MONITORING COUNTRY PROGRESS IN CENTRAL AND EASTERN EUROPE & EURASIA

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SUMMARY

I. Introduction and Methodology

This paper presents USAID/E&E's system for monitoring country progress with a focus on developing criteria towards graduation from USAID assistance. Country progress is analyzed in a sequence of steps for twenty-seven countries of the region. First, we look at the progress towards economic reforms and democratization. Progress on both fronts must reach a certain threshold before we can begin to consider graduation.

Next, we look at indications of sustainability; that is, macroeconomic performance and social conditions. Economic reforms need to translate into solid macroeconomic performance if they are to be sustained. Trends in social conditions need to be tracked as well to give us a pulse on the possibilities of economic and democratic "reform fatigue." Social conditions or living standards influence macroeconomic performance, too.

The primary indicators are drawn from standard, well-established data sources that are external to USAID. An important step of the process is the holding of annual reviews with area specialists from U.S. government agencies.

II. Findings

a. Economic Trends

Recent trends in economic reforms and macroeconomic conditions in the transition region have been very favorable. Economic reforms advanced more on an annual basis in 2000 than they have since at least 1996 when we started tracking such progress. Economic reform gains in 2001 have been nearly as significant. Annual economic growth rates in 2000-2001 for the region overall are the highest rates since the transition began, and such gains have been broadly shared among the countries.

Nineteen of the twenty-seven transition countries advanced in economic reforms on balance in 2000, while no country experienced overall backsliding. Of the twelve economic reform areas that are tracked, only two did not show region-wide advancement in 2000: small-scale privatization (a reform area that most countries have essentially completed), and banking reform (though several gains were registered here in several Central and Eastern Europe (CEE) countries).

The economic reform gains in 2000 were widely shared between CEE and Eurasia. There was no evidence, as has been the case in recent years past, of a growing economic reform gap between the two subregions. In fact, there was some narrowing of the spread between the Northern Tier CEE leaders and Eurasia in first stage economic reforms, which partly reflected the dissipation of the adverse spillover effects from the 1998 Russian financial crisis.

A preliminary assessment of reform progress through fall 2001 suggest that the pace and patterns of economic reform change in 2000 have generally continued into 2001. Most impressive gains continue to occur in the Southern Tier CEE countries, and most notably in Yugoslavia and Bosnia-Herzegovina. However, economic reform gains in 2001 have been widely dispersed throughout CEE and Eurasia; such reforms have advanced on balance in 2001 in a large majority of the transition countries. Most of the EU accession candidates of CEE have continued to make steady progress, with notable progress being made in Lithuania, Slovakia, and Romania. Much of the gains in these CEE countries have been second-stage reforms, particularly large-scale privatization and banking reform.

Of the Eurasian countries, Russia has perhaps made the greatest economic reform gains in 2001, registering advances in both first stage reforms (of liberalization) and second stage reforms (notably in enterprise restructuring and corporate governance). Other Eurasian countries, including Kazakhstan, Armenia, and Kyrgyzstan, have moved forward on large-scale privatization and banking reform. Even Belarus and Uzbekistan have made good progress towards liberalizing their pervasive controls and restrictions on prices, trade, and access to foreign exchange. Of all the transition countries, perhaps only Turkmenistan has backslid on balance in economic reforms since late 2000.

A medium term assessment of the economic reform trends since 1997 reveals little evidence that the 1998 Russian financial crisis and the 1999 Kosovo conflict had any significant long-lasting adverse spill-over effects on the pace of reforms in neighboring countries. Of the three subregions, the most impressive economic reform gains from 1998-2000 occurred in the Southern Tier CEE, particularly in Bulgaria, followed by Macedonia and Bosnia-Herzegovina, three countries that looked especially vulnerable to economic disruption and reform backsliding as a result of the Kosovo conflict.

A salient characteristic of the economic reform trends from 1998-2000 in Eurasia is the wide diversity in outcomes. While Russia, far and away, saw the greatest economic reform backtracking (of all the transition countries) during this period, several Eurasian countries (notably, Azerbaijan, Kazakhstan, and Tajikistan, followed by Georgia and Ukraine) made significant gains despite Russia's troubles. During this three-year period, backsliding in economic reforms occurred on balance in the three transition reform laggards, Belarus, Turkmenistan, and Uzbekistan, and in one reform leader, the Czech Republic.

Many recent macroeconomic trends in the transition region have been favorable as well. By most counts, macroeconomic trends in 2000 were exceptionally favorable. Preliminary 2001 data reveal somewhat slower economic growth and higher macroeconomic imbalances for the transition region as compared to 2000. Nevertheless, while the transition economies have not been immune to the worldwide economic slowdown in 2001, most seem to be weathering the adverse global conditions better than other emerging market economies. Of the transition economies, those in Eurasia seem to be so far least exposed to the worldwide economic downturn.

On average, the transition economies grew by 6.1 percent in 2000, far surpassing annual growth rates in all the previous transition years. 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. 2001 estimates show somewhat slower, though still reasonably robust, economic growth across the transition region: 4.0 percent overall; highest in Eurasia (4.4 percent), followed by Southern Tier CEE (3.9 percent) and the Northern Tier CEE (3.2 percent). Macedonia may be the only transition country in 2001 to experience a contracting economy.

Fiscal balances continued to improve through 2000, from a population-weighted average region-wide 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. Slower economic growth in 2001 is likely to increase fiscal imbalances some. While inflation remains too high in most transition countries, roughly half of the countries, nevertheless, were able to hold inflation in 1999-2000 to close to single-digit levels. Inflation is forecast to be lower in 2001 in the transition region overall as compared to 2000; the only transition countries likely to have annual inflation rates in 2001 greater than 20 percent are Belarus, Yugoslavia, Tajikistan, Romania, Uzbekistan, and Russia.

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 percent region-wide in 1998 and about 1 percent in 1999, while growing from 10-15 percent in 2000. 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). Export revenues in Eurasia grew largely because of an increase in demand from the Russian economy (which grew by 7.5 percent) as well as favorable prices of commodity exports.

With a significant slowdown in economic activity in the world economy (from 4.8 percent in 2000 to an estimated 2.5 percent in 2001) and particularly in export growth among the advanced economies (from 11.5 percent in 2000 to perhaps 3 percent in 2001), transition country exports have also slowed, to roughly 7 percent in 2001. This slowdown likely disproportionately affects those transition countries that have been more successful in integrating with the advanced economies, i.e., many of the CEE countries. On the other hand, the reversal in commodity prices (from significant increases in 2000 to modest decreases in 2001) are adversely affecting the Eurasian countries dependent on energy, metals, and cotton for export.

The September 11, 2001 terrorist attacks on the United States have aggravated the global economic slowdown and will likely contribute to prolonging it. As a consequence, the

CEE countries are likely to be adversely affected by a further slowdown in demand from export markets in Western Europe and perhaps a significant decline in capital flows. Many of the Eurasian countries may suffer greater volatility in commodity export prices as well as greater political tensions and the potential for high refugee inflows. Finally, by most counts, external debt burdens have increased significantly in recent years for all the Central Asian Republics and maintaining fiscal stability for all (except perhaps Kazakhstan) could be a considerable challenge as war in neighboring Afghanistan continues.

b. Social Conditions Revisited

New data and analyses of social conditions reveal a picture that, while still grim for many persons in the region, is not quite as dismal as depicted in previous *Monitoring Country Progress* reports. First, new estimates of poverty, mostly for 1998-1999, show poverty rates varying widely not only by country but also by poverty threshold. Roughly, four out of ten persons in the transition region are found to be in poverty at a higher poverty threshold of $4.30 per day. However, when a lower, arguably more appropriate threshold of $2.15 per day is used, poverty overall in the region is "reduced" by more than a multiple of three (from 39 percent to 12 percent).[1] This rate compares favorably to poverty in the developing world: at $2 per day, the poverty rate in Latin America and the Caribbean is 32 percent; in Sub-Saharan Africa, it is 78 percent; and in South Asia, 84 percent.

Second, official GDP estimates reveal that only a handful of countries have essentially regained pre-transition income levels. 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, particularly in Eurasia, and that unofficial income has likely greatly offset official income losses. On average, officially recorded GDP in 2000 in Eurasia 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.

Third, new data on inequality temper some of the hardships implied from earlier estimates. These data still support that income inequality has increased dramatically overall in the transition region, by perhaps 50 percent from 1987 to 1999 which represents a change of unprecedented magnitude in the given time period. However, they also show that: (1) the increase in income inequality in the CEE countries since the beginning of the transition is less than previously calculated partly because the new estimates have adjusted for higher pre-transition inequality; (2) since the mid-1990s, the pace of the increase in income inequality has slowed considerably in most countries; and

[1] The $2.15 per day poverty line is comparable to the bottom end of the range of national poverty lines, expressed in purchasing power terms, of the poorer countries in the transition region.

(3) the inequality gap between the subregions narrows some when the more accurate distribution of consumption measures are used in lieu of income measures. Consumption measures of inequality better capture informal economic activity than do income measures. They 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.

c. CEE-Eurasia Distinctions

Notwithstanding the relatively favorable economic trends and the revised social indicators, significant distinctions between the CEE countries, particularly the Northern Tier CEE, and Eurasia remain. As in the past, these distinctions form the basis of the predominate theme that emerges from the overall *Monitoring Country Progress* data set. Moreover, these data may imply more than simply that one group of countries is lagging behind another. In important respects, different transition paths continue to persist.

Overall, the findings of this report lend support to USAID graduation decisions. The eight countries of the Northern Tier CEE, and the only "graduates" of the transition region from USAID assistance, continue to be in a transition stage far advanced from the rest. In some important respects, though certainly not all, several Southern Tier CEE countries, particularly Bulgaria and Croatia, appear to be approaching Northern Tier progress and standards. Moreover, progress in the Southern Tier is likely to be greatly facilitated by the pull of EU membership and may accelerate further now that Yugoslavia is participating. However, most indicators of this report suggest that all the Southern Tier countries still have far to go.

i. Reform progress. The *Summary Figure* attempts to show both the status of economic and democratic reforms in the transition region in 2000, as well as a preliminary assessment of the direction of change that has so far occurred in 2001. Several key observations surface. 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. Second, while the reform gap between the Northern Tier and Southern Tier CEE countries remains large, it is narrowing. That is, of the three subregions, the greatest overall reform gains in 2000-2001 have occurred in the Southern Tier where the majority of countries (Croatia, Bulgaria, Bosnia-Herzegovina, Yugoslavia, and Albania) have moved forward on both economic and democratic reform fronts.

Third, the 2001 reform data highlight the continuing divergence in transition paths between the Eurasian countries and CEE. What is striking about the 2000-2001 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 2000, one-half of the Eurasian countries made gains in economic reforms while simultaneously backsliding in democratization: Georgia; Russia; Ukraine; Kazakhstan; Kyrgyzstan; and Belarus. In 2001, this may have decreased to four countries: Kazakhstan; Kyrgyzstan; Belarus; and Moldova. In 2000, all seven of the transition countries that experienced economic reforms advancing alongside gains in democratization were in CEE: Estonia; Latvia; Lithuania; Bulgaria; Croatia; Albania; and Bosnia-Herzegovina. In 2001, four of the five countries that have so far experienced advancement in both domains are in CEE: Bulgaria; Lithuania; Macedonia; and Albania; Armenia has also advanced in both economic and democratic reforms in 2001.

The gap in democratic freedoms between the CEE and Eurasian countries is large and growing. 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). 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 out of 192 countries to receive the poorest score. Democratic freedoms in Uzbekistan, Tajikistan, and Belarus are not much greater than those in Turkmenistan.

The growing democratization gap is evident whether one looks at the most recent trends in 2000-2001, or a medium-term timeframe (from 1998-2000), or trends since communism's collapse. 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.

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 (all but Bosnia-Herzegovina) have advanced in democratic reforms, many no doubt at a historically unprecedented pace. However, since the transition began in Eurasia (i.e., since 1991 and after Gorbachev's "glasnost" reforms), nine of the twelve Eurasian countries have regressed in democratic freedoms through 2000. 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. However, with the probable exception of Turkmenistan, all the countries of the former Soviet Union have greater democratic freedoms today than those that existed during the much more repressive Soviet times of the mid-1980s.

Corruption is a significant problem throughout the transition region, and generally much higher than what exists in the OECD countries. However, large differences prevail within the transition region. Corruption in a handful of Eurasian countries is perceived to be among the highest worldwide, while corruption in the Northern Tier CEE countries comes closest to the OECD norm of all the emerging markets, slightly lower than in Latin America and the Caribbean. Efforts to "unbundle" or disaggregate corruption reveal that more than twice the percentage of firms in Eurasia are significantly affected by "state capture" than in the Northern Tier CEE, 27 percent vs. 12 percent, respectively. (State capture refers to efforts on the part of firms to purchase advantages directly from the state). Illicit payments as a percent of firm revenues (i.e., "administrative or petty corruption") range from around 1 percent in Croatia, Belarus, Latvia, and Slovenia to more than 5 percent in Azerbaijan and Kyrgyzstan.

ii. Integration into the world economy. While economic growth in recent years has been relatively impressive across the transition region, the sources of this growth, and hence its sustainability, vary widely among the countries. Similarly, the extent and nature of integration into the world economy continue to vary widely as well. Robust export growth has contributed to rapidly expanding economies throughout the region, particularly in 2000. However, for most of the Eurasian countries, growing export revenues have derived from a substantial reliance on the Russian market and heavy dependence on natural resource exports. Given the rapidly expanding Russian economy and high prices of commodity exports in 2000 (the price of oil, e.g., increased by close to 60 percent in 2000), many of the Eurasian countries have been able to reap benefits from such dependencies. In fact, the natural resource exporters in Eurasia were among those with the fastest growing economies in 2000. Turkmenistan (energy and cotton) had an economy that grew 17.6 percent in 2000; Azerbaijan (energy), 10.3 percent; Kazakhstan (energy and metal), 9.4 percent; and Russia (energy and metal), 7.5 percent. However, as has happened in the past, these dependencies could just as easily turn into liabilities. Coinciding with moderately declining commodity prices in 2001 and a projected economic expansion in Russia of about 4 percent, economic growth among the natural resource rich Eurasian countries is projected to be lower in 2001 (though still robust).

The economies of the CEE countries, in contrast, are much more closely linked to Western Europe, and generally much more diversified in terms of export markets and export products. Worldwide comparisons suggest, however, that even the Northern Tier CEE countries have considerable scope for more integration into the world economy.

The Northern Tier CEE countries re-oriented and diversified exports relatively early on in the transition; by 1996, 60 percent of Northern Tier CEE exports were going to the EU. The Southern Tier CEE countries, however, are not far behind; by 1999, only Yugoslavia and Bosnia-Herzegovina of the Southern Tier CEE had less than 50 percent of exports going to the EU. Moreover, institutional integration with the industrial market economies is taking place almost exclusively among the CEE countries, and primarily still in the Northern Tier. All but three of the CEE countries (Yugoslavia, Bosnia-Herzegovina, and Macedonia) have become members of the World Trade Organization (WTO); only four Eurasian countries (Kyrgyzstan, Georgia, Moldova, and Armenia) are WTO members. The ten transition countries invited to join the EU are all CEE countries.

The Northern Tier CEE countries have considerably larger trade sectors than the rest of the transition countries. Merchandise exports plus imports on average equaled 32 percent of purchasing power parity (PPP) GDP in 1999 in the Northern Tier CEE. This compares to 19 percent and 12 percent in the Southern Tier and Eurasia, respectively. Worldwide comparisons suggest that the Southern Tier CEE and Eurasian countries have global integration profiles closer to developing countries than OECD countries, and that even the Northern Tier CEE countries have considerable scope for expansion of trade with the

West. Specifically, the trade sector share as a percent of GDP in the EU is 53 percent (i.e., much higher than in the Northern Tier). Trade sector shares in Latin America and the Caribbean and Sub-Saharan Africa are 18 and 16 percent, respectively (i.e., close to those of the Southern Tier and Eurasia).

Virtually all the relatively autarchic economies (those with small trade sectors) are also the poorest economies (those with the lowest per capita income). All but one (Albania) is in Eurasia. Of the twenty-five 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 (Uzbekistan and Kyrgyzstan), 9 percent (Azerbaijan), 12 percent (Moldova) to only 13 percent of GDP (Armenia). Albania's per capita income and its trade share (14 percent) are also very low.

The most recent data available show outward-orientation (or trade shares of GDP) declining across the three subregions. For the transition region as a whole, trade as a proportion of 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.

The Northern Tier CEE countries also continue to receive the lion's share of foreign direct investment (FDI): on a per capita basis since 1989, nine times more than in Eurasia, and roughly three times more than in the Southern Tier CEE countries. However, 1999 FDI flows as a percent of (PPP) GDP 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 in 1999 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.

Another key distinction between CEE and Eurasia is in the fiscal policy domain. For most of the CEE countries, 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. At the same time, accession to the EU will require substantial expenditure to bring these economies up to EU standards (including in the environment, nuclear safety, transport infrastructure, legal reforms, and social policy). According to some estimates, annual accession costs could be as high as 11 percent of annual regional GDP over a ten-year period. This will be offset some by annual EU transfers leading up to membership (which will range from around 0.3 percent of GDP for Slovenia to 2 percent of GDP for Bulgaria).

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 (found, in particular, in

Kyrgyzstan, Georgia, Tajikistan, Armenia, and Moldova). On average, general government revenues in Eurasia less Russia are only 24 percent of GDP (vs. 40 percent of GDP in CEE). Government revenues are extraordinarily low in some Eurasian countries: perhaps 15 percent of GDP in Tajikistan and Georgia. Large sectors of these economies remain "underground" and/or are "taxed" informally through petty bribes from government officials.

iii. Social conditions. There are also many stark differences between the subregions in social conditions. A key one is in how labor markets are adjusting. Unemployment rates are generally higher in CEE than they are in Eurasia. They are highest and particularly troublesome in the Southern Tier CEE, ranging from 30-40 percent in Macedonia, Yugoslavia, and Bosnia-Herzegovina; to 15-18 percent in Croatia, Bulgaria, and Albania; and lowest in Romania, at 10.5 percent. However, unemployment rates remain stubbornly problematic in the Northern Tier CEE as well, 12.8 percent on average in 2000. Since 1997, Northern Tier CEE unemployment rates have been increasing on balance, reversing an earlier pattern of falling rates (and contrasting with the current EU trend of declining unemployment rates).

Officially lower unemployment rates in Eurasia partly reflect limitations in the reliability of the data and measurement techniques. In many Eurasian countries, registered unemployment figures are still reported in lieu of more reliable survey estimates. More fundamentally, however, higher open unemployment in Eurasia has so far been avoided partly 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. 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. Available data confirm that real wages have dropped much more significantly in Eurasia than in CEE. Wage arrears and hidden unemployment also characterize and distinguish labor markets adjustments in Eurasia.

Estimates of the relative poverty burden of various segments of the transition population support the observation that being employed confers more of a benefit in the Northern Tier CEE countries than elsewhere in the transition region, and, similarly, that being unemployed carries more of a penalty (that is, it increases one's risk of being poor). In Eurasia, in contrast, 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.

Per capita income (at $6,240 in PPP terms) for the transition region overall is only one-fourth the average of the advanced economies ($25,690). However, this average masks wide variation. The Northern Tier CEE per capita income average is almost twice that found in the Southern Tier CEE and Eurasia. Moreover, income is much more evenly distributed in the Northern Tier, comparable now to inequality found in the EU. 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, in Latin America and Sub-Saharan Africa.

At $4.30 per day, almost one in two persons in Eurasia are poor; in the Northern Tier, it is closer to one in seven persons. At $2.15 per day, the poverty rate is 1 percent in the Northern Tier CEE, 6 percent in the Southern Tier CEE, and 17 percent in Eurasia.

Infant and child mortality rates have fallen in all three subregions over the transition, 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. However, 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, though the gap has been closing. 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. These rates have fallen by almost thirty percent in the Southern Tier from 1990-1999, though less than 10 percent in Eurasia.

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 is 78 years 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.

During the early transition years, life expectancy fell fairly uniformly in virtually all the countries. However, this fall was particularly short-lived for persons in the Northern Tier where by 1996 life expectancy 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 remains below pre-transition levels, and is about the same as pre-transition levels for females. 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.

Secondary school enrollment is highest in the Northern Tier CEE countries where it has increased from 84.2 percent of the relevant age group in 1990 to 96.5 percent in 1997. Enrollment is lowest in the Southern Tier CEE where it decreased from 83.9 percent in 1990 to 71.7 percent in 1997. Enrollment also decreased in Eurasia, from 94 percent in 1990 to 86.9 percent in 1997. 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). Nevertheless, while secondary school enrollments declined fairly steadily from 1990-1997 for the Southern Tier and Eurasian countries on average, this has not been the trend in primary school enrollments: initial drops from 1990-1993 in these subregions on average have been followed by (smaller) increases from 1993-1998.

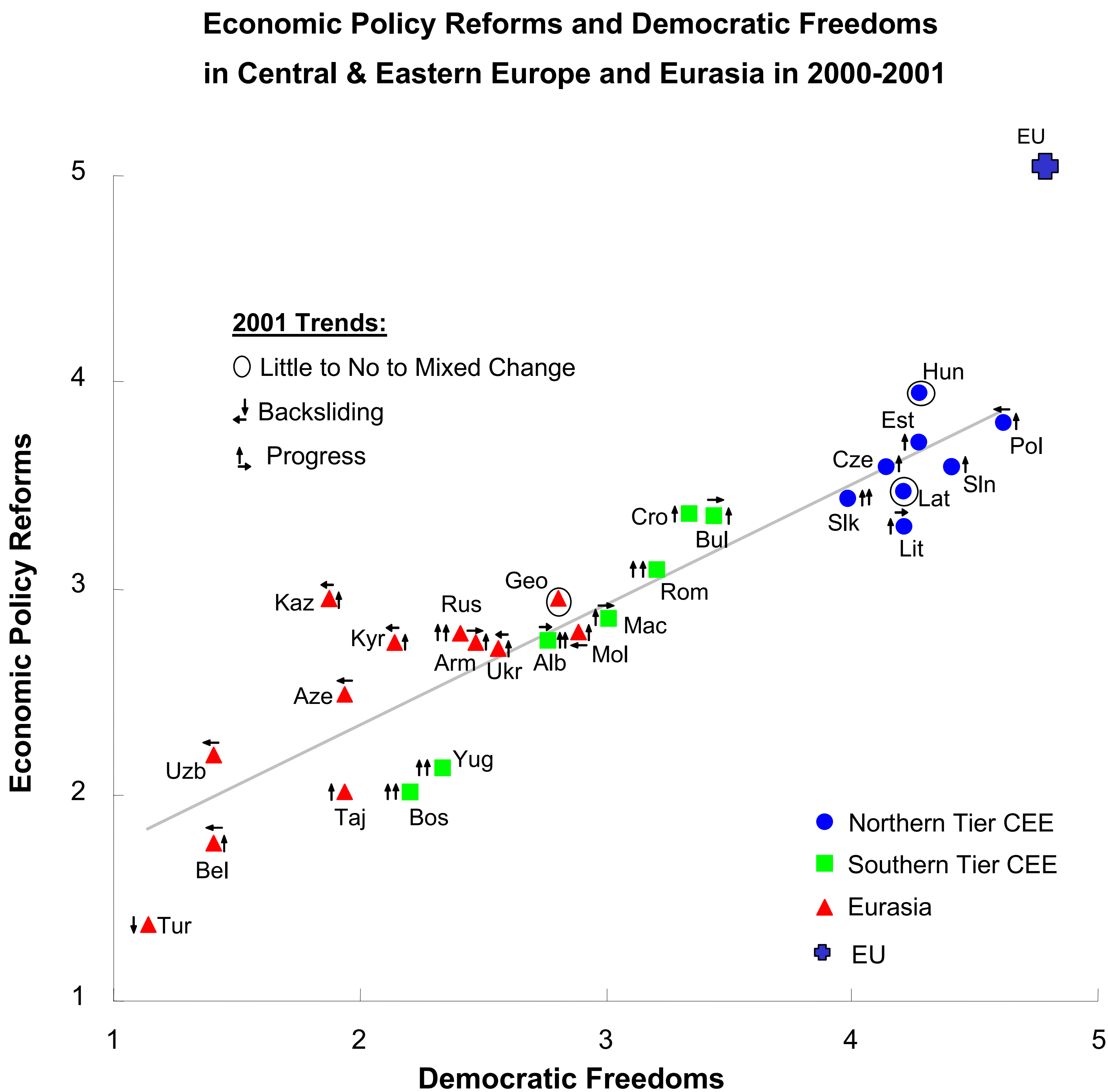
From 1990-1998, human development (as measured by the UNDP's human development index) has advanced in the Northern Tier CEE countries on average (though the three Baltic countries are the exception), has remained the same in the Southern Tier CEE, and has fallen fairly significantly in Eurasia. The greatest drops occurred in Moldova, Tajikistan, Ukraine, and Russia. By this measure, human development is considered high in eight transition countries in 1999 (Croatia plus the Northern Tier countries minus Latvia), and medium in the rest. Slovenia ranks the highest, 29th out of 162 countries in the worldwide sample in 1999; Tajikistan ranks the lowest (103rd).

III. Concluding remarks

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

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

Summary Figure



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