czech Republic.

At the same time, accession to the EU will require substantial expenditure to bring these economies up to EU standards. Accession requirements include additional expenditure in upgrading environmental standards and nuclear safety, transport infrastructure, legal reforms, the steel industry, the energy sector, agriculture, telecommunications, and social policy. It is estimated that annual EU transfers leading up to membership will range from around 0.3 percent of GDP (for Slovenia) to 2 percent of GDP (for Bulgaria).[36] However, EU assistance is not likely to come close to filling the financing gap. According to some estimates, annual accession costs could be as high as 11 percent of annual regional GDP over a ten-year period.[37] Moreover, these costs must be addressed in the context of existing constraints imposed by already large public sectors and high tax burdens.

The primary fiscal challenge for Eurasia is even more fundamental, namely increasing the capacity of government to raise revenues (and to fend off powerful interest groups intent on undermining that capacity). For some of these countries, this amounts to efforts to mitigate or avert mounting and unsustainable debt burdens. General government revenues as a percent of GDP are extraordinarily low in some Eurasian countries: perhaps 15 percent of GDP in Tajikistan and Georgia. On average, general government revenues in Eurasia less Russia are 24 percent of GDP. This compares to government revenues of 40 percent of GDP in CEE.

Table 12 shows trends in domestic investment and the share of the economies in private sector hands. The ***private sector share of the economy*** is a rough proxy of the extent of economic restructuring, either through the privatization process or the growth of new private-sector firms. Those economies where private sector output predominates are much more likely to generate momentum towards greater economic expansion overall.

Twenty countries of the region in fact now have a private sector generating at least 50 percent of GDP. The average for all of the transition countries is 63 percent. This represents very impressive gains; in 1989, the region's private sector share was probably closer to 10 percent of GDP.

Most OECD economies have private sectors that range from 70-85 percent of GDP. Nine transition countries (six Northern Tier countries, Russia, Albania, and Bulgaria) now have private sectors that meet this threshold. The private sector share of GDP is highest in Hungary and the Czech Republic (both at 80 percent). Slovenia's private sector as a

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[36] EBRD, *Transition Report Update* (April 2001), p. 9.
[37] EBRD, *Transition Report 2000* (November 2000), p. 56.

share of GDP is 55 percent. This is the lowest among the Northern Tier countries, though perhaps not much different from that of its neighbors, Austria and Italy.

There is a close fit between progress in economic reforms and the size of the private sector. As noted, the reform leaders of Hungary and Poland have the highest private sector share of GDP. Moreover, the seven countries that have private sector shares less than 50 percent of GDP all rank at the bottom of progress in economic reforms (in *Table 8*). Smallest private sectors are found in Belarus (20 percent of GDP) and Turkmenistan (25 percent). The two "outlier" countries are Slovenia, which ranks relatively high in economic reforms (4^{th}), yet has a relatively small private sector share (55 percent of GDP), and Albania, which ranks only 17^{th} in economic reforms, yet has among the highest private sector shares (75 percent of GDP).

Domestic investment (*Table 12*) contributes to the productive capacity of the economy and hence helps provide the momentum that is necessary for sustained economic expansion further down the road. Of the three subregions, domestic investment as a percent of GDP was highest in Eurasia at the outset of the transition (30 percent of GDP in 1990), but has since fallen the most there, to 18 percent of GDP in 1999. The proportion of domestic investment of GDP is also 18 percent on average in Sub-Saharan Africa. In contrast, domestic investment as a percentage of GDP has increased slightly in the Northern Tier CEE countries from 1990-1999, and at 27 percent is not far below the average (of 30 percent) found in the East Asian developing countries. Domestic investment in the Southern Tier falls somewhere in between the other two regions; 21 percent of GDP in 1999, a decrease from 26 percent in 1990.

Five countries (for which data are available) have witnessed a precipitous drop in the domestic investment share of GDP; that is, at least a 40 percent decline from 1990-1999: Albania; Russia; Armenia; Kazakhstan; and Uzbekistan.

Trends in ***labor productivity***, or output per employee, can provide important insights into the extent to which firms are restructuring. The efficiency gains from an increase in productivity can stem from a number of factors, including fewer excess workers, greater skilled and/or motivated workers, improved capital stock, and/or a greater capacity to manage.

Productivity growth in industry (*Table 13*) over the entire transition has been the most impressive in the Northern Tier CEE, growing on average by more than 8 percent annually since 1992. This growth has been particularly impressive in Poland and Hungary. While much of the earlier year productivity gains in the Northern Tier countries stemmed from labor shedding (or employment reduction), much of the more recent gains have stemmed from relatively rapid output growth and technological innovations. Productivity gains in the Southern Tier countries (for which data are available) have been more modest and even negative in recent years for some countries. Of this subregion, productivity gains have been greatest in Croatia.

The highest productivity growth in industry in the past several years has occurred in a handful of Eurasian countries, most notably in Kyrgyzstan, Georgia, Armenia, Russia, Belarus, Kazakhstan, and Azerbaijan. The most recently available three-year productivity growth averages in these countries have all been greater than 10 percent. As with patterns in output, rapid productivity growth in recent years in most if not all of these countries comes on the heels of very significant productivity drops in earlier transition years.[38] Particularly in the context of relatively stagnant labor markets for many of these countries (that is, relatively minimal labor shedding, mobility, and/or turnover), this may suggest that recent labor productivity gains in these countries are more a reflection of output recovery than of any significant enterprise restructuring.

The productivity pattern in Uzbekistan is an interesting contrast. Consistent with the GDP pattern in Uzbekistan, the change in productivity has exhibited little of the "J-curve" trend (that is, a large initial drop followed by recovery) that has been the transition norm elsewhere. More generally, the economic data for Uzbekistan suggest that it is in a transition category all its own, or in some sense, still in a pre-transition stage. Salient in this regard is insignificant progress in economic reforms with a relatively low private sector share of GDP, coupled with relatively stagnant output and productivity trends, and virtually no official unemployment.

How and to what extent these economies integrate into the world economy figure prominently into the type of their transition path and its sustainability. *Tables 14* through *16* highlight some key aspects of this integration: export growth and openness to trade; institutional integration; current account balances; foreign direct investment; and external debt.

Table 14 looks at international trade and "institutional integration" into the world economy. The gains from trade can be substantial, and range from the tangible (of increasing an economy's quantity and quality of available goods, including capital goods) to the intangible (of providing incentives and a constituency to maintain the market-based reforms which also serve as pre-requisites to institutional integration with the industrial market economies).

Certainly there are also downsides to integrating into the world economy through trade. As has been evident in the transition region in recent years, not only the magnitude but also the nature of trade links are key in this regard. In general, the greater the dependency on few trading partners and few exports products, particularly primary products, the more vulnerable is the economy to "exogenous shocks." Many of the Eurasian countries have recently been reaping benefits from such dependencies (on Russia and commodity exports), but, as has happened in the past, these dependencies could just as easily turn to liabilities.

Exports rebounded significantly in 2000 for the region as a whole from little to no growth in recent years past. Available data indicate that exports contracted by roughly 8

[38] See *Figure 4, Monitoring Country Progress*, No. 6 (May 2000).

percent region-wide in 1998 and about 1 percent in 1999, while growing from 10-15 percent in 2000.[39] Virtually all the CEE countries witnessed double-digit export growth rates in 2000, reflecting in large part an increase in demand in Western Europe and renewed access to these markets (due to restoration of peace and relative stability in the Balkans). All the Eurasian countries (for which data are available) witnessed export growth in 2000 as well with one exception (Uzbekistan). As previously noted, export revenues in Eurasia grew largely as a result of an increase in demand from Russia as well as favorable prices of commodity exports.

Table 14 also provides data on ***openness to trade*** or a country's outward orientation. To what extent are these economies integrated into the world economy? Are they becoming more or less integrated over time? In short, these data suggest several salient observations: (1) there is wide variation across the region in terms of outward-orientation; (2) there is considerable scope for further integration (even among the Northern Tier CEE countries); and (3) in fact, more recent trends, at least through 1999, suggest that most countries have become more inward-oriented or autarchic in recent years.

The Northern Tier CEE countries are the most outward-oriented; their merchandise exports plus imports on average equaled 32 percent of (purchasing power parity) GDP in 1999. Such openness to trade, to some extent, is a reflection of the competitiveness of an economy (though smaller economies also tend to be more open out of necessity). The Northern Tier average on this score is roughly comparable to the average of the advanced economies (37 percent of GDP), though it falls short of the EU average of 53 percent. This suggests that there remains significant scope for expansion of trade between Western Europe and the Northern Tier countries.

The Eurasian countries and the Southern Tier CEE countries generally have considerably smaller trade sectors than do the Northern Tier CEE countries; 12 percent and 19 percent of GDP on average, respectively. By comparison, trade sector shares of GDP in Latin America and the Caribbean and Sub-Saharan Africa are 18 percent and 16 percent, respectively. In other words, by this measure, the Southern Tier CEE and Eurasian transition countries have global integration profiles much closer to developing countries than OECD countries.

A comparison of outward-orientation of the transition economies with per capita income (*Table 19* below) reveals a strong link between the two; namely, the more outward-oriented the transition economy is, the higher is its per capita income. Slovenia has the highest per capita income of all the transition countries ($16,804 in purchasing power parity dollars in 2000), and alongside Estonia, is the most outward-oriented (59 percent of PPP GDP). Virtually all the relatively autarchic economies (those with small trade sectors) are also the poorest economies (those with the lowest per capita income). Of the twenty countries for which PPP per capita income data are available, the poorest six countries have trade sectors ranging from 6 percent of GDP (Georgia), 8 percent

[39] The IMF estimates that exports grew for the region by 15% export in 2000, from 0.6% in 1999. *World Economic Outlook* (May 2001).

(Uzbekistan and Kyrgyzstan), 9 percent (Azerbaijan), 12 percent (Moldova) to only 13 percent of GDP (Armenia).

A very broad indicator of integration into the global economy of *Table 14* is the ***growth of real trade less GDP growth*** from 1989-1999. By this measure, most of the transition economies have become more outward-oriented since communism's collapse, particularly the Northern Tier CEE countries. However, the large initial drops in GDP in the early transition years for most countries makes interpretation of this indicator difficult. For many countries (at least for some years), a positive number may primarily mean that the trade sector has been contracting less than the overall drop in economic activity. In any event, three countries (for which data are available) have experienced growing autarchy by this measure (i.e., a negative figure of significant magnitude): Armenia (-11.7 percent); Belarus (-5.1 percent) and Bulgaria (-4.1 percent).

More recent available trends on openness to trade are less favorable. In fact, there has been a notable fall in the proportion of trade to GDP in all three subregions from 1997-1999. For the transition region as a whole, trade as a proportion to GDP fell from 27 percent in 1997 to 16 percent in 1999. The largest fall occurred in Eurasia: from 24 percent to 12 percent. Only in the highly autarchic economies of Albania and Armenia, did the trade share rise during this period. These trends coincide with largely unfavorable trends in the world economy (starting with the global financial crisis of 1997, to Russia's financial crisis in 1998, to the 1999 Kosovo conflict). Hence, 2000 data may reveal a reversal in the region's trend towards inward-orientation, and this bears watching.

Finally, *Table 14* also tabulates key indicators of ***institutional integration***. An important means to catalyze the reform progress and to lock-in the gains from reforms is through the institutionalization of global integration, or memberships in international organizations. For our purposes, this includes membership or participation towards membership in the OECD, the World Trade Organization, NATO, and the European Union. As shown in *Table 14*, institutional integration, as so defined, is taking place almost exclusively among the CEE countries, and primarily still in the Northern Tier. Of all the transition countries, the Czech Republic, Hungary, and Poland continue to have the closest institutional ties with the West. All three are members of both the OECD and NATO. All three plus Slovenia and Estonia were invited in 1997 to participate in the next round of negotiations towards EU membership. All three are WTO members.

In October 1999, five more transition countries were invited to participate in negotiations towards EU membership: Slovakia, Latvia, Lithuania, and two Southern Tier countries, Romania, and Bulgaria. As a preliminary step towards this invitation, the EU had previously negotiated Association Agreements (AA) with all ten of these countries. More recently, Macedonia has become the first country of a newly designated West Balkan region to begin negotiations with the EU towards a Stabilization and Association Agreement (SAA), a step removed from an AA. Croatia is likely to soon follow.

Since our last review (May 2000), Slovakia has become a member of the OECD, and four countries have joined the World Trade Organization (WTO): Lithuania; Croatia; Albania;

and Georgia. Presently fourteen transition countries are members of the WTO.   Twelve countries are in CEE and two (Kyrgyzstan alongside Georgia) are in Eurasia. Armenia's membership into the WTO is imminent.

To some extent, as the economies climb out of the "transition trough" and incur robust economic growth, ***current account deficits*** can be expected, and may reflect positive developments (*Table 15*). Such deficits may be temporary if much of the imports are capital goods that in turn spur an increase in competitiveness and exports. This is certainly part of the story in some CEE countries, in the Northern Tier CEE in particular. In addition, current account deficits are less burdensome if, as is the case in many Northern Tier CEE countries, they can be financed in large part by FDI inflows.

Nevertheless, macroeconomic stability can be at significant risk in the presence of large current account deficits, particularly if they are sustained over several years. Similarly, financing the deficit can contribute to unsustainable debt burdens if alternative sources (such as FDI) are not forthcoming.

Current account trends differ widely across the transition region. On the one hand, several Eurasian countries have benefited from high-energy prices and/or depreciated currencies that in turn have contributed to very favorable current account balances. Russia's high current account surplus in 1999 (of 12.4 percent of GDP) was followed by an even higher surplus in 2000 (18.4 percent). Ukraine and Kazakhstan also experienced growing and significant surpluses from 1999 to 2000. Turkmenistan and Azerbaijan were able to reverse very high (double-digit) current account deficits in recent years to a small deficit in 2000 in the case of Azerbaijan (1.5 percent of GDP) and even a slight surplus in the case of Turkmenistan (0.9 percent).

Yet, there remain many transition countries across the three subregions with current account deficits that are too high. In the Northern Tier CEE countries, current account deficits remain above 5 percent of GDP in the three Baltic countries and Poland. Nevertheless, all but Estonia and the Czech Republic of the Northern Tier countries saw a reduction in the deficits from 1999-2000. In the Southern Tier CEE, current account deficits continue to be too high in Bosnia-Herzegovina (above 20 percent of GDP on average since 1996; 21 percent in 2000), Yugoslavia (about 13 percent of GDP in 1999-2000); and Albania (8-9 percent of GDP since 1996). In Eurasia, current account deficits are highest in the countries with the highest debt burdens: Kyrgyzstan (9.2 percent of GDP in 2000); Georgia (8.1 percent); Armenia (14.5 percent); Moldova (7.8 percent); and Tajikistan (6.4 percent).

Foreign direct investment (FDI) is key to the transition (*Table 15*). It helps meet the substantial fixed investment needs of the region that arise from obsolete fixed capital stocks and inadequate infrastructure. It does so without adding to the external debt burden. In the context of highly volatile short-term capital flows, it is a stabilizing influence. And, it brings with it some very important externalities, including access to advanced technology and export markets, and exposure to advanced management and marketing techniques. Not only does FDI follow reforms, it contributes towards catalyzing and sustaining them, as well.

The Northern Tier CEE countries continue to receive the lion's share of 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. The Czech Republic surpassed Hungary in 2000 in attracting the greatest cumulative FDI per capita of all the transition countries since 1989. Relative to other transition countries, Estonia and Latvia have received significant FDI as well on a per capita basis.

Two primary elements in the transition region have attracted FDI. First and foremost, FDI has been attracted to a stable business environment and to countries where economic reforms are well advanced. Similarly, much of the FDI has been associated with large-scale privatization. In fact, six large-scale privatizations accounted for one-third of the total FDI in the Northern Tier CEE countries in 2000. Large-scale privatizations have also accounted for considerable FDI flows in the Southern Tier CEE. Second, countries rich in energy resources have been able to attract FDI even in the absence of much reform progress. The salient case is Azerbaijan, though this also pertains to Kazakhstan and Turkmenistan.

Even in the Northern Tier CEE countries, however, there is considerable scope for more FDI. This is illustrated when one compares the magnitude of FDI flows in the region with FDI to other parts of the world. *Table 15* shows such a comparison of gross FDI as a percent of purchasing power parity GDP, albeit for only one year (1999). By this measure, 1999 FDI flows to the Northern Tier were only one-third the amount that went to the EU, and even less than the amount that went to Latin America and the Caribbean. FDI flows to Eurasia as a percent of GDP were of the same magnitude as those that went to Sub-Saharan Africa. As with the openness to trade measure, this comparison of FDI flows suggests that most transition countries have global integration profiles much closer to developing countries than to the industrial market economies.

A key challenge for those transition countries nearing the completion of large-scale privatization is to attract FDI into existing and/or new ("Greenfield") private sector ventures. Until further reform progress is made, however, FDI will generally continue to favor the industrialized market economies as well as some other emerging markets.

External debt and debt burden continue to grow in the majority of transition countries (*Table 16*). For a handful of transition countries, most of them low-income Eurasian countries, the external debt burden is very high and perhaps unsustainable.

From 1996 to 2000, total external debt as a percent of exports increased in all three subregions and in nineteen of the twenty-seven transition countries. In 2000, region-wide external debt was 137 percent of exports, somewhat below the average of 173 percent for all the developing countries. A large majority of transition countries have also experienced an increase in debt service as a percent of exports, though the region-wide average remains relatively low; at 14 percent in 2000, this is equal to the average debt service ratio in Sub-Saharan Africa, but much below that found in Latin American and the Caribbean (42 percent). Moreover, only five transition countries in 2000 had debt service in excess of 20 percent (Latvia, Kyrgyzstan, Turkmenistan, Moldova, and Uzbekistan).

According to the World Bank's indebtedness classification scheme, two transition countries in 1996 were severely indebted (Bulgaria and Bosnia-Herzegovina) and four were moderately indebted (Hungary, Macedonia, Georgia, and Kyrgyzstan). This had increased by 1999 to three countries that were severely indebted (Bulgaria, Bosnia-Herzegovina, and Kyrgyzstan) and seven that were moderately indebted (Hungary, Estonia, Russia, Moldova, Georgia, Turkmenistan, and Armenia), excluding Yugoslavia for which data are not available.[40]

External debt in the Northern Tier CEE countries, while not insignificant, appears to be manageable, particularly given the potential for further economic growth and development in the subregion. For much of the transition, and for most indicators of debt, Hungary has had the highest debt of this group. However, debt service as a percent of exports has fallen significantly in Hungary from 37 percent in 1997 to 17 percent in 2000. Slovenia has the lowest external debt of the Northern Tier countries. Debt service as a percent of exports is quite high in Latvia (21 percent), Lithuania (18 percent), and Slovakia (18 percent).

External debt is much more troublesome in the Southern Tier CEE. Of all the transition countries, external debt as a percent of exports was highest in Yugoslavia in 2000 (565 percent). Most of Yugoslavia's debt is in arrears, and debt restructuring and reductions may be a necessity. Albania had the second highest level of external debt as percent of exports in 2000 (358 percent). However, more than half of this debt is concessional, and thus Albania's debt service burden is low. External debt in Bosnia-Herzegovina remains high as well, though debt reduction agreements with the London Club in 1997 and the Paris Club in 1998 significantly reduced its debt burden. Roughly 40 percent of Bosnia-Herzegovina's debt is concessional. Of the ten CEE countries on the EU accession track, only Bulgaria exceeded the Maastricht debt ceiling of 60 percent of GDP in 2000. As with Yugoslavia, virtually all of Bulgaria's debt is nonconcessional and thus more onerous to service.

In Eurasia, external debt burdens are particularly high and by most counts, increasing in five relatively poor countries: Kyrgyzstan; Georgia; Tajikistan; Armenia; and Moldova.

[40] This scheme is based on the present value of debt which is defined as the sum of short-term debt plus the discounted sum of total debt service payments due on public, publicly guaranteed, and private nonguaranteed long-term external debt of the life of existing loans. Evidence from developing countries has shown that debt service difficulties become increasingly likely when the ratio of the present value of debt to exports reaches 200% and the ratio of debt service to GNP exceeds 40%. Drawing from this experience, the World Bank has classified countries with a present value of debt service greater than 220% of exports or 80% of GNP as severely indebted; countries that were not severely indebted but whose present value of debt service exceeded 132% of exports or 48% of GNP as moderately indebted; and countries that did not fall into the above two groups as less indebted.

In 2000, external debt as a percent of exports averaged 250 percent in these countries, ranging from 195 percent in Armenia to 306 percent in Kyrgyzstan. Debt service as a percent of exports is highest in Kyrgyzstan (26 percent) and Moldova (22 percent). A key reason it is not higher is that much of the debt is concessional: about 55 percent on average for the five countries in 1999, ranging from 25 percent in Moldova to almost 60 percent in Tajikistan. External debt has been accumulating rapidly in these countries given the debt-free start at the outset of the transition in 1991.[41] The current levels of debt in this group are particularly problematic in the context of limited scope for economic growth and development.

[41] In 1991, Russia assumed all the financial liabilities of the former Soviet Union.

Table 9. Growth in Real GDP (%)

	1992	1993	1994	1995	1996	1997	1998	1999	2000	1998-2000 average
Turkmenistan	-5.3	-10.0	-17.3	-7.2	-6.7	-11.3	5.0	16.0	17.6	12.9
Bosnia-Herzegovina	…	…	…	32.4	85.8	39.9	12.8	8.6	10.0	10.5
Azerbaijan	-22.6	-23.1	-19.7	-11.8	1.3	5.8	10.0	7.4	10.3	9.2
Albania	-7.2	9.6	9.4	8.9	9.1	-7.0	8.0	7.3	7.8	7.7
Belarus	-9.6	-7.0	-12.6	-10.4	2.8	11.4	8.3	3.4	6.0	5.9
Tajikistan	-29.0	-11.0	-21.4	-12.5	-4.4	1.7	5.3	3.7	8.3	5.8
Armenia	-41.8	-14.1	5.4	6.9	5.9	3.3	7.3	3.3	6.0	5.5
Hungary	-3.1	-0.6	2.9	1.5	1.3	4.6	4.9	4.5	5.3	4.9
Slovenia	-5.5	2.8	5.3	4.1	3.5	4.6	3.8	5.2	4.9	4.6
Poland	2.6	4.3	5.2	6.8	6.0	6.8	4.8	4.1	4.1	4.3
Latvia	-34.9	-14.9	0.6	-0.8	3.3	8.6	3.9	1.1	6.6	3.9
Bulgaria	-7.3	-1.5	1.7	2.2	-10.9	-6.9	3.5	2.4	5.0	3.6
Kyrgyzstan	-19.0	-15.5	-19.8	-5.4	7.1	10.0	2.1	3.7	5.0	3.6
FYR Macedonia	-8.0	-7.5	-1.8	-1.1	1.2	1.4	2.9	2.7	5.1	3.6
Kazakhstan	-2.9	-9.2	-12.6	-8.2	0.5	1.7	-1.9	2.8	9.4	3.4
Uzbekistan	-11.1	-2.3	-4.2	-0.9	1.6	2.5	4.3	4.3	1.5	3.4
Estonia	-14.2	-8.2	-2.0	4.3	3.9	10.6	4.7	-1.1	6.4	3.3
Slovakia	-6.5	-3.7	4.9	6.9	6.6	6.5	4.1	1.9	2.2	2.7
Georgia	-44.8	-29.3	-10.4	2.6	10.5	10.7	2.9	2.9	2.0	2.6
Russia	-14.5	-10.4	-11.6	-4.2	-3.4	0.9	-4.9	3.2	7.5	1.9
Croatia	-11.7	-8.0	5.9	6.8	6.0	6.6	2.5	-0.4	3.5	1.9
Lithuania	-21.3	-16.2	-9.8	3.3	4.7	7.3	5.1	-4.2	2.7	1.2
Ukraine	-13.7	-14.2	-23.0	-12.2	-10.0	-3.3	-1.9	-0.4	6.0	1.2
Czech Republic	-0.5	0.1	2.2	5.9	4.8	-1.0	-2.2	-0.8	3.1	0.0
Yugoslavia	-27.9	-30.8	2.7	6.0	7.8	10.1	1.9	-19.0	10.7	-2.1
Romania	-8.8	1.5	3.9	7.1	3.9	-6.1	-5.4	-3.2	1.6	-2.3
Moldova	-29.1	-1.1	-31.2	-1.4	-5.9	1.6	-6.5	-3.4	0.0	-3.3

Regional Averages	1992	1993	1994	1995	1996	1997	1998	1999	2000	1998-2000 average
CEE & Eurasia	-12.3	-8.3	-8.5	-2.1	-0.2	1.9	-0.5	2.0	6.1	2.5
Northern Tier CEE	-2.2	0.6	3.4	5.4	5.0	5.5	3.7	2.7	4.1	3.5
Southern Tier CEE	-12.8	-6.6	3.6	7.5	8.1	1.3	0.3	-3.7	5.1	0.6
Eurasia	-14.8	-10.9	-13.8	-5.9	-3.1	1.1	-1.8	2.9	6.8	2.6
European Union	1.2	-0.4	2.8	2.4	1.7	2.6	2.7	2.6	3.4	2.6
Advanced Countries	2.1	1.4	3.3	2.7	3.2	3.4	2.4	3.4	4.1	3.1
Developing Countries	6.4	6.4	6.7	6.1	6.5	5.7	3.5	3.8	5.6	4.3

Benchmarks (a) 3 years positive economic growth, (b) 3 year average growth rate of 2% or more

These figures should be interpreted only as indicative of broad orders of magnitude in large part because the growth of output of new private enterprises of the informal economy is not fully reflected, particularly in recent years. IMF, *World Economic Outlook* (May 2001); EBRD, *Transition Report Update* (April 2001).

Table 10. Inflation

	1994	1995	1996	1997	1998	1999	2000	1999-00	1998-00
Azerbaijan	1,664	412	20	4	-1	-9	2	-4	-3
FYR Macedonia	127	16	3	2	0	-1	6	2	2
Lithuania	72	40	25	9	5	1	1	1	2
Bosnia-Herzegovina	780	-4	-14	10	0	3	5	4	3
Armenia	5,273	177	19	14	9	1	-1	0	3
Latvia	36	25	18	8	5	2	3	3	3
Estonia	48	29	23	11	8	3	4	4	5
Croatia	98	2	4	4	6	4	6	5	5
Czech Republic	10	9	9	9	11	2	4	3	6
Albania	23	8	13	33	21	0	0	0	7
Slovenia	21	14	10	8	8	6	9	7	8
Georgia	15,607	163	39	7	4	19	4	12	9
Kazakhstan	1,892	176	39	17	7	8	13	11	10
Poland	32	28	20	15	12	7	10	9	10
Slovakia	13	10	6	6	7	11	12	11	10
Bulgaria	96	62	123	1,082	19	3	10	7	11
Hungary	19	3	24	18	14	10	10	10	11
Turkmenistan	1,748	1,005	992	84	17	24	8	16	16
Ukraine	891	377	80	16	11	23	28	25	20
Kyrgyzstan	229	41	31	26	12	37	19	28	22
Moldova	330	30	24	12	8	39	31	35	26
Uzbekistan	1,568	305	54	59	29	29	25	27	28
Tajikistan	350	7	418	88	44	28	34	31	35
Yugoslavia	7.9E+10	72	93	19	30	37	60	49	42
Russia	311	198	48	15	28	86	21	53	45
Romania	137	32	39	154	59	46	46	46	50
Belarus	2,221	709	53	64	73	294	169	232	179

REGIONAL AVERAGES	1994	1995	1996	1997	1998	1999	2000	1999-00	1998-00
CEE & Eurasia	784	190	61	50	23	49	24	37	32
Northern Tier CEE	28	21	18	13	11	7	8	7	9
Southern Tier CEE	167	38	53	283	35	27	33	30	32
Eurasia	1,077	264	74	23	23	65	26	46	38
European Union	3.0	2.9	2.5	1.8	1.4	1.4	2.3	1.9	1.7
Advanced Countries	2.6	2.6	2.4	2.1	1.5	1.4	2.3	1.9	1.7
Developing Countries	54.7	23.2	15.3	9.7	10.1	6.6	6.2	6.4	7.6
Benchmarks								< 10.0	< 15.0

Retail/consumer prices, annual average. 1994 regional average excludes Yugoslavia.

IMF, *World Economic Outlook* (May 2001); EBRD, *Transition Report Update* (April 2001).

Table 11. Fiscal Balance as Percent of GDP

	1992	1993	1994	1995	1996	1997	1998	1999	2000	1998-00 average
FYR Macedonia	-9.8	-13.4	-2.7	-1.0	-1.4	-0.4	-1.8	0.0	1.0	-0.3
Bulgaria	-2.9	-8.7	-3.9	-5.7	-10.4	-2.1	0.9	-0.9	-1.0	-0.3
Turkmenistan	-9.4	-4.1	-2.3	-2.6	0.3	0.0	-2.7	0.9	0.2	-0.5
Slovenia	0.3	0.6	-0.2	-0.3	-0.2	-1.7	-1.4	-0.9	-1.0	-1.1
Estonia	-0.3	-0.7	1.3	-1.3	-1.9	2.2	-0.3	-4.6	-0.7	-1.9
Ukraine	-25.4	-16.2	-7.7	-6.1	-6.1	-5.0	-3.0	-2.5	-0.5	-2.0
Uzbekistan	-18.3	-10.4	-6.1	-4.1	-7.3	-2.4	-3.0	-1.8	-1.2	-2.0
Russia	-18.9	-7.3	-10.4	-6.0	-8.9	-7.6	-8.0	-1.0	2.5	-2.2
Belarus	-3.3	-5.2	-1.3	-6.9	-1.9	-1.2	-0.6	-5.6	-0.6	-2.3
Tajikistan	-30.5	-20.9	-5.2	-5.3	-5.8	-3.3	-3.8	-3.1	-0.6	-2.5
Latvia	-0.8	0.6	-4.4	-3.9	-1.8	0.3	-0.8	-4.2	-2.7	-2.6
Poland	-4.9	-2.4	-2.2	-3.1	-3.3	-3.1	-3.2	-3.3	-3.0	-3.2
Czech Republic	-3.1	0.5	-1.1	-1.4	-0.9	-1.7	-2.0	-3.3	-4.2	-3.2
Moldova	-26.6	-7.5	-5.9	-5.8	-9.7	-7.5	-3.2	-3.2	-4.0	-3.5
Slovakia	-11.9	-6.0	-1.5	0.4	-1.3	-5.2	-5.0	-3.6	-3.3	-4.0
Azerbaijan	2.7	-15.3	-12.1	-4.9	-2.8	-1.6	-4.2	-5.4	-2.6	-4.1
Romania	-4.6	-0.4	-2.2	-2.5	-3.9	-4.6	-5.0	-3.5	-4.0	-4.2
Croatia	-3.9	-0.8	-1.2	-1.4	-1.0	-1.4	-0.4	-6.2	-6.7	-4.4
Kazakhstan	-7.3	-4.1	-7.7	-3.4	-5.3	-7.0	-7.7	-5.3	-0.8	-4.6
Hungary	-7.2	-6.6	-8.4	-6.7	-5.0	-6.6	-5.6	-5.6	-3.6	-4.9
Armenia	-13.9	-54.7	-9.0	-8.6	-5.8	-6.0	-3.7	-5.9	-6.3	-5.3
Yugoslavia	…	…	…	-4.3	-3.7	-7.6	-5.4	-8.4	-3.7	-5.8
Lithuania	0.5	-5.3	-4.8	-4.5	-4.5	-1.8	-5.8	-8.6	-3.3	-5.9
Georgia	-25.4	-26.2	-7.4	-5.3	-4.9	-7.0	-6.5	-6.7	-4.6	-5.9
Bosnia-Herzegovina	...	...	-17.0	-0.3	-4.4	-0.5	-7.4	-5.7	-5.5	-6.2
Albania	-23.1	-15.5	-12.7	-10.1	-12.1	-12.6	-10.4	-11.3	-8.8	-10.2
Kyrgyzstan	-17.4	-14.4	-5.7	-8.4	-8.8	-8.8	-11.2	-12.8	-7.2	-10.4

REGIONAL AVERAGES	1992	1993	1994	1995	1996	1997	1998	1999	2000	1998-00 average
CEE & Eurasia	-14.6	-8.3	-7.1	-5.0	-6.3	-5.4	-5.3	-2.9	-0.7	-3.0
Northern Tier CEE	-4.9	-2.8	-2.9	-3.1	-3.0	-3.2	-3.4	-3.9	-3.2	-3.5
Southern Tier CEE	-6.0	-4.0	-3.3	-3.7	-5.1	-4.9	-4.2	-4.8	-3.9	-4.3
Eurasia	-18.4	-10.4	-8.7	-5.7	-7.4	-6.0	-6.0	-2.3	0.6	-2.6
European Union	-5.2	-6.3	-5.6	-5.4	-4.3	-2.4	-1.6	-0.6	1.3	-0.3
Advanced Countries	-4.3	-4.7	-4.0	-3.8	-3.1	-1.7	-1.2	-0.8	0.3	-0.6
Developing Countries	-3.6	-3.7	-3.8	-3.2	-2.7	-3.1	-4.6	-5.0	-3.7	-4.4
European Union Target										-3.0
Benchmark										-3.0

Fiscal balance is overall general balance (i.e. all levels of government). 1999 and 2000 figures for Yugoslavia exclude Kosovo.

EBRD, *Transition Report Update* (April 2001); IMF, *World Economic Outlook* (May 2001).

Table 12. Domestic Investment and Private Sector Share of GDP

Country	Gross Domestic Investment 1990	Gross Domestic Investment 1999	Gross Domestic Investment 1990-1999	Private Sector Output 1996	Private Sector Output mid-2000
	% of GDP	% of GDP	% change	% of GDP	% of GDP
Czech Republic	25	28	12	75	80
Hungary	25	29	16	70	80
Albania	29	17	-41	75	75
Estonia	30	25	-17	70	75
Slovakia	33	32	-3	70	75
Lithuania	33	23	-30	70	70
Poland	25	26	4	60	70
Russia	30	15	-50	60	70
Bulgaria	26	19	-27	45	70
Latvia	40	26	-35	60	65
Romania	30	20	-33	60	60
Armenia	47	19	-60	50	60
Croatia	10	23	130	50	60
Georgia	...	17	...	50	60
Kyrgyzstan	24	18	-25	50	60
Ukraine	27	20	-26	50	60
Kazakhstan	32	18	-44	40	60
FYR Macedonia	19	21	11	50	55
Slovenia	17	28	65	45	55
Moldova	29	22	-24	40	50
Uzbekistan	32	15	-53	40	45
Azerbaijan	...	40	...	25	45
Yugoslavia	...	13	...	...	45
Tajikistan	...	9	...	20	40
Bosnia-Herzegovina	...	35	...	...	35
Turkmenistan	40	46	15	20	25
Belarus	27	24	-11	15	20

REGIONAL AVERAGES	1990	1999	1990-1999	1996	mid-2000
	% of GDP	% of GDP	% change	% of GDP	% of GDP
CEE & Eurasia	29	20	-31	54	63
Northern Tier CEE	26	27	3	64	73
Southern Tier CEE	26	21	-20	57	61
Eurasia	30	18	-41	50	61
High Income	23	22	-4	70-85	
Low and Middle Income	26	23	-12		
Sub-Saharan Africa	15	18	20		
East Asia/Pacific	35	30	-14		
Benchmarks			*no decline*	*more than 70%*	

Source: World Bank, *World Development Indicators 2001* (2001); and EBRD, *Transition Report 2000* (November 2000). Yugoslavia figures are recent World Bank estimates.

Table 13. Labor Productivity

Region/Country	Labor Productivity in Industry (% change) 1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	1997-99[1] average	1999/1989[2] (%)
Kyrgyzstan	-0.4	7.4	-23.7	-17.0	-14.5	-25.8	16.5	48.8	18.0	…	27.8	88
Georgia	...	-14.9	-20.5	-7.7	-34.4	-0.6	49.9	2.8	-7.3	…	15.1	...
Armenia	-9.9	-0.3	-41.5	0.5	7.4	19.0	20.4	12.4	7.8	…	13.5	98
Russia	2.1	-6.3	-13.9	-11.9	-11.4	4.5	0.8	12.0	19.1	7.3	12.8	97
Belarus	3.6	0.7	-4.7	-6.3	-13.1	-0.9	...	18.6	10.5	7.5	12.2	...
Kazakhstan	0.7	-2.4	-10.7	-1.0	-21.2	0.0	-3.1	18.6	1.8	13.8	11.4	91
Azerbaijan	-3.5	7.3	-18.4	-12.0	-21.0	-16.6	...	17.3	3.5	…	10.4	...
Albania	…	…	…	…	…	23.8	26.5	-8.8	9.0	…	8.9	...
Hungary	-4.0	-8.2	3.9	16.4	14.8	10.5	4.3	9.3	7.4	9.4	8.7	181
Croatia	-10.4	-13.1	-0.8	-2.8	1.6	5.8	11.4	14.1	7.4	3.8	8.4	114
Poland	-19.7	0.0	12.5	13.8	13.0	6.5	9.1	11.6	4.3	9.1	8.3	171
Lithuania	...	...	...	-23.1	-11.1	14.1	6.5	2.4	8.0	…	5.6	...
Uzbekistan	0.4	0.5	-1.7	2.3	10.5	-1.6	4.4	6.3	5.3	…	5.3	129
Moldova	0.9	-4.4	-20.0	7.3	-23.6	12.0	8.6	10.5	-3.2	…	5.3	82
Slovakia	-4.0	-15.7	7.3	-1.1	9.0	4.0	2.5	3.8	7.8	2.6	4.7	115
Slovenia	-7.9	...	...	...	-10.5	-3.9	4.0	2.7	5.4	5.7	4.6	...
Ukraine	3.7	-4.0	-1.8	-3.0	-20.3	-4.5	2.5	7.3	2.8	…	4.2	82
FYR Macedonia	-7.5	-10.3	-10.1	-9.7	-4.1	5.2	-7.8	14.0	-0.2	-1.9	4.0	70
Latvia	...	...	...	-26.7	2.7	10.5	7.4	2.5	11.0	-2.7	3.6	...
Bulgaria	-8.6	-3.8	7.9	2.3	9.9	-3.3	...	-4.3	12.3	-2.8	1.7	...
Czech Republic	0.6	-9.5	26.3	-1.0	8.7	11.2	12.0	0.7	3.4	-2.5	0.5	156
Estonia	...	...	...	...	...	3.7	8.2	-1.0	9.6	-10.9	-0.8	...
Turkmenistan	-0.5	9.4	-12.3	-5.9	-25.9	21.4	26.0	-38.7	4.3	…	-2.8	65
Romania	-21.1	-18.7	-10.0	10.4	8.6	16.3	...	5.6	-14.9	…	-4.7	...
Tajikistan	-1.5	-1.7	-22.5	8.2	-22.5	-3.2	-23.1	-16.6	10.4	…	-9.8	43

REGIONAL AVERAGES	Labor Productivity in Industry (% change) 1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	1997-99[1] average	1999/1989[2] (%)
CEE & Eurasia	-2.5	-5.0	-6.6	-3.4	-6.7	3.4	4.1	9.3	9.0	4.5	7.6	105
Northern Tier CEE	-12.5	-4.1	12.9	7.6	10.2	7.7	8.0	8.0	5.4	6.1	6.5	158
Southern Tier CEE	-16.3	-14.3	-4.9	5.9	7.3	11.2	12.5	3.8	-4.1	-0.6	-0.3	96
Eurasia	1.7	-3.9	-11.2	-7.3	-12.9	1.2	2.7	10.5	11.9	7.9	10.1	97

Note: Productivity is calculated as the ratio of industrial production to industrial employment.

[1]1996-1998 for Albania, Armenia, Georgia, Kyrgyzstan, Lithuania, Moldova, Tajikistan, Turkmenistan, Ukraine and Uzbekistan. 1997-1998 for Azerbaijan and Romania. [2]1998/1989 ratio for Armenia, Kyrgyzstan, Moldova, Tajikistan, Turkmenistan, Ukraine and Uzbekistan.

EBRD, *Transition Report 2000* (November 2000); and earlier editions.

Table 14. Integration into the World Economy (I)

Country	Export Growth[1] (avg annual %) 1997-1999	Real Export Growth (% Change) 1999	2000	Growth in Real Trade less GDP growth 1989-99	Openness to Trade[2] (% of PPP GDP) 1997	1998	1999	Institutional[3] Integration 2000
Czech Republic	8	6.6	18.8	9.9	48	44	42	(1) (2) (3) (4) (5)
Hungary	16	13.2	23.0	7.6	55	42	46	(1) (2) (3) (4) (5)
Poland	7	1.0	5.0	11.3	27	26	22	(1) (2) (3) (4) (5)
Slovakia	5	3.6	15.9	11.1	51	46	38	(1) (2) (4) (6)
Slovenia	1	1.8	…	0	76	67	59	(2) (4) (5)
Estonia	12	-2.4	3.4	13	92	58	59	(2) (4) (5)
Latvia	9	-6.4	14.0	7	45	37	31	(2) (4) (6)
Bulgaria	-6	-5.2	20.0	-4.1	25	23	23	(2) (4) (6)
Romania	2	9.7	23.9	6.4	20	15	14	(2) (4) (6)
Lithuania	-1	-18.3	16.4	12	57	40	32	(2) (4) (6)
Croatia	-1	-0.2	7.8	…	54	44	37	(2)
Albania	10	…	…	10.5	11	11	14	(2)
Kyrgyzstan	-3	-10.4	…	-0.4	12	12	8	(2)
Georgia	6	…	…	…	11	8	6	(2)
FYR Macedonia	2	2.5	17.4	6.1	45	…	33	(4)
Belarus	2	-2.3	…	-5.1	32	24	18	
Turkmenistan	5	…	…	-1	32	15	17	
Ukraine	-7	-7.9	15.7	7.8	39	19	14	
Kazakhstan	-1	18.7	16.6	8.5	19	18	13	
Armenia	-4	5.9	…	-11.7	12	13	13	
Moldova	-16	-24.5	13.9	14.6	32	20	12	
Russia	-5	-4.5	6.0	1.5	21	14	11	
Azerbaijan	12	67.1	7.9	25.2	13	14	9	
Uzbekistan	-8	-1.9	-6.6	1.4	13	15	8	
Tajikistan	-5	…	…	…	22	25	…	
Bosnia-Herzegovina	44	…	…	-0.7	...	…	…	
Yugoslavia	…	-46.9	15.3	…	...	...	...	
CEE & Eurasia	-2	-1.4	9.9	4.8	27	20	16	
Northern Tier CEE	6	2.4	11.2	11.5	40	35	32	
Southern Tier CEE	4	-6.8	19.5	3.9	25	20	19	
Eurasia	-5	-1.5	7.8	3.5	24	16	12	
Europe EMU					51	54	53	
High Income Countries					39	38	37	
Latin America and the Caribbean							18	
Sub-Saharan Africa							16	

1 Export growth is in US dollar terms. 2 Openness to trade is the sum of merchandise exports plus imports expressed as a percentage of purchasing power parity GDP. 3 Institutional integration refers to membership or participation in (1) OECD, (2) WTO, (3) NATO, (4) Europe Agreements with EU, (5) invited to participate in July 1997 in negotiations toward EU membership, (6) invited to participate in October 1999 in negotiations toward EU membership.

EBRD, *Transition Report Update* (April 2001); World Bank, *World Development Indicators 2001* (2001).

Table 15. Integration into the World Economy (II)

Country	Current Account Balance (% of GDP)			Foreign Direct Investment (net inflows in U.S. $ per capita)				Gross FDI as a % of PPP GDP
	1996-98	1999	2000	1989-2000	1998	1999	2000	1999
Czech Republic	-5.3	-3.0	-4.8	2,102	256	605	434	4.0
Hungary	-3.6	-4.3	-3.5	1,935	144	140	164	2.0
Poland	-2.9	-7.5	-6.1	751	128	164	240	2.6
Slovakia	-10.0	-5.7	-3.6	669	70	130	278	1.3
Slovenia	-0.2	-3.9	-2.9	768	125	72	67	0.7
Estonia	-10.2	-5.8	-6.7	1,337	397	154	168	3.6
Latvia	-7.4	-9.7	-6.8	1,027	124	139	139	2.4
Bulgaria	1.3	-5.5	-5.5	407	65	98	120	2.1
Romania	-7.6	-3.8	-3.7	303	92	48	45	0.8
Lithuania	-10.5	-11.2	-6.0	642	249	129	96	2.7
Croatia	-8.2	-7.6	-4.4	907	173	304	167	4.8
Albania	-9.1	-8.0	-8.5	161	13	15	27	0.4
Kyrgyzstan	-17.9	-16.3	-9.2	97	23	9	9	0.3
Georgia	-9.4	-8.0	-8.1	128	41	11	19	0.6
FYR Macedonia	-7.6	-4.0	-8.3	219	88	14	85	0.3
Belarus	-5.5	-2.2	-1.5	78	14	22	9	0.3
Turkmenistan	-21.0	-16.0	0.9	165	13	18	19	0.9
Ukraine	-2.8	2.7	4.8	67	15	10	12	0.3
Kazakhstan	-4.3	1.0	5.3	571	74	106	77	2.2
Armenia	-19.2	-16.6	-14.5	159	58	34	39	2.6
Moldova	-15.2	-2.6	-7.8	102	20	8	23	0.6
Russia	0.9	12.4	18.4	85	12	5	14	0.5
Azerbaijan	-27.2	-13.0	-1.5	502	129	64	61	2.2
Uzbekistan	-4.5	-1.0	1.0	28	9	5	3	…
Tajikistan	-7.6	-3.4	-6.4	23	4	3	4	…
Bosnia-Herzegovina	-25.9	-22.2	-21.0	71	24	21	27	…
Yugoslavia	-9.5	-13.1	-12.6	13	11	6	35	…
CEE & Eurasia	-4.0	1.5	4.9	326	51	57	64	1.1
Northern Tier CEE	-4.4	-6.4	-5.3	1,111	155	214	243	2.6
Southern Tier CEE	-8.1	-7.7	-7.5	345	69	62	62	1.4
Eurasia	-3.1	5.4	9.9	119	20	15	18	0.7
European Union	1.3	0.3	-0.3					7.8
Advanced Economies	1.5	-0.5	-1.0					
Sub-Saharan Africa								0.7
Latin America and the Caribbean								3.0
Less Developed Countries								1.3
Benchmarks	3 year average current account balance no worse than -5%							

Note: Foreign direct investment figures for 1989-2000 are cumulative. FDI data for Bosnia-Herzegovina exclude capital transfers for reconstruction. Current account figures for Bosnia-Herzegovina exclude official transfers. Current account figures for Advanced Economies and the European Union exclude Belgium-Luxembourg, Denmark and the Netherlands.

EBRD, *Transition Report Update* (April 2001); IMF, *World Economic Outlook* (May 2001); World Bank, *World Development Indicators 2001* (2001).

Table 16. Integration into the World Economy (III)

Country	External Debt (% of exports): Debt 1996	Debt 2000[1]	Debt Service 1997	Debt Service 2000[2]	Present value of External Debt in 1996: % of GNP	% of Exports	Present value of External Debt in 1999: % of GNP	% of Exports	1999 Debt Category
Czech Republic	70	60	15	10	62	70	43	64	Less
Hungary	144	105	37	17	41	158	60	99	Moderately
Poland	170	214	7	9	31	102	33	125	Less
Slovakia	70	80	12	18	41	66	44	69	Less
Slovenia	38	58	9	10	21	36	…	…	…
Estonia	48	65	4	6	9	14	54	68	Moderately
Latvia	78	145	21	21	9	20	39	79	Less
Bulgaria	154	152	14	16	89	151	77	157	Severely
Romania	89	82	20	17	23	89	27	90	Less
Lithuania	49	97	11	18	16	35	34	80	Less
Croatia	68	119	10	18	24	56	47	106	Less
Albania	320	358	6	8	32	101	18	67	Less
Kyrgyzstan	205	306	12	26	37	130	104	228	Severely
Georgia	265	237	5	17	26	209	45	136	Moderately
FYR Macedonia	86	99	9	12	74	106	37	83	Less
Belarus	14	12	2	3	4	21	4	16	Less
Turkmenistan	34	91	27	22	18	39	54	116	Moderately
Ukraine	45	54	9	13	18	48	34	75	Less
Kazakhstan	83	115	25	12	14	48	41	89	Less
Armenia	167	195	15	17	27	114	…	135	Moderately
Moldova	87	218	14	22	39	92	74	126	Moderately
Russia	133	122	12	14	25	97	35	153	Moderately
Azerbaijan	50	58	7	7	10	45	22	57	Less
Uzbekistan	61	150	9	26	9	56	…	131	…
Tajikistan	169	297	15	15	24	69	37	92	Less
Bosnia-Herzegovina	550	221	38	13	53	408	35	…	Severely
Yugoslavia	454	565	1	2	…	…	…	…	…
CEE & Eurasia	123	137	12	14	26	87	37	115	
Northern Tier CEE	131	153	13	12	35	93	40	104	
Southern Tier CEE	212	216	14	13	41	129	39	103	
Eurasia	104	117	12	15	21	79	36	124	
Developing Countries	168	173	25	21					
Sub-Saharan Africa				14					
Latin America and the Caribbean				42					
Benchmark	debt service less than 20%				below the "moderately indebted" threshold (i.e., debt < 132% of exports)				

1 Datum for Georgia is for 1999. 2 Data for Armenia, Georgia and Russia are for 1999. Yugoslavia has been in default on virtually all of its external debt since 1992.

The debt classification is per the World Bank. Countries with a present value of debt service greater than 220% of exports or 80% of GNP are considered severely indebted; countries that are not severely indebted but whose present value of debt service exceed 132% of exports or 48% of GNP are classified as moderately indebted; countries that do not fall into the above two groups are classified as less indebted. The present value of debt is the sum of short-term external debt plus the discounted sum of total debt service payments due on public, publicly guaranteed, and private nonguaranteed long-term external debt over the life of existing loans. Debt service as a % of current account revenues. The IMF estimates that the debt service ratio of the transition countries overall decreased from 16.5% in 1999 to 14.4% in 2000.

World Bank, *World Development Indicators 2001* (2001); EBRD, *Transition Report Update* (April 2001); IMF, *World Economic Outlook* (May 2001).

2. Social Conditions

Ultimately, the sustainability of transition progress hinges on the well being of the individual and a reasonably fair distribution of the gains and costs from the transition. Humanitarian considerations and support are important. However, equally if not more compelling are the links between living standards, popular expectations, and the level of public support for economic and political reforms--reforms which have coincided with, if not contributed to, both a dramatic initial drop in overall income and significant increases in income inequalities and poverty in most cases. The links between social conditions and macroeconomic performance may be growing in importance as well, particularly in a setting of sustained deterioration of social conditions. Productivity is eroded or stifled in such a setting.

Tables 17 through *25* and *Figure 3* highlight social conditions. ***Unemployment*** rates (*Table 17* and *Figure 3*) are high and rising in most transition countries. Far and away, the highest rates are in the Southern Tier CEE, particularly in those countries that were part of the former communist Yugoslavia.[42] The unemployment rate on average for the subregion in 2000 was 21 percent, highest since the transition began. Unemployment rates range from 30-40 percent in Macedonia, Yugoslavia, and Bosnia-Herzegovina; 15-18 percent in Croatia, Bulgaria, and Albania; and is lowest in Romania, at 10.5 percent.

Despite favorable macroeconomic trends, unemployment remains stubbornly problematic in the Northern Tier CEE, 12.8 percent on average in 2000. This compares to 8.2 percent in the EU. Earlier in the transition, through 1997, unemployment rates in the Northern Tier had been falling, coinciding with a similar trend in Western Europe. The Northern Tier CEE unemployment rate in 1997 (at 8.7 percent) had even fallen below the EU average (of 10.4 percent). Since then, however, Northern Tier unemployment rates have been increasing on balance (while EU rates continue to fall). Rates are highest in Slovakia (17.9 percent), Lithuania (15.4 percent), Poland (15 percent), Estonia (13.7 percent), and Latvia (13.2 percent). Unemployment in the Czech Republic is close to 9 percent, and represents a notable increase from rates in earlier transition years. The two Northern Tier exceptions are Hungary and Slovenia. In both, unemployment rates peaked early in the transition (1993 or 1994), and have fallen fairly steadily since, to levels that are now below the EU average: 6 percent in Hungary; and 7.2 percent in Slovenia.

Official unemployment rates are generally lower in Eurasia than in CEE; the 1999 Eurasian average was 8.4 percent. One reason why this is so is because the data are often less reliable in Eurasia, and/or are not directly comparable to those in CEE. In a handful of Eurasian countries, generally where recorded unemployment rates are lowest, registered unemployment figures are reported in lieu of survey estimates. The former technique tends to underestimate actual unemployment rates, particularly where there is little incentive to register one's unemployment (i.e., where unemployment compensation is minimal or insignificant). Registered unemployment rates are used in Uzbekistan, Moldova, Belarus, Tajikistan, and Kyrgyzstan, where, by these measures, unemployment ranges from 0.6

[42] The striking exception to the trend of high unemployment among the countries of former communist Yugoslavia is Slovenia where unemployment is now 7.2% of the labor force.

percent in Uzbekistan to 5.4 percent in Kyrgyzstan. Unofficial estimates, however, indicate substantially higher rates in, for example, Kyrgyzstan (around 20 percent) and Tajikistan (30 percent). Armenia's official unemployment figures (10.7 percent in 2000) are also registered unemployed, though again, unofficial estimates indicate that substantially higher unemployment rates exist there as well. In Turkmenistan, unemployment does not officially exist since every citizen is "guaranteed" employment. However, a household survey found urban unemployment there to be 19 percent in 1998.

In some Eurasian countries, official unemployment rates are high, and closer to CEE norms. Russia, Georgia, and Azerbaijan (in addition to Armenia) all have official unemployment rates in double-digits, from close to 10 percent in Russia to 14 percent in Azerbaijan and 15 percent in Georgia.

To some extent higher open unemployment in Eurasia has so far been avoided because labor markets have been adjusting somewhat differently in Eurasia than in CEE. To a great extent this is another way of saying that enterprise restructuring continues to lag in much of Eurasia vis-à-vis CEE. Similarly, the degree of open unemployment currently experienced in CEE and some of Eurasia may be an indication of what is to come in the rest of Eurasia.

More specifically, the tendency in many firms in Eurasia to avoid labor shedding (or making "quantity adjustments") when demand for labor falls or shifts has put greater pressure on "price adjustments" in the labor markets, that is, on reducing real wages. *Figure 3* sheds some light in this regard. Real wages have dropped much more significantly in Eurasia than in CEE. From 1990 to 1995, real wages fell by more than 80 percent on average in the six Eurasian countries for which data are available, recovering to close to 40 percent by 1998. In contrast, real wages in the Northern Tier CEE countries never fell below 35 percent of 1990 levels, and by 1998 were roughly 10 percent less than 1990 real wages.

Other distinguishing labor market adjustments characterize Eurasia for which cross-country data are not readily available. These include wage arrears and hidden unemployment or, more broadly, substantial underemployment. Many workers in much of Eurasia have remained officially employed, but have often gone without pay for periods or are put on involuntary leave and/or are given fewer hours to work.[43] In short, labor market adjustments in much of Eurasia may be just as significant and tumultuous (if not more so) than those in CEE, though they have manifest in a variety of different often less transparent ways.

Another important consideration, and arguably a growing concern as the transition stretches, is ***long-term unemployment***. We know that unemployment is a crucial determinant of poverty. In addition, there may be growing evidence that an underclass of poor is forming

[43] According to Pinto, Drebentsov, and Morosov (2000), wage arrears in the public sector alone at end 1999 were equivalent to roughly 1% of GDP in Georgia, 1.6% in Moldova, and 2.7% in Armenia. More broadly, wage arrears in Russia in four sectors of the economy (industry, agriculture, transport, and construction) equaled 2.9% of GDP in 1998. B. Pinto, V. Drebentsov, and A. Morozov, "Dismantling Russia's Nonpayments System: Creating the Conditions for Growth," World Bank (2000).

in parts of the transition region. Long-term unemployment trends could shed light on this issue.

Table 18 shows what data are available on long-term unemployment. Not surprisingly, and unfortunately, such data for most of Eurasia are not available. In any event, the data for the CEE countries plus Russia are striking: the proportion of unemployed that is long-term has increased greatly since 1992, and, as of 1996-1998, ranges from 31 percent in the Czech Republic to 81 percent in Macedonia.

It is also important to note, however, that the proportion of long-term unemployed in Western Europe is comparable to that found in most of CEE. Moreover, this proportion has been increasing in Western Europe as well. Fifty-six percent of the unemployed in Spain in 1996-1998 was long-term, an increase from 47 percent in 1992. In Germany, almost one-half of the unemployed in 1996-1998 had been unemployed for more than one year; in 1992 it was closer to one-third. The truly exceptional labor market is found in the United States where only 9 percent of the unemployed is long-term (and only 4 percent of the labor force is out of work).

Data that shed light on who is the long-term unemployed are needed. In Macedonia, for example, entrance into and out of the labor market is very restricted, and the majority of the long-term unemployed consists of new entrants to the labor force; relatively young Macedonians who have not yet landed a job. This unemployment profile is particularly disturbing in the current highly unstable context in Macedonia. How prevalent are these labor market rigidities in other transition countries?

Table 19 looks at ***per capita income*** and how it is distributed. Income on average in the transition economies remains significantly below that in the advanced economies. In purchasing power parity (PPP) terms, per capita income (at $6,240) for the transition region overall is only one-fourth the average of the advanced economies ($25,690). It is considerably lower when market exchange rates are used to calculate average income, closer to one-twelve the average of the advanced economies. Furthermore, the transition economy average masks wide variation. The Northern Tier CEE per capita income average is almost twice that found in the Southern Tier CEE and Eurasia in PPP terms. Four Northern Tier CEE countries have average income greater than $10,000 (Slovenia, $16,840; the Czech Republic, $13,100; Hungary, $11,750; and Slovakia, $10,600), while four Eurasian countries have average income levels closer to $2,000 (Armenia, $2,420; Uzbekistan, $2,210; Moldova, $2,030; and Tajikistan, roughly $1,100).

What may be more important for our purposes is how the income levels have changed during the transition, and how it has been distributed within countries. Other things equal, the greater the income disparities and collapse in incomes, the more pronounced are the hardships and the greater is the likelihood of "reform fatigue."

Trends in the ***distribution of income*** and consumption (*Table 19*) are drawn primarily from the World Bank, *Making Transition Work for Everyone: Poverty and Inequality in Europe and Central Asia* (September 2000). This study represents a notable advancement in efforts to quantify trends in inequality and poverty, and enables us to draw more (and presumably more accurate) conclusions on such trends.

Several observations on inequality stand out. First, income inequality has increased dramatically overall in the transition region. In little more than a decade (from 1987 to 1999), income inequality, as measured by gini coefficients, increased for the transition region as a whole by 50 percent. This likely represents a change of unprecedented magnitude in the given time period. To compare, income inequality increased by 2 percent in the EU from 1986 to 1993.

Virtually all the transition economies had relatively equal income distributions prior to communism's collapse, generally more equal than those found in the developed market economies.[44] Since the transition began, however, income inequality trends have differed significantly between the subregions. Income inequality has increased far more in Eurasia (by over 60 percent) than it has in the Northern Tier CEE countries (14 percent) and the Southern Tier CEE (36 percent). For the Northern Tier CEE countries, income inequality is now on a par with that found in the EU, and slightly lower than all of the advanced economies on average. To a large extent, the increase in inequality in these advanced transition economies is an expected byproduct of developing a market-oriented economy.

In contrast, income inequality in a handful of Eurasian countries, most notably Armenia, followed by Russia, Tajikistan, and Kyrgyzstan, may approach those levels found among the most unequal economies worldwide, found in Latin America and Sub-Saharan Africa. The income distribution estimates of a handful of comparator countries in *Table 19* provide a rough basis for comparison.[45] Income inequality is among the highest worldwide in Brazil, Guatemala, and South Africa where gini coefficient estimates range from 0.59 in South Africa to 0.60 in both Brazil and Guatemala. Of the transition countries, income inequality in Armenia comes closest (with a gini coefficient estimate of 0.58). The gini coefficients for Russia and Tajikistan are 0.47; for Kyrgyzstan, 0.44. It is also worth noting, however, that income inequality in the United States (gini = 0.41) is not much lower than that found in the above-mentioned countries and in the overall Eurasian average (0.44).

Most of the increase in income inequality in the transition region appears to have taken place relatively early on in the transition, by the mid 1990s. The most recent changes in income inequality for which data are available show considerable slowing of the increase in inequality overall, and even a notable decrease in at least two countries, Slovenia and Kyrgyzstan. Since the mid-1990s, income inequality increased by only 2 percent on

[44] It is probable, however, that the gini estimates of pre-transition income distribution, particularly in Eurasia, underestimate income inequality. Typically, pre-transition surveys excluded many of the poorer segments of society.

[45] The gini estimates of the comparator countries in *Table 19* are drawn from a different source from within the World Bank (its *World Development Indicators*), and hence are likely derived somewhat differently than the transition country estimates in the table.

average for the sixteen transition countries for which data are available; i.e., comparable to the recent trend in the EU.

The inequality gap between subregions is narrower if the ***distribution of consumption*** (rather than income) is used to measure inequality (*Table 19*). In general, consumption measures of inequality are superior to income measures since they better capture informal economic activities, self-employment, and nonwage earnings, and may be more likely to reflect underlying, longer-term (or "permanent") income trends. The distinction between the two inequality measures may be particularly key in the case of Eurasia where wages reportedly represent less than 40 percent of household incomes, and in some countries, such as Armenia and Georgia, perhaps less than 15 percent. In CEE, wages account for 60 to 80 percent of household incomes.[46] As shown in *Table 19*, consumption measures of inequality are lower than income measures on average in Eurasia and, to a lesser extent, in the Southern Tier CEE, while slightly higher in the Northern Tier CEE. Consumption inequality is considerably lower than income inequality in Tajikistan, Armenia, Kyrgyzstan, Georgia, and Bulgaria. These findings are consistent with existing cross-country estimates of informal economic activity that show that these five countries have among the largest informal economies (as a share of official GDP) of all the transition countries.[47]

Overall, these new data on inequality provide a more favorable picture of transition trends than previously depicted in past *Monitoring Country Progress* reports on at least three counts: (1) the increase in income inequality in the CEE countries since the beginning of the transition is less than previously calculated because these new estimates have adjusted for higher pre-transition inequality; (2) more time-series data reveal that most of the increase in income inequality occurred in the first part of the transition; since the mid-90s, the pace of increase has slowed considerably; and (3) the inequality gap between the subregions narrows some when the more accurate distribution of consumption measures are used in lieu of income measures.

Another important consideration in gauging the extent of transition hardships is the pattern of overall economic activity over the transition, or the ***trends in GDP***. All the transition economies witnessed at least an initial significant drop in output before economic growth resumed. However, the pattern of economic decline and recovery has varied widely among the countries. For the Northern Tier CEE countries, official GDP on average fell by roughly 20 percent early on in the transition before economic growth resumed. In Eurasia, recorded GDP dropped closer to 50 percent of pre-transition income on average.[48]

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[46] World Bank, *Making Transition Work for Everyone* (September 2000). p. 143.

[47] For estimates of the size of informal economies, see S. Johnson, D. Kaufmann, and A. Shleifer, "Politics and Entrepreneurship in Transition Economies,*" Working Paper Series*, No. 57, The William Davidson Institute, University of Michigan (1997); and F. Schneider and D. Enste, "Shadow Economies: Size, Causes, and Consequences, " *The Journal of Economic Literature* 38 (March 2000), pp. 77-114.

[48] *Figure 3* of *Monitoring Country Progress*, No. 6 (May 2000) shows the distinct GDP patterns of the three transition subregions, and *Figure 4* further disaggregates into seven GDP patterns among the transition countries.

Table 20 provides an updated snapshot of these trends by comparing the size of the transition economies in 2000 with 1989 GDP levels. Two series are calculated, the officially recorded GDP trends and official GDP trends combined with very rough estimates of informal sector activity.

The official GDP estimates reveal that only a handful of countries have essentially regained pre-transition income levels. Most of these are Northern Tier CEE countries: Poland, Slovenia, Hungary, Slovakia, and the Czech Republic. However, Albania's economy is also now back to its pre-transition size by this measure, and Uzbekistan's economy is close. Albania's economy has been growing steadily since 1993 (except for 1997) after a precipitous drop. As noted previously, Uzbekistan's economy has yet to experience much of a drop in GDP, or robust economic growth; its pattern of economic activity is quite unique to the transition region.

At the other end of the spectrum is a handful of countries with formal economies that are at least one-half the size of what they were in 1989. All but one are Eurasian countries. Officially recorded 2000 GDP in Tajikistan, Azerbaijan, and Yugoslavia is roughly 50 percent of 1989 GDP. In Ukraine, Georgia, and Moldova, it is closer to one-third. These numbers suggest considerable hardship for many.

However, it is widely recognized that ***unofficial economic activity*** is very significant in virtually all the transition countries, and that unofficial income has likely greatly offset official income losses. Measuring the informal economy is by definition very difficult, though there are a variety of ways to get at rough orders of magnitude. Some stem from analyzing household survey data, which is done in some detail in *Appendix II* of *Monitoring Country Progress, No.* 6 (May 2000).[49]

An increasingly common "back-of-the-envelope" technique to measure unofficial economic activity is to compare officially measured economic activity with electricity consumption. From this approach, one finds that many of those countries that have experienced a particularly large decrease in official economic activity have also seen relatively large increases in unofficial economic activity. Drawing from estimates by Johnson, Kaufmann, and Shleifer (1997), for example, one finds that unofficial economic activity in Eurasia is almost twice as large relative to official GDP as it is in CEE. In Eurasia, it was almost 40 percent of official GDP on average in 1995 (and still rising); in the CEE, it was closer to 20 percent (and falling).[50]

The second GDP series of *Table 20* attempts to account for this informal economic activity by combining estimates of the unofficial economy with the officially recorded GDP figures. Estimates of the size of the informal economy as a percent of official GDP for seventeen countries from 1989 to 1995 were taken from Johnson et. al. These estimates were then combined with official GDP figures to get total economic activity

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[49] It's also worthy to note that official income statistics are continually being revised, and efforts are often made to include informal economic activity into these figures.
[50] S. Johnson, D. Kaufmann, and A. Shleifer, "Politics and Entrepreneurship in Transition Economies," *Working Paper Series,* No. 57, The William Davidson Institute, University of Michigan (1997).

trends through 1995. Next, these trends were updated to 2000 by extrapolating the generally observed inverse relationship between changes in the official economy with changes in the informal sector. For example, an expansion of 15 percent of official GDP from 1996-2000 would translate into a contraction of 15 percent in the informal economy; a contraction in the official economy means an expansion of the unofficial economy by an equal proportion. While obviously very rudimentary in technique, the end-result hopefully provides a more complete picture of current overall economic activity in relation to pre-transition activity, and more realistic implications regarding the scope of hardships.

How do these estimates compare to official economy trends only? In general, adding informal economic activity narrows the spread in performance across the countries. The Northern Tier CEE countries are slightly less advanced in economic activity over the transition when this broader measure of economic activity is used; the decrease in informal economic activity started early in the transition for these countries and has slightly outweighed the growth in the formal economy. More striking are the trends in Eurasia where, on balance, economic activity is notably greater when the informal economy is combined with official GDP trends. On average, officially recorded GDP in 2000 is 61 percent of 1989 GDP; this increases (albeit in a smaller sample) to 71 percent with the informal sector included. The drop in official GDP has been mitigated the most by the informal economy in Russia, followed by Ukraine, Azerbaijan, Georgia, and Kazakhstan. The informal economy has offset official income drops to a lesser extent in Bulgaria, Moldova, and Latvia.

Only two countries in Eurasia show a greater drop in output when the informal economy is included: Uzbekistan and Belarus. In other words, the relatively impressive performance of these two economies vis-à-vis other Eurasian countries is downgraded some by this score.[51]

New estimates of ***poverty*** are taken from the World Bank (September 2000) and are shown in *Table 20* (absolute poverty) and *Table 21* (relative poverty burden). Survey years range from 1995 to 1999, though most estimates are for poverty in 1998 or 1999, and are hence much more recent than the 1993-1995 estimates cited in *Monitoring Country Progress*, No. 6 (May 2000). Two international poverty lines are used in calculating absolute poverty (or the headcount index): $4.30 and $2.15 per person per day.[52] The $2.15 poverty line may be the most appropriate for the transition countries.

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[51] Anders Aslund makes further adjustments from official figures to assess economic activity trends through 1995. In addition to including the informal sector, he attempts to account for the significant overestimation of GDP prior to communism's collapse from two sources: (1) those that stemmed from unsalable output (primarily manufacture production that essentially detracted value); and (2) those that derived from implicit trade subsidies in energy within the communist bloc. As expected, the resulting revisions further mitigate the declines in economic output across the transition region through the mid-1990s. Aslund, *The Myth of Output Collapse after Communism*, Carnegie Endowment for International Peace Working Paper, Number 18 (March 2001).

[52] To derive a poverty headcount or the percentage of those who are poor, the U.S. dollar poverty line is first converted into national currency using 1996 purchasing power parity (PPP) exchange rates (the most

This poverty line is roughly equal to the lowest absolute poverty lines that are used by many governments in the transition countries, and are based on a nationally determined minimum food basket plus an allowance for nonfood expenditures. The $4.30 per day poverty line is included partly because most transition countries also have national poverty lines that exceed the $2.15 threshold. Moreover, the most commonly cited cross-country poverty estimates of the transition region to date have been based on a $4 per day poverty line.[53] The World Bank generally uses two absolute poverty thresholds in assessing absolute deprivation in the developing world: one and two dollars a day per person. For the transition countries, however, the two dollar-a-day threshold may be the more appropriate of the two since the colder climate in the region necessitates expenditures on heat, winter clothing, and food over and above what is typically incurred in the developing world.

As shown in *Table 20*, poverty rates vary widely both by country as well as by poverty threshold. Roughly four out of ten persons in the transition region are found to be in poverty at the higher poverty threshold of $4.30 per day. However, the range in poverty rates by country is enormous, from 1 percent in Slovenia and the Czech Republic to 96 percent in Tajikistan. The subregional differences are large as well, from 15 percent in the Northern Tier CEE to 46 percent in Eurasia. The regional averages of poverty at $4.30 per day are very similar to the earlier (1993-1995) estimates of poverty at $4 per day by Milanovic, though some individual country estimates vary widely between the two series.

Poverty rates are much lower as expected when the poverty threshold is lowered to $2.15 per day. By this measure, only one percent of persons in the Northern Tier CEE is poor, 6 percent is living in poverty in the Southern Tier CEE (vs. 36 percent with a $4.30 per day threshold), and 17 percent in Eurasia. The differences between countries and subregions remain very large, and the country ranking is very similar, though not identical, with that of the higher threshold. However, poverty overall in the region is "reduced" by more than a multiple of three (from 39 percent to 12 percent) when the lower poverty threshold is used.

We can make a very rough comparison of poverty in the transition region with that found among the developing countries by using the World Bank's estimates of poverty at $2 a day in the developing world.[54] Overall, poverty appears to be much lower in the transition region than it is in the developing world. The poverty rate in Latin America and the Caribbean (32 percent at $2/day) is about 50 percent higher than in the transition region overall (21 percent at $2/day).[55] The magnitude of poverty is much higher still in Sub-Saharan Africa (78 percent) and South Asia (84 percent) at this $2 per day threshold.

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recent ones available). Next, the poverty line is adjusted for inflation to yield an absolute poverty line for the year in which the data are collected.

[53] These estimates derive from the work of Branko Milanovic. *Income, Inequality, and Poverty during the Transition to a Market Economy*, Washington, D.C.: World Bank, 1998.

[54] World Bank, *Global Economic Prospects and the Developing Countries 2001* (2001), p. 37.

[55] The World Bank's country classification of the transition region includes Turkey (which has a poverty rate of 18% at $2/day).

There is much, of course, that these relatively favorable comparisons for the transition countries of absolute poverty rates do not capture. In important respects, as ably articulated in World Bank (September 2000), the transition country poor and their situation are very different than in other parts of the world, better in some ways, but clearly worse in others. In contrast to the majority of poor people in developing countries, most of the poor in the transition countries are literate, many are well educated, and before communism's collapse, had secure employment. The drop into poverty was sudden and chaotic, and the magnitude of the increase in the poverty rate has probably been without parallel. Milanovic (1998) estimates that the poverty rate at $4 per day increased from roughly 4% in 1987-88 to 40% by 1993-1995 for the transition region overall. Moreover, these changes have occurred in the context of tumultuous change across the board in the economic, political and social domains, as well as in the context of an important legacy of the (Communist) past that associated poverty with individual failings or deviancy. Many of the mental and physical illnesses that have emerged during the transition are likely better understood in this context.

The relative poverty burden of various segments of the transition population is assessed in *Table 21* drawing from the same surveys used to measure the absolute poverty rates of *Table 20*. In this analysis, persons below the relative poverty line of 50 percent of median income, adjusted for household economies of scale, are defined as poor. The relative poverty burden is calculated by dividing the share of total poverty of a particular segment of the population (e.g., children or elderly, male or female) by that segment's share of the total population. Hence, a relative poverty burden in excess of "1" represents a disproportionate share (or burden) of the nation's poverty. Similarly, persons in groups that score higher than "1" are more at risk to being poor; those in groups with a score less than "1" are less at risk. The populations are segmented by age (children vs. elderly), education (with primary education only vs. higher education), location (rural vs. urban), and household head (male vs. female; employed vs. not employed).[56]

Perhaps the most striking result that emerges from an examination of the data is the significant differences across the categories between the CEE countries (particularly Northern Tier CEE) and Eurasia. In short, the poverty profiles tend to be much more sharply differentiated in CEE than in Eurasia; that is, distinctions based on one characteristic (such as education, location, age) reveal much greater differences in poverty risks in CEE than in Eurasia. Part of the explanation is because markets (from labor markets to product markets) are more advanced in the CEE countries; they are "working better" there. In Eurasia, on the other hand, there are more diverse factors that combine to affect a household poverty status, many of which are nonmarket-based.

More specifically, the data suggest the following. First, children are disproportionately at risk to being poor across the three subregions, but much more so in CEE, and particularly in the Northern Tier CEE. On the other hand, the elderly in the Northern Tier CEE countries have a lower poverty risk than the national averages of these countries, while the elderly in Eurasia are more at risk; they are disproportionately poor. Part of the

[56] "Not employed" includes the unemployed and all those, including retirees, who are not in the labor force.

distinction likely stems from the tendency for the elderly in the Northern Tier countries to be better protected and supported by government safety nets, and pensions in particular.

Second, education appears to be a very significant determinant to financial well being in all three subregions, though particularly in the Northern Tier CEE. In other words, the chances of being poor in the Northern Tier are much greater if one has a primary education only and much less with advanced education. This tendency is less evident in Eurasia where apparently the returns to education are lower (and presumably the importance of political or personal connections and corruption towards securing a job are greater). These findings are consistent with the many anecdotal reports that well-educated persons in Eurasia are unable to find employment commensurate with their educational background.

Third, other things equal, rural populations are much more at risk than urban populations to being poor in CEE. The urban areas in CEE are presumably where most of the jobs and economic opportunities are. In Eurasia, in contrast, location matters little to poverty risks. There is little advantage to living in an urban setting in Eurasia presumably because of the absence of sufficient jobs and adequate economic infrastructure. There may be little to gain by living in rural areas in Eurasia as well, though farming the lands at least provides a means to cope and perhaps avert deep and/or sustained poverty.

Fourth, there seems to be a stronger link between gender and poverty in the Southern Tier CEE and Eurasia than in the Northern Tier CEE. In particular, women tend to be much more at risk to finding themselves in poverty than men in most of Eurasia and the Southern Tier CEE countries. In contrast, in the Northern Tier CEE countries, gender seems to be much less of a determinant of poverty.[57] This suggests that discrimination and the importance of connections are less significant in the Northern Tier CEE and market forces are more important.

Finally, being employed, or living in a household in which the head of the household is employed, reduces one's chances of being poor in all three subregions. However, with perhaps the exception of Poland, being employed confers more of a benefit in the Northern Tier CEE countries than elsewhere in the transition region. Similarly, not being employed carries more of a penalty in the Northern Tier; i.e., it increases the risk of being poor. These findings are consistent with our earlier observations on the distinctions in labor market trends between CEE and Eurasia. In Eurasia, where wage arrears often prevail and where real wages have fallen further, there is less of a guarantee that being employed will keep a person out of poverty. Moreover, given the greater prevalence of the informal economy in Eurasia, there is a weaker link between being officially unemployed (in the formal economy) and being poor.

[57] At first look, the Czech Republic seems to be a salient exception to this rule: the relative poverty burden for females in the Czech Republic is very high (and serves to pull up the Northern Tier CEE average). However, this takes on much less meaning in the context of a negligible poverty rate nationwide (of 1% at $4.30/day).

Table 22 highlights trends in ***infant and child mortality rates*** as estimated by the World Bank. The source of these data is an important issue because there are considerable discrepancies in some of the country estimates between World Bank figures and other sources, most notably, UNICEF. UNICEF estimates generally show infant and child mortality rates to be higher than World Bank measures in many countries of the former Soviet Union and in the Southern Tier CEE.[58] However, both data sets are reasonably consistent in regards to how mortality rates are changing over time. Here, the results are striking and very encouraging. From *Table 22* we see that infant and child mortality rates have fallen in all three subregions over the transition, by about 20 percent for the transition region overall. Only two countries, Ukraine and Latvia, have not experienced a drop in infant mortality rates from 1990-1999.

The decrease in infant mortality rates in the 1990s is consistent with significantly falling rates in the 1980s. However, the overall dramatic drop over the past twenty years has not been a linear one, at least for most of the Southern Tier CEE countries and for countries of the former Soviet Union where infant mortality rates increased in the early transition years.

The Northern Tier CEE trends have been the most impressive: infant and child mortality rates were the lowest in the Northern Tier at the outset of the transition and have fallen the most there during the transition, by almost one half. Northern Tier rates still exceed EU rates (which also have been dropping notably), but the gap has been closing. In 1999, infant mortality rates in the Northern Tier CEE on average was eight deaths per 1,000 live births, while the under five mortality rate average was 10 deaths; the EU average for both mortality rates is five deaths. The Czech Republic is the only transition country that has infant and child mortality rates equal to the EU averages.

The average infant and child mortality rates in the Southern Tier CEE are slightly less than the Eurasian averages, and about twice the averages of the Northern Tier CEE rates. The average mortality rates in both the Southern Tier and Eurasia are well below developing country norms, almost one-half the mortality rates incurred in Latin America and the Caribbean. However, the subregional averages mask large differences between countries. Infant and child mortality rates are highest in the five Central Asian Republics, Albania, and Romania. Some of these countries, Turkmenistan most notably, do have mortality rates that are comparable to those in some developing countries.

One might expect to see fairly consistent patterns between infant/child mortality rates and ***life expectancy*** in the transition countries, since the former trends contribute to the latter. However, overall life expectancy trends are much less encouraging than trends in infant and child mortality (*Table 23*). Even though infant and child mortality rates have improved substantially, life expectancy has fallen for the transition population as a whole from 1989-1999. Most of the declines occurred earlier in the transition. Still, more recent trends are not all favorable. The latest data available show life expectancy

[58] The largest discrepancies are found in mortality estimates in the Central Asian Republics. Infant mortality rates on average in these five countries is roughly fifty deaths per 1,000 live births according to UNICEF, and twenty-five deaths by World Bank estimates.

dropping in Russia in 1999 (after stabilizing for several years), from 67 to 66 years, while only two countries, Estonia and Uzbekistan, witnessed an increase in life expectancy from 1998-1999.

The overall decline in life expectancy during the transition also contrasts with life expectancy patterns in the decade prior to communism's demise. In particular, with the exception of Armenia, life expectancy remained steady or increased throughout the communist world in the 1980s.

As with virtually all transition trends, however, life expectancy patterns differ greatly by subregion. During the early transition years, life expectancy fell fairly uniformly in virtually all the countries, even in the Northern Tier CEE countries. However, this fall was particularly short-lived for persons in the Northern Tier. By 1996, life expectancy in the Northern Tier countries on average was higher, for both males and females, than it had been at the outset of the transition. In contrast, life expectancy for males in the Southern Tier CEE, as of 1998, remains below pre-transition levels, and about the same as pre-transition levels for females in the subregion. Life expectancy has dropped for both males and females in Eurasia, though much more so for males. The largest drops in total life expectancy from 1989-1999 have occurred in Kazakhstan, Russia, Ukraine, and Belarus.

Average life expectancy in the Northern Tier countries is now about 73 years. In the Southern Tier CEE countries, it is 71 years, and in Eurasia, 67 years. Even the Northern Tier levels remain well below developed country norms. Life expectancy for persons in the Czech Republic and Slovenia, at 75 years, comes closest to the 78 years life expectancy in the EU. Southern Tier CEE and Eurasia levels are roughly comparable to levels in Latin America and the Caribbean where life expectancy is 70 years on average.

Table 24 sheds light on trends in education, ***primary and secondary school enrollments***, in part to help gauge the extent, if any, to which human capital may be deteriorating over the transition. The first conclusion to draw may be that more information is needed. The data are taken from two sources (the World Bank on the secondary school enrollment series and UNICEF on primary school enrollment), and they do not always appear to be consistent and/or compatible. More data are needed as well, including those for years that are more recent.

Overall, the data show a small decline in primary and secondary school enrollments in the transition region from 1989/90 to 1997/98 from relatively high enrollment levels. Most of the Northern Tier CEE countries have largely been immune to this trend. Secondary school enrollment in this subregion has increased by about 15 percent from 1990 to 1997, and primary school enrollment is roughly the same in 1998 as it was in 1989, after a small decline early on in the transition.

Available data show that the greatest percentage drops in either or both secondary and primary school enrollments have occurred in the Central Asian Republics, the Caucasus, and several Southern Tier countries (Yugoslavia, Albania, and Romania). If the data are to be believed, secondary school enrollments have dropped significantly from 1990-1997 in Albania (52%), Tajikistan (24%), Kyrgyzstan (21%), Georgia (19%), Romania (15%), Azerbaijan (14%), and Kazakhstan (11%). Available primary school enrollment data show substantial percentage drops from 1989-1998 in Yugoslavia (27%), Georgia (13%), Turkmenistan (12%), Armenia (11%), and Tajikistan (8%). However, data gaps exist (particularly for Turkmenistan and Yugoslavia), and/or the two series do not always closely mesh (particularly in the cases of Albania, Kyrgyzstan, and Armenia).

For the Southern Tier CEE and Eurasia countries on average, secondary school enrollments declined fairly steadily from 1990-1997. However, this has not been the trend in primary school enrollments: initial drops (from 1989-1993) in these subregions on average have been followed by small increases from 1993-1998. There are exceptions of course to this "U" shaped trend in primary school enrollments. Yugoslavia and Turkmenistan are the salient ones.

School enrollment levels in the transition countries generally compare favorably to much of the rest of the world. For example, secondary school enrollment ratios in Latin America and the Caribbean are about 60 percent on average, and in Sub-Saharan Africa, it is less than 30 percent. In the Northern Tier CEE, secondary school enrollment is 97%; in the Southern Tier, it is 72%; and in Eurasia, 87%. However, these levels in the transition region fall short of standards in the developed countries. Secondary school enrollment is 108% in the EU.

Finally, *Table 25* provides data from the UNDP that attempt to gauge trends in ***human development*** in the transition countries. The UNDP's Human Development Index (HDI) is based on three indicators: longevity, as measured by life expectancy; educational attainment, as measured by a combination of adult literacy (two-thirds weight), and combined primary, secondary and tertiary enrollment ratios (one-third weight); and standard of living, as measured by real GDP per capita (PPP$). The HDI ranges from zero to one; the higher is the value, presumably the greater is the human development. The UNDP classifies 174 countries into three categories in the *Human Development Report 2000*: high; medium; and low human development.

Human development is considered high in six transition countries (the Northern Tier countries except Lithuania and Latvia), and medium in the rest. Slovenia ranks the highest, 29th out of 174 countries in the worldwide sample. The Eurasian countries have the lowest HDI rating of the three transition subregions on average, though the differences in scores among the Eurasian countries are large, ranging from Belarus (ranked 57th) to Tajikistan (ranked 110th).

The level of human development in the Northern Tier CEE countries on average is well-below OECD standards, and comparable to that in Chile or Uruguay. Human development in the Southern Tier is slightly more advanced than that in Latin America and the Caribbean on average, comparable to that found in Venezuela or Malaysia. Human development in Eurasia on average comes closest to that in Brazil or Thailand.

Since 1990, human development has advanced in the Northern Tier CEE countries on average (though the three Baltic countries are the exception), has remained the same in the Southern Tier CEE, and has fallen fairly significantly in Eurasia. The greatest drops from 1990-1998 have occurred in Moldova, Tajikistan, Ukraine, and Russia.

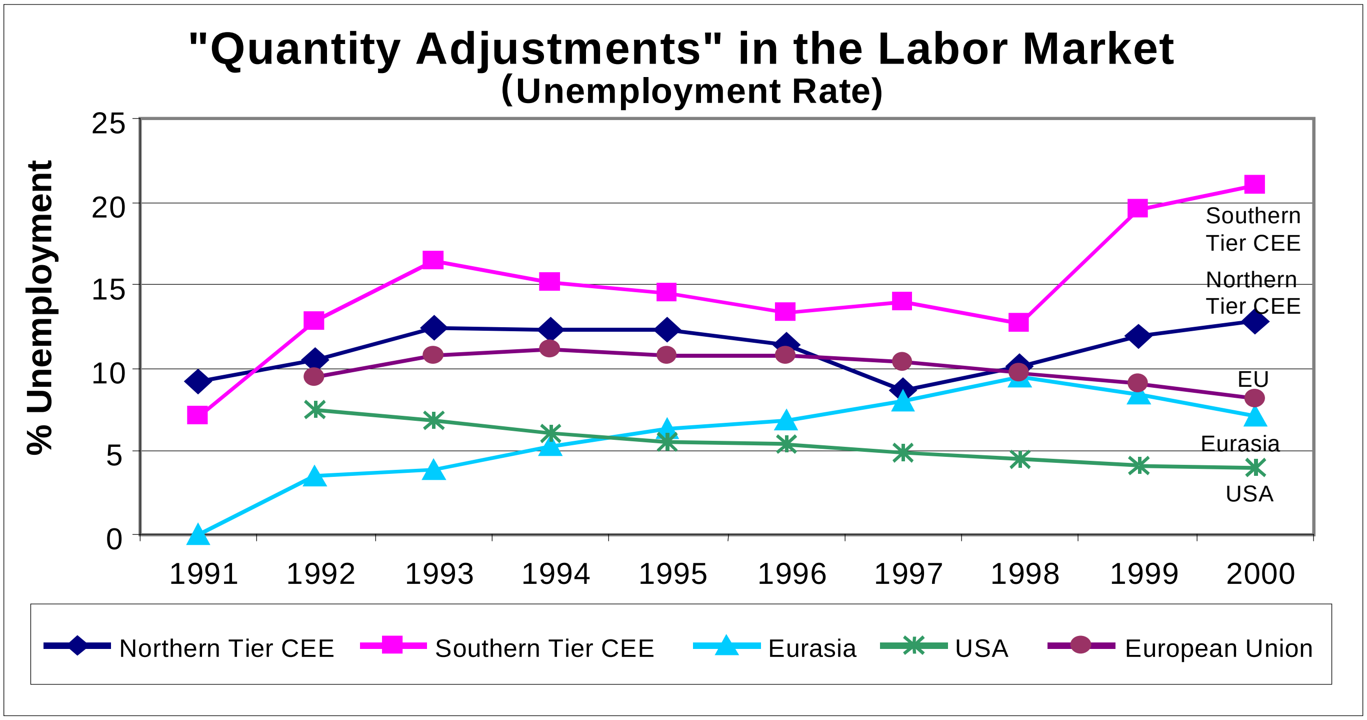
Table 17. Unemployment Rate

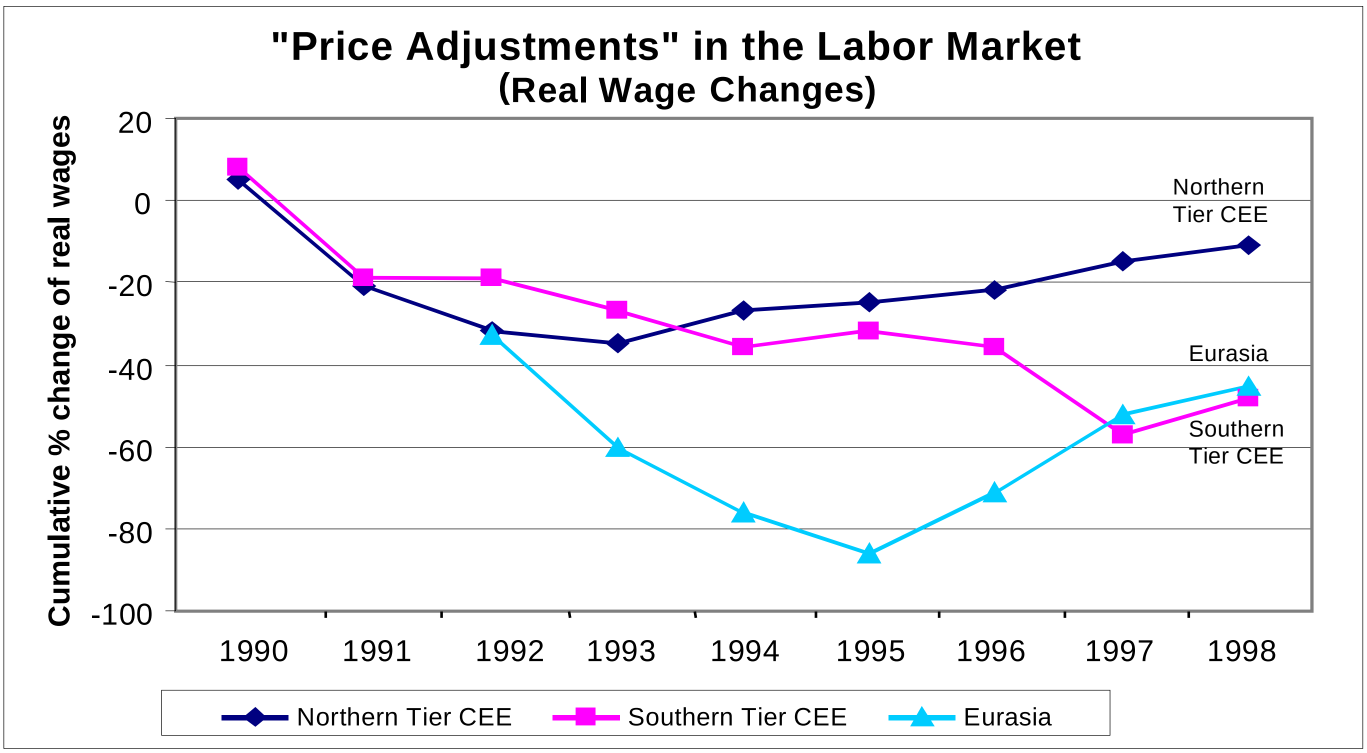
	1992	1993	1994	1995	1996	1997	1998	1999	2000	1998-2000[1] (average)
CEE										
Hungary	9.7	***10.9***	9.7	9.9	9.2	7.7	7.0	6.5	6.0	6.5
Slovenia	8.3	9.1	***9.1***	7.4	7.3	7.1	7.6	7.4	7.2	7.4
Czech Republic	2.6	3.5	3.2	2.9	3.5	5.2	7.5	***9.4***	8.8	8.6
Romania	8.2	10.4	10.1	8.2	6.5	7.4	10.4	***11.5***	10.5	10.8
Estonia	...	6.6	7.6	9.8	10.0	9.7	9.9	12.3	***13.7***	12.0
Poland	14.3	***16.4***	16.0	14.9	13.2	8.6	10.4	13.0	15.0	12.8
Croatia	13.2	14.8	14.5	14.5	10.0	9.9	11.4	13.6	***15.1***	13.4
Latvia	3.9	8.7	16.7	18.1	***19.4***	14.8	14.0	13.5	13.2	13.6
Lithuania	1.3	4.4	3.8	***17.5***	16.4	14.1	13.3	14.1	15.4	14.3
Bulgaria	15.3	16.4	12.8	11.1	12.5	13.7	12.2	16.0	***17.9***	15.4
Slovakia	10.4	14.4	14.6	13.1	12.8	12.5	15.6	***19.2***	17.9	17.6
Albania	27.9	***28.9***	19.6	16.9	12.4	14.9	17.8	18.0	17.1	17.6
Yugoslavia	...	23.1	23.1	24.6	25.7	24.5	25.1	32.6	***40.1***	32.6
FYR Macedonia	27.8	28.3	31.4	***37.7***	31.9	36.0	34.5	32.4	32.1	33.0
Bosnia-Herzegovina	...	...	...	...	...	37.0	38.0	40.0	***40.1***	39.4
Eurasia										
Uzbekistan	0.1	0.3	0.4	0.4	0.4	0.4	0.5	0.5	***0.6***	0.5
Moldova	0.7	0.7	1.1	1.4	1.8	1.5	1.9	***2.0***	***...***	1.8
Belarus	0.5	1.4	2.1	2.7	***3.9***	2.8	2.3	2.1	2.1	2.2
Tajikistan	0.3	1.2	1.7	2.0	2.6	2.8	***2.9***	2.8	2.5	2.7
Ukraine	0.2	0.3	0.3	0.5	1.3	2.3	3.7	**4.3**	4.2	4.1
Kyrgyzstan	...	...	3.1	4.4	***6.0***	4.3	4.3	5.4	...	4.7
Kazakhstan	0.4	0.6	8.1	***13.0***	8.6	7.3	6.6	6.3	...	6.7
Armenia	3.5	6.3	5.8	8.4	10.1	11.3	8.9	***11.6***	10.7	10.4
Russia	5.3	6.0	7.8	9.0	9.9	11.2	***13.3***	11.7	9.7	11.6
Georgia	5.4	9.1	3.6	3.1	2.8	7.5	14.7	***14.9***	...	12.4
Azerbaijan	***15.4***	9.6	10.4	11.7	12.1	12.7	12.9	13.9	...	13.2
Turkmenistan	...	...	...	...	...	...	...	...	...	...
CEE & Eurasia	5.8	7.1	7.8	8.5	8.5	8.9	9.9	***10.6***	10.4	10.3
Northern Tier CEE	10.6	12.5	12.3	12.3	11.4	8.7	10.1	12.0	***12.8***	11.6
Southern Tier CEE	12.8	16.4	15.2	14.5	13.3	13.9	12.7	19.6	***21.0***	17.8
Eurasia	3.5	3.9	5.3	6.4	6.8	8.0	***9.4***	8.4	7.1	8.6
Advanced Economies	7.2	***7.6***	7.4	7.0	7.1	6.8	6.7	6.4	5.9	6.3
USA	***7.5***	6.9	6.1	5.6	5.4	4.9	4.5	4.2	4.0	4.2
EU	9.4	10.7	***11.1***	10.7	10.7	10.4	9.7	9.1	8.2	8.9
Benchmarks										< 10.0

1 Average for Moldova, Georgia, Azerbaijan, Kazakhstan and Kyrgyzstan are from 1997-99. Some of the estimates, most notably for Eurasia, remain registered unemployment figures that typically underestimate the true unemployment rate. This includes figures for Armenia, Belarus, Kyrgyzstan, Moldova, Tajikistan, and Uzbekistan. In Kyrgyzstan, e.g., the rate of unemployment is unofficially estimated to be around 20%; in Tajikistan, the World Bank estimates the unemployment rate in 1998 at about 30%. In Turkmenistan, unemployment does not officially exist since every citizen is guaranteed employment. However, a household survey found urban unemployment at 19% in 1998. Unofficial estimates in Armenia indicate substantially higher unemployment. The figures for Yugoslavia exclude workers that are on "forced holidays" (or about 20-25% of the labor force). The figures for Albania do not account for emigrant workers abroad (about 18% of the labor force in 1995). Peak years are in bold print.

EBRD, *Transition Report Update* (April 2001); IMF, *World Economic Outlook* (May 2001).

Figure 3.





EBRD, *Transition Report Update* (April 2001); IMF, *World Economic Outlook* (May 2001).
The samples for real wage changes are limited in the case of the Southern Tier CEE (n=2, Romania and Bulgaria only), and Eurasia (n=6, Moldova, Russia, Azerbaijan, Georgia, Kazakhstan, and Kyrgyzstan). EBRD, *Transition Report 2000* (November 2000); UNICEF, *Young People in Changing Societies*, Regional Monitoring Report, No. 7 (2000).

Table 18. Long-Term Unemployment in CEE and Russia
(% of Total Unemployed)

Country	1992	1993	1994	1995	1996	1996 - 98	% Change: 1992 -98[1]
Albania	…	65	…	…	...	…	...
Bulgaria	…	53	59	***66***	64	60	14
Croatia	58	***58***	55	…	...	…	...
Czech Republic	14	19	22	31	***33***	31	118
Hungary	18	33	41	48	***52***	51	185
Latvia	…	…	…	…	...	63	...
FYR Macedonia	86	87	***88***	82	81	…	-6
Poland	24	36	38	***42***	38	38	58
Romania	21	…	45	47	42	***47***	124
Slovakia	…	33	43	54	***56***	50	52
Slovenia	46	55	***57***	53	53	55	20
Russia	12	15	…	30	…	***33***	173
Northern Tier CEE	22	33	37	***43***	41	41	87
Southern Tier CEE	31	***60***	52	54	50	51	61
CEE Overall	25	39	42	***46***	44	44	76
France	36	34	38	40	38	***41***	14
Germany	33	36	38	40	...	***48***	45
Spain	47	50	56	***57***	...	56	18
Sweden	8	11	17	16	17	***30***	270
UK	30	38	***40***	38	36	39	29
US	...	...	...	...	...	9	...

1 Percentage change for Bulgaria and Slovakia are 1993-98, and for FYR Macedonia 1992-96.

The long-term unemployed are those who are unemployed for more than one year. Peak years are in bold print.

EBRD, *Transition Report 2000* (November 2000); World Bank, *World Development Indicators 2001* (2001); C. Allison and D. Ringold, *Labor Markets in Transition in Central and Eastern Europe: 1989-1995*; World Bank, Social Challenges of Transition Series (December 1996); and Bureau of the Census, *Populations at Risk in CEE: Labor Markets*, No. 2, prepared for USAID/ENI/PCS (February 1995).

Table 19. Per Capita Income and Distribution of Income and Consumption

	Distribution of Income[1]				% change		Distribution of Consumption 1997-99[3]	2000 Average Income	
	87/90	93/94	95/96	97/99	1987-99	Most Recent[2]		US$	PPP$
Slovenia	22	29	...	25	14	-14	27	10,490	16,840
Czech Republic	19	23	24	...	26	4	24	5,130	13,100
Hungary	21	23	...	24	14	4	27	4,940	11,750
Slovakia	...	20	...	...	...	...	...	3,840	10,600
Poland	28	28	...	30	7	7	31	4,260	8,770
Estonia	24	35	...	36	50	3	37	3,580	8,610
Croatia	36	...	...	35	-3	...	30	4,700	7,530
Russia	26	48	...	47	81	-2	46	2,390	7,430
Belarus	23	...	25	25	9	0	30	2,670	7,000
Lithuania	23	33	...	33	43	0	32	2,690	6,610
Latvia	24	...	31	32	33	3	32	2,550	6,520
Romania	23	29	...	30	30	3	...	1,500	6,060
Bulgaria	23	38	40	...	74	5	27	1,480	5,300
Kazakhstan	30	33	34	...	13	3	...	1,350	5,170
FYR Macedonia	...	...	36	...	...	...	32	1,740	4,810
Turkmenistan	28	36	...	39	39	8	...	790	3,920
Ukraine	24	...	27	31	29	15	32	870	3,470
Albania	...	...	25	...	...	...	...	1,000	3,460
Yugoslavia	...	...	...	...	...	...	...	870	2,760
Georgia	29	...	...	41	41	...	35	640	2,610
Azerbaijan	28	43	...	42	50	-2	...	490	2,600
Kyrgyzstan	31	55	...	44	42	-20	39	320	2,510
Armenia	27	...	...	58	115	...	31	510	2,420
Uzbekistan	...	33	...	...	...	...	...	720	2,210
Moldova	27	...	...	41	52	...	40	400	2,030
Bosnia-Herzegovina	...	...	...	...	...	...	...	1,400	...
Tajikistan	28	...	...	47	68	...	31	290	...
CEE & Eurasia	26	40	...	40	50	2	38	2,170	6,240
Northern Tier CEE	24	24	...	28	14	5	29	4,460	9,950
Southern Tier CEE	25	31	...	31	36	4	29	1,590	5,140
Eurasia	26	47	...	44	61	1	41	1,690	5,600
Advanced Economies		32			3			26,440	25,690
EU		28			2			22,250	22,180
United States				41					
Italy			27						
Germany		30							
Austria	23								
Sweden		25							
Brazil			60						
Guatemala	60								
South Africa		59							

Note: Average (or per capita) income is measured in US$ converting through official exchange rates, and through purchasing power parity (PPP) figures, using 1999 World Bank figures and updating to 2000 with 2000 per capita economic growth rates. The distribution of income and consumption are measured by the gini coefficient, which ranges from 0 to 100; the higher the figure, the greater the inequality. Most gini coefficient estimates, particularly the later years, are adjusted for household economies of scale (theta = 0.75). For the Advanced Economies and the EU, percent change in income distribution is roughly from 1986 to 1993.

1 A consumption gini coefficient was used in lieu of income due to insufficient income data in the case of Azerbaijan (in 1993-94 and 1997-99), Albania (1995-96), Kazakhstan (1995-96), Ukraine (1995-96), Romania (1997-99) and Turkmenistan (1997-99).

2 From 1995/96 to 1997/99 if available; otherwise from 1993/94 to 1997/99 or 1993/94 to 1995/96. 3 Data for Bulgaria, Czech Republic and FYR Macedonia are for 1995-96.

World Bank, *World Development Indicators* (2001), IMF, *World Economic Outlook* (May 2001), World Bank, *Making Transition Work for Everyone* (September 2000); P. Gottschalk and T. Smeeding, "Cross-National Comparisons of Earnings and Income Inequality," *Journal of Economic Literature* 35 (June 1997), pp. 633-687.

Table 20. GDP Trends, the Informal Economy, and Poverty

Country	2000 GDP % 1989 GDP: Official	2000 GDP % 1989 GDP: Official & Informal Sector[1]	Survey Year	Absolute Poverty (%) (Head count Index): $4.30/day	Absolute Poverty (%) (Head count Index): $2.15/day[2]
Slovenia	114	…	1997/98	1	0
Czech Republic	98	102	1996	1	0
Croatia	80	…	1998	4	0
Belarus	85	84	1999	10	1
Poland	127	121	1998	18	1
Hungary	105	102	1997	15	1
Estonia	82	79	1998	19	2
Slovakia	103	101	1997	9	3
Ukraine	39	52	1999	29	3
Bulgaria	70	79	1995	18	3
Lithuania	64	67	1999	23	3
Kazakhstan	68	79	1996	31	6
Latvia	64	71	1998	35	7
FYR Macedonia	77	…	1996	44	7
Romania	77	76	1998	45	7
Turkmenistan	75	…	1998	34	7
Albania	102	…	1996	59	12
Russia	62	76	1998	50	19
Georgia	34	45	1999	54	19
Azerbaijan	52	64	1999	64	24
Armenia	63	…	1999	86	44
Kyrgyzstan	66	…	1998	84	49
Moldova	32	39	1999	85	55
Tajikistan	47	…	1999	96	68
Uzbekistan	96	90	…	…	…
Yugoslavia	48	…	…	…	…
CEE & Eurasia	71	79		39	12
Northern Tier CEE	112	109		15	1
Southern Tier CEE	72	…		36	6
Eurasia	61	71		46	17
Latin Amer. & Carib.					32
South Asia					84
Sub-Saharan Africa					78

1 Informal economic activity data from 1989 to 1995 are taken from S. Johnson, D. Kaufmann, and A Shleifer, *Politics and Entrepreneurship in Transition Economies*, Working Paper Series, No. 57, The William Davidson Institute, University of Michigan (1997). Informal economic activity from 1996 to 2000 is estimated by calculating the inverse of the changes of official GDP. 2 Absolute poverty is based on $2/day in 1998 for the comparator countries.

EBRD, *Transition Report Update* (April 2001); World Bank, *World Development Indicators 2001* (2001); Johnson, Kaufmann, and Shleifer (1997); A. Aslund, *The Myth of Output Collapse after Communism*, Working Paper No. 18, Carnegie Endowment for the International Peace (March 2001); World Bank, *Making Transition Work for Everyone* (September 2000); World Bank, *World Economic Prospects* (2001).

Table 21 Relative Poverty Burden

Country	Age		Education		Location		Household Head			
	Children	Elderly	Primary	Higher	Rural	Urban	Male	Female	Employed	Not Employed
Slovenia	1.0	1.7	1.7	0.1	…	…	0.9	1.1	0.6	1.8
Czech Republic	2.3	0.1	1.2	0.3	0.9	1.0	0.8	2.6	0.6	2.4
Croatia	0.8	2.2	1.9	0.1	1.3	0.9	0.9	1.4	0.5	1.8
Belarus	1.2	1.3	1.4	0.2	1.3	0.9	0.9	1.1	0.8	1.4
Poland	1.6	0.6	1.2	0.1	1.6	0.6	1.0	1.0	1.0	1.1
Hungary	1.6	0.6	1.5	0.0	1.5	0.7	1.0	1.0	0.7	1.6
Estonia	…	…	…	…	1.2	0.9	1.0	1.0	0.7	1.5
Ukraine	1.0	1.5	1.3	0.8	0.7	1.2	0.8	1.2	0.6	1.2
Bulgaria	1.2	1.3	1.0	1.3	1.3	0.9	0.9	1.4	0.6	1.3
Lithuania	1.4	1.0	1.2	0.1	1.7	0.7	0.8	1.3	0.9	1.4
Kazakhstan	1.2	1.1	1.4	0.5	1.1	0.9	1.0	0.9	0.8	1.3
Latvia	1.3	0.8	1.4	0.2	1.4	0.8	0.9	1.1	0.8	1.3
FYR Macedonia	1.3	0.9	1.1	0.0	1.3	0.7	1.0	0.6	1.0	1.0
Romania	1.5	0.8	1.2	0.1	1.5	0.6	0.9	1.4	0.9	1.1
Turkmenistan	1.2	0.7	0.7	0.5	1.4	0.4	1.0	0.8	0.9	1.1
Albania	1.6	0.5	0.9	0.2	1.4	0.3	0.9	1.8	1.0	0.8
Russia	1.1	1.2	…	0.4	1.1	1.0	0.9	1.5	0.8	1.4
Georgia	1.0	1.1	1.4	0.6	1.0	1.0	0.9	1.3	0.9	2.0
Azerbaijan	1.0	1.1	2.6	0.3	1.1	0.6	0.9	1.4	…	1.2
Armenia	1.1	1.1	1.3	0.5	1.0	1.0	0.9	1.3	0.8	1.3
Kyrgyzstan	1.1	1.0	0.9	0.2	1.3	0.3	1.0	1.1	0.9	1.2
Moldova	1.1	1.0	1.1	0.5	1.2	0.8	1.0	1.0	1.0	1.1
Tajikistan	1.1	0.9	0.9	0.5	1.0	1.0	0.9	1.4	1.0	1.0
CEE & Eurasia	1.2	1.1	1.3	0.4	1.2	0.9	0.9	1.3	0.8	1.3
Northern Tier CEE	1.7	0.6	1.3	0.1	1.5	0.7	1.0	1.3	0.9	1.4
Southern Tier CEE	1.4	1.0	1.2	0.3	1.4	0.7	0.9	1.4	0.8	1.2
Eurasia	1.1	1.2	1.4	0.5	1.0	1.0	0.9	1.3	0.8	1.3

Relative poverty burden is calculated by dividing a particular population segment's share of total poverty in the country by its share of the total population. Anything over "1" represents a disproportionate share (or burden) of the nation's poverty. The estimates are drawn from the surveys used to calculate absolute poverty (of *Table 20*); see *Table 20* for survey years. The relative poverty line used is 50% of the median income. Estimates are adjusted for household economies of scale (Theta=0.75). Children are from 0-15 years of age; elderly, 65 years and older. Definitions vary some across countries in terms of education categories and rural vs. urban, though are roughly comparable. Employed heads of households include those who are self-employed; not employed heads include the unemployed plus all others not in the workforce, such as retired household heads.

World Bank, *Making Transition Work for Everyone: Poverty and Inequality in Europe and Central Asia* (September 2000).

Table 22. Infant and Child Mortality

	Infant Mortality (per 1,000 live births)				% Change	Under 5 Yrs. mortality rates		% Change
	1980	1990	1993	1999	1990-99	1990	1999	1990-99
Czech Republic	16	11	9	5	-55	12	5	-58
Slovenia	15	8	7	5	-38	10	6	-40
Croatia	21	11	10	8	-27	13	9	-31
Hungary	23	15	13	8	-47	17	10	-41
Slovakia	21	12	11	8	-33	14	10	-29
Poland	26	19	16	9	-53	22	10	-55
Lithuania	20	10	16	9	-10	14	12	-14
Estonia	17	12	16	10	-17	17	12	-29
Belarus	16	12	13	11	-8	16	14	-13
Yugoslavia	33	23	22	12	-48	26	16	-38
Bulgaria	20	15	16	14	-7	19	17	-11
Ukraine	17	13	15	14	8	…	17	…
FYR Macedonia	54	32	24	16	-50	33	17	-48
Bosnia-Herzegovina	…	15	23	13	-13	21	18	-14
Armenia	26	19	17	14	-26	24	18	-25
Latvia	20	14	16	14	0	18	18	0
Georgia	25	16	18	15	-6	…	20	…
Russia	22	17	20	16	-6	21	20	-5
Azerbaijan	30	23	28	16	-30	…	21	…
Moldova	35	19	22	17	-11	25	22	-12
Romania	29	27	23	20	-26	36	24	-33
Kazakhstan	33	26	28	22	-15	34	28	-18
Uzbekistan	47	35	32	22	-37	…	29	…
Tajikistan	58	41	47	20	-51	…	34	…
Albania	47	28	33	24	-14	42	35	-17
Kyrgyzstan	43	30	32	26	-13	41	38	-7
Turkmenistan	54	45	46	33	-27	…	45	…
CEE & Eurasia	26	19	20	15	-18	23	19	-20
Northern Tier CEE	23	16	14	8	-46	18	10	-47
Southern Tier CEE	30	23	21	16	-27	29	19	-29
Eurasia	26	20	22	17	-9	23	22	-7
LDCs		66		59	-11	91	85	-7
Latin Amer. & Carib.		41		30	-27	49	38	-22
Sub-Saharan Africa		101		92	-9	155	161	4
High Income Countries		8		6	-25	9	6	-33
Europe EMU		8		5	-38	9	5	-44
Benchmarks					no worsening			

From 1998-1999, only one country, Estonia, witnessed an increase in its infant mortality rate; 11 countries witnessed a decrease (Poland, Hungary, Yugoslavia, Latvia, Romania, Russia, Armenia, Moldova, Albania, Azerbaijan, and Tajikistan).

World Bank, *World Development Indicators 2001* (2001). For 1999 under 5 mortality in Albania: UNICEF, *State of the World's Children 2001* (December 2000).

Table 23. Life Expectancy at Birth
(Years)

	Male			Female			Total Population				% change	% change
	1989	1998	% change	1989	1998	% change	1980	1989-92	1998	1999	1980-99	1989-99
Czech Republic	68	71	4.3	75	78	3.4	70	72	75	75	7.1	4.2
Slovenia	69	71	3.2	77	79	3.0	70	73	75	75	7.1	2.7
Armenia	69	71	2.9	75	78	4.4	73	70	74	74	1.4	5.7
Bosnia-Herzegovina	69	…	...	74	…	...	70	71	73	73	4.3	2.8
Croatia	68	69	1.2	76	77	1.9	70	73	73	73	4.3	0.0
FYR Macedonia	70	70	0.0	74	75	1.9	72	72	73	73	1.4	1.4
Georgia	68	69	1.3	76	77	1.7	71	72	73	73	2.8	1.4
Poland	67	69	3.3	76	77	2.0	70	72	73	73	4.3	1.4
Slovakia	67	69	3.1	75	77	2.1	70	71	73	73	4.3	2.8
Albania	70	69	-0.9	76	75	-0.7	69	72	72	72	4.3	0.0
Lithuania	67	67	0.0	76	77	0.9	71	71	72	72	1.4	1.4
Yugoslavia	69	…	...	74	…	...	70	72	72	72	2.9	0.0
Azerbaijan	66	68	2.4	74	75	1.1	68	71	71	71	4.4	0.0
Bulgaria	69	67	-2.3	75	75	0.0	71	72	71	71	0.0	-1.4
Hungary	65	66	0.9	74	75	1.6	70	71	71	71	1.4	0.0
Estonia	66	64	-2.6	75	75	0.0	69	70	70	71	2.9	1.4
Latvia	65	64	-2.0	75	76	1.1	69	69	70	70	1.4	1.4
Uzbekistan	66	66	0.0	72	73	1.2	67	69	69	70	4.5	1.4
Romania	67	66	-0.9	73	73	0.0	69	71	69	69	0.0	-2.8
Tajikistan	66	66	0.0	71	71	0.0	66	69	69	69	4.5	0.0
Belarus	67	63	-6.1	76	74	-3.0	71	71	68	68	-4.2	-4.2
Kyrgyzstan	64	63	-1.9	72	71	-1.1	65	66	67	67	3.1	1.5
Moldova	66	63	-3.8	72	70	-3.2	66	68	67	67	1.5	-1.5
Ukraine	66	62	-6.2	75	73	-2.9	69	70	67	67	-2.9	-4.3
Russia	64	61	-5.0	75	73	-2.0	67	69	67	66	-1.5	-4.3
Turkmenistan	62	63	1.9	68	70	2.3	64	66	66	66	3.1	0.0
Kazakhstan	64	59	-7.7	73	70	-4.0	67	68	65	65	-3.0	-4.4
CEE & Eurasia	66	64	-2.9	74	74	0.0	68	70	69	69	0.4	-2.1
Northern Tier CEE	67	69	2.9	75	77	1.9	70	72	73	73	4.1	1.8
Southern Tier CEE	68	67	-1.5	74	74	0.0	70	72	71	71	1.6	-1.1
Eurasia	65	62	-4.4	74	73	-1.8	68	69	67	67	-0.9	-3.2
LDCs		63			67		60			64		
Latin Amer. & Carib.		67			73		65			70		
Sub-Saharan Africa		49			52		48			47		
High Income		75			81		74			78		
Europe EMU		…			…		74			78		
Benchmarks			no decline			no decline						

World Bank, *World Development Indicators 2001* (2001); World Bank, *World Development Report 2000-2001* (September 2000) and earlier editions.

Table 24. Education

Country	Secondary School Enrollment[1] (% of age group) 1990	1993	1997	% change 1990-97[2]	Primary School Enrollment[1] (% of age group) 1989[3]	1993	1998[4]	% change 1989-98
Hungary	78.6	94.3	97.8	24.4	99.0	99.1	99.2	0.2
Slovenia	91.1	90.3	91.7	0.7	96.1	97.8	98.2	2.2
Poland	81.5	93.9	97.6	19.8	97.9	97.2	98.1	0.2
Czech Republic	91.2	91.8	98.7	8.2	97.6	99.1	97.6	0.0
Romania	92.0	79.4	78.4	-14.8	93.6	90.3	97.0	3.6
Belarus	93.0	90.9	92.9	-0.1	95.6	93.3	96.5	0.9
Lithuania	91.9	80.9	86.3	-6.1	94.6	91.6	96.1	1.6
Estonia	101.9	93.9	103.8	1.9	96.5	91.4	95.0	-1.6
Croatia	76.2	82.8	81.8	7.3	94.0	89.0	94.3	0.3
Bulgaria	75.2	70.1	76.8	2.1	98.4	94.0	94.3	-4.2
Slovakia	…	88.6	94.0	6.1	96.0	94.9	93.9	-2.2
Kazakhstan	98.0	92.0	87.0	-11.2	94.7	94.0	93.2	-1.6
Moldova	80.0	84.0	80.5	0.6	95.0	79.1	92.5	-2.6
Azerbaijan	90.0	87.0	77.0	-14.4	88.4	89.2	91.6	3.6
Latvia	92.7	87.0	83.7	-9.7	95.4	89.1	90.9	-4.7
Uzbekistan	99.0	94.0	94.0	-5.1	92.2	87.9	89.7	-2.7
Kyrgyzstan	100.0	90.0	79.0	-21.0	92.5	89.7	89.7	-3.0
Russia	93.3	87.0	…	-6.8	90.8	88.3	89.1	-1.9
Ukraine	92.8	91.2	…	-1.7	93.0	91.0	89.0	-4.3
Tajikistan	102.0	82.0	78.0	-23.5	95.6	87.1	87.8	-8.2
Albania	78.3	41.2	37.5	-52.1	90.8	86.6	87.6	-3.5
FYR Macedonia	55.7	57.3	62.9	12.9	89.4	86.2	86.9	-2.8
Armenia	…	88.0	90.0	2.3	93.7	84.6	83.2	-11.2
Turkmenistan	…	…	…	…	94.3	92.0	83.1	-11.9
Georgia	95.0	77.0	77.0	-18.9	94.4	82.3	81.8	-13.3
Yugoslavia	…	…	62.0	…	95.0	72.5	69.2	-27.2
CEE & Eurasia	91.2	87.7	86.5	-2.9	93.3	90.2	90.9	-2.6
Northern Tier CEE	84.2	92.3	96.5	14.7	97.6	96.9	97.5	-0.1
Southern Tier CEE	83.9	73.7	71.7	-10.5	94.4	86.5	89.3	-5.3
Eurasia	94.0	88.5	86.9	-6.5	92.0	89.0	89.5	-2.7
European Union	96.7	108.4	108.4	12.1				
Benchmark		no decline in enrollment						

1 Calculated as gross enrollment ratios; i.e., the ratio of total enrollment, regardless of age, to the population of the age group that officially corresponds to the level of education shown, primary or secondary. 2 For Russia and Ukraine % change is from 1990-93; for Slovakia and Armenia % change is from 1993-97; 3 1990 for FRY Macedonia; 4 1995 for Albania; 1996 for FYR Macedonia; 1997 for Croatia, Turkmenistan and Uzbekistan.

World Bank. *World Development Indicators 2001* (2001); UNICEF, *Young People in Changing Societies,* Regional Monitoring Report, No. 7 (2000).

Table 25. Human Development
(Human Development Index)

Country	1990 Score	1998 Score	1998 Rank	1990-98 % Change
Slovenia	0.840	0.861	29	2.5
Czech Republic	0.830	0.843	34	1.6
Slovakia	0.812	0.825	40	1.6
Hungary	0.798	0.817	43	2.4
Poland	0.785	0.814	44	3.7
Estonia	0.806	0.801	46	-0.6
Croatia	0.786	0.795	49	1.1
Lithuania	0.809	0.789	52	-2.5
Belarus	0.804	0.781	57	-2.9
Bulgaria	0.782	0.772	60	-1.3
Russia	0.812	0.771	62	-5.0
Latvia	0.797	0.771	63	-3.3
Romania	0.771	0.770	64	-0.1
FYR Macedonia	...	0.763	69	...
Georgia	...	0.762	70	...
Kazakhstan	0.784	0.754	73	-3.8
Ukraine	0.793	0.744	78	-6.2
Azerbaijan	...	0.722	90	...
Armenia	0.750	0.721	93	-3.9
Albania	0.697	0.713	94	2.3
Kyrgyzstan	...	0.706	98	...
Turkmenistan	...	0.704	100	...
Moldova	0.757	0.700	102	-7.5
Uzbekistan	0.690	0.686	106	-0.6
Tajikistan	0.712	0.663	110	-6.9
CEE & Eurasia	0.790	0.765		-2.8
Northern Tier CEE	0.798	0.818		2.4
Southern Tier CEE	0.769	0.768		0.0
Eurasia	0.791	0.751		-4.8
OECD		0.893		
Latin Amer. & Carib.		0.758		
Sub-Saharan Africa		0.464		

The HDI is based on three indicators: longevity, as measured by life expectancy; educational attainment, as measured by a combination of adult literacy (two-thirds weight), and combined primary, secondary and tertiary enrollment ratios (one-third weight); and standard of living, as measured by real GDP per capita (PPP$). The HDI ranges from zero to one; the higher is the value, presumably the greater is the human development.

UNDP, *Human Development Report 2000* (2000) and earlier editions.

IV. Concluding Remarks

Decisions on the magnitude and duration of U.S. assistance to the transition region are made on the basis of several factors:

(a) progress the country has made toward a sustainable transition to a market-based democracy;

(b) strategic importance of the country to the United States;

(c) importance of the recipient country to U.S. citizens; and

(d) effectiveness of particular assistance activities.

This paper has presented an approach to analyzing the first factor. The second and third are not as readily quantifiable but are matters of judgment that are regularly considered, along with the first, in making country-level budget decisions. The fourth factor, based on both regular reporting against strategic objective targets and on occasional field-based evaluations, is used primarily to inform the allocation of country budget levels among strategic objectives but is also a basis for determining whether a country assistance program is having enough impact to warrant continuation.

USAID collects, analyzes, and reports on the country performance indicators once a year. Inter-agency reviews are held as a means to assess the data and to better take stock of progress in the region. These data are also provided to the State Department-based Coordinators for U.S. Assistance to CEE and Eurasia and discussed with them when country planning levels are determined.

The overall ratings of the transition countries in terms of economic policy reforms and democratic freedoms (as depicted in the *Summary Figure*) provide a rough guide to policy in this regard. Countries with the highest ratings are obvious candidates for earlier "graduation." Countries with the lowest ratings would seem to fall into one of three contrasting 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 their commitment to reform increases; (2) those where reform now appears likely but requires greater resources; or (3) those which possess characteristics that match well with the Agency's priorities for sustainable development programs. Countries in the middle are likely candidates for continuing programs through existing funding mechanisms, as long as the assistance is effective and Congress continues to appropriate funds for this purpose.

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