

***MONITORING COUNTRY PROGRESS
IN EASTERN EUROPE & EURASIA***

***USAID/E&E/PO
Program Office
Bureau for Europe & Eurasia
U.S. Agency for International Development***

***December 2008 Draft
No. 11***

Executive Summary

Economic and Democratic Reforms. The three primary sub-regions of Eastern Europe and Eurasia (E&E) have very distinct economic and democratic reform profiles. The Northern Tier Central and Eastern Europe (CEE) countries are well out front. Eurasia is lagging considerably, particularly in democratic reforms. The most recent trends show continued advancement, albeit modest, in economic reforms, particularly in the Southern Tier CEE and Eurasia. However, the large democratization gap between CEE and Eurasian countries continues to grow. In fact, drawing from a six indicator index from available global datasets, we find that Eurasia lags behind all other major regions of the world in democracy and governance. Moreover, we find evidence that history, economic structural conditions, and geography matter to democratization prospects. An important implication is that democratic progress is not likely to advance quickly nor easily in Eurasia any time soon.

Economic performance. Economic growth in the transition region has exceeded the global average every year since 2000 through 2007, and is forecast to do the same in 2008 and 2009. However, economic growth worldwide is forecast to be significantly lower in 2008 and 2009 primarily as a result of the still unfolding global financial crisis. Global economic growth in 2009 is now forecast to be less than half its 2007 rate (from 5% in 2007 to only 2.2% in 2009). For the E&E region overall, economic growth is forecast to fall even more, from 7.2% in 2007 to 2.9% in 2009. A key characteristic of Eurasia's economic integration into the global economy has been a significant and growing reliance on primary products for exports. Eight Eurasian countries have at least one-half of their export sectors concentrated in energy and/or metals. Dependency on Russian energy is high; at least ten transition countries had close to 80% of their domestic consumption of natural gas or more come from Russia in 2006.

Human capital. Open unemployment rates remain extraordinarily high in a handful of transition countries (i.e., close to 20% or higher), and are double-digit in almost one-half of the transition countries. However, most unemployment rates in E&E are now falling. In CEE, life expectancy has been increasing steadily since the mid-1990s. In Eurasia, life expectancy did not return to pre-transition level until 2006. The highest life expectancy gender gap in the world is found in a number of E&E countries. The most significant declines in population worldwide from 2006 to 2015 are forecast to take place in seven E&E countries: Bulgaria; Moldova; Ukraine; Russia; Romania; Latvia; and Belarus.

High primary school enrollments have been maintained across the sub-regions, and tertiary enrollments have been increasing since the mid-1990s. However, secondary and tertiary enrollment rates remain very low in many Eurasian and Southern Tier CEE countries. There is still no clear trend in Eurasia that secondary school enrollment rates are recovering. While traditionally-measured literacy rates in the E&E region are high, "functional literacy," or how well students and adults can function in a market economy given their formal and informal education, may be a concern in at least some countries.

(1) Introduction and General Method

This paper updates USAID/Europe & Eurasia (E&E) Bureau's analysis of transition region trends. It is the eleventh such report in a series of periodic Monitoring Country Progress (MCP) in E&E reports. As in past editions, transition progress is tracked and analyzed along four primary dimensions: (1) economic reforms; (2) democratization; (3) macroeconomic performance; and (4) human capital. Much of the focus of this report is to assess the change that has occurred in the region since the last MCP report in August 2006, and to provide salient findings from related research efforts. In regards to the latter, two themes in particular are examined in some detail here: (1) the democratization gap in Eurasia, and some aspects as to why it is so prevalent and seemingly intractable; and (2) key concerns regarding global economic integration, including very recent regional trends and considerations stemming from the yet unfolding global financial crisis.

The MCP method employs a two step analysis. First, we examine reform progress (both economic and democratic reforms). Next, we examine progress in macroeconomic performance and human capital. Data are from publicly available sources. The primary data used in the four MCP indices are all converted into a "1" to "5" scale, where a "1" represents the worst performance on that indicator in the E&E region and a "5" the best worldwide.

The MCP technique incorporates several basic principles. One, reform progress is necessary but not sufficient for a country to complete the transition to a market-oriented democracy. Solid macroeconomic performance and human capital development must ensue for reform progress to be sustained. Two, gains in macroeconomic performance and human capital are also necessary though not sufficient. Countries (such as Belarus in the case of human capital and Turkmenistan in the case of economic performance) may do relatively well on these "outcome" dimensions in the absence of adequate reform progress, but such conditions cannot be sustained over the long term. It's also important to bear in mind that, in some circumstances, progress in economic performance can forestall reform progress, such as seems particularly plausible in the case of energy-exporting economies. Hence, the third principle: the sequence is important; reform progress needs to precede or at the least accompany economic performance and human capital progress.

These principles underscore the beneficial and critical linkages between reform progress and favorable outcomes from the reforms. A fourth underlying principle stems from the inter-connectedness of the two reform dimensions as well as mutual causality of the two sets of outcome indicators (i.e. between economic performance and human capital). Restated, another key consideration in the analysis is the importance of the causal relationships between the transition sectors. Economic progress contributes to democratization and vice-a-versa; so, too the relationship between the economic sector and the social sector (or human capital), and democratization and human capital. These inter-relationships suggest that sustaining the gains in any one sector is less likely to occur if other sectors are lagging considerably. The fourth principle re-phrased: the

sustainable development path necessarily involves economic and democratic reforms progressing together in the medium term if not year-to-year; similarly, we want to see relatively balanced results and progress between economic performance and human capital.

(2) Economic and Democratic Reforms

Figure 1 and *Table 1* provide the most recent picture of economic and democratic reform progress across the twenty-nine country transition region. *Figures 2* and *3* compare 2007-2008 progress with that of the status of reforms ten years ago. Economic reform data are taken from the EBRD's annual *Transition Report*, and democratic reform data are from Freedom House's annual *Nations in Transit* report.¹ Both sets of data are converted to a 1 to 5 scale in which a "5" represents standards of advanced industrial market economies.

Four summary findings stand out in a comparison of reform progress today vs. that of roughly ten years ago. First, there has been reasonably good progress in economic reforms in most of the E&E countries, and across the three primary sub-regions (of Eurasia, the Southern Tier Central & Eastern Europe (CEE) countries and the Northern Tier CEE countries).² Turkmenistan, Belarus, and Uzbekistan are the salient exceptions, the laggards.

Second, democratization paths between Eurasia and CEE have been widely divergent. There have been impressive gains in democratic reforms in CEE since 1998 and stagnation if not backsliding in most of Eurasia. Ukraine is the salient exception to the Eurasian trend.

Third (and partly stemming from the second observation), the reform profiles of countries within the three sub-regions have become increasingly similar and the reform profiles between the sub-regions have become notably different. The Northern Tier CEE countries are much more similar in levels of reform progress in 2007-2008 than they were

¹ The economic reform index consists of nine indicators drawn from the EBRD's annual *Transition Report*: (1) small-scale privatization; (2) large-scale privatization; (3) price liberalization; (4) trade and foreign exchange liberalization; (5) banking reforms; (6) non-bank financial reforms; (7) enterprise reforms (or policies towards corporate governance); (8) infrastructure reforms (electric power, water and waste water, railways, telecommunications, and roads); and (9) competition policy. The democratic reform index is drawn from Freedom House's annual *Nations in Transit*: (1) electoral process (largely, the extent to which elections are free, fair, and competitive); (2) civil society (primarily the development of the non-government organization (NGO) sector); (3) the independence of media; (4) national public governance; (5) local public governance; (6) rule of law (primarily judicial reform); and (7) anti-corruption measures. *Appendix 1* provides elaboration of indicator definitions.

² Eurasia consists of 12 countries (the former Soviet Union less the three Baltic states: Russia; Ukraine; Moldova; Belarus; Armenia; Georgia; Azerbaijan; the Kyrgyz Republic; Kazakhstan; Turkmenistan; Uzbekistan; and Tajikistan). The Southern Tier CEE countries (n= 9) include Bulgaria, Romania, Croatia, Albania, Bosnia-Herzegovina, Serbia, Kosovo, Montenegro, and Macedonia. The Northern Tier CEE countries (n=8) include Hungary, the Czech Republic, Slovakia, Slovenia, Poland, Estonia, Latvia, and Lithuania.

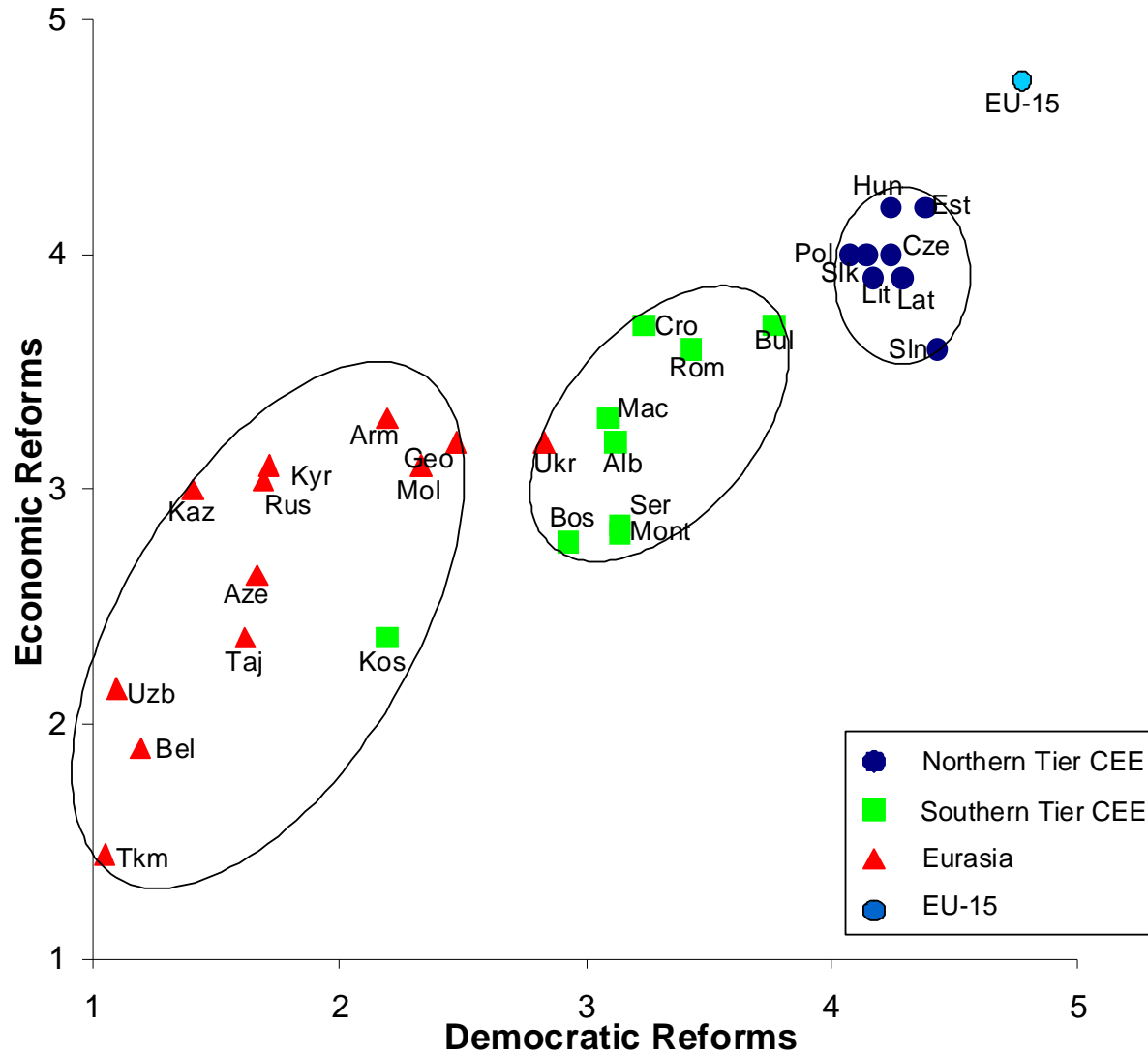
in 1998; so too, Southern Tier CEE, and to a lesser extent, Eurasia. Sub-regional outliers are Ukraine, which is much farther ahead on democracy than the Eurasian average, and Kosovo, which is lagging considerably relative to Southern Tier CEE standards on both economic and democratic reform dimensions.

Fourth, while eleven of these twenty-nine countries have now “graduated” from United States Government (USG) assistance, and ten of those eleven are now members of the European Union, not even the reform leaders are yet quite at the reform standards of Western Europe (and more broadly the advanced industrial market democracies).³ In this regard, the economic reform gap (between the E&E transition leaders and the EU-15 or Western Europe) is larger than the democratic reform gap.

³ The 11 country graduates from USG assistance include: Estonia (in 1996); the Czech Republic (1997); Slovenia (1997); Hungary (1999); Latvia (1999); Lithuania (2000); Poland (2000); Slovakia (2000); Bulgaria (2006); Romania (2006); and Croatia (2006). All of these countries except Croatia are also now members of the European Union.

Figure 1

Economic and Democratic Reforms in 2007-2008



Ratings are based on a 1 to 5 scale, with 5 representing most advanced. Freedom House, *Nations in Transit 2008* (June 2008) and EBRD, *Transition Report 2008* (November 2008).

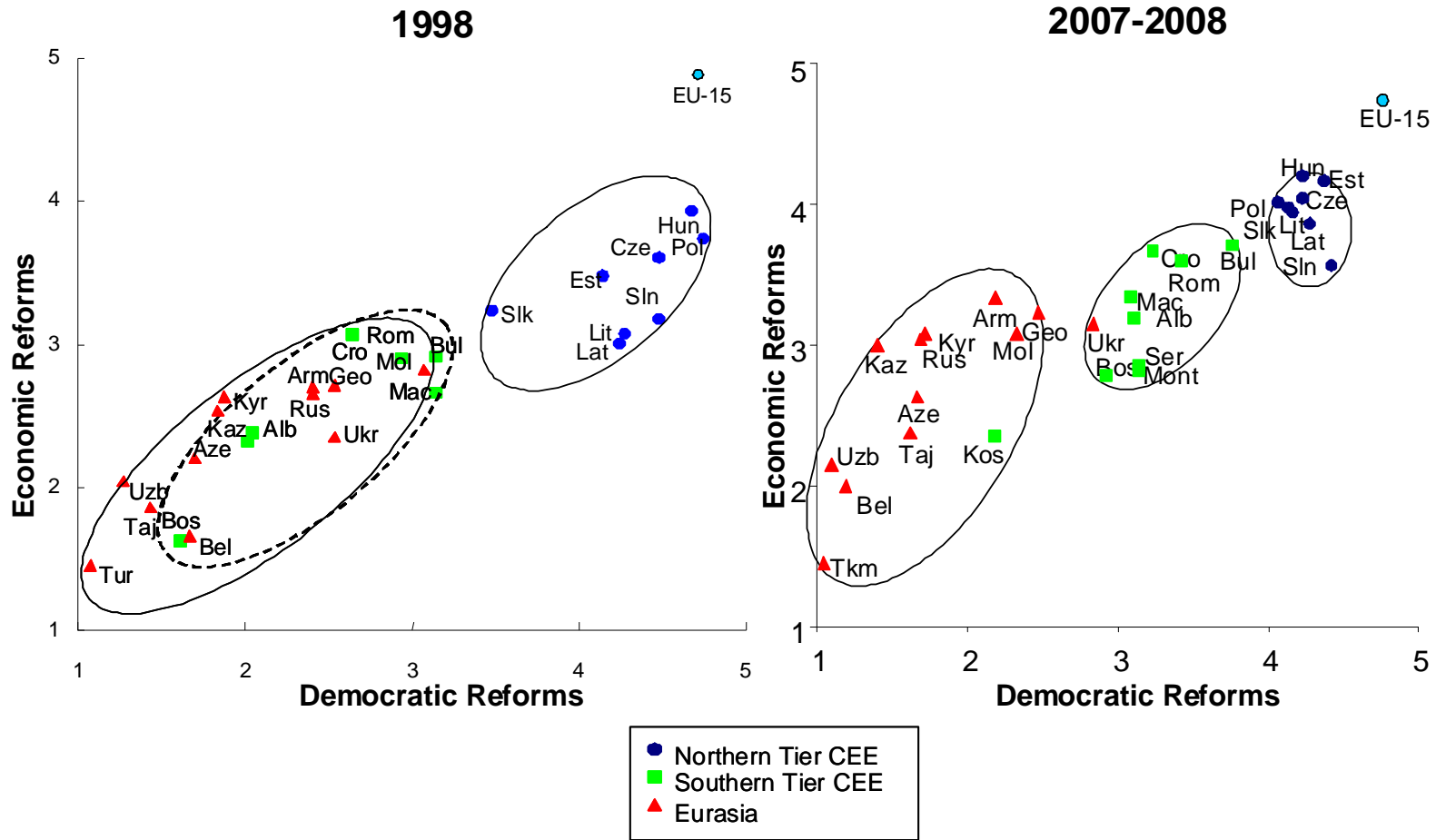
**Table 1. Economic and Democratic Reforms
in Central and Eastern Europe & Eurasia: 2007-2008**

	<u>ECONOMIC REFORMS</u>		<u>DEMOCRATIC REFORMS</u>		
	<u>RATING</u> <u>(1 to 5)</u>	<u>RANKING</u>	<u>RATING</u> <u>(1 to 5)</u>	<u>RANKING</u>	
HUNGARY	4.2	1	SLOVENIA	4.4	1
ESTONIA	4.2	1	ESTONIA	4.4	1
CZECH REPUBLIC	4.0	3	LATVIA	4.3	3
POLAND	4.0	3	CZECH REPUBLIC	4.2	4
SLOVAK REPUBLIC	4.0	3	HUNGARY	4.2	4
LITHUANIA	3.9	6	LITHUANIA	4.2	4
LATVIA	3.9	6	SLOVAKIA	4.1	7
BULGARIA	3.7	8	POLAND	4.1	7
CROATIA	3.7	8	BULGARIA	3.8	9
ROMANIA	3.6	10	ROMANIA	3.4	10
SLOVENIA	3.6	10	CROATIA	3.2	11
ARMENIA	3.3	12	MONTENEGRO	3.1	12
MACEDONIA	3.3	12	SERBIA	3.1	12
GEORGIA	3.2	14	ALBANIA	3.1	12
UKRAINE	3.2	14	MACEDONIA	3.1	12
ALBANIA	3.2	14	BOSNIA AND HERZEGOVINA	2.9	16
MOLDOVA	3.1	17	UKRAINE	2.8	17
KYRGYZ REPUBLIC	3.1	17	GEORGIA	2.5	18
RUSSIAN FEDERATION	3.0	19	MOLDOVA	2.3	19
KAZAKHSTAN	3.0	19	ARMENIA	2.2	20
SERBIA	2.9	21	KOSOVO	2.2	20
MONTENEGRO	2.8	22	KYRGYZ REPUBLIC	1.7	22
BOSNIA AND HERZEGOVINA	2.8	22	RUSSIA	1.7	22
AZERBAIJAN	2.6	24	AZERBAIJAN	1.7	22
KOSOVO	2.4	25	TAJIKISTAN	1.6	25
TAJIKISTAN	2.4	25	KAZAKHSTAN	1.4	26
UZBEKISTAN	2.2	27	BELARUS	1.2	27
BELARUS	1.9	28	UZBEKISTAN	1.1	28
TURKMENISTAN	1.4	29	TURKMENISTAN	1.0	29
Rating (1 to 5)			Rating (1 to 5)		
Northern Tier CEE	4.0		Northern Tier CEE	4.2	
Southern Tier CEE	3.1		Southern Tier CEE	3.1	
Eurasia	2.7		Eurasia	1.8	
Romania & Bulgaria in 2002	3.3		Romania & Bulgaria in 2002	3.4	
Rom, Bul, Cro in 2006	3.4		Rom, Bul, Cro in 2006	3.5	

USAID calculations drawing from EBRD, *Transition Report 2008* (November 2008) and Freedom House, *Nations in Transit* (Ju

Figures 2-3

Economic and Democratic Reforms 1998 vs. 2007-2008



Ratings are based on a 1 to 5 scale, with 5 representing most advanced. Freedom House, *Nations in Transit 2008* (June 2008) and EBRD, *Transition Report 2008* (November 2008).

Economic reforms

Figure 4 and *Tables 2* and *3* provide the economic reform data drawn from the EBRD, updated to include progress up to September 2008. Economic reform gains have been gradual yet steady in recent years across the three sub-regions. Economic reform progress was much greater by these measures in the early part of the transition (in the 1990s), though partly because the initial focus was on completing the easier, first stage reforms (particularly trade and domestic price liberalization, and small-scale privatizations). Hence, while the gains has slowed in recent years, most of the changes have occurred in the second stage economic reforms; in the financial sector and in corporate governance and competition policy, all reforms which require institution building and developing government's capacity to regulate and facilitate economic development.

The Northern Tier CEE countries continue to lead quite substantially, though the Southern Tier CEE countries are slowly closing the gap. Economic reform progress in Eurasia has been slower than in CEE in recent years; i.e., the economic reform gap between Eurasia and both the Southern Tier CEE and Northern Tier CEE countries is not closing. Since 2005 (and the findings from *MCP #10* (August 2006), the greatest economic reform gains have occurred in the Southern Tier CEE countries, and in three such countries in particular: Montenegro; Kosovo, and Macedonia. Ukraine has also made significant economic reforms gains in this time period, from 2005 to 2008. The broadest economic reform gains in 2008 occurred in Serbia, with advancement in three dimensions: banking; infrastructure; and trade & foreign exchange reforms.

We supplement the macroeconomic reform trends drawn from the EBRD with microeconomic reform trends from the World Bank's *Doing Business* dataset (*Figures 5* and *6* and *Table 4*). The World Bank's *Doing Business in 2009* is the fifth in an annual series which attempts to measure the business climate or environment of a country based on government policy vis-à-vis the private sector. The 2008 measures include scores for 181 countries across ten business environment aspects: (1) starting a business; (2) dealing with licenses; (3) hiring and firing workers) (4) registering property; (5) getting credit; (6) protecting investors; (7) paying taxes; (8) trading across borders; (9) enforcing contracts; and (10) closing a business.⁴

Change in the business climate is assessed in *Figure 5* by calculating the percentile ranking worldwide of each country for scores for the past four years, 2005-2008. Percentile ranking was used since the sample size has increased from year to year. The sub-regional trends in these microeconomic reforms (of *Figure 5*) have similarities to the macroeconomic reforms trends (of *Figure 4*). Namely, these business environment

⁴ The technique employed for each *Doing Business* indicator is to define a specific type of business in a specific type of environment, and to compare the experience of that firm in that setting across the countries. In the days to start a business indicator, e.g., the firm is a limited liability company which operates in the country's most populous city, is 100% domestically owned, has up to 50 employees, etc. This technique allows for a manageable and precise way to measure trends across countries. However, one may not be able to generalize the results across different parts of any one country.

reforms are notably more advanced in the Northern Tier CEE countries as compared to the other two sub-regions. Eurasia lags the most. Some modest regional progress since 2005 has been made, however, in both the Southern Tier CEE countries and Eurasia.

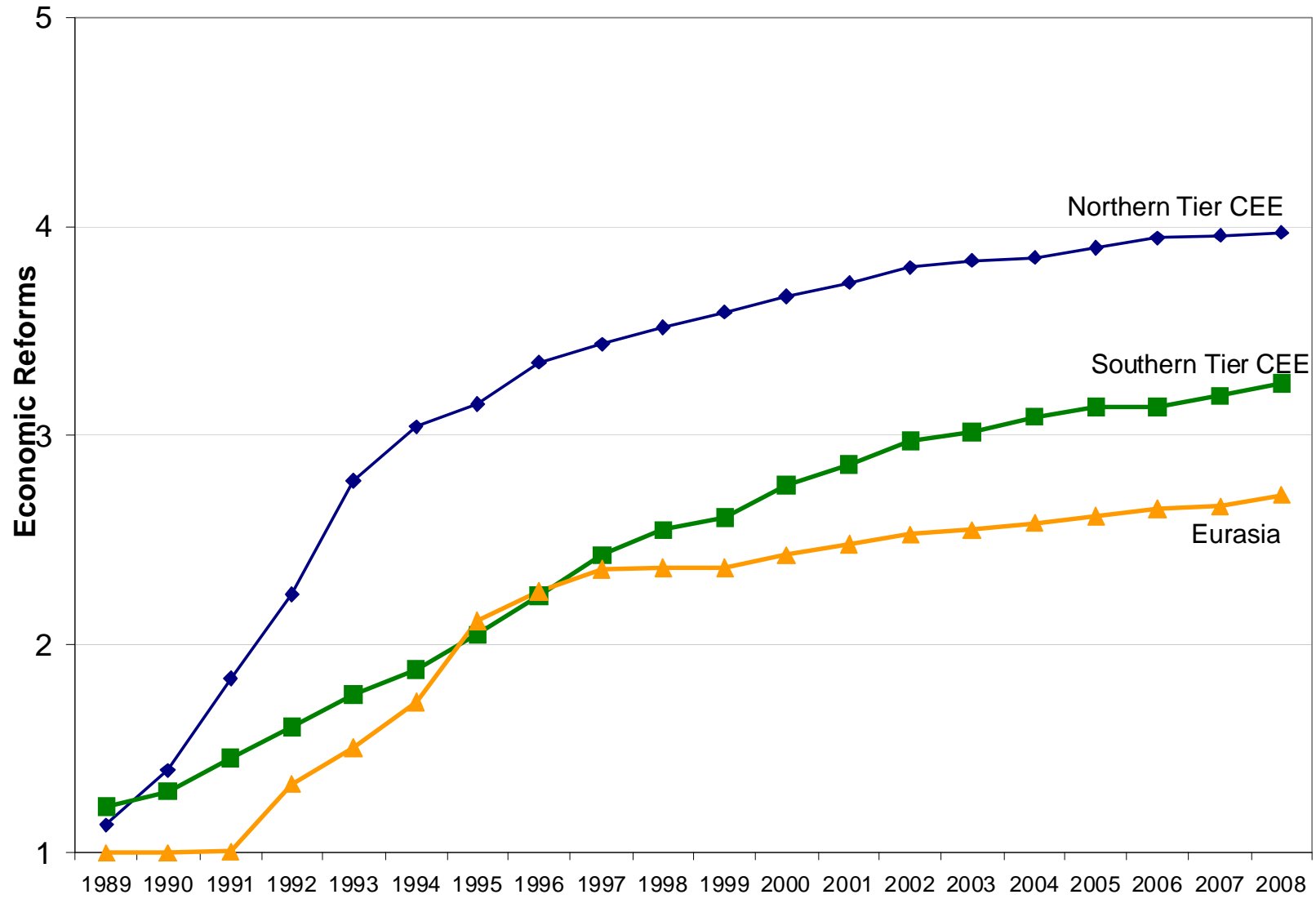
The regional trends, however, mask some key country-specific differences across the transition region and over time. As *Figure 6* illustrates, there is considerable diversity in business climates within the sub-regions, particularly in Eurasia, and to a lesser extent the Southern Tier CEE countries. One striking observation is how well the three Caucasus countries do on these measures. In fact, of all the transition countries, the most friendly business environment by these measures is now in Georgia. All three Caucasus countries have business environments comparable to Northern Tier CEE standards.

On the other hand, Croatia's business environment lags considerably relative to its economic reform standings by the EBRD measures (and relative to most other rankings in other transition dimensions). Despite good progress since 2005, Croatia in 2008 ranked 106 out of 181 countries worldwide in then *Doing Business* measures, worse than Moldova (103), Belarus (eighty-five), Kazakhstan (seventy), and the Kyrgyz Republic (sixty-eight).

Of all the transition countries, the most significant (relative) improvement in the business environment from 2005 to 2008 occurred in Georgia (which increased from the 64th percentile rank in 2005 to 8th worldwide in 2008), followed by Azerbaijan, Kazakhstan, Belarus, and the Kyrgyz Republic. The most significant relative deterioration in the business environment since 2005 occurred in Tajikistan, Bosnia-Herzegovina, Montenegro, the Czech Republic, and Russia. Hence, while the broad trends between the macroeconomic reforms and the microeconomic reforms generally mesh, there are considerable country-specific differences.

Figure 4

Economic Reform



Ratings are based on a 1 to 5 scale, with 5 representing most advanced. EBRD, *Transition Report 2008* (November 2008 and earlier editions).

Table 2. First Stage Economic Policy Reforms in 2008							
	Small scale privatization	Trade & Forex system	Price Liberalization	Large scale privatization	First Stage Economic Reform		
ESTONIA	5.0	5.0	5.0	4.0	4.8		
HUNGARY	5.0	5.0	5.0	4.0	4.8		
LITHUANIA	5.0	5.0	5.0	4.0	4.8		
SLOVAK REPUBLIC	5.0	5.0	5.0	4.0	4.8		
CZECH REPUBLIC	5.0	5.0	5.0	4.0	4.8		
BULGARIA	4.0	5.0	5.0	4.0	4.5		
GEORGIA	4.0	5.0	5.0	4.0	4.5		
LATVIA	5.0	5.0	5.0	3.7	4.7		
ARMENIA	4.0	5.0	5.0	3.7	4.4		
KYRGYZ REPUBLIC	4.0	5.0	5.0	3.7	4.4		
POLAND	5.0	5.0	5.0	3.3	4.6		
ROMANIA	3.7	5.0	5.0	3.7	4.3		
ALBANIA	4.0	5.0	5.0	3.3	4.3		
CROATIA	5.0	5.0	4.0	3.3	4.3		
MACEDONIA	4.0	5.0	5.0	3.3	4.3		
SLOVENIA	5.0	5.0	4.0	3.0	4.3		
MOLDOVA	4.0	↑	5.0	4.0	4.0		
UKRAINE	4.0		5.0	↑↑	4.0		
MONTENEGRO	3.7		4.0	4.0	3.8		
KAZAKHSTAN	4.0		3.7	4.0	3.7		
RUSSIAN FEDERATION	4.0		3.3	4.0	3.6		
SERBIA	3.7		3.7	↑	4.0	3.5	
BOSNIA AND HERZEGOVINA	3.0		4.0	↑	4.0	3.5	
AZERBAIJAN	3.7		4.0	4.0	2.0	3.4	
TAJIKISTAN	4.0		3.3	3.7	2.3	3.3	
KOSOVO	3.3		4.0	4.0	1.0	3.1	
UZBEKISTAN	3.3		2.0	2.7	2.7	2.7	
BELARUS	2.3		2.3	2.7	1.7	↑	2.3
TURKMENISTAN	2.3	↑	2.0	↑↑	2.7	1.0	2.0
Northern Tier CEE	5.0		5.0	4.9	3.8	4.7	
Southern Tier CEE	3.8		4.5	4.4	3.1	4.0	
Eurasia	3.6		3.8	3.9	2.8	3.5	
Romania & Bulgaria in 2002	3.7		4.5	5.0	3.5	4.2	
Rom, Bul, Cro in 2006	4.0		5.0	4.2	3.7	4.2	

EBRD, Transition Report 2008 (November 2008). Ratings are based on a 1 to 5 scale, with 5 being most advanced. A "↑" indicates an advancement of one increment from September 2007 to September 2008;

↑↑ represents an advancement of two or more increments.

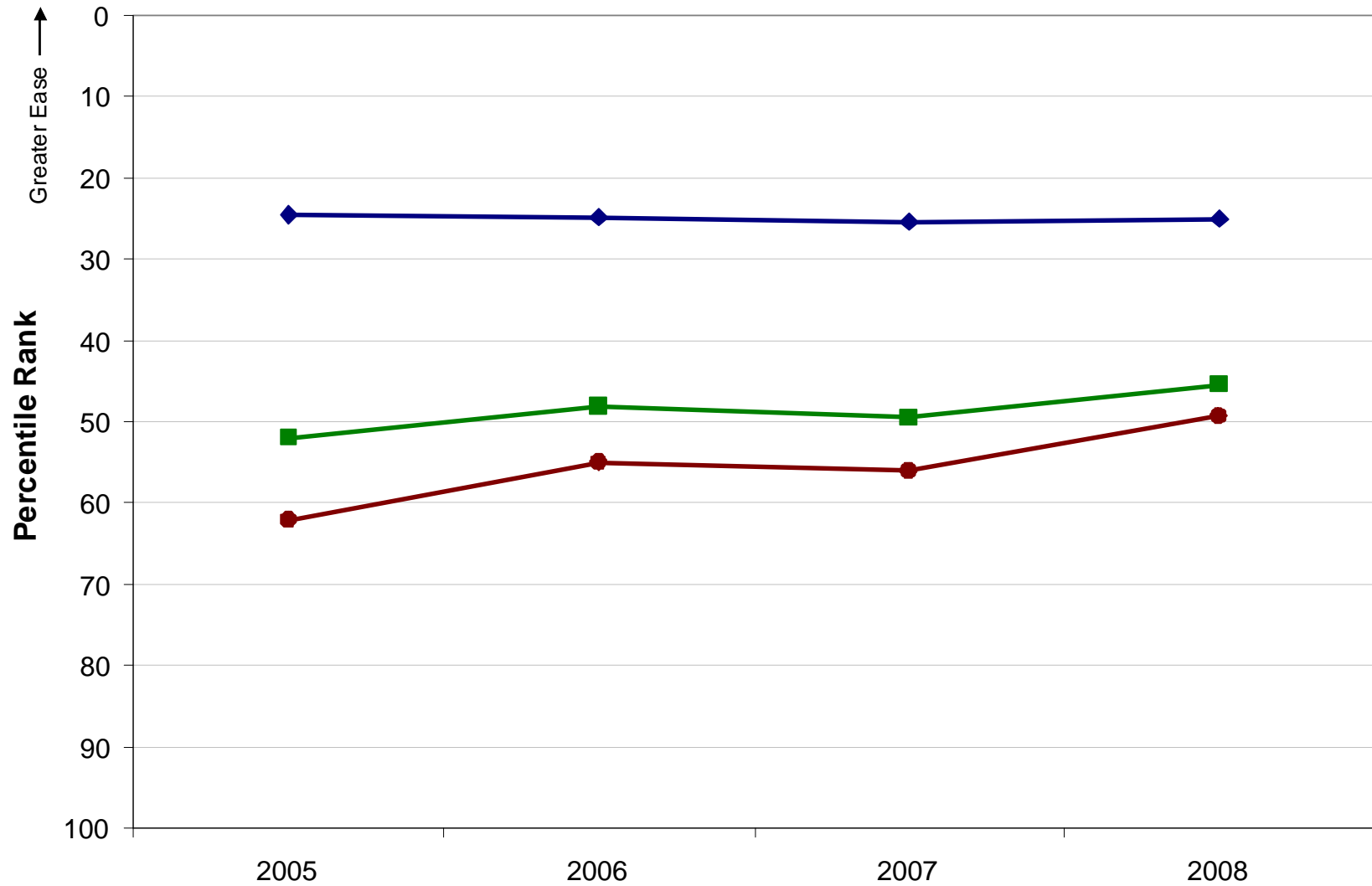
Table 3. Second Stage Economic Policy Reforms in 2008						
	Enterprise restructuring	Competition Policy	Banking Reform	Non-bank financial Reform	Infrastructure Reform	Second Stage Economic Reform
HUNGARY	3.7	3.3	4.0	4.0	3.7	3.7
ESTONIA	3.7	3.7	4.0	3.7	3.3	3.7
POLAND	3.7	3.3	3.7	3.7	3.3	3.5
CZECH REPUBLIC	3.3	3.0	4.0	3.7	3.3	3.5
SLOVAK REPUBLIC	3.7	3.3	3.7	3.0	3.0	3.3
LITHUANIA	3.0	3.3	3.7	3.3	3.0	3.3
LATVIA	3.0	3.0	4.0	3.0	3.0	3.2
CROATIA	3.0	2.7	4.0	3.0	3.0	3.1
BULGARIA	2.7	3.0	↑	3.7	3.0	3.1
ROMANIA	2.7	2.7	3.3	3.0	↑	3.0
SLOVENIA	3.0	2.7	3.3	3.0	↑	3.0
RUSSIAN FEDERATION	2.3	2.3	2.7	3.0	2.7	2.6
MACEDONIA	2.7	2.3	3.0	↑	2.3	2.5
KAZAKHSTAN	2.0	2.0	3.0	2.7	2.7	2.5
ARMENIA	2.3	2.3	2.7	2.3	↑	2.5
UKRAINE	2.0	2.3	3.0	2.7	2.3	2.5
MOLDOVA	2.0	2.3	3.0	2.0	2.3	2.3
SERBIA	2.3	2.0	3.0	↑	2.0	2.3
ALBANIA	2.3	2.0	3.0	↑	1.7	2.3
BOSNIA AND HERZEGOVINA	2.0	2.0	3.0	↑	1.7	2.2
GEORGIA	2.3	2.0	2.7	1.7	2.3	2.2
MONTENEGRO	2.0	1.7	3.0	↑	1.7	2.1
AZERBAIJAN	2.0	2.0	2.3	1.7	2.0	2.0
KYRGYZ REPUBLIC	2.0	2.0	2.3	2.0	1.7	2.0
KOSOVO	2.0	1.7	↑	2.3	1.7	1.8
BELARUS	1.7	↑	2.0	2.0	2.0	1.8
UZBEKISTAN	1.7	1.7	1.7	2.0	1.7	1.7
TAJKISTAN	1.7	1.7	2.3	1.0	1.3	1.6
TURKMENISTAN	1.0	1.0	1.0	1.0	1.0	1.0
Northern Tier CEE	3.4	3.2	3.8	3.4	3.2	3.4
Southern Tier CEE	2.4	2.2	3.1	2.2	2.4	2.5
Eurasia	1.9	2.0	2.4	2.0	2.0	2.1
Romania & Bulgaria in 2002	2.2	2.3	3.0	2.2	2.9	2.5
Rom, Bul, Cro in 2006	2.8	2.6	3.6	2.7	3.1	2.9

EBRD, Transition Report 2008 (November 2008). Ratings are based on a 1 to 5 scale, with 5 being most advanced. A "↑" indicates an advancement of one increment from September 2007 to September 2008;

↑↑ represents an advancement of two or more increments.

Figure 5

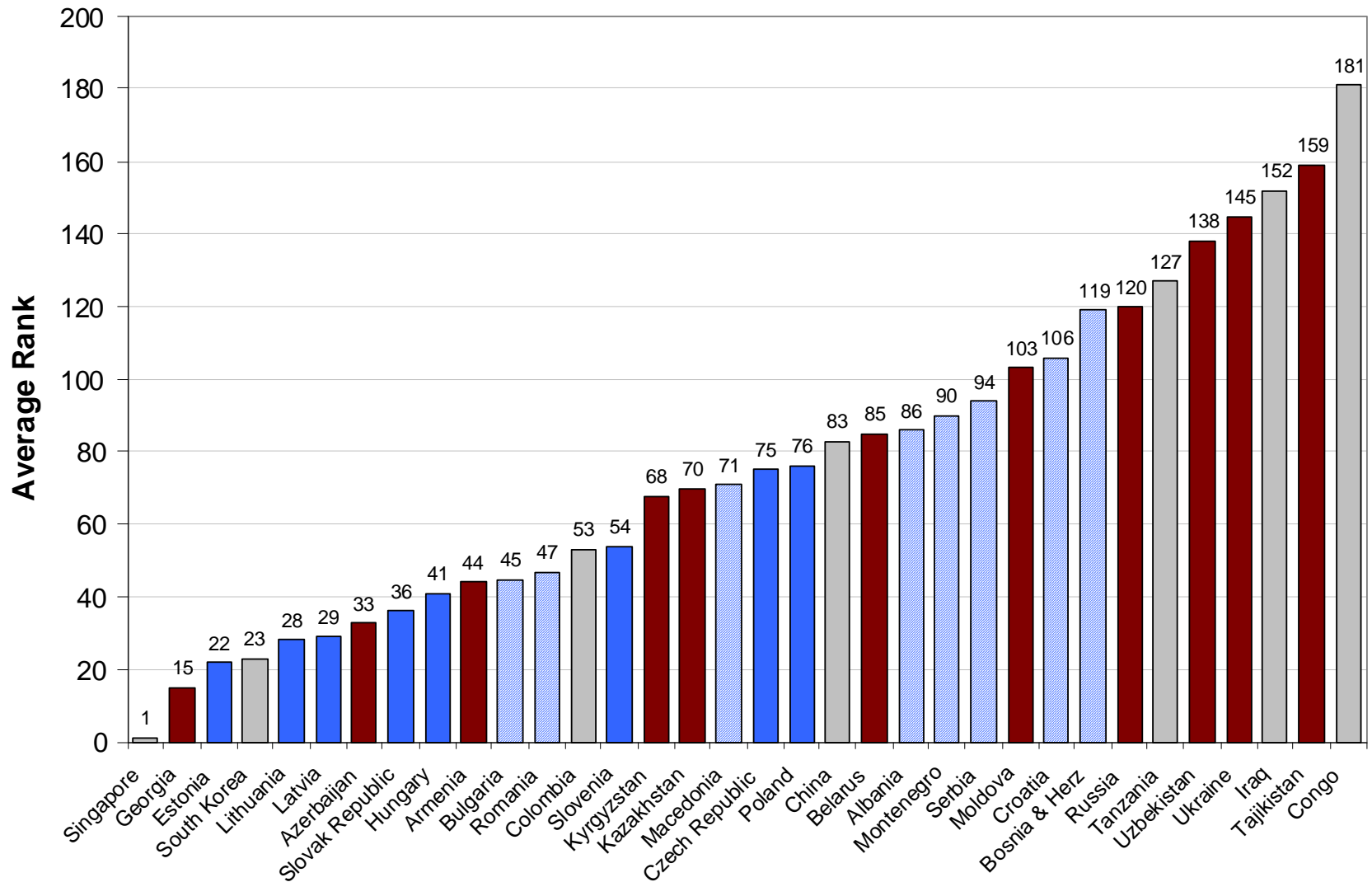
Business Environment



World Bank, *Doing Business in 2009* (2008). Worldwide scores range from 1 to 181 and include 10 topics: starting a business, dealing with construction, hiring and firing workers, registering a property, getting credit, protecting investors, paying taxes, trading across borders, enforcing contracts, closing a business.

Figure 6

Business Environment in 2008



World Bank, *Doing Business in 2009* (2008). Worldwide scores range from 1 to 181 and include 10 topics: starting a business, dealing with construction, hiring and firing workers, registering a property, getting credit, protecting investors, paying taxes, trading across borders, enforcing contracts, closing a business.

Table 4. Doing Business, percentile rank					
	2005	2006	2007	2008	2005-2008 change
BOSNIA AND HERZEGOVINA	52	54	65	66	-14
TAJIKISTAN	74	76	86	88	-14
MONTENEGRO	37	40	46	50	-13
CZECH REPUBLIC	29	30	36	41	-12
RUSSIA	55	55	62	66	-11
MOLDOVA	50	59	51	57	-7
LITHUANIA	9	9	15	15	-6
UKRAINE	75	73	80	80	-5
ARMENIA	21	19	23	24	-3
ESTONIA	10	10	10	12	-2
SLOVAKIA	19	21	20	20	-1
POLAND	42	43	40	42	0
LATVIA	18	14	14	16	2
SLOVENIA	32	35	35	30	2
SERBIA	54	39	50	52	2
BULGARIA	34	31	24	25	9
UZBEKISTAN	86	84	80	76	10
HUNGARY	34	38	28	23	11
ROMANIA	41	28	26	26	15
MACEDONIA	54	53	44	39	15
ALBANIA	66	69	75	48	18
CROATIA	77	71	59	59	18
KYRGYZ REPUBLIC	59	51	55	38	21
BELARUS	71	74	64	47	24
KAZAKHSTAN	68	70	44	39	29
AZERBAIJAN	57	57	54	18	39
GEORGIA	64	21	12	8	56
Northern Tier CEE	24	25	25	25	-1
Southern Tier CEE	52	48	49	46	6
Eurasia	62	58	56	49	13

USAID drawing from World Bank, *Doing Business in 2009* (2008).

Democratization

The following analysis of democratization in the E&E region attempts to first describe the major trends and then attempts to delve further by addressing plausible explanations as to why these trends are occurring. We look at democratization trends in the region, drawing on analysis from region-specific data as well as global datasets, the latter so as to compare progress in E&E vis-à-vis the world. The region-specific data primarily come from Freedom House's *Nations in Transit*, IREX's *Media Sustainability Index*, and USAID's "in-house" effort (in concert with MSI), the *NGO Sustainability Index*. The global data primarily come from Freedom House's *Freedom in the World* and *Freedom of the Press* and the World Bank Institute's *Governance Matters*. Much of the analysis on global comparisons is drawn from *Democracy and Governance in Eurasia: A Global Comparison*, USAID Working Paper #9 (September 2008).

Table 5 provides the most recent data (2007) from Freedom House's annual region-specific *Nations in Transit* report, disaggregated by seven democratization components. Freedom House has been tracking such trends in E&E since 1997. Figure 7 shows these trends by the three primary E&E sub-regions, using the *Nations in Transit* data from 1997 to 2007, and filling in prior to 1997 with the use of Freedom House's *Freedom in the World* indices (of political rights and civil liberties).⁵

More transition countries witnessed democratic backsliding than progress in 2007. This trend was particularly prevalent in Eurasia where seven countries witnessed net regression (most notably, the Kyrgyz Republic, Tajikistan, Russia, and Georgia, and to a lesser extent, Moldova, Belarus, and Uzbekistan), four countries no change on balance (Ukraine, Armenia, Azerbaijan, and Kazakhstan), and only one (Turkmenistan from the "cellar"), saw a slight gain on balance in democratization. Democratic reforms in the Southern Tier CEE was a "wash" on balance in 2007; i.e., four countries progressed (Kosovo, Croatia, Bulgaria, and Montenegro), four countries regressed (Serbia, Macedonia, Bosnia-Herzegovina, and Romania), and one country (Albania) saw no change in democratization. Three Northern Tier CEE countries saw some democracy backsliding in 2007 (Slovakia, Slovenia, and Poland), two experienced gains (Estonia and the Czech Republic), and three had no change on balance (Latvia, Hungary, and Lithuania).

Figure 7 puts these 2007 democracy trends in broader perspective. The primary story of Figure 7 is the growing democratization gap between Eurasia and the CEE countries, a trend that started in the early 1990s and accelerated in the late 1990s. However, perhaps the secondary story is the general slowing down of democratization progress in the entire E&E region in very recent years. The Northern Tier CEE countries have seen a gradual erosion in democratization since 2002, in large part perhaps because these countries have been approaching a democratization "ceiling" with standards of democratic reforms close

⁵ Extrapolating trends back in time prior to 1997 was done in the following fashion. An increase (decrease) in both political rights and civil liberties translated into a "0.2" increase (decrease) in our 1-5 scores. An increase (decrease) in one dimension resulted in an increase (decrease) of "0.1." A "directional" change in democratic freedoms in a country according to Freedom House translated into a change of "0.05."

to Western European norms. To a lesser extent, the pace of change and progress has also slowed in the Southern Tier CEE countries, though it remains to be seen the extent to which 2007 results are more the anomaly than the current medium term trend.

The *Media Sustainability Index* and the *NGO Sustainability Index* allow us to look at two key sectors of democratization from sources other than Freedom House (*Figures 8 and 9*). *Figure 8* shows the trends on average in media from 2000-2007 in the Southern Tier CEE and Eurasia countries according to the *Media Sustainability Index*. The Northern Tier CEE countries are not included in the index. By this measure, progress in the sustainability of independent media is notably more advanced in the Southern Tier CEE countries than it is in Eurasia. No Southern Tier CEE countries have achieved the media sustainability stage, though all are “near sustainable.”⁶ The media sectors in Eurasia, in contrast, are all less developed than those in the Southern Tier CEE, and range widely from “unsustainable anti-free press” (Turkmenistan, Uzbekistan, and Belarus), to “unsustainable mixed system” (Kazakhstan, Tajikistan, Moldova, Russia, the Kyrgyz Republic, Armenia, and Azerbaijan), to marginally “near sustainable” (Ukraine and Georgia).

According to IREX (*Figure 8*), the media sector in the Southern Tier CEE countries has seen some progress towards sustainability since 2000 despite modest regression in 2007. The media sector in Eurasia has advanced on average very slightly from 2000 to 2007.

According to the most recent analysis of the *NGO Sustainability Index*, seven of the eight Northern Tier CEE countries (all but Slovenia) were considered to have “consolidated” NGO sectors in 2007 (*Figure 9*). Most of these sectors were deemed “consolidated” the first year that USAID undertook the *NGO Sustainability Index* analysis. This includes Hungary, Poland, and Slovakia since 1997, and the Czech Republic and Estonia since 2000. By this analysis, all of the NGO sectors in the Southern Tier CEE countries fall into the “mid-transition” range of sustainability. Of the three transition sub-regions, the most significant progress in the NGO sector has occurred in the Southern Tier CEE since the late 1990s. In contrast, the NGO sector in Eurasia has seen no change on average during this time, though the average is somewhat misleading since eight Eurasian countries had NGO sectors developing towards sustainability since the late 1990s, while only four countries had NGO sectors regressing.

Figure 10 highlights the democracy sector trends since 1999 in Eurasia as measured by Freedom House’s *Nations in Transit* analysis. As shown, all sectors have regressed by this analysis. According to Freedom House, while civil society is the most advanced aspect of democratization in Eurasia, it has not been immune to some backtracking in recent years. The most significant regression has occurred in public governance, followed by independent media. While the cross-country standings and relative ranking of countries between the different sources of data (between Freedom House, IREX, and USAID/MSI) generally hold, the trends over time do not always closely mesh. In particular, IREX’s *Media Sustainability Index* and USAID/MSI’s *NGO Sustainability*

⁶ Croatia’s media sector was deemed “sustainable” in 2005, only to have the sector regress since then back to “near sustainable.”

Index show a more favorable picture of trends in Eurasia in those sectors than does Freedom House; little change in Eurasia on average (IREX and USAID/MSI) vs. fairly significant erosion (Freedom House).⁷

Democracy and governance in Eurasia: a global comparison.⁸ We constructed a democracy and governance index from available global datasets to examine democratization trends in Eurasia with the rest of the world. The index consists of six indicators, all standardized on a one to five scale where five represents the most advanced performance worldwide: (1) political rights; (2) civil liberties; (3) independent media; (4) rule of law; (5) control of corruption; and (6) government effectiveness. The first three indicators are drawn from Freedom House, *Freedom in the World* and *Freedom of the Press*; the last three from World Bank Institute, *Governance Matters*.

Figure 11 summarizes the global comparison in the aggregate, and *Figures 12* and *13* show the disaggregated results for Eurasia compared to the OECD as well as to the Middle East and North Africa region. By this measure, Eurasia lags behind all other major regions of the world in governing justly and democratically. This holds true even when the five Central Asian Republics are not included in the Eurasian average. Eurasia's democracy and governance gaps against OECD are very large, though even the OECD countries on average do not come very close to the top score of "5" on the three governance indicators as well as on media (*Figure 12*). Of all the global regions, only the Middle East and North Africa region has fewer political rights than Eurasia, albeit only so slight, and the same amount of civil liberties (*Figure 13*). Eurasia's governance gaps and media gap vis-à-vis the Middle East and North Africa are quite significant.

Progress in governing justly and democratically varies across the Eurasian countries with broadly three tiers of development (*Figure 14*). Ukraine, Georgia, Moldova, and Armenia are notably more advanced than are the other eight Eurasian countries on this score, though even these countries remain below the global average. Azerbaijan, Kazakhstan, the Kyrgyz Republic, Russia, and Tajikistan constitute the middle tier—five countries grouped closely at the Eurasian average on the index. The countries of the third and least advanced tier—Turkmenistan, Uzbekistan, and Belarus—are among the ten least democratic nations worldwide. Of the 153 country dataset, only three countries are less advanced than Turkmenistan in democracy and governance: Somalia; Burma; and North Korea. Democratization in Belarus lags behind Cuba and Iraq. Democratic

⁷ The differences in results likely highlight some limitations in our ability to define and measure democratization. A 2008 study from the National Academy of Sciences critically assesses current efforts to measure democracy and finds credible faults with virtually all efforts, including those that make up our global governing justly and democratically index (described in the next section). The NAS study contends that "the development of a widely recognized disaggregated definition of democracy, with clearly defined and objectively measurable components, would be the result of a considerable research project that is yet to be done (NAS, *Improving Democracy Assistance* (2008), p. 61). It is unfortunate that the NAS study did not explicitly critique Freedom House's *Nations in Transit* analysis; i.e., its transition region-specific disaggregated measures of democratization. Nevertheless, the thrust of the NAS study's observations no doubt remains valid.

⁸ This section draws from J. Swedberg and R. Sprout, *Democracy and Governance in Eurasia: A Global Comparison*, USAID/E&E Working Paper #9 (September 2008).

progress in Azerbaijan and Tajikistan is comparable to that found in China; progress in Russia, Kazakhstan, and the Kyrgyz Republic is comparable to that found in Pakistan, Saudi Arabia, and Venezuela.

Figures 15 and 16 attempt to assess democratization trends over time across the globe by separating out the democratization dimensions into the two broad sub-categories: democratic freedoms and governance. Eurasia's democratic freedom trends (i.e., trends in political rights and civil liberties) over time are very unique. Democratic freedoms in Eurasia have been much more volatile, more subject to both advances and backsliding, than any of the regions in the developing and developed world.

Three periods of democratization in Eurasia are evident since 1972 (*Figure 15*). From 1972 until 1987, democratic freedoms were fewer in Eurasia (then united under the USSR) than any other region worldwide and they eroded significantly during this period. From 1987 until the collapse of communism in 1991, democratic freedoms in Eurasia increased at a very fast pace by historical standards, matched only by the pace of political liberalization in CEE. The rapid pace of democratic liberalization from 1987 to 1991 was the period in Eurasia of the glasnost reforms under Gorbachev. From 1991 to the present, the overall Eurasian regional trend has been an erosion of democratic freedoms. According to these measures, democratic freedoms in Eurasia in 2007 (latest year of available data) were fewer than such freedoms in 1991, at the collapse of communism. In contrast, since the early 1990s, democratic freedoms have either increased or have been stable in all other major regions of the world. Eurasia's erosion of democratic freedoms since the early 1990s is comparable to that experienced by Eurasia in the 1970s to mid-1980s.

Figure 16 combines the three indicators of the governance side of governing justly and democratically index: rule of law; control of corruption, and government effectiveness. Overall, *Figure 16* reveals stable trends in governance since 1996, even in Eurasia. These measures are less volatile than are the democratic freedom trends over time. Of all the regions, only the Central and Eastern Europe region witnessed a notable improvement in governance in this period. Most regions witnessed minor erosion in governance from 1996 to 2007. While governance in Eurasia has not backslid during this time period, it nevertheless is the least developed of all the regions of the world, including in Sub-Saharan Africa and South Asia. The levels of governance in OECD far exceed levels of governance in all other parts of the world.

Why is democratization stagnating in Eurasia? Here we explore in a very preliminary fashion available data to help test some plausible determinants as to why the democracy deficit in Eurasia is so problematic.⁹ We consider as possible causal factors the duration of communism (or historical conditions), the prevalence of the middle class, economic dependency on natural resources, and geography. With the exception of our analysis of natural resource dependence, the following analysis examines bivariate trends and

⁹ Many thanks to Emre Cilem for providing the primary research effort on this topic during the summer of 2008.

relationships only, and hence does not control for other possible intervening causal factors. The following analysis hence provides suggestive findings at best.

One theory posits that a key determinant if not the primary determinant as to why democracy has been so slow to emerge in much of Eastern Europe and Eurasia stems from the corrosive and long lasting impact of the communist system on democratic values and institutions. One way to elaborate on this may be to suggest that communism eroded social capital; i.e., behavioral aspects of institutional change and governance.¹⁰ In contrast to human capital, which is about skills, social capital may be defined in terms of voluntary compliance with established laws, trust, cooperative behavior and basic codes of conduct. There are arguably economic as well as democratic costs to weak social capital. The EBRD, in its *Transition Report 1999*, has emphasized the economic costs of weak social capital: “with weak social capital, physical capital is misused, destroyed or misappropriated and human capital can be wasted and diminished.” However, weak social capital can also arguably adversely affect democratic institutions and behavior by affecting both the demand for democracy and the capacity to supply democracy.

Figure 17 attempts to categorize the Eastern Europe & Eurasia countries into one of four possible quadrants defined by the degree of democracy and the number of years under communism. The results are consistent with the observation that the longer (shorter) a country was under the sway of communism, the less (more) democratic it is today. In fact all but three countries fall into one of the two expected quadrants according to this theory; namely, quadrant I: relatively democratic with relatively fewer years under communism, or quadrant IV: relatively undemocratic with relatively more years under communism. The three outliers are Kosovo, Moldova, and Ukraine. If one subscribes to the inverse relationship between years of communism and democracy then, other things equal, Moldova and Kosovo should be more democratic, and Ukraine should be less democratic. Similarly, the three Baltic countries have levels of democracy comparable to the rest of the Northern Tier CEE countries, even though their years under communism were greater than the rest of the Northern Tier CEE. Hence, the credible conclusion would seem to be that weak social capital as manifested in duration (and depth) of communism is likely a key ingredient, though not the only ingredient, towards explaining Eurasia’s democracy gap.

Conventional wisdom has it that a large and growing middle class is in some way(s) a good thing for a society. It is often hypothesized that the benefits derived from a significant middle class are both economic and democratic. The greater is the size of the middle class, the healthier is the economy perhaps partly because of greater consumer demand and a larger small and medium enterprise sector. In addition, the greater is the size of the middle class, the greater is the demand for democracy and the institutional capacity to develop a democracy. Moreover, the economic and democratic dynamics favorably reinforce each other.

Figure 18 is consistent with the observation that the size of the middle class does favorably affect democratic reforms. There appears to be a strong positive non-linear

¹⁰ Drawing from EBRD, *Transition Report 1999: Ten Years of Transition* (November 1999), pp. 5-7.

relationship consistent with the observation that the greater the proportion of the population is middle class, the more democratic is the society. Furthermore, a growing middle class may have a greater impact on democracy at lower levels of democracy than at higher levels.

Russia and Belarus are the rather extreme outliers in *Figure 18*. If the size of the middle class were the only determinant of democratization, then both Russia and Belarus (with relatively large middle classes) would be much more democratic than they are.

We also have examined the potential impact of the dependence on natural resources on economic and democratic trends in Eastern Europe and Eurasia. More specifically, we looked for evidence of the so-called natural resource curse in Eurasia. The resource curse refers to the burden that typically falls on countries confronted with a natural resource boom (usually in energy and/or minerals). As will be shown in greater detail later in this paper, many of the Eurasian countries are highly dependent on energy and minerals for export and have been experiencing a boom in such production in light of skyrocketing prices (until very recently) of these commodities. Most of the focus on the effects of the resource curse, certainly on the part of economists, stems from the so-called Dutch Disease, which tells us that the economy will experience growing sectoral disparities and ultimately slower, less sustainable economic growth. We certainly witness growing sectoral disparities in much of Eurasia, though economic growth has also been very high among these primary product exporters (not surprisingly given that the prices of energy and mineral had been rising very significantly).

However, there is also theory from the political scientists that the resource curse will adversely affect democracy reforms. *Figure 19* provides some support to this thesis. Here we define resource exports to include energy and metals exports. Select countries outside the E&E region are included to see if they hold to a similar pattern. Overall, the picture is consistent with the observation that resource export dependence and democratization are inversely related, albeit in a non-linear fashion.

Drawing in large part on the work of Michael Ross, a political science professor at UCLA, we tested for this econometrically and found strong evidence in the transition region to support this claim that dependence on energy and metals for export adversely affects democracy. Our basic model regressed a number of independent variables on democracy: (1) energy exports as % of GDP; (2) mineral exports as % of GDP; (3) per capita income; (4) proportion of the population which is Muslim; (5) democracy in the past; and (6) a time trend variable. All independent variables were lagged five years. For the full sample of E&E countries we found both energy and mineral exports to have a negative and statistically significant effect on democracy, with energy having a more negative impact than minerals. The larger was the Muslim population of a country, the less democratic, though this finding was not statistically significant. Per capita income had a positive though statistically insignificant effect on democracy.¹¹

¹¹ N. Srinivas and R. Sprout, *Tracking the Resource Curse in Eastern Europe and Eurasia*, USAID/E&E/PO. Presentation to USAID (July 17, 2008). Presentation and draft paper available on

We also looked at different channels through which this causality might occur and found evidence that the “rentier effect” is likely an important mechanism. This effect largely stems from fiscal policy dynamics: governments with large coffers from booming resource exports don’t need to tax the population for revenues and are able to spend liberally on public works without taxing. This presumably has the effect of essentially decreasing the demand for democracy and government accountability (and increasing the prevalence of corruption).

Finally, we considered the relationship between geography and democracy in the transition region. How much does location contribute to democratic orientation? One aspect of this is to consider the influence of neighbors. Are a country’s prospects of being democratic greater, the more democratic are its neighbors? *Figure 20* suggests the answer is yes. Here we measured the progress of democracy in each of the E&E country’s immediate (contiguous) neighbors (E&E and non-E&E neighbors), and found an apparent close fit between the extent of democracy “at home” with the extent of democracy “next door.” The country outliers—Belarus, and to a lesser extent, the Baltic states—are among those countries on the “fault line” between relatively democratic Europe and relatively undemocratic Eurasia. *Figure 21* helps provide the visual by showing where on the map are the “free”, “partly free” and “not free” E&E countries as defined by Freedom House. The “free” countries are clustered together as are the “not free.” The “partly free” are mostly on the E&E border with the rest of the world.

request. The primary source is from Michael Ross: Does Oil Hinder Democracy? *World Politics* 53 (April 2001), pp 325-361.

Table 5. Democratic Reform in 2007

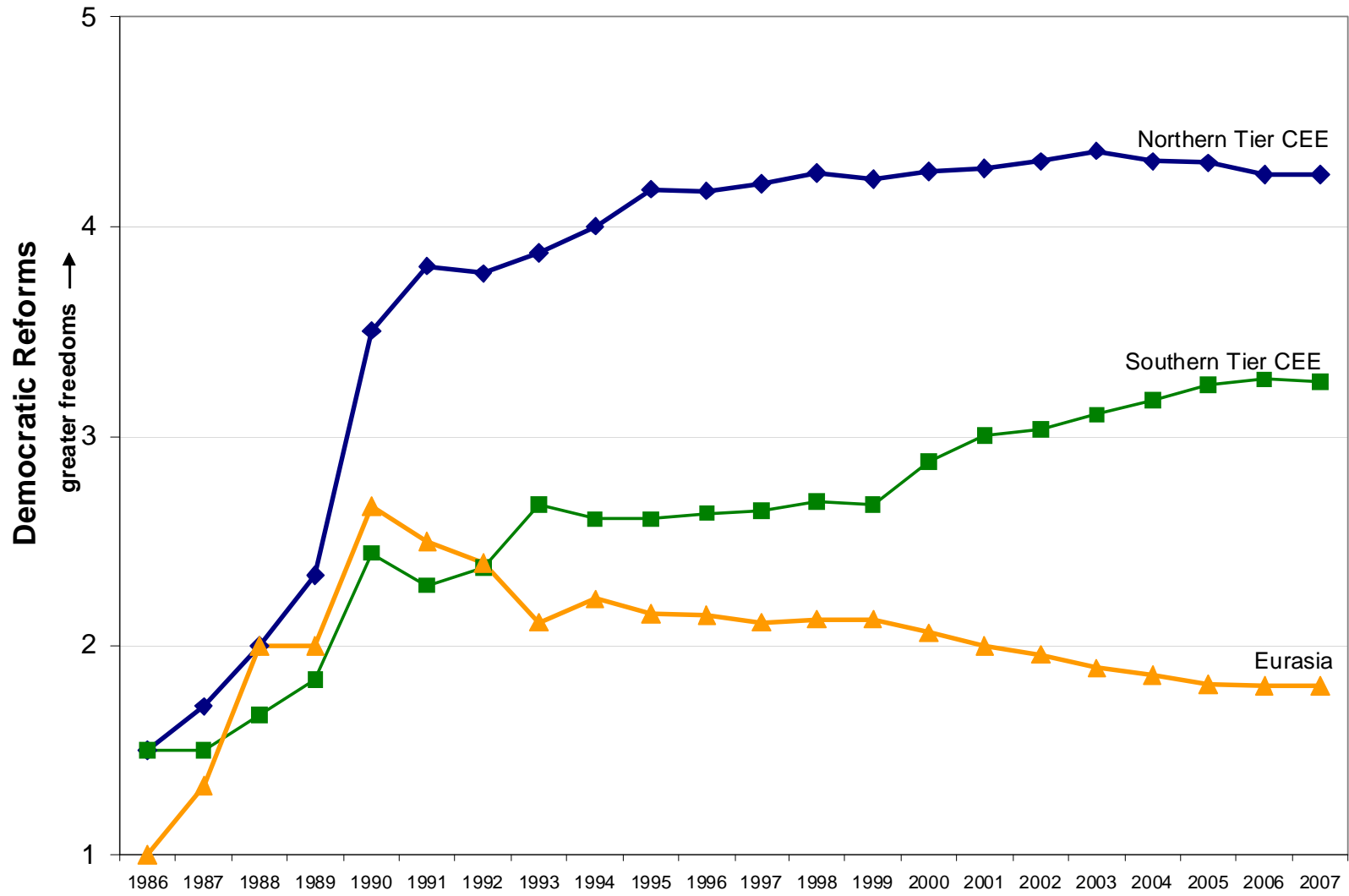
	<u>Electoral Process</u>		<u>Civil Society</u>		<u>Independent Media</u>		<u>National Governance</u>		<u>Local Governance</u>		<u>Rule of Law</u>		<u>Corruption</u>		<u>Democratic Reforms</u>	
SLOVENIA	4.7		4.3		4.2	↓	4.3		4.7		4.7		4.2		4.4	
ESTONIA	4.7		4.5	↑	4.7		4.2		4.0		4.7		4.0		4.4	
LATVIA	4.3		4.5		4.5	↓	4.3		4.2	↑	4.5		3.7		4.3	
CZECH REPUBLIC	4.5		4.8	↑	4.2		3.8	↑	4.5		4.3		3.5	↑	4.2	↑↑
HUNGARY	4.5		4.7		4.0		4.2		4.2		4.5		3.7		4.2	
LITHUANIA	4.5		4.5		4.5		4.0		4.0		4.5		3.2		4.2	
SLOVAKIA	4.7		4.7		4.0	↓	4.0	↓	4.2	↓	4.0	↓	3.5		4.1	↓↓
POLAND	4.3		4.8	↑	4.2		3.3	↓	4.2		4.0	↓	3.7		4.1	
BULGARIA	4.5		4.0		3.3		3.7		3.7		3.8		3.3	↑	3.8	
ROMANIA	3.8		4.2		3.2		3.2	↓	3.7		3.0	↓	3.0		3.4	↓
CROATIA	3.5		3.8		3.2	↑	3.5	↑	3.2		2.8		2.7	↑	3.2	↑↑
MONTENEGRO	3.5	↑	3.8	↑	3.2	↓	2.8	↑	3.5		3.0	↑	2.2	↑	3.1	↑↑
SERBIA	3.5		3.8		3.2	↓	3.0	↓	3.2		2.7	↓	2.7		3.1	↓↓
ALBANIA	3.0		3.7		3.2		2.8		3.8		3.0		2.3		3.1	
MACEDONIA	3.5		3.5		2.8		3.0	↓	3.2		3.0	↓	2.7		3.1	↓
BOSNIA & HERZ	3.7		3.3		2.8	↓	2.3	↓	2.5		3.0		2.8		2.9	↓
UKRAINE	3.7		3.8		3.3	↑	2.5		2.2		2.5	↓	1.8		2.8	
GEORGIA	2.5	↓	3.3		2.8	↓	1.8	↓	2.0		2.5		2.3		2.5	↓↓
MOLDOVA	3.2		3.2		2.0	↓	1.8		1.8		2.7		1.7		2.3	
ARMENIA	2.0	↑	3.3		1.8		2.2		2.0		2.2	↓	1.8		2.2	
KOSOVO	2.7		3.0	↑	2.0		2.0	↑	2.0		1.8		1.8	↑	2.2	↑↑
KYRGYZ REPUBLIC	1.7	↓	2.7		1.7	↓	1.5	↓	1.3	↓	1.7	↓	1.5	↓	1.7	↓↓
RUSSIA	1.2	↓	2.0	↓	1.5		1.5	↓	1.8		2.2		1.7		1.7	↓↓
AZERBAIJAN	1.3		2.2		1.5		1.7		1.7		1.8		1.5		1.7	
TAJIKISTAN	1.3		2.0	↓	1.7	↑	1.5		1.7	↓	1.7	↓	1.5		1.6	↓
KAZAKHSTAN	1.2	↓	2.0	↑	1.2		1.2		1.5		1.5		1.3		1.4	
BELARUS	1.0		1.3		1.2		1.0		1.2	↓	1.2		1.5		1.2	
UZBEKISTAN	1.0	↓	1.0		1.0		1.0		1.2		1.2		1.3		1.1	
TURKMENISTAN	1.0		1.0		1.0		1.0		1.2	↑	1.0		1.2		1.0	
Northern Tier CEE	4.5		4.5	↑↑	4.3	↓↓	4.0		4.2		4.4	↓	3.6		2.1	
Southern Tier CEE	3.5		3.7	↑	3.0	↓	3.0	↓	3.1		3.0	↓	2.6	↑↑	3.8	
Eurasia	1.8	↓↓	2.3		1.7		1.6	↓↓	1.7		1.9	↓↓	1.6		5.8	↓↓
Rom & Bul in 2002	4.3		3.5		3.3		3.2		3.2		3.3		2.8		3.3	
R,B,C in 2006	3.9		4.0		3.2		3.4		3.5		3.3		2.9		3.3	

Ratings are based on a scale from 1 to 5, with 1 representing most advanced--or, in the case of corruption, most free. Freedom House, Nations in Transit 2008 (June 2008).

A "↑" indicates an increase in democratization from January 1st, 2007 to December 31st, 2007; a "↓" signifies a decrease. One arrow represents a change greater than 0.1 and less than 0.5; two arrows represents change 0.5 and greater.

Figure 7

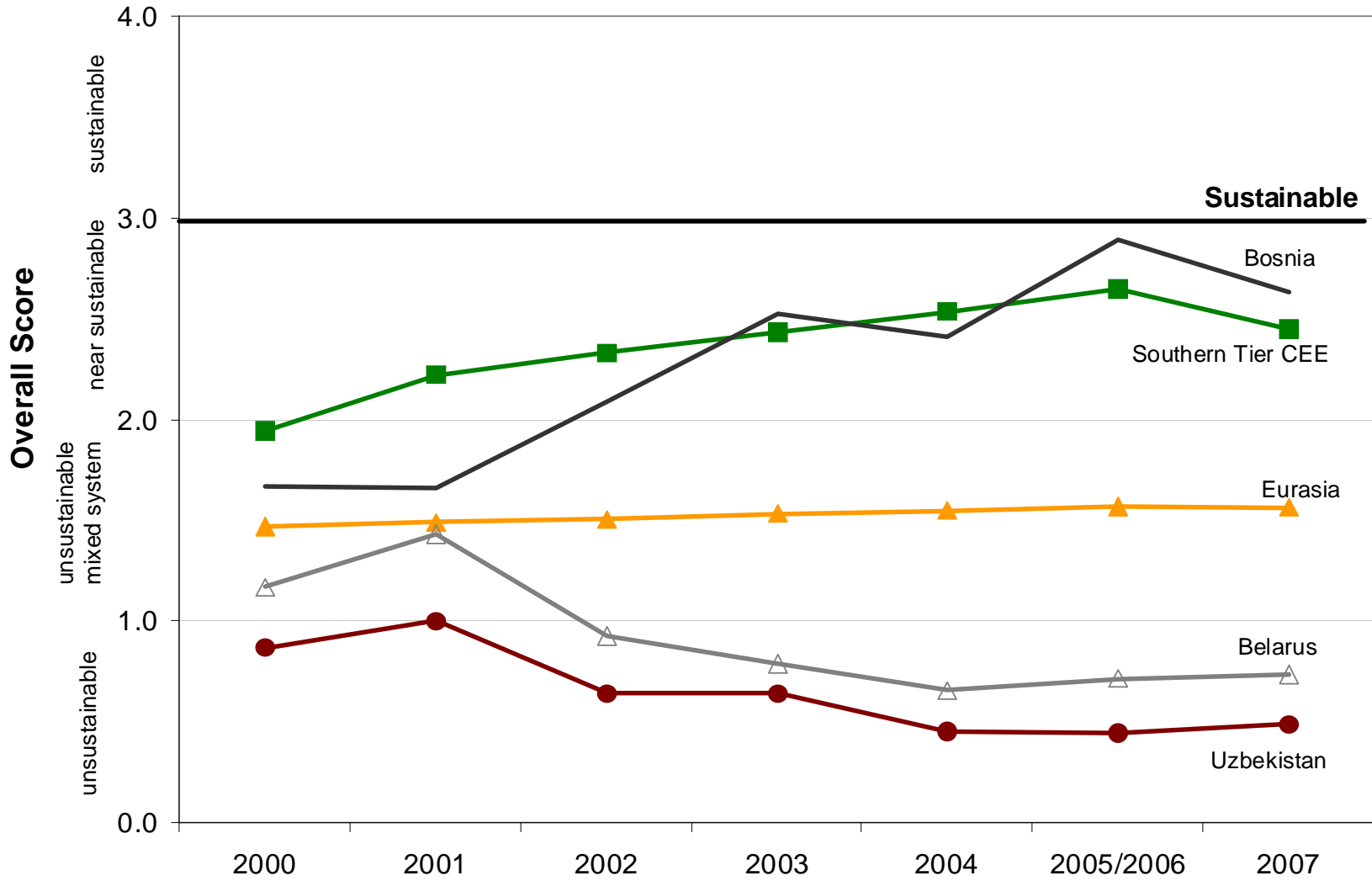
Democratic Reforms



Ratings from 1 to 5, with 5 representing greatest development of democratic reforms. Freedom House, *Freedom in the World 2008* (December 2007 and previous editions), *Nations in Transit 2008* (June 2008).

Figure 8

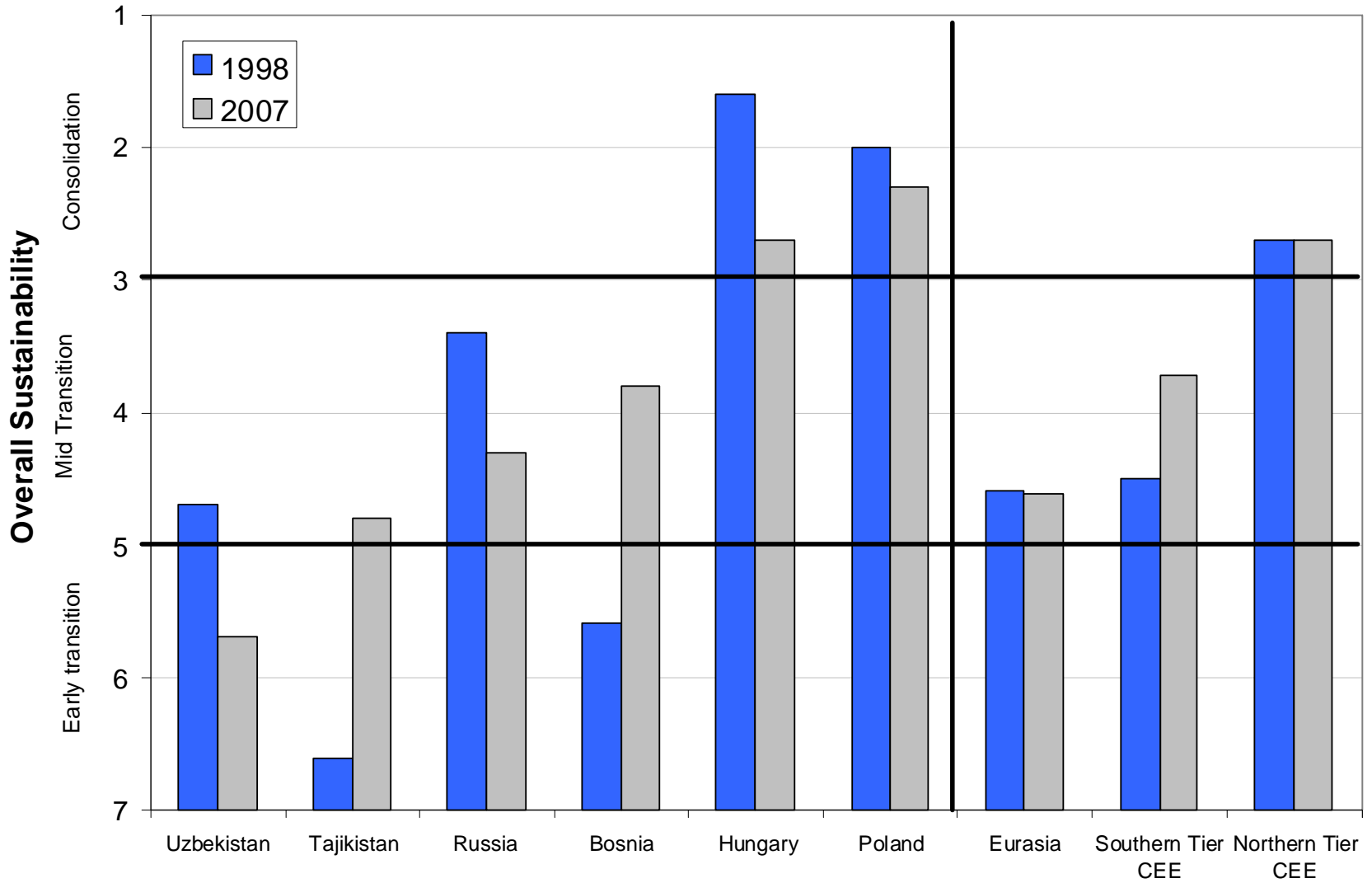
Media Sustainability Index



IREX, *Media Sustainability Index 2008* (2008).

Figure 9

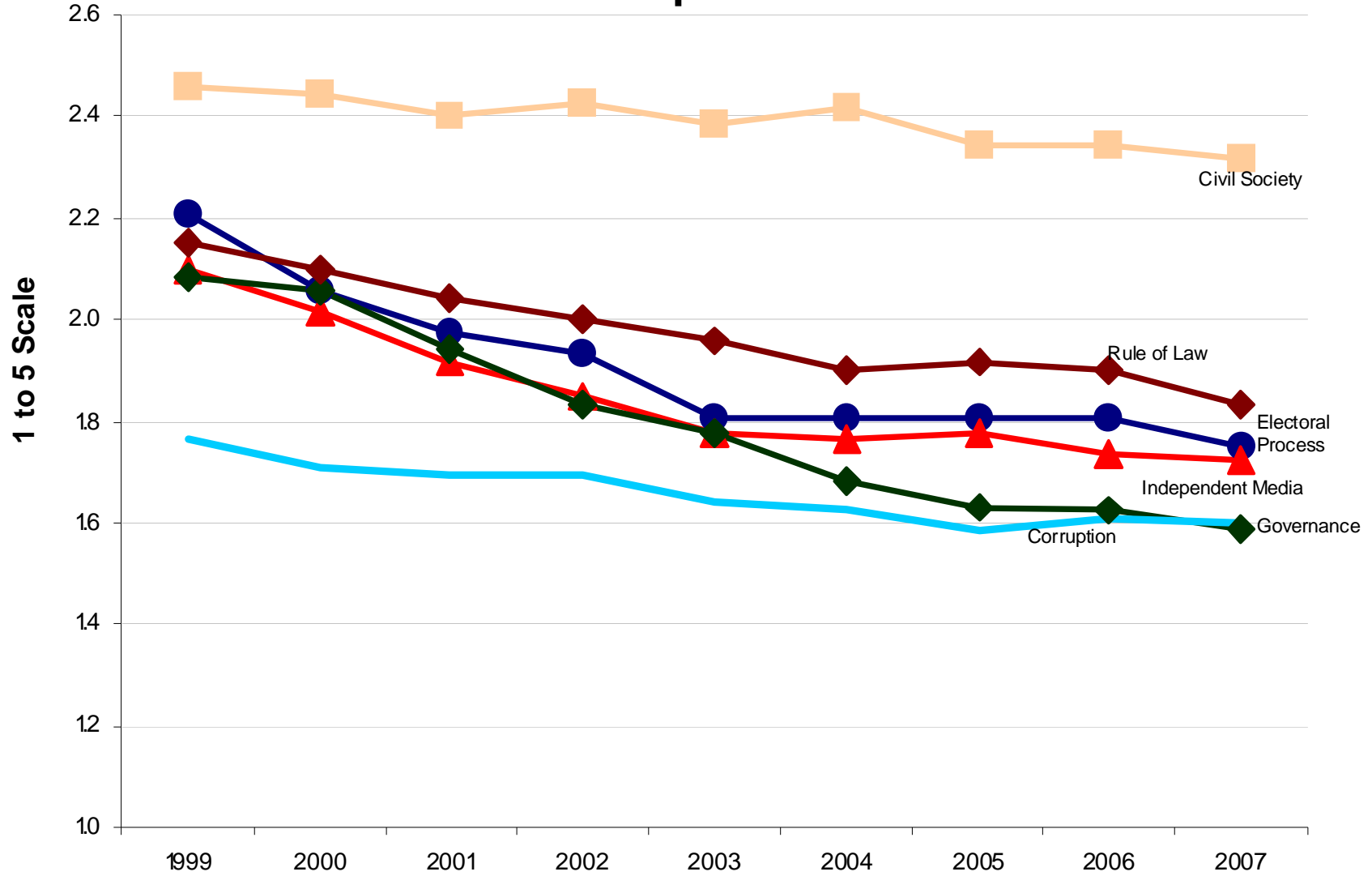
NGO Sustainability Index



USAID/EE/DGST, *The 2008 NGO Sustainability Index for Central and Eastern Europe and Eurasia* (June 2008).

Figure 10

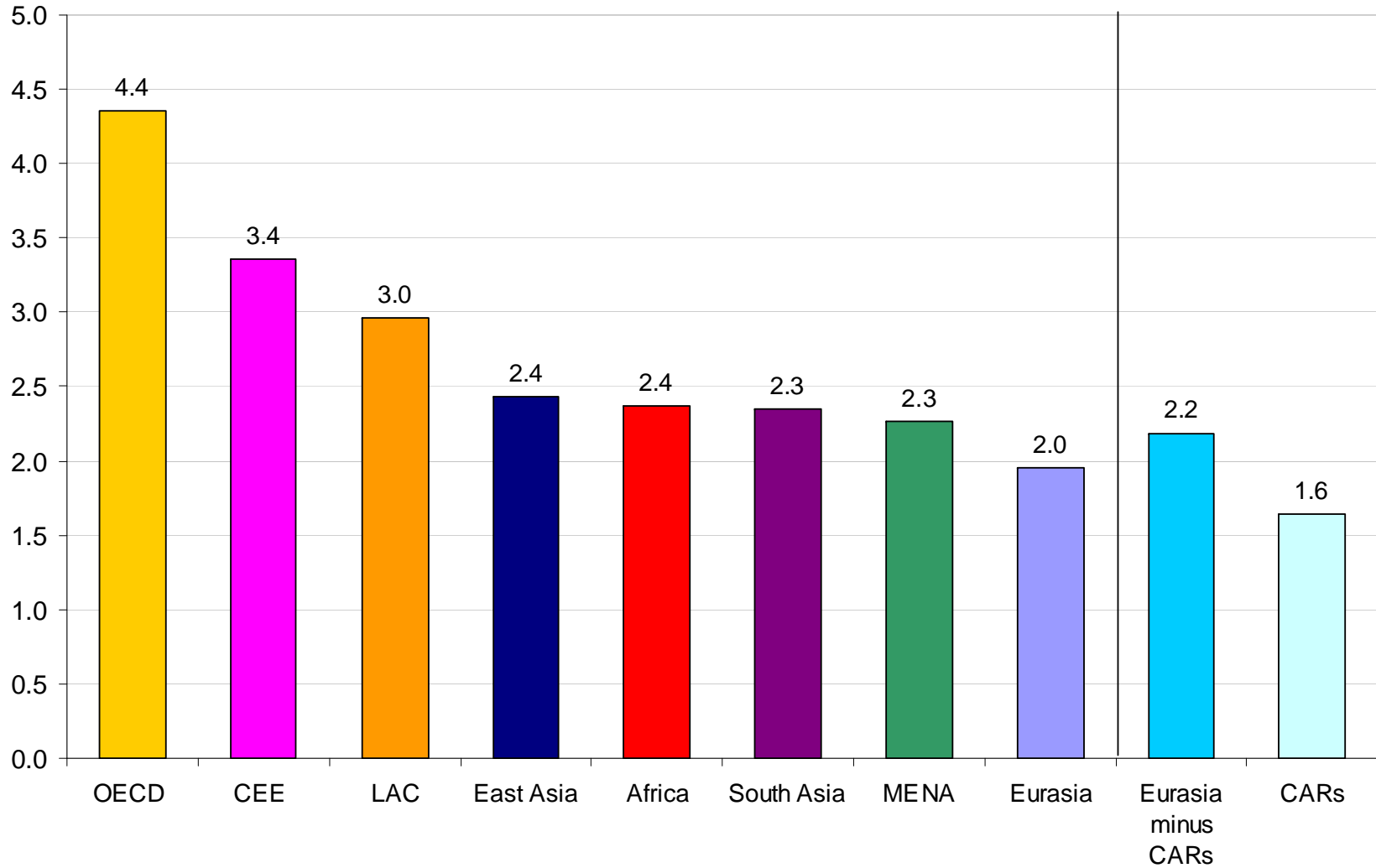
Democratic Reform Components In Eurasia over Time



Freedom House, *Nations in Transit 2008* (June 2008).

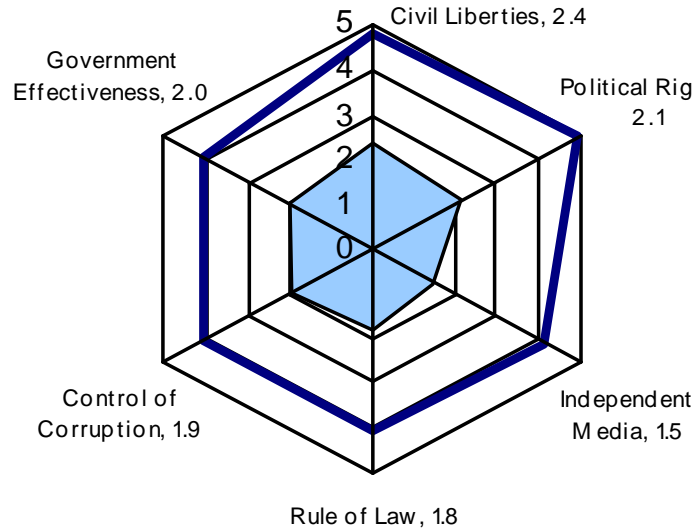
Figure 11

Governing Justly and Democratically in the World

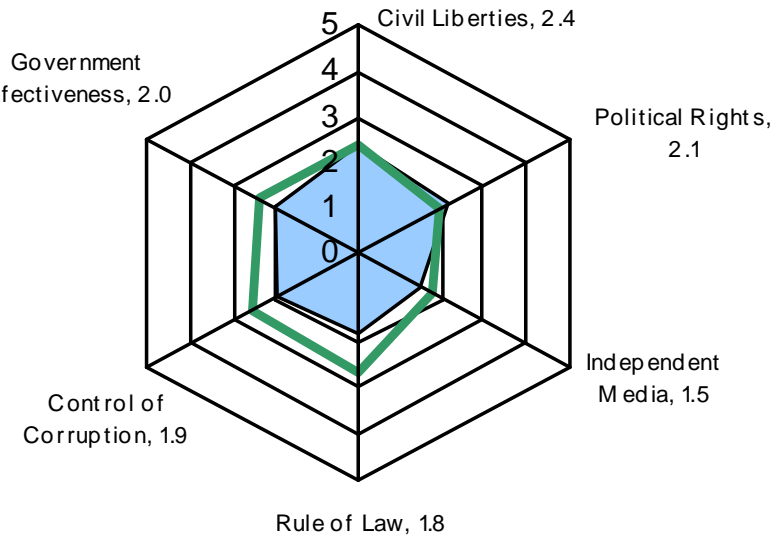


Ratings are based on a scale from 0.5 to 5.0, with 5 representing the best score. World Bank Institute, *Governance Matters Indicators* (2007); Freedom House, *Freedom in the World* 2008 (December 2007), and *Freedom of the Press* 2008 (2007).

Governing Justly and Democratically



Eurasia vs. OECD

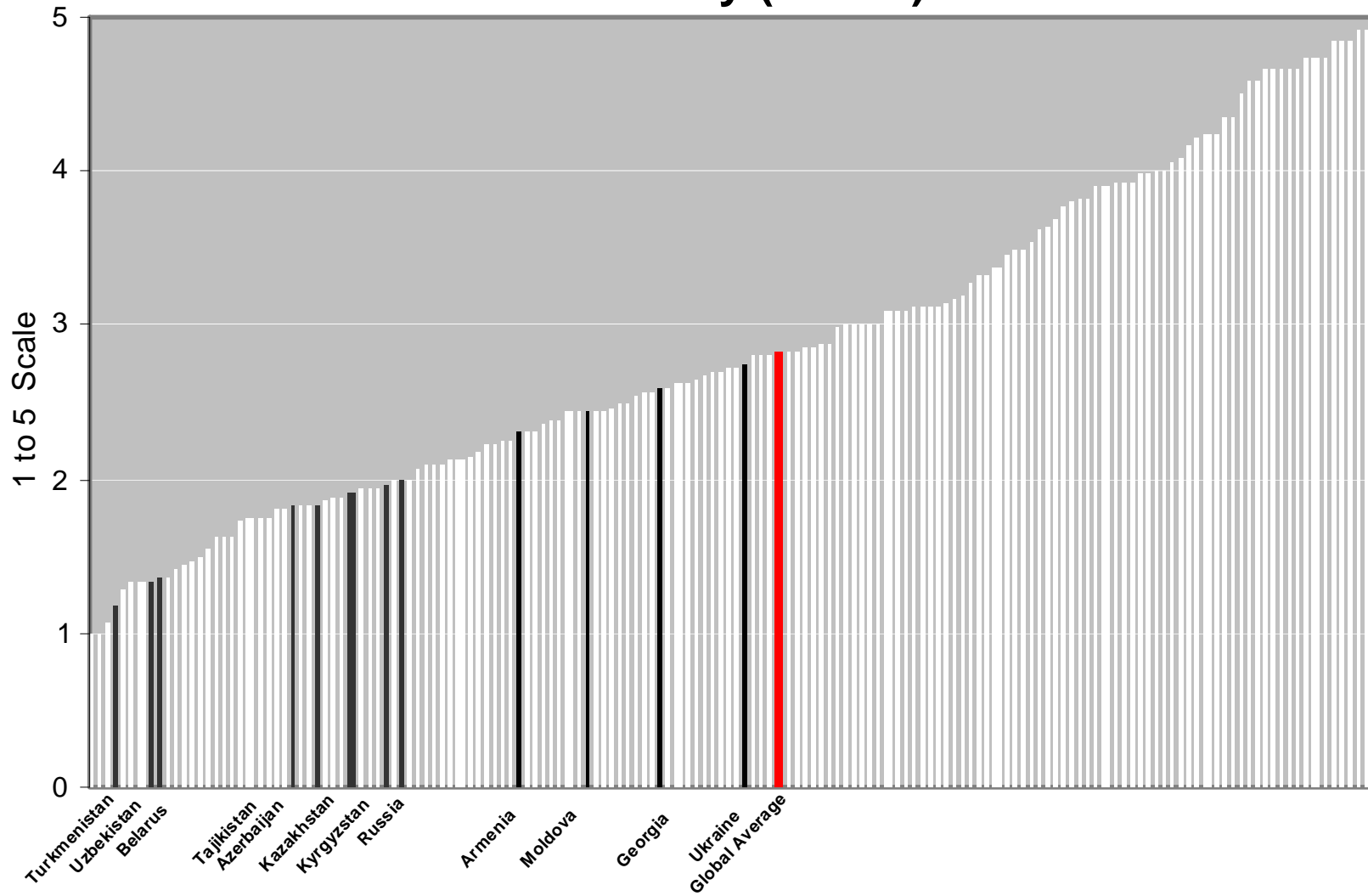


Eurasia vs. Middle East/ North Africa

Ratings are based on a scale from 0.5 to 5.0, with 5 representing the best score. World Bank Institute, *Governance Matters Indicators* (2007); Freedom House, *Freedom in the World 2008* (December 2007) and *Freedom of the Press 2008*.

Figure 14

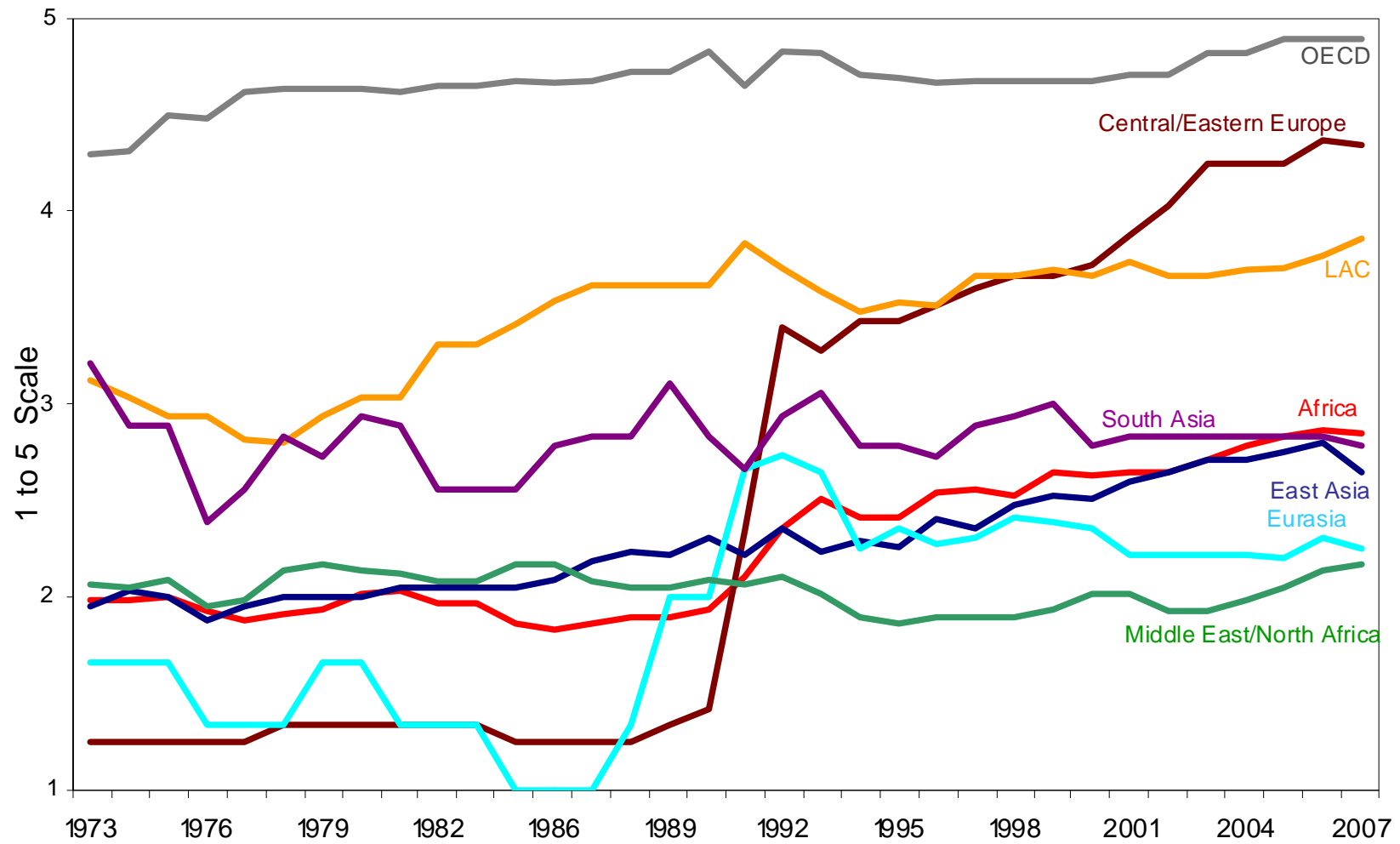
Eurasia vs. Global Dataset for Governing Justly & Democratically (n=153)



Ratings are based on a scale from 0.5 to 5.0, with 5 representing the best score. World Bank Institute, *Governance Matters Indicators* (2007); Freedom House, *Freedom in the World 2008* (December 2007), and *Freedom of the Press 2008* (2007).

Figure 15

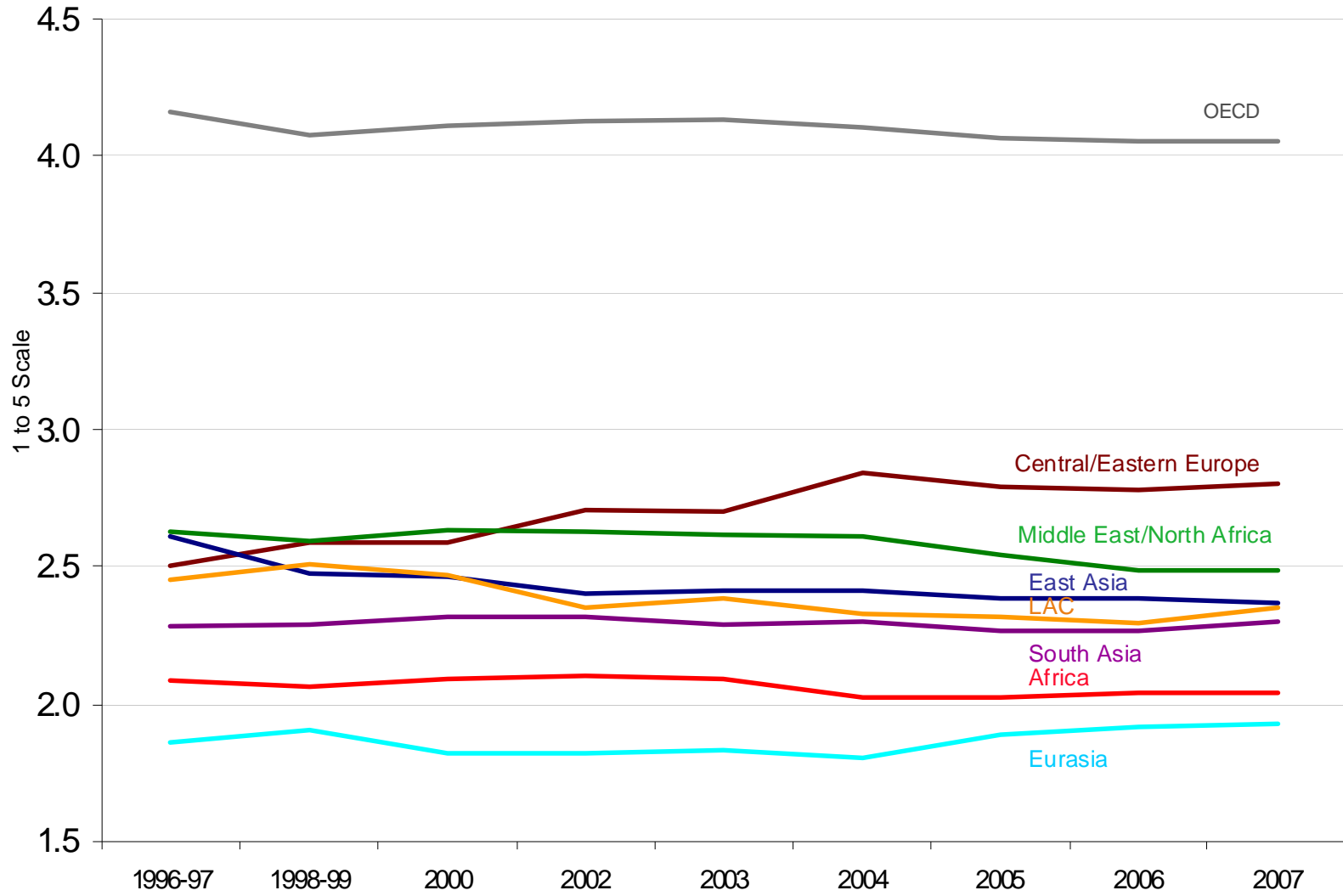
Freedom in the World – 1972-2007



Freedom House, *Freedom in the World 2008* (December 2007). These data combine Freedom House's political rights & civil liberties indicators. The CEE OECD countries are included in the CEE country grouping only.

Figure 16

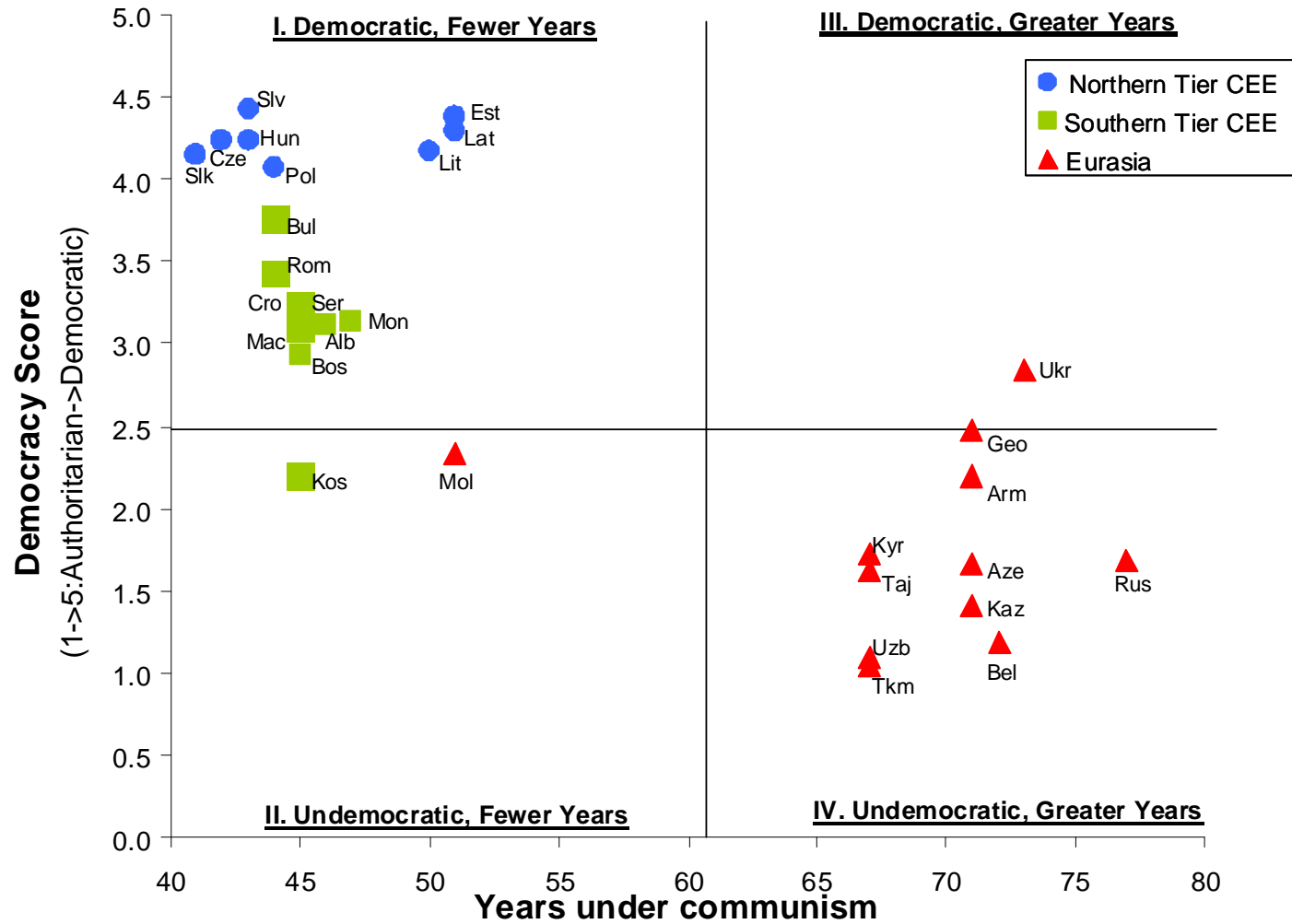
Institutions of Governance



Freedom House, *Freedom in the World 2008* (December 2007). These data combine Freedom House's political rights & civil liberties indicators. The CEE OECD countries are included in the CEE country grouping only.

Figure 17

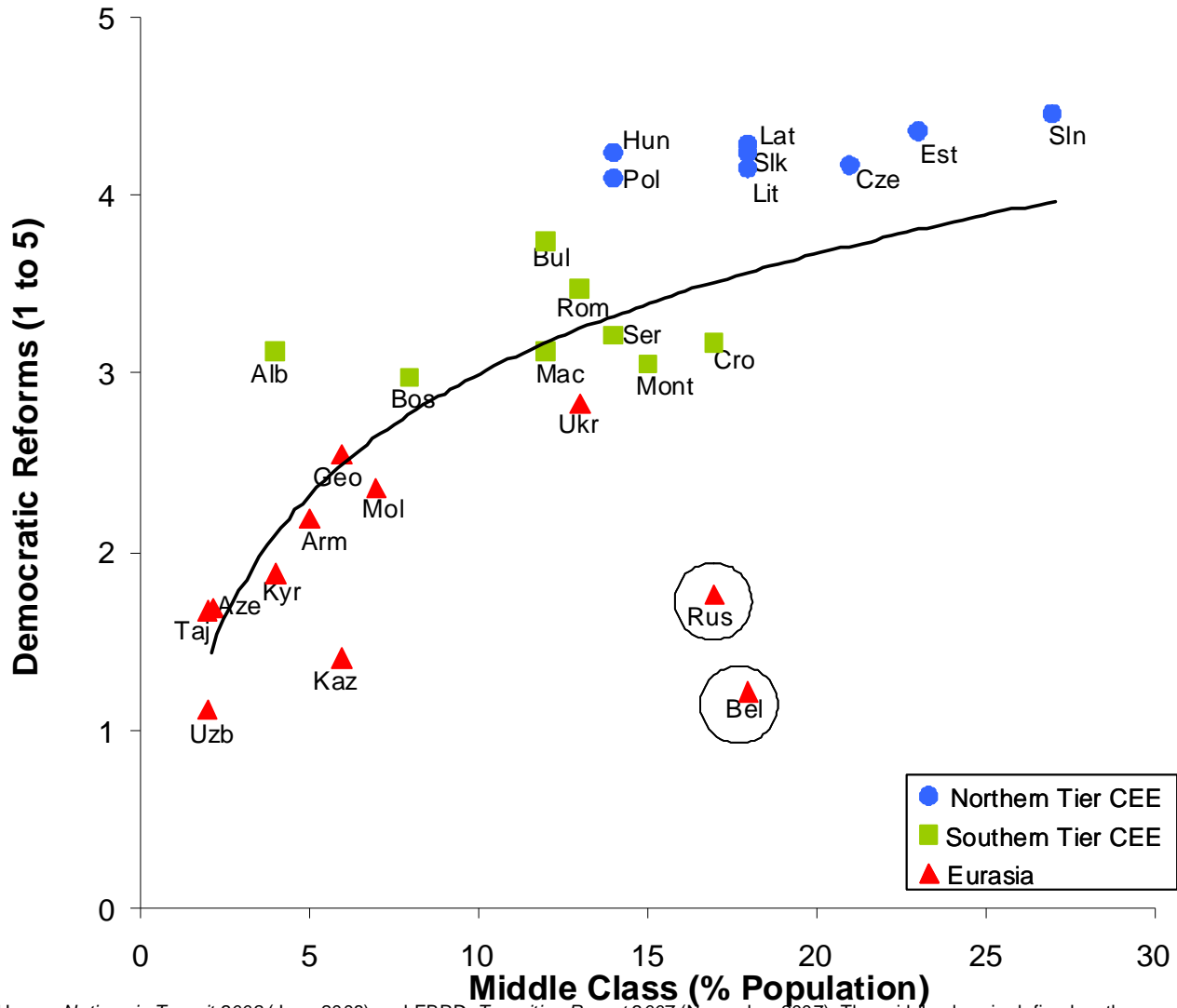
Duration of communism in relation to Democracy Score



USAID calculated from Economist Intelligence Unit, *Country Briefings* (2008) and Freedom House, *Nations in Transit 2008* (June 2008)..

Figure 18

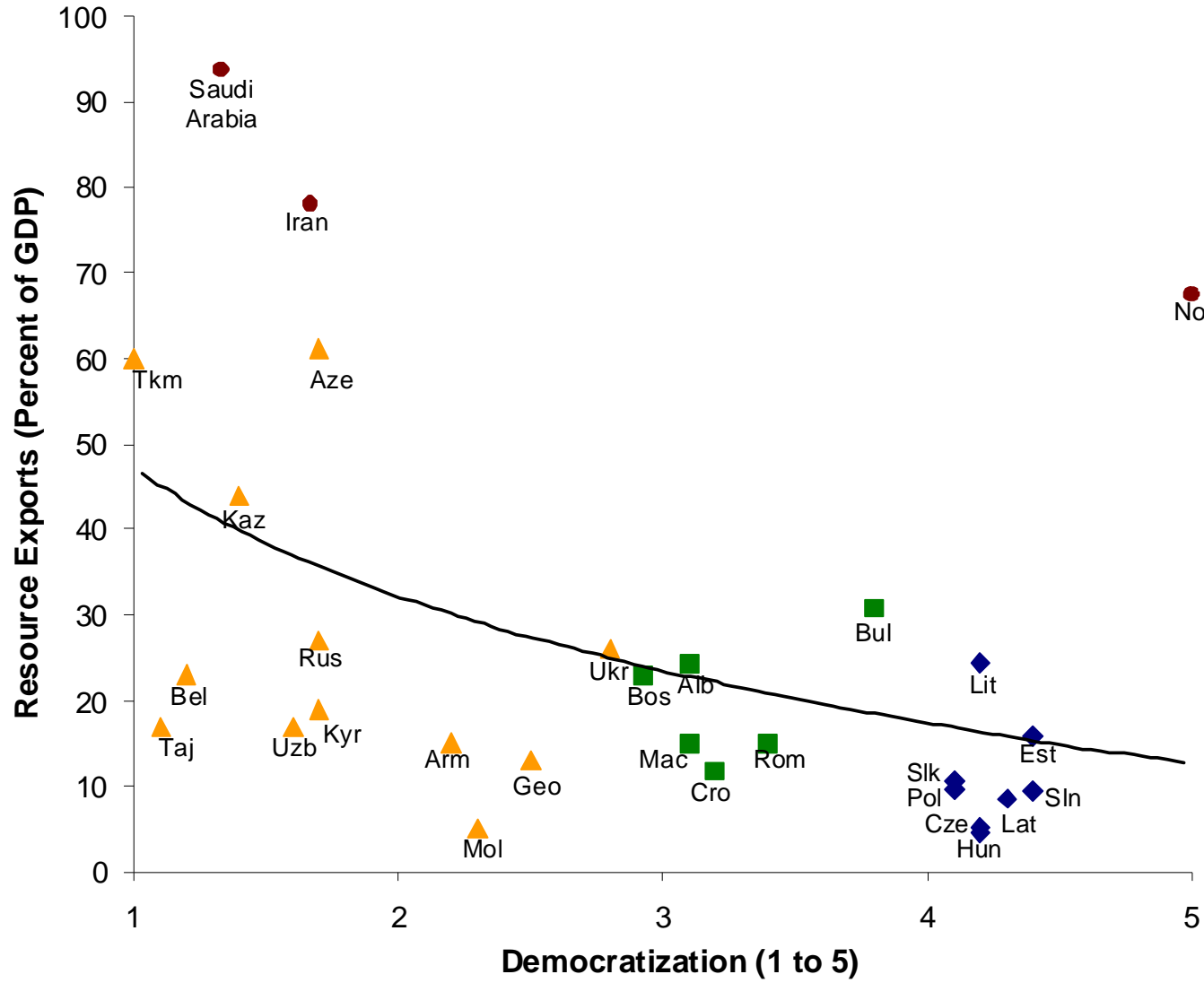
Democracy & the Middle Class



Freedom House, *Nations in Transit 2008* (June 2008) and EBRD, *Transition Report 2007* (November 2007). The middle class is defined as the ownership per household of two or more of the following, a car, a secondary residence, a computer and/or internet access at home and either a post-secondary degree or experience in a skilled professional occupation during a person's working life.

Figure 19

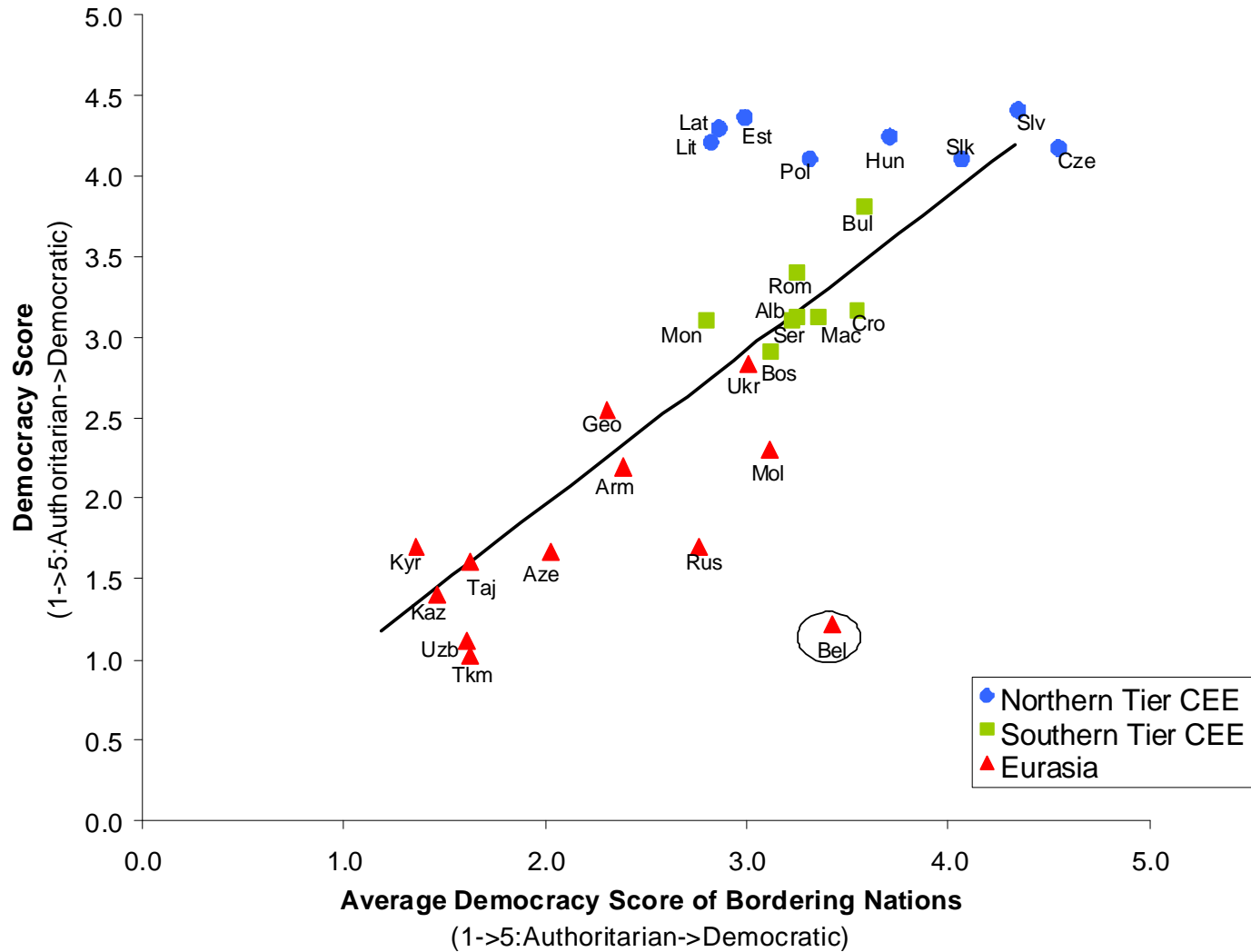
The Resource Curse?



Freedom House, *Nations in Transit 2008* (June 2008) and UN, *ComTrade Database* (2008). Resource exports include fuels, ores, metals & precious stones.

Figure 20

Democracy Scores in relation to Contiguous States



Freedom House, *Nations in Transit 2008* (June 2008) and *Freedom in the World 2008* (December 2007).

Figure 21

Freedom in the World 2008



(3) Economic Performance and Human Capital

Table 6 and *Figure 22* summarize the status of economic performance and human capital in the transition region using the MCP indices. Primary sources include the World Bank (*World Development Indicators*), the EBRD (*The Transition Report*), the IMF (*World Economic Outlook* and various country reports), the Asian Development Bank (*Outlook*), UNICEF (the *TransMonee* dataset), UNDP, Economist Intelligence Unit (various country reports), UNECE, the Fund for Peace (*Failed States Index*), the International Labor Organization, and the World Health Organization.

Considerable changes to the methodology of both economic performance and human capital indices have taken place since *MCP #10* (August 2006). During the fall of 2007 through winter of 2008, an E&E Bureau-wide Graduation Criteria Working Group convened to help conceptualize and measure Administrator Fore's concept of "graduation to sustainable partnerships" in the E&E region. A by-product of those discussions was the advancement towards measuring the MCP indices of economic performance and human capital. Colleagues from the field provided very key reality checks to the largely Washington-based discussions. Video conference calls with USAID/Sarajevo and USAID/Kiev in particular proved to be very helpful.

On February 21, 2008, the EUR/ACE Coordinator convened an interagency (Sub-PCC) meeting to review the proposed changes to the MCP system that stemmed from the E&E working group. During the Sub-PCC, there was general consensus that the proposed changes to the economic performance and human capital indices would provide a more accurate measurement of countries' progress, and the decision was made that these changes should be put into effect.¹²

Most of the changes in measurement have occurred in the economic performance index which now has ten indicators: (1) private sector share of GDP (same as before); (2) share of total employment in micro, small, and medium sized enterprises (previously, we measured only the share of employment in small and medium firms); (3) an index incorporating export share of GDP, manufactured exports as a percent of total exports, and high tech exports as a percent of total exports (previously, we measured only export share of GDP); (4) per capita foreign direct investment (FDI), the most recent five years (previously we measured per capita FDI cumulative since 1989); (5) the most recent five years of annual average economic growth rate (previously we used the most recent GDP as a percent of 1989 GDP); (6) an index of macroeconomic stability which includes the average of the most recent average annual three year inflation rate, external debt as a percent of GDP, current account balance as percent of GDP, and fiscal balance as a

¹² Consideration was also given to changing the phase-out thresholds that had been used in the MCP system to guide USG decisions towards graduating E&E countries from USG assistance. USAID recommended a new threshold based on the year in which USG assistance to Romania, Bulgaria, and Croatia was phased out (2006) rather than the year that Romania and Bulgaria were invited to join NATO and received favorable indications regarding European Union membership (2002). While the Coordinator acknowledged that the proposed higher assistance phase-out thresholds more accurately reflect the level of transition progress that permitted the USG to end assistance to Bulgaria, Romania, and Croatia, the decision to change the phase-out thresholds was deferred.

percent of GDP (previously, we used two of these indicators as separate parts of the six indicator economic performance index: external debt and inflation rate); (7) domestic inequality, an average of three types of inequality: by culture and religion; population quintile; and regions within country (previously, there was no inequality measure); (8) long-term unemployment as a percent of total employment (previously, there was no such indicator in the economic performance index); (9) services as a percent of GDP (previously no such indicator); and (10) energy security measured as the average of energy efficiency and energy dependence (previously no such indicator).

The human capital index now has seven indicators: (1) per capita income in purchasing power parity terms (same as before); (2) life expectancy (same as before); (3) under five mortality rate (same as before); (4) an index of education gaps which combines twelve indicators which attempt to measure either the quantity of education (such as enrollments) or the quality of education, drawing from various surveys of functional literacy (previously, we used secondary school enrollment as the primary education indicator in the human capital index); (5) the average of public expenditures on education and health as a percent of GDP (previously, we used both of these indicators as separate indicators, as two of the six indicators in the human capital index); (6) tuberculosis incidences per 100,000 (no such indicator previously); and (7) vulnerable populations which combines the proportion of children and elderly in poverty at \$2.15 per day and the rate of institutionalized children (previously, there was no such indicator in the human capital index).¹³

Figures 23 and 24 compare economic and democratic reform progress in the region with economic performance and human capital. The three primary sub-regions are generally less distinguishable by progress in macroeconomic performance and human capital than they are in reforms. While the Northern Tier CEE countries are generally out front on both dimensions, the Southern Tier CEE and Eurasian countries are less distinguishable between each other, particularly in economic performance.

Sub-regional country outliers in *Figure 24* include Belarus, Ukraine, Kosovo, and Croatia. Human capital in Belarus is well above the Eurasian average, and closer to the

¹³ Two indicators have been given a double-weight over the others. The economic growth indicator is counted twice in the economic performance indicator (because it is arguably the most important of the 10 indicators), and the education gap indicator is counted twice in the human capital index (to give the education dimension equal weight with the health dimension in the index). The Graduation Criteria Working Group also considered different weighting schemes for the economic and democratic reform indices. In the end, however, while agreement was obtained on which indicators are more important, there was no agreement on how important and, hence, how to show that empirically. The decision to error on the side of keeping the method simple by equally weighting all the reform indicators was facilitated by a sensitivity analysis which showed that the results changed very little from different weighting schemes.

The *Appendix* provides elaboration of indicator definitions. For elaboration of much of the discussion, issues, and analyses that stemmed from the E&E Graduation Criteria Working Group, see: (1) USAID/E&E, *The Monitoring Country Progress in Eastern Europe & Eurasia System: Some analysis and proposed changes* (June 25, 2008); (2) USAID/E&E, *E&E Graduation Criteria Working Group: Issues and Parameters* (October 1, 2007); and (3) U.S. State Department, EUR/ACE, *Sub-PCC Discussion of Proposed Changes to How the USG Measures Reform in Europe & Eurasia* (March 31, 2008). All are available upon request.

Southern Tier CEE average. Ukraine is also significantly advanced in human capital relative to Eurasian standards as well as the Eurasian leader on economic performance; its profile overall is closer to that of the Southern Tier CEE countries. Kosovo, on the other hand, has a profile closer to Eurasia's than that found in the Southern Tier CEE; i.e., Eurasian average on human capital and below Eurasian average on economic performance. Finally, Croatia's profile resembles that of the Northern Tier CEE countries and scores particularly well on human capital.

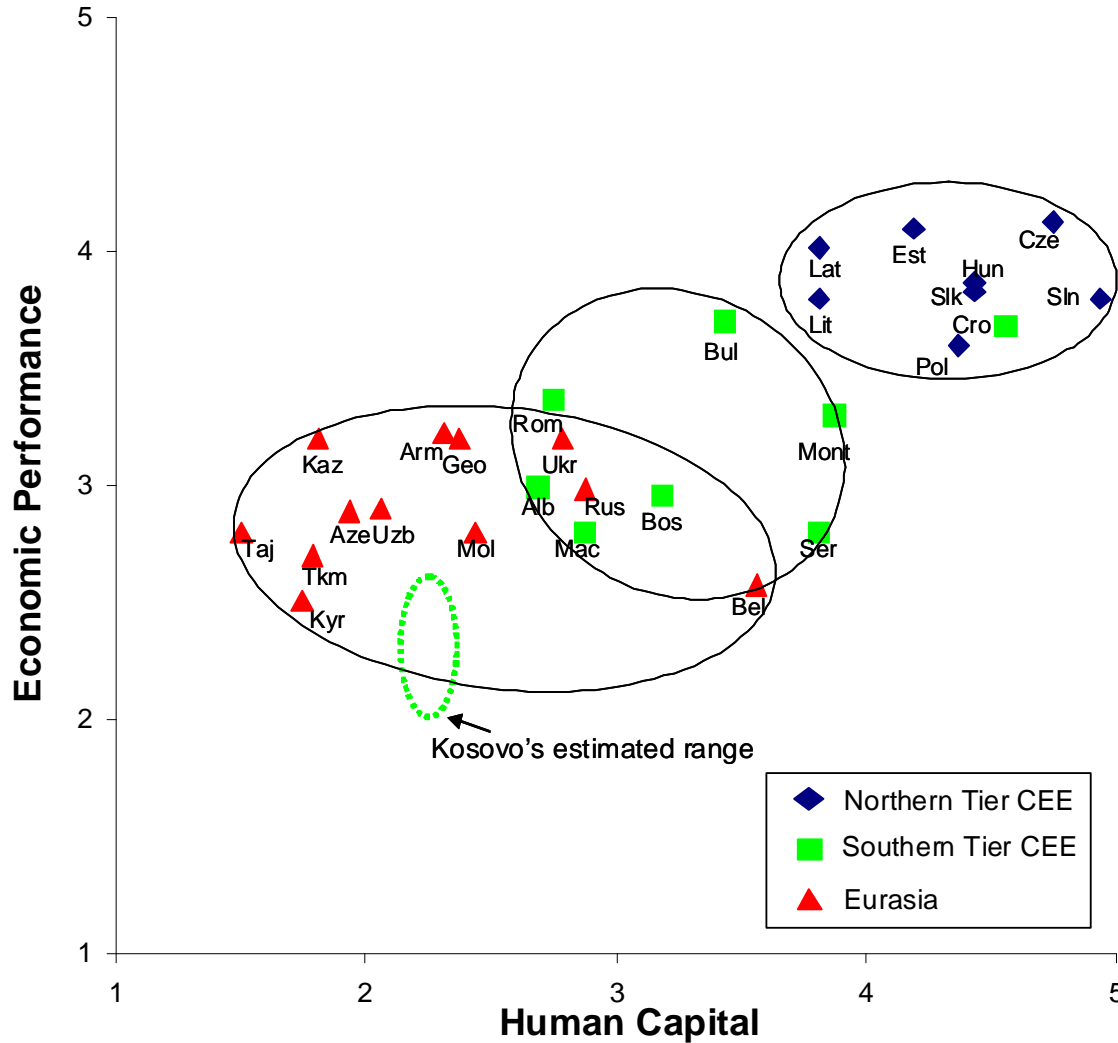
Broadly, the current cross-country picture of economic performance and human capital (*Figure 22*) is roughly similar to the cross-country picture of economic and democratic reforms in 1998 (*Figure 2*). One working hypothesis is that one will see (or is beginning to see) a pattern of change over time in economic performance and human capital which is similar to what has happened in the economic and democratic reform dimensions; namely, the economic performance and human capital profiles within the three sub-regions will become increasingly similar while such profiles between the sub-regions will become increasingly different. This will largely depend on the extent to which economic and democratic reforms drive changes in economic performance and human capital.

The range in human capital in E&E is much larger than is the variability of economic performance across the region. On most, though not all, dimensions, human capital in much of the Northern Tier CEE countries and in Croatia approaches advanced industrial market economy standards. The under five mortality rate in the European Union (EU) is four deaths per 1,000 live births; it is seven deaths on average in the Northern Tier CEE (four deaths in the Czech Republic and Slovenia), and six deaths in Croatia. Life expectancy in the EU is eighty years; it is seventy-four years in the Northern Tier CEE countries on average, highest in Slovenia at seventy-eight. Educational gaps, both in terms of enrollments, public expenditures, and functional literacy are roughly comparable between the Northern Tier CEE countries and Western Europe. Perhaps the largest human capital gap between the Northern Tier CEE countries and Western Europe is per capita income: \$31,000 in purchasing power parity terms in the EU vs. \$18,700 in the Northern Tier CEE (and \$15,000 in Croatia). Slovenia, at \$25,000 per capita income, comes closest to the Western Europe average.

Human capital in E&E as measured by the MCP index is weakest in Central Asia, and within Central Asia, it is weakest in Tajikistan. Even Tajikistan, however, human capital conditions are notably more favorable on most, though not all, dimensions as compared to Sub-Saharan Africa. The under five mortality rate is far higher in Sub-Saharan Africa than in Central Asia: 157 deaths per 1,000 live births vs. sixty-eight deaths in Tajikistan and fifty-one deaths in Turkmenistan (highest in E&E is Azerbaijan at eighty-eight deaths). Life expectancy in Sub-Saharan Africa is fifty years; it is sixty-three years in Turkmenistan and sixty-seven years in Tajikistan. Per capita income in Africa is \$1,700 which is what it is in Tajikistan. Secondary school education enrollment rates in Sub-Saharan Africa at 31% are actually slightly higher than those found in Tajikistan, with 27% enrollment. Tertiary enrollments in Sub-Saharan Africa are five percent on average; in Tajikistan these enrollments are thirteen percent of the tertiary age population.

Figure 22

Economic Performance and Human Capital in 2006-2008



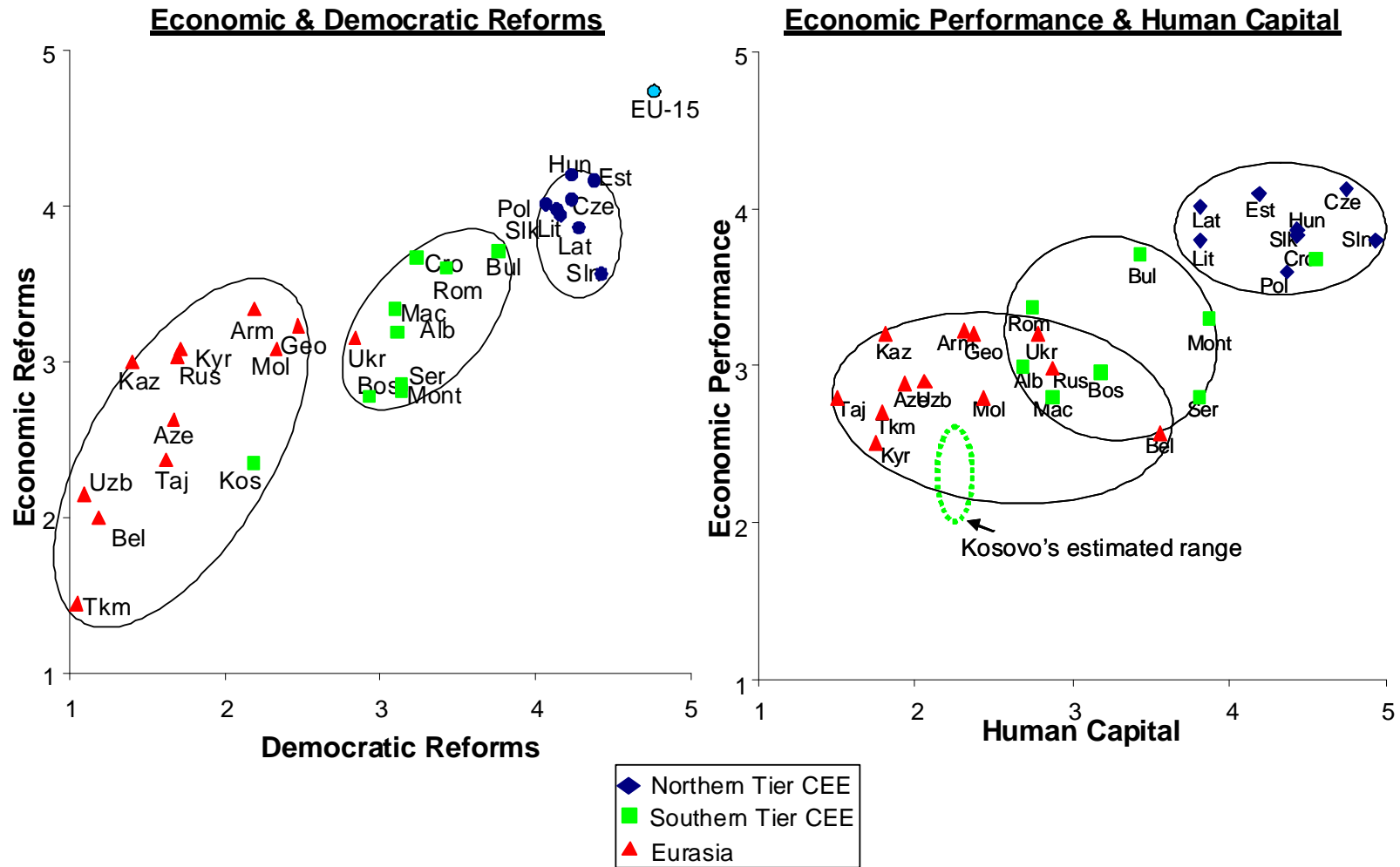
Ratings are based on a scale from 1 to 5, with 5 representing the best score. World Bank, *World Development Indicators 2008* (April 2008); EBRD, *Transition Report 2008* (November 2008), UNECE, *Statistical Division Database* (2008); Fund for Peace, *Failed States Index* (2008); IFC & World Bank, *MSME Database* (2007); UNICEF, *TransMONEE Database* (August 2008); World Health Organization European Health For All Database (2008); Murphy, Petric and Sprout, *Education in Eastern Europe & Eurasia*, USAID/E&E Working Paper #2 (October 2005); IEA, *PIRLS 2008 International Report* (2008) and OECD, *PISA 2006 Science Competencies for Tomorrow's World* (December 2007).

**Table 6. Economic Performance and Human Capital
in Central and Eastern Europe & Eurasia: 2006-2008**

	<u>ECONOMIC PERFORMANCE</u>		<u>HUMAN CAPITAL</u>		
	<u>RATING</u> (1 to 5)	<u>RANKING</u>	<u>RATING</u> (1 to 5)	<u>RANKING</u>	
ESTONIA	4.1	1	CZECH REPUBLIC	4.8	1
CZECH REPUBLIC	4.1	1	CROATIA	4.6	2
LATVIA	4.0	3	SLOVENIA	4.6	2
HUNGARY	3.9	4	POLAND	4.4	4
LITHUANIA	3.9	4	HUNGARY	4.3	5
SLOVAKIA	3.9	4	SLOVAKIA	4.3	5
SLOVENIA	3.7	7	ESTONIA	4.3	5
CROATIA	3.7	7	MONTENEGRO	3.9	8
BULGARIA	3.7	7	SERBIA	3.9	8
POLAND	3.7	7	LATVIA	3.8	10
ROMANIA	3.5	11	BELARUS	3.6	11
UKRAINE	3.2	12	LITHUANIA	3.6	11
GEORGIA	3.3	13	BULGARIA	3.4	13
KAZAKHSTAN	3.3	13	BOSNIA & HERZEGOVINA	3.3	14
ARMENIA	3.3	13	MACEDONIA	3.0	15
MONTENEGRO	3.3	13	UKRAINE	3.1	16
ALBANIA	3.0	17	RUSSIA	2.9	17
RUSSIA	3.0	17	ALBANIA	2.8	18
BOSNIA & HERZ.	3.0	17	ROMANIA	2.8	18
TAJIKISTAN	2.9	20	KOSOVO	2.1	20
AZERBAIJAN	2.9	20	MOLDOVA	2.4	21
MOLDOVA	2.8	22	GEORGIA	2.4	21
UZBEKISTAN	2.9	23	AZERBAIJAN	2.2	23
SERBIA	2.9	23	ARMENIA	2.2	23
MACEDONIA	2.9	23	KYRGYZ REPUBLIC	2.0	25
TURKMENISTAN	2.8	26	UZBEKISTAN	1.9	26
BELARUS	2.6	27	KAZAKHSTAN	1.8	27
KYRGYZ REPUBLIC	2.6	27	TAJIKISTAN	1.8	27
KOSOVO	---		TURKMENISTAN	1.8	27
Rating (1 to 5)			Rating (1 to 5)		
Northern Tier CEE	3.9		Northern Tier CEE	4.3	
Southern Tier CEE	3.2		Southern Tier CEE	3.4	
Eurasia	2.9		Eurasia	2.2	
Rom, Bul, Cro in 2006	3.5		Rom, Bul, Cro in 2006	3.5	

Ratings are based on a scale from 1 to 5, with 5 representing the best score. World Bank, *World Development Indicators 2008* (April 2008); EBRD, *Transition Report 2008* (November 2008), UNECE, *Statistical Division Database* (2008); Fund for Peace, *Failed States Index* (2008); IFC & World Bank, *MSME Database* (2007); UNICEF, *TransMONEE Database* (August 2008); World Health Organization European Health For All Database (2008); Murphy, Petric and Sprout, *Education in Eastern Europe & Eurasia*, USAID/E&E Working Paper #2 (October 2005) and IEA, *PIRLS 2008 International Report* (2008).

Monitoring Country Progress



Ratings are based on a scale from 1 to 5, with 5 representing the best score. Freedom House, *Nations in Transit 2008* (June 2008) and EBRD, *Transition Report 2008* (November 2008); World Bank, *World Development Indicators 2008* (April 2008); UNECE, *Statistical Division Database* (2008); Fund for Peace, *Failed States Index* (2008); IFC & World Bank, *MSME Database* (2007); UNICEF, *TransMONEE Database* (August 2008); World Health Organization European Health For All Database (2008); Murphy, Petric and Sprout, *Education in Eastern Europe & Eurasia*, USAID/E&E Working Paper #2 (October 2005); IEA, *PIRLS 2008 International Report* (2008) and OECD, *PISA 2006 Science Competencies for Tomorrow's World* (December 2007).

Economic performance

Table 7 provides the primary data (converted to a one to five score) for the ten indicators of the economic performance index. *Tables 8* through *12* provide the disaggregated data that goes into *Table 7*.

Economic growth in the transition region continues to be well above the global average (*Figure 25*). In fact, economic growth in the transition region has exceeded the global average every year since 2000 through 2007, and is forecast to do the same in 2008 and 2009. From 2000-2007, the E&E region experienced annual average economic growth of 6%; the global 2000-2007 annual average was 4.1%. Since 1999, the highest economic growth within the E&E sub-regions has been in Eurasia, and this trend is forecast to continue in 2008 and 2009.

The 2008 and 2009 economic growth figures are from the IMF's recently-released November 2008 *World Economic Outlook*. In this assessment, the IMF substantially revised economic growth downward from its estimates of only a month before. These figures hence reflect some initial estimates of the impact of the unfolding global financial crisis. The E&E region has not been immune to the global crisis. A rough first approximation of the impact of the global financial crisis is to compare economic growth rates in 2007 with forecasts for 2009. For the E&E region overall, economic growth is forecast to be 4.3% lower in 2009 than 2007 growth, roughly a 60% decrease from 7.2% economic growth in 2007 to 2.9% economic growth in 2009.

However, as shown in *Table 13*, the change in economic growth rates between 2007 and 2009 differs widely across the transition countries. Ten transition countries are forecast to have economic growth in 2009 at least five percentage points lower than that in 2007. This includes four Northern Tier CEE countries (the three Baltic states and Slovakia), five Eurasian countries (the three Caucasus countries, Kazakhstan, and Ukraine) and one Southern Tier CEE country (Montenegro). Other events are contributing to the slowdown in economic growth in these countries, of course; war between Russia and Georgia, e.g., has had a significant added negative impact on growth in the Caucasus. In some countries which have been adversely affected by the global crisis as evidenced by falling currencies, stock markets, and negotiations for assistance with the IMF, the slowdown is nevertheless at this point forecast to be relatively modest (e.g., by 2.7% in Serbia) or not at all (in Hungary, economic growth is forecast to be slightly higher in 2009 at 1.7% than what it was in 2007 at 1.3%).

It is also instructive to compare economic growth rate forecasts from the IMF's July 2008 *World Economic Outlook* projections with the IMF's November projections. This more directly gets at the IMF's initial assessment of the detrimental impact of the global financial crisis, and suggests that the E&E region will be disproportionately adversely affected. Specifically, the IMF downgraded its estimate of 2009 world growth by -1.7%, economic growth in the United States by -1.7%, and growth in the Euro area by -1.7%. By comparison, 2009 economic growth was downgraded by -2.0% in CEE, and in the Eurasian countries by -4.0% (with Russia's growth down by -3.8%).

Global economic integration.¹⁴ A key trend since the beginning of the transition has been a large and often growing development gap between the CEE countries and Eurasia. We find this to be the case in democracy trends as well as in some health trends. On the economic front, while Eurasia has shown stronger economic growth in recent years than CEE, there are nevertheless certain indicators that might suggest a growing economic performance gap over the long term. We don't (yet) see evidence of such a growing gap from an analysis of economic performance trends from the MCP economic performance index.¹⁵ Nevertheless, a 2005 World Bank study which focused on global economic integration of the transition countries suggested that such a gap is emerging.¹⁶

In particular, the World Bank study argued that “two new inter-regional trade blocs are emerging. One is tending toward trade with the advanced countries in Western Europe and enjoying relatively high national incomes. The other bloc is significantly poorer, and tending to pull back toward a Russia-centric sphere. Its economies are still dominated by commodity trade, and risk non-participation in the modern international division of labor.”¹⁷

We find mixed support for the World Bank's working hypothesis from an analysis of the available data. We looked for evidence primarily in terms of volume, direction, and composition of trade.

Figure 26 shows that the export share of GDP is higher in 2007 in both CEE sub-regions than what it was in the mid-1990s, and both CEE sub-regions have witnessed a very similar pattern of change from year to year over this time. In Eurasia, in contrast, the export sectors are no larger today relative to GDP than what they were in 1995 on average. Moreover, export shares of GDP in Eurasia have been falling in recent years.

Of the three sub-regions, the most outward-oriented countries by this measure are the Northern Tier CEE countries. However, as *Table 11* shows, there is much diversity in export shares within the sub-regions. In Eurasia, export shares range from 70-72% of GDP in Azerbaijan and Turkmenistan to 22-23% in Armenia and Tajikistan. In Southern Tier CEE, export shares range from 64% in Bulgaria to perhaps as low as 9% in Kosovo. In the Northern Tier CEE countries, export shares range from 86% in Slovakia to 41% in Poland.

The Northern Tier CEE countries have also been the largest recipients of foreign direct investment per capita cumulative since the transition began (*Figure 27*), though the Southern Tier CEE countries are closing the FDI gap vis-à-vis the Northern Tier CEE

¹⁴ Much of this section updates and extends the analysis in: R. Murphy and R. Sprout, *Divergence and Convergence in Eastern Europe & Eurasia: One Transition Path or Two?* USAID/E&E Working Paper # 8 (February 2007). We much appreciate Alex Marmar who provided the primary research effort for Working Paper #8, and Disha Shah who updated and extended the effort in the summer of 2007.

¹⁵ Murphy and Sprout, *Divergence & Convergence* (February 2007), p. 10.

¹⁶ Harry Broadman, editor, *From Disintegration to Reintegration: Eastern Europe and the Former Soviet Union in International Trade*, World Bank (2005).

¹⁷ Broadman, *From Disintegration to Reintegration* (2005), p. 1.

countries. Montenegro, Croatia, and Bulgaria are in the top five E&E recipients of FDI on a per capita basis from 2003 to 2008; Estonia and the Czech Republic are also in the top five (*Figure 28*). The Eurasia countries are not closing the FDI gap vis-à-vis the CEE countries.

Figures 29-34 provide context to the notion of two trading blocs posited by the World Bank, highlighting partly what's at stake. They show the size—measured by area, population, and GDP--of the two global entities that according to the World Bank study are emerging into separate trading blocs. Measured by area, Eurasia is far larger than (Eastern and Western) Europe; four times larger (*Figures 29 and 30*). However, the population of Europe is almost two times larger than that in Eurasia (*Figures 31 and 32*). Moreover, in terms of economic size, Europe is roughly four times larger than Eurasia (*Figures 33 and 34*). Clearly, to the extent that these two trading blocs are forming, *Figures 33 and 34* underscore at least on the basis of economic size (and the numerous benefits that derive from various economic principles including economies of scale, specialization, aggregate demand, and positive externalities), it is far better, other things equal, to be a member of the Europe club than the Eurasia club.

Figure 35 shows that both the Northern Tier and Southern Tier CEE countries have increased their share of exports to the Europe bloc and decreased their share of exports, albeit slightly, to Eurasia since at least 1996. Moreover, the proportion of CEE exports to the Europe bloc is very large; 85% of Northern Tier CEE exports in 2007 and 72% of Southern Tier CEE exports. *Figure 36* disaggregates those numbers and shows that the lion's share of CEE exports to Europe are to Western Europe (or EU-15).

However, *Figure 35* also suggests that on the basis of trade flows, there is no evidence of a growing Russia-centric trading bloc. Eurasian exports to Eurasia declined from 25% in 1996 to 19% in 2007. In addition, Eurasia countries export more to the Europe bloc than they do among themselves, and in fact, the proportion of Eurasian exports to Europe increased significantly from 38% in 1996 to 51% in 2007.

Figure 37 shows that most of the decline in merchandise exports to Eurasia from all three transition sub-regions from 1996 to 2007 is due to a decrease in exports to Russia. In fact, the percent of total exports from Northern Tier and Southern Tier CEE to Eurasia less Russia essentially did not change from 1996 to 2007. *Figure 38* highlights that the dependence on the Russian market among the Eurasian countries for exports, while still significant in several countries, has fallen dramatically since 1996. The most significant decreases in the percentage of total exports going to Russia have been in Moldova (from 54% of total exports to Russia in 1996 to 20% in 2007) and Kazakhstan (from 42% in 1996 to 12% in 2007). However, double digit declines have also occurred in Georgia (from 28% to 5%), Armenia (from 34% to 15%), Ukraine (38% to 22%), Azerbaijan (18% to 3%), and even Belarus (from 53% to 38%).

A key characteristic of Eurasia's economic integration into the global economy has been a significant and growing reliance on primary products for exports, particularly energy and metals. *Figures 39 and 40* show the extent of Eurasia's dependence on these primary

products (using a relatively broad definition of fuels, ores, metals, and precious stones). Of all twelve of the Eurasian countries, only Moldova has a proportion of energy and metals exports as a percent of total exports (at 10%) which is comparable to CEE standards. Eight Eurasian countries have at least one-half of their export sectors concentrated in energy and/or metals and five countries (Kazakhstan, Azerbaijan, Turkmenistan, Russia, and Tajikistan) have energy and/or metals constituting around 75% of total exports or more. All Eurasian countries have witnessed a notable increase in the proportion of energy and/or metal exports to total exports since the mid-1990s.

A country can have a significant proportion of energy and metal exports to total exports coincide with a small export sector relative to GDP. In such an instance, the potential repercussions of this concentration of these exports would be much less significant than if the export sector were relatively large. Hence, *Figure 40*, which shows these exports for the latest year for which data are available (2006-2008) as a percent of GDP, is a more accurate gauge of the potential impact on the economy than the measures in *Figure 39* which assess the magnitude of energy and metal exports relative to total exports. As compared to GDP, three economies stand out as having a very significant reliance on energy and/or metals for export. Such exports in Azerbaijan and Turkmenistan constitute roughly 60% of the economy; for Kazakhstan, it is closer to 44%. Changes in these export sub-sectors will have significant consequences on these economies.

Figure 41 shows the “opposite side of the coin” to the large and growing concentration of primary product exports in Eurasia: a low and stagnant share of high-technology exports. Examples of high tech exports include highly processed chemicals, electrical machinery, combustion engines, electronics, and optical goods. Eurasia’s high tech exports constitute only about 2-3% of total exports which is not much higher than that found in Sub-Saharan Africa (closer to 1%). High tech exports as a percent of total exports has increased in the CEE countries from 1996 to 2006, with a particularly large proportionate increase in the Northern Tier CEE countries. Still, even in the Northern Tier CEE countries the proportion of high tech exports (at roughly 7%) is about one-half the proportion of such exports among the OECD countries.

An important reason why energy and metal exports in Eurasia have increased so dramatically is because the prices of these goods have increased dramatically. According to the IMF in its *World Economic Outlook* (October 2008), global oil prices increased by 24% from 2003-2007 on an average annual basis (in U.S. dollars). Prices of metals have increased even more so, by 28% annually during this period. *Figure 42* shows the price trends of fuels and metals since 1990: relatively little price changes in the 1990s and tremendous leaps in prices throughout much of the 2000s. It is also significant to note that the price trends of the various energy and metal commodities tend to move together.

For much of the Eurasian countries, much of the high economic growth rates have presumably stemmed in no small part from high and rising prices of key primary product exports. *Figure 43* is consistent with that observation and shows a reasonably close link in recent years between the price of oil and economic growth in Eurasia. When oil prices rose in 1998 to 2000, economic growth increased. When oil prices declined or stagnated

in the next two years, economic growth declined. When the price of oil resumed its increase in 2003, economic growth in Eurasia resumed its increase.

A key part of the current global financial crisis of course is the rapidly declining prices of energy and metals. The price of oil, e.g., has fallen by more than 50% since July 2008 (*Figure 44*). Prices of metals have recently been plummeting as well. Such dramatic and destabilizing price movements are a characteristic of commodity prices as shown in the longer view of oil price changes in *Figure 45*. Partly as a consequence, economic growth in Eurasia is forecast to fall in 2008 to 6.9% and in 2009 to 3.5% (as was shown in *Figure 25*).

In CEE, as suggested in *Figure 46*, economic growth has been increasingly driven by economic growth in Western Europe as the CEE's share of exports to Western Europe has increased. The positive link between economic growth in CEE and Western Europe first becomes apparent in 2000, and appears to have increased in strength since 2003.

We previously showed a significant de-linking of Eurasian exports to the Russian market. Trends of Eurasian imports from Russia show a more mixed picture. Roughly one-half of the Eurasian countries have seen a proportionate increase in imports from Russia since 1999. From 1999 to 2005, imports from Russia increased in Belarus (from 56% of total imports to 61%), Tajikistan (from 14% to 19%), Uzbekistan (10% to 27%), Georgia (7% to 15%), and Armenia (4% to 13%). Over this time period, imports from Russia decreased in Ukraine (from 47% to 36%), Kazakhstan (37% to 35%), Moldova (24% to 12%), the Kyrgyz Republic (12% to 6%), Turkmenistan (11% to 9%) and Azerbaijan (22% to 17%).

Energy security. How much of these imports from Russia are energy imports? How dependent are the Eurasian countries as well as the CEE countries on energy imports in general? We start with the latter question by showing net fuel exports as a percentage of total trade across the transition region. Of the twenty-five E&E countries for which data are available (i.e., less Serbia, Montenegro, Kosovo, and Tajikistan) fourteen are substantial net fuel importers (*Figure 47*). Most dependent in this regard is Ukraine, Moldova, Armenia, and Georgia. At the other end of the spectrum are four Eurasian countries which are substantial net exporters of fuel: Russia; Kazakhstan; Turkmenistan; and Azerbaijan.

Figure 48 measures energy dependence slightly differently (net energy imports as a percent of energy use) and combines it with a measure of energy efficiency (GDP per unit of energy use). Together, these two indicators make up our new energy security indicator which is part of the economic performance index (*Table 12*). We divide the transition countries into four quadrants or four categories: (1) energy efficient but dependent; (2) efficient and independent; (3) energy dependent and inefficient; and (4) energy independent but inefficient. Consistent with the previous picture, only a handful of transition countries are energy independent by our definition (with negative net energy imports as a percent of energy use, or, i.e., positive net energy exports): Russia; Azerbaijan; Kazakhstan; Turkmenistan; and Uzbekistan. All of these countries, however,

are relatively energy inefficient (with relatively little GDP produced per unit of energy use). Most transition countries (fifteen) fall into the efficient but dependent quadrant.

The most troublesome country group of course is that which consists of countries which are both energy dependent and energy inefficient (Quadrant II of *Figure 48*). This includes five Eurasian countries (Moldova, Belarus, Tajikistan, the Kyrgyz Republic, and Ukraine) and one CEE country (Bulgaria). By these definitions, no transition country is both energy efficient and energy independent (Quadrant III).¹⁸

An important aspect of energy security for the transition region is dependency on Russian energy. *Table 14* fills in the picture some and shows a very high degree of dependency on Russian energy for the large majority of transition countries included in the table. Three different measures are compared: (1) a country's percentage of its domestic consumption of natural gas which comes from Russia (for 2005 and 2006); (2) the percentage of total gas imports in 2005 which came from Russia; and (3) the percentage of total oil imports in 2005 from Russia. Several Western European countries are also included for comparisons.¹⁹

Dependency on Russian energy by these measures is high throughout the three transition sub-regions. In 2005, seven of the eight Northern Tier CEE countries imported more than 90% of their oil imports from Russia. For four of those countries, 100% of their 2005 natural gas imports came from Russia. All of Bulgaria's gas imports in 2005 came from Russia and 89% of its oil imports; for Romania, it was 63% from Russia for each oil and gas.

The proportion of domestic consumption of gas which comes from Russia provides a better measure of impact and dependency than does the proportion of total gas or oil imports coming from Russia. (One country could have 100% of its energy imports come from Russia and yet those imports might constitute but a small proportion of total energy consumption). Of the seventeen transition countries for which data are available, ten of those countries had close to 80% of the domestic consumption of natural gas or more come from Russia in 2006. By this measure, highest dependence on Russia is found in Slovakia (100% of domestic consumptions of gas from Russia), Macedonia (100%), Georgia (100%), Belarus (98%), Bulgaria, (96%), and Serbia-Montenegro (87%).²⁰

¹⁸ Data for Serbia-Montenegro combined show net energy dependency is also high in these countries, at 29% of energy use; no data are available for Serbia, Montenegro, or Kosovo on energy efficiency.

¹⁹ The data were derived from three primary sources: (1) U.S. Department of Energy, Energy Information Administration, *Russia: Country Analysis Brief* (May 2008); (2) A. Cohen, *Europe's Strategic Dependence on Russian Energy*, Heritage Foundation (November 2007); and (3) Z. Baran, *Central and Eastern Europe: Assessing the Democratic Transition*, Hudson Institute, Hearing of the U.S. House of Representatives Committee on Foreign Affairs (July 25, 2007).

²⁰ These are 2006 estimates and we know at least in the case of Georgia that the proportion of domestic consumption of gas which comes from Russia has changed. Georgia now imports some natural gas from Azerbaijan as well.

Macroeconomic stability and financial markets. As in other parts of the world, most transition countries are now feeling more acutely some of the downsides of being globally integrated. A number of transition countries have been adversely affected by their financial links to the global economic system. Hungary, Ukraine, Serbia, and Belarus have sought assistance from the IMF. Russia's economy has been adversely exposed. Other countries that have been identified as at the least relatively vulnerable include the three Baltic States, Romania, Bulgaria, and Kazakhstan. The three big Eurasian countries---Russia, Kazakhstan, and Ukraine---have been adversely impacted by developments in both the financial markets (vulnerable banking sectors, stock markets, and currencies) and commodity markets (falling prices of oil, gas, and steel).

There is certainly no consensus at this stage as to the relative severity of the impacts of the financial crisis on the transition countries and even which countries within are likely to be the most negatively affected. In no small part, this is due to the fact that the crisis is still unfolding, and very much a "moving target." We noted previously the IMF's assessment of economic growth trends and which countries are likely to be downgraded the most.

What follows is a first attempt to identify which transition countries are likely to be more vulnerable or at risk on the basis of some key indicators of the countries' participation in the global financial system. Broadly, we look at current account balances and external debt (i.e., the need for external financing) and FDI flows and the stock of foreign exchange reserves (i.e., a country's ability to pay deficits and debt). We also look at measures of the extent to which the country's financial sector (banks and stock markets) are developed and hence exposed to external financial shocks. We also consider foreign bank involvement in the banking sector.

One key characteristic of many transition countries is a very large current account balance, stemming largely from imports far exceeding exports (*Table 8*). Other things equal, this imbalance increases the vulnerability of an economy to financial crisis and credit shortage. The IMF has defined a current account deficit of 3% of GDP or more for three years or more as an unacceptable threshold. Almost one-half of the transition countries had current account deficits in 2007 that exceeded 10% of GDP.

The Southern Tier CEE region is the most troublesome on this measure. Of the nine countries, Macedonia (at -1.0% of GDP) is the only country that does not have a very large current account deficit. Five Southern Tier CEE countries had 2007 current account deficits ranging from eight to twelve percent of GDP: Croatia (8.3%); Romania (8.8%); Albania (9.9%); and Serbia (12%); and Bosnia-Herzegovina (12.5%). Much higher still are the deficits in Bulgaria (21%), Montenegro (23%), and Kosovo (39%).

The three Northern Tier CEE countries with significant current account deficits are the three Baltic states: Lithuania (12.3%); Estonia (16.2%); and Latvia (24%). Eurasia has a combination of extreme current account balances. While the energy producers (particularly Uzbekistan and Azerbaijan) have very large surpluses, four smaller, poorer

Eurasian countries have very significant deficits: Moldova (9.2%); Tajikistan (15.2%); Georgia (15.9%); and the Kyrgyz Republic (17.2%).

High external debt is also obviously at least potentially problematic in the current global economic environment. *Figure 50* shows the range of current account balances in the transition region and combines these figures with external debt to GDP figures. Highest external debt relative to GDP worldwide is generally found in Sub-Saharan Africa. At least seven Sub-Saharan Africa countries had a level of total external debt as a percent of GDP at 100% or more in 2006: Burundi (162%); Congo (137%); the Gambia (145%); Guinea (100%); Guinea Bissau (241%); Liberia (541%); and Sierra Leone (101%). To compare, four E&E countries had external debt greater than 100% of GDP in 2007: Latvia (143%); Estonia (121%); Slovenia (109%); and Bulgaria (105%). Five other transition countries had external debt greater than 70% of GDP in 2007: Hungary (99%); Kazakhstan (93%); Croatia (88%); Lithuania (79%); and Moldova (75%). All of these countries with high external debt have also been incurring current account deficits. Latvia, Estonia, and Bulgaria stand out in particular in *Figure 49* with both particularly high current account deficits and debt.

The ability to pay debt and finance deficits is an important consideration in judging vulnerabilities in the global financial system. Current account deficits, e.g., might be financed largely by FDI inflows. In addition, the burden of high external debt and large current account deficits can be tempered by large foreign exchange reserves. Hence, the relatively high FDI flows into Estonia, Croatia, and Bulgaria, help offset the large current account deficits and decrease the need to borrow from international banks to finance the deficits (*Figure 28*). Similarly, Russia's huge foreign exchange reserves (equivalent to the purchases of seventeen months of imports) greatly dampen financial crisis prospects (*Table 15*).

Another important aspect of the current crisis is the health and scope of the financial sectors in each country. *Table 15* shows some measures of the banking sector as well as the stock market. A rough proxy as to the size and depth of the domestic banking sector might be the amount of domestic credit available to the private sector as a percent of GDP. In addition, it is generally recognized that foreign owned banks provide an important stabilizing effect and add often-times much needed expertise as well as competition. These international banks also can have larger reserves to draw from in the event there is credit shortage. *Table 15* highlights the number of banks in each transition country, as well the number of foreign owned banks and the foreign banks' asset share of the domestic banking system. *Table 15* also shows the stock market capitalization as a percent of GDP for each country, a rough proxy of the size of the stock market.

Table 16 attempts to analyze and synthesize much of the aforementioned financial data to provide a rough sketch of relative vulnerability across the region to the global financial crisis. Four ratios are considered. The first one is short term debt to foreign exchange reserves. This is an indicator that has become commonly used to track financial vulnerability by the IMF and others. We used this as one of the key measures to assess

the impact of the East Asian financial crisis of 1997 and the Russian crisis of 1998.²¹ Other things equal, a country with short term debt in excess of foreign exchange reserves is vulnerable to outside financial shocks. In this paper (as in the 1999 paper) we define that threshold (i.e., 1.0 or greater) as “highly vulnerable,” and a country with a lower threshold of a ratio of short term debt to reserves of greater than 0.4 but less than 1.0 as “at risk.”

In 1998, Russia’s volume of short term debt was more than two times greater than its reserves. With a ratio of 2.2, Russia was the only transition country that exceeded the threshold whereby debt was greater than reserves (i.e., a ratio of 1.0).²² In 1998, Tajikistan was at the threshold (at 1.0), followed by Slovakia (0.9), Ukraine (0.7), and Hungary (0.6). Most of the East Asian countries which had been buffeted hard by a financial crisis prior to Russia, all had short term debt in excess of reserves. Average short term debt to reserve scores from 1996 to 1998 were 1.7 in Indonesia, 1.6 in Korea, 1.2 in Thailand, 1.2 in Philippines, and 0.6 in Malaysia.

In the transition region currently, short term debt exceeds reserves in six countries: Belarus by more than three times with a score of 3.1; Estonia; (2.6); Latvia (2.3); Lithuania (1.3); Slovakia (1.2); and Moldova (1.1). Russia today, in striking contrast, has a short term debt to reserves ratio of only 0.1, one of the lowest scores of all the transition countries. Russia’s short term debt is very low; as a percent of total debt it is only 16%. In addition, Russia’s reserves are extremely high, equivalent to seventeen months of imports. The transition region reserves average is five months of imports.

The second ratio of *Table 16* is the current account deficit share of GDP to the FDI share of GDP. To what extent do FDI inflows finance the current account deficits in the region? Fourteen transition countries had current account deficits in excess of FDI inflows in 2007. The largest gap (by far) between the deficit and FDI was in Belarus; Belarus’ current account deficit was more than six times greater than inflows of FDI in 2007. Other “highly vulnerable” transition countries on this count include Latvia, Lithuania, the Kyrgyz Republic, Bosnia-Herzegovina, Montenegro, and Albania. Only four transition countries—Russia, Azerbaijan, Turkmenistan, and Uzbekistan—had current account surpluses in 2007.

The third ratio is domestic credit as a proportion of GDP relative to the domestic bank asset share of foreign banks. Other things equal, the more domestic credit is available to the private sector, the more exposed is the economy to credit shocks. In addition, we make the assumption that the lower is the proportion of bank asset share by foreign banks, the more vulnerable is the banking sector.

Hence, both dynamics mean that the higher is this ratio of domestic credit to foreign ownership of domestic banks, the more vulnerable is the economy to external financial

²¹ USAID/E&E, Appendix II, *Monitoring Country Progress in E&E*, No. 5 (July 1999), drawn from a longer version, USAID/E&E, *The Global Financial Crisis and the Transition Countries* (March 1999). Available upon request.

²² *Ibid.*, *Table 5*.

shocks. The most vulnerable transition countries according to this criterion are Russia, Azerbaijan, and Slovenia. Russia and Azerbaijan have a very small foreign bank presence in-country. Slovenia has the most domestic credit as a percent of GDP of all the transition countries, and a relatively small role of foreign banks in its economy.

The fourth ratio is the stock market capitalization to GDP, a rough proxy for the size of the stock market and hence an economy's exposure to global financial developments on this dimension. Large stock markets largely exist in the more advanced and/or larger economies. In the transition region, stock market capitalization is relatively significant in a relatively few number of countries. In only three transition countries, is stock market capitalization as large or larger than GDP: Croatia (120%); Russia (112%); and Montenegro (99%). (Stock market capitalization as percent of GDP is 120% on average in the high income developed countries of the world). Stock market capitalization is also significant in Ukraine (80% of GDP), and to a lesser extent in Slovenia (57% of GDP), Serbia (54%), Kazakhstan (54%), Bulgaria (51%), and Poland (44%).

In *Table 16*, we make an attempt to synthesize these four ratios by estimating a country's degree of vulnerability to global financial market shocks. For each of the four ratios, we define "highly vulnerable" and a lower threshold, "at risk," and assign scores to these thresholds: "1.5" for highly vulnerable; and "1.0" for "at risk."²³ The highest possible score is a "6.0" (or a "1.5" for each of the four ratios). Hence, 100% vulnerable translates into being "highly vulnerable" in each ratio.

We find almost one-half of the transition countries with relatively high vulnerabilities or exposure to the global financial crisis. Bulgaria is vulnerable on all four ratios. Nine other countries are vulnerable on three of four, including Montenegro, Latvia, Belarus, Moldova, Croatia, Ukraine, Slovenia, Estonia, and Kazakhstan. Russia and Lithuania are "highly vulnerable" on two of four ratios.

Finally on macroeconomic performance, as an important element in overall macroeconomic stability, it is worth noting recent trends in inflation. In virtually all the prior MCP reports, we noted a trend of falling inflation rates throughout E&E. This time, however, may not be the case. *Figure 50* shows the trends in inflation by the sub-regions in 2006 through 2008 as recently projected by the World Bank. In all three sub-regions, inflation is on the rise, and in Eurasia it has returned to double-digits in 2008. This has been explained in part because of rising food prices and domestic demand pressures (i.e., rapidly expanding economies approaching capacity constraints). Very recently, however, even food prices have joined the commodity price trend of dramatic decreases and economic growth estimates continue to be forecast down. Hence, 2008 inflation figures may soon need to be adjusted down some as well.

²³ For short term debt to reserves, "highly vulnerable" is greater than 1.0 (i.e., debt exceeds reserves); "at risk" is greater than 0.4 but less than 1.0. For current account deficits to FDI, highly vulnerable is greater than 2.0 (i.e. the deficit is more than two times the FDI); at risk is greater than 1.0 but less than 2.1. For domestic credit to foreign bank ownership, highly vulnerable is greater than 200; at risk is greater than 90 but less than 201. For stock market capitalization, highly vulnerable is greater than 80; at risk is greater than 40 but less than 81.

Table 7. Economic Performance

	FDI CUMULATIVE PER CAPITA		PRIVATE SECTOR SHARE OF GDP		Macro Stability	GDP Growth	Domestic Inequality	Export Share & Composition	MSME SHARE OF EMPLOYMENT	Long Term Unemployment			Services % GDP	Energy Security	Economic Performance Index		
	2004-2008	2007	2006-2008	2004-2008	2007	2006-2008	2004-2008	2006	2001-2006	2002-2006	2006	2005	2005				
ESTONIA	4301	5.0	80	5.0	2.5	6.4	4.0	3.0	4.8	56	3.5	2.3	5.0	67.8	5.0	3.5	4.1
CZECH REPUBLIC	3274	5.0	80	5.0	3.1	5.7	3.5	5.0	4.8	62	4.0	2.9	5.0	58.0	3.0	3.5	4.1
LATVIA	2622	5.0	70	4.0	1.8	8.3	4.5	2.0	2.6	74	5.0	2.2	5.0	74.8	5.0	4.3	4.0
HUNGARY	1689	4.5	80	5.0	2.3	3.1	2.5	4.0	4.8	72	5.0	3.3	4.5	65.0	5.0	2.5	3.9
LITHUANIA	1544	4.5	75	4.5	2.6	7.1	4.0	2.0	3.4	71	5.0	1.9	5.0	60.6	4.0	3.5	3.9
SLOVAKIA	2785	5.0	80	5.0	2.9	7.5	4.0	4.0	4.8	62	4.0	8.5	2.0	64.8	4.5	2.5	3.9
SLOVENIA	-324	0.5	70	4.0	3.1	5.1	3.5	5.0	4.0	63	4.0	2.4	5.0	63.4	4.0	4.3	3.7
CROATIA	3212	5.0	70	4.0	2.5	4.5	3.0	4.5	3.3	65	4.0	6.7	3.0	62.3	4.0	4.3	3.7
BULGARIA	3938	5.0	75	4.5	2.3	6.3	4.0	3.0	3.1	79	5.0	3.8	4.0	59.2	3.0	3.0	3.7
POLAND	1603	4.5	75	4.5	3.3	5.4	3.5	3.0	2.5	68	4.5	5.4	3.0	63.9	4.0	4.3	3.7
ROMANIA	2073	5.0	70	4.0	2.5	6.9	4.0	3.0	2.3	30	2.0	3.7	4.0	51.5	3.0	4.3	3.5
MONTENEGRO	4343	5.0	65	3.5	3.4	6.9	4.0	---	2.5	36	2.0	25.8	0.5	70.0	5.0	---	3.3
KAZAKHSTAN	1620	4.5	70	4.0	3.0	8.6	4.5	2.0	1.9	17	1.0	2.9	5.0	53.8	3.0	2.5	3.3
GEORGIA	1083	3.5	80	5.0	2.5	7.9	4.5	3.0	2.3	43	2.0	8.9	2.0	60.6	4.0	2.5	3.3
ARMENIA	579	2.0	75	4.5	3.6	12.2	5.0	4.5	1.9	34	2.0	4.7	4.0	34.1	1.0	2.5	3.3
UKRAINE	718	2.5	65	3.5	2.6	7.1	4.0	3.0	3.2	67	4.5	---	---	56.7	3.0	2.0	3.2
ALBANIA	633	2.5	75	4.5	2.9	5.8	3.5	4.5	1.8	44	2.0	12.7	1.0	55.7	3.0	4.3	3.0
RUSSIA	170	1.0	65	3.5	3.8	7.2	4.0	1.0	1.1	50	3.0	2.3	5.0	56.4	3.0	3.5	3.0
BOSNIA & HERZ.	1383	4.0	60	3.0	2.8	5.9	3.5	3.0	2.2	53	3.0	33.9	0.5	64.5	4.5	3.5	3.0
AZERBAIJAN	-676	0.5	75	4.5	4.0	21.1	5.0	3.0	1.9	5	0.5			24.5	1.0	3.5	2.9
UZBEKISTAN	81	0.5	45	1.5	4.3	8.0	4.5	2.0	---	57	3.5	---	---	42.5	2.0	3.0	2.9
SERBIA	1626	4.5	55	2.5	2.0	7.1	4.0	1.0	2.3	59	3.5	16.9	1.0	63.0	4.0	---	2.9
TAJIKISTAN	111	1.0	55	2.5	1.6	7.4	4.0	3.0	2.8	25	2.0	0.6	5.0	50.2	3.0	2.5	2.9
MACEDONIA	775	2.5	65	3.5	4.0	4.5	3.0	2.0	2.4	62.1	4.0	29.8	0.5	57.7	3.0	3.5	2.9
MOLDOVA	418	2.0	65	3.5	2.4	5.7	3.5	3.0	2.4	22	1.0	2.3	5.0	62.2	4.0	1.0	2.8
TURKMENISTAN	643	2.5	25	0.5	4.3	12.5	5.0	1.0	2.4	---	---	---	---	40.3	2.0	---	2.8
BELARUS	440	2.0	25	0.5	3.0	9.6	5.0	3.0	3.3	15	1.0	---	---	47.3	2.0	1.5	2.6
KYRGYZ REPUBLIC	153	1.0	75	4.5	2.3	4.9	3.0	3.0	1.3	5	0.5	3.1	4.5	46.9	2.0	3.0	2.6
KOSOVO	136	1.0	---	---	2.8	4.0	2.5	---	0.5	---	---	34.6	0.5	64.3	4.5	---	---
Northern Tier CEE	2187	4.3	76	4.6	2.8	6.5	3.9	3.5	3.9	66	4.4	3.4	4.3	64.8	4.3	3.5	3.9
Southern Tier CEE	2013	3.8	67	3.7	2.8	5.3	3.3	3.0	2.5	54	3.2	14.7	1.8	60.5	3.7	3.8	3.2
Eurasia	445	1.9	60	3.2	3.2	9.7	4.5	2.6	2.2	31	1.9	4.5	3.7	48.0	2.5	2.5	3.0
R,B,C in 2006	2186	4.7	72	4.2	2.6	5.7	3.5	3.5	2.9	58	3.7	6.4	3.0	57.7	3.3	3.8	3.5

GDP Growth is double weighted in the economic performance index. EBRD, *Transition Report 2008* (November 2008); World Bank, *World Development Indicators 2008* (April 2008) and *Kosovo Health Financing Reform Survey* (May 2008); Fund for Peace, *Failed States Index* (2008); UNECE, *Statistical Division Database* (2008); IFC & World Bank, *MSME Database* (2007); and UNMIK, *Semiannual Macroeconomic Bulletin* (2008).

Table 8. Macro Stability

	INFLATION		EXTERNAL		Fiscal	Current Account			MACRO
	3 YEAR		DEBT		Balance	Balance			
	AVERAGE		(% OF GDP)		(% of GDP)	(% of GDP)			
	(%)								
	2006-2008		2007		2007		2007		
UZBEKISTAN	12.8	3.0	17.5	4.0	2.3	5.0	20.0	5.0	4.3
TURKMENISTAN	10.1	3.0	7.7	4.5	0.5	4.5	7.1	5.0	4.3
MACEDONIA	2.0	5.0	36.3	3.0	-1.0	4.0	-1.0	4.0	4.0
AZERBAIJAN	14.8	2.0	18.6	4.0	2.4	5.0	19.8	5.0	4.0
RUSSIA	10.5	2.0	31.7	3.0	3.7	5.0	6.5	5.0	3.8
ARMENIA	4.6	4.5	23.3	3.5	-2.6	2.5	-3.0	4.0	3.6
MONTENEGRO	3.2	4.0	18.2	4.0	3.0	5.0	-23.0	0.5	3.4
POLAND	1.9	5.0	55.2	2.0	-2.4	3.0	-4.3	3.0	3.3
SLOVENIA	2.9	4.5	108.5	0.5	-1.5	3.5	-2.6	4.0	3.1
CZECH REPUBLIC	2.4	5.0	44.2	2.5	-4.0	2.0	-3.9	3.0	3.1
BELARUS	10.2	2.0	28.4	3.5	0.5	4.5	-6.2	2.0	3.0
KAZAKHSTAN	9.0	2.5	92.8	1.5	4.3	5.0	-3.3	3.0	3.0
ALBANIA	3.1	4.0	26.4	3.5	-3.9	2.0	-9.9	2.0	2.9
SLOVAKIA	3.2	4.0	59.1	2.0	-2.9	2.5	-5.2	3.0	2.9
KOSOVO	9.0	3.5	30.0	3.0	-0.9	4.0	-39.3	0.5	2.8
BOSNIA & HERZ.	3.6	4.0	48.5	2.5	-1.4	3.5	-12.5	1.0	2.8
LITHUANIA	4.0	4.0	78.5	1.5	-0.5	4.0	-12.3	1.0	2.6
UKRAINE	11.8	3.0	59.9	2.0	-2.7	2.5	-3.7	3.0	2.6
CROATIA	3.1	4.0	87.8	1.5	-2.6	2.5	-8.3	2.0	2.5
GEORGIA	9.0	2.5	30.8	3.0	-1.3	3.5	-15.9	1.0	2.5
ROMANIA	7.1	2.5	42.2	2.5	-2.5	3.0	-8.8	2.0	2.5
ESTONIA	5.0	3.5	120.8	0.5	2.8	5.0	-16.2	1.0	2.5
MOLDOVA	12.4	2.0	75.1	1.5	-0.5	4.0	-9.2	2.0	2.4
BULGARIA	6.9	3.0	104.5	0.5	2.3	5.0	-20.8	0.5	2.3
HUNGARY	5.2	3.5	98.9	0.5	-6.4	2.0	-4.1	3.0	2.3
KYRGYZ REPUBLIC	6.7	3.0	61.2	2.0	-2.2	3.0	-17.2	1.0	2.3
SERBIA	12.0	2.0	64	2.0	-2.3	3.0	-12.0	1.0	2.0
LATVIA	7.8	2.5	143.4	0.5	-1.3	3.5	-24.0	0.5	1.8
TAJIKISTAN	10.1	2.0	40.6	2.5	-14.1	1.0	-15.2	1.0	1.6
Northern Tier CEE	4.1	4.0	88.6	1.3	-2.0	3.2	-9.1	2.3	2.7
Southern Tier CEE	5.6	3.6	50.9	2.5	-1.0	3.6	-15.1	1.5	2.8
Eurasia	10.2	2.6	40.6	2.9	-0.8	3.8	-1.7	3.1	3.1
R,B,C in 2006	5.8	3.3	65.9	2.0	-0.9	3.5	-12.6	1.5	2.6

EBRD, *Transition Report 2008* (November 2008); World Bank, *World Development Indicators 2008* (April 2008) and *Kosovo Health Financing Reform Survey* (May 2008).

Table 9. Domestic Inequality

	<u>Ethnic & Religious Inequality</u>			<u>Income Inequality of top Q to bottom Q</u>			<u>Urban-Rural Inequality of Poverty Rates</u>			Avg Rank	1 to 5 score:
	1-10	rank	H/M/L	ratio	rank	H/M/L	coef.of var	rank	H/M/L		
CZECH REPUBLIC	3.9	28	L	3.5	25	L	--	--	---	26.5	5.0
SLOVENIA	5.4	24	L	3.9	22	L	--	--	---	23.0	5.0
ALBANIA	6.1	20	L	4.1	18	L	29.2	17	L	18.3	4.5
ARMENIA	6.0	22	L	5.0	12	M	13.1	21	L	18.3	4.5
CROATIA	5.7	23	L	4.8	14	M	--	--	---	18.5	4.5
HUNGARY	6.3	16	M	3.8	23	L	43.3	13	M	17.3	4.0
SLOVAKIA	6.5	15	M	4.0	20	L	--	--	---	17.5	4.0
AZERBAIJAN	7.4	6	H	2.6	26	L	44.1	12	M	14.7	3.0
BELARUS	7.2	10	M	4.5	15	M	46.7	10	M	11.7	3.0
BOSNIA & HERZ.	7.2	10	M	3.8	23	L	30.6	14	M	15.7	3.0
BULGARIA	6.2	17	M	4.4	16	M	49.7	7	H	13.3	3.0
ESTONIA	4.9	25	L	6.4	6	H	30.3	15	L	15.3	3.0
GEORGIA	7.0	12	M	8.3	1	H	16.8	20	L	11.0	3.0
KYRGYZ REPUBLIC	8.0	3	H	4.4	16	M	19.1	18	L	21.3	3.0
MOLDOVA	7.5	5	H	5.3	10	M	18.6	19	L	11.3	3.0
POLAND	4.8	26	L	5.6	8	H	115.5	2	H	12.0	3.0
ROMANIA	6.1	20	L	4.9	13	M	96.3	4	H	12.3	3.0
TAJKISTAN	7.3	8	H	5.2	11	M	8.5	22	L	13.7	3.0
UKRAINE	7.0	12	M	4.1	18	L	95.6	5	H	11.7	3.0
KAZAKHSTAN	6.2	17	M	5.6	8	H	118.1	1	H	8.7	2.0
LATVIA	7.0	12	M	6.8	5	H	48.7	9	M	8.7	2.0
LITHUANIA	6.2	17	M	6.3	7	H	103.2	3	H	9.0	2.0
MACEDONIA	7.4	6	H	7.5	4	H	29.6	16	L	8.7	2.0
UZBEKISTAN	8.6	1	H	4.0	20	L	49.1	8	M	9.7	2.0
RUSSIA	8.2	2	H	7.6	3	H	46.2	11	M	5.3	1.0
SERBIA	7.7	4	H	---	8	M	67.7	6	H	6	1.0
TURKMENISTAN	7.3	8	H	7.7	2	H	--	--	---	5	1.0
MONTENEGRO	4.3	27	L	---	---	---	--	--	---	---	--
KOSOVO	---	---	---	---	---	---	--	--	---	---	--
Northern Tier CEE	5.6	20.4		5.0	14.5		68.2	8.4	---	16.2	3.5
Southern Tier CEE	6.3	15.9		4.9	13.7		50.5	10.7	---	13.3	3.0
Eurasia	7.3	8.8		5.4	11.8		43.3	13.4	---	11.9	2.6
R,B,C in 2006	6.0	20.0		4.7	14.3		73.0	5.5	---	14.7	3.5

Peters, Sprout & Melzig, *The Impact of Regional Disparities on Economic Performance in Eastern Europe and Eurasia*, USAID/E&E Working Paper #2 (October 2005); World Bank, *World Development Indicators 2008* (April 2008) and Fund for Peace, *Failed States Index* (2008).

Table 10. Long Term Unemployment as % of Labor Force

	Long Term Unemployment % total unemployment 2004-2006	Unemployment Rate 2006-2007	Long Term % labor force	1 to 5
LITHUANIA	44.3	4.3	1.9	5.0
LATVIA	36.2	6.0	2.2	5.0
ESTONIA	48.2	4.7	2.3	5.0
SLOVENIA	49.3	4.6	2.3	5.0
MOLDOVA	44.8	5.1	2.3	5.0
RUSSIA	38.5	6.1	2.3	5.0
KAZAKHSTAN	39.2	7.3	2.9	5.0
CZECH REPUBLIC	54.2	5.3	2.9	5.0
KYRGYZ REPUBLIC	37.1	8.3	3.1	4.5
HUNGARY	45.1	7.4	3.3	4.5
ROMANIA	57.8	6.4	3.7	4.0
BULGARIA	55.7	6.9	3.8	4.0
POLAND	56.1	9.6	5.4	3.0
CROATIA	60.1	9.6	5.8	3.0
SLOVAKIA	76.3	11.1	8.5	2.0
GEORGIA	66.8	13.3	8.9	2.0
ALBANIA	92.3	13.8	12.7	1.0
SERBIA	81.0	18.1	14.7	1.0
MONTENEGRO	85.0	19.7	16.7	1.0
BOSNIA & HERZEGOVINA	71.0	27.0	19.2	1.0
ARMENIA	71.6	31.6	22.6	0.5
MACEDONIA	85.4	34.9	29.8	0.5
KOSOVO	83.5	30-43%	34.6	0.5
TAJKISTAN	25.0	--	--	--
BELARUS	17.2	--	--	--
AZERBAIJAN	---	6.5	--	--
UKRAINE	---	6.4	--	--
UZBEKISTAN	---	--	--	--
TURKMENISTAN	---	--	--	--
Northern Tier CEE	51.2	6.6	3.4	4.3
Southern Tier CEE	74.6	19.8	14.7	1.8
Eurasia	42.5	10.6	4.5	3.7
R,B,C in 2006	57.9	11.0	6	3.0

ILO, *Various Labor Force Surveys* (2008); EBRD, *Transition Report 2008* (November 2008); and UNECE, *Trends in Europe and North America* (2008).

Table 11. Export Size & Composition							
	Export Share % GDP 2007		Manufacturing % Merch Exports 2006		High Tech % Exports 2006		Average x share *2, manu, high tech
CZECH REPUBLIC	76	4.5	89	5.0	11.4	5.0	4.8
HUNGARY	78	4.5	84	5.0	20.6	5.0	4.8
SLOVAKIA	86	5.0	85	5.0	6.1	4.0	4.8
ESTONIA	80	5.0	64	3.5	12.1	5.0	4.6
SLOVENIA	69	4.5	87	5.0	4.1	3.0	4.3
LITHUANIA	60	3.5	58	3.5	3.4	3.0	3.4
TURKMENISTAN	72	4.5	---	---	1.0	1.0	3.3
CROATIA	48	2.5	66	4.0	7.9	4.0	3.3
BULGARIA	64	4.0	53	3.0	2.8	2.0	3.3
BELARUS	60	3.5	50	2.5	1.4	2.0	2.9
UKRAINE	47	2.5	73	4.5	2.2	2.0	2.9
POLAND	41	1.5	79	5.0	3.0	3.0	2.8
AZERBAIJAN	70	4.5	8	0.5	0.1	1.0	2.6
MONTENEGRO	48	2.5	---	---	--	--	2.5
MACEDONIA	50	2.5	69	4.0	0.8	1.0	2.5
LATVIA	44	2.0	60	3.5	3.0	2.0	2.4
ROMANIA	34	1.0	79	5.0	2.7	2.0	2.3
GEORGIA	33	1.0	48	2.5	9.1	4.0	2.1
MOLDOVA	46	2.0	31	1.0	1.0	2.0	1.8
SERBIA	27	1.0	---	---	4.4	3.0	1.7
KAZAKHSTAN	51	2.5	13	0.5	0.4	1.0	1.6
KYRGYZ REPUBLIC	39	1.5	46	2.5	0.6	1.0	1.6
BOSNIA & HERZEGOVINA	25	0.5	62	3.5	--	--	1.5
ARMENIA	22	0.5	56	3.5	0.5	1.0	1.4
RUSSIA	34	1.0	17	0.5	1.5	2.0	1.1
ALBANIA	25	0.5	27	1.0	0.8	1.0	0.8
UZBEKISTAN	38	1.5	10	0.5	--	--	0.5
TAJKISTAN	23	0.5	---	---	--	--	0.5
KOSOVO	9	0.5	---	---	--	--	0.5
Northern Tier CEE	67	3.8	76	4.4	8.0	3.8	4.0
Southern Tier CEE	37	1.7	59	3.4	3.2	2.2	2.2
Eurasia	45	2.1	35	1.9	1.8	1.7	2.0
R,B,C in 2006	47	2.3	69.0	4.2	4.5	2.7	2.9

World Bank, *World Development Indicators 2008* (April 2008). High tech export data are 2004 for Czech Republic, Kazakhstan & Serbia and 2000 for Tajikistan & Turkmenistan.

Table 12. Energy Security

	Dependency		Efficiency		Energy Security
	Net Energy Imports % Energy Use		GDP per unit of energy use		
	2005		2005 PPP \$ per Kilogram of oil equivalent		
ALBANIA	51	3.0	7.2	5.0	4.3
CROATIA	57	3.0	6.6	5.0	4.3
LATVIA	51	3.0	6.4	5.0	4.3
POLAND	15	4.0	5.6	4.0	4.3
ROMANIA	27	4.0	5.3	4.0	4.3
SLOVENIA	53	3.0	6.2	5.0	4.3
AZERBAIJAN	-97	5.0	2.8	2.0	3.5
BOSNIA & HERZEGOVINA	33	4.0	4.7	3.0	3.5
CZECH REPUBLIC	27	4.0	4.6	3.0	3.5
ESTONIA	27	4.0	4.3	3.0	3.5
LITHUANIA	54	3.0	5.6	4.0	3.5
MACEDONIA	47	3.0	5.5	4.0	3.5
RUSSIA	-83	5.0	2.6	2.0	3.5
BULGARIA	47	3.0	3.6	3.0	3.0
KYRGYZ REPUBLIC	48	3.0	3.2	2.0	3.0
UZBEKISTAN	-20	5.0	1.1	1.0	3.0
ARMENIA	66	2.0	4.9	3.0	2.5
GEORGIA	60	2.0	4.9	3.0	2.5
HUNGARY	63	2.0	6.2	5.0	2.5
KAZAKHSTAN	-132	5.0	2.5	1.0	2.5
SLOVAKIA	65	2.0	4.5	3.0	2.5
TAJIKISTAN	56	3.0	2.8	2.0	2.5
UKRAINE	43	3.0	1.8	1.0	2.0
BELARUS	86	1.0	3.1	2.0	1.5
MOLDOVA	98	1.0	2.4	1.0	1.0
MONTENEGRO	---	---	--	--	---
SERBIA	29	4.0	--	--	---
TURKMENISTAN	-274	5.0	--	--	---
KOSOVO	---	---	--	--	---
Northern Tier CEE	44	3.0	5.4	4.0	3.5
Southern Tier CEE	42	3.0	5.5	4.0	3.8
Eurasia	-12	5.0	2.9	2.0	2.5
R,B,C in 2006	44	3.0	5.2	4.0	3.8

World Bank, *World Development Indicators 2008* (April 2008).

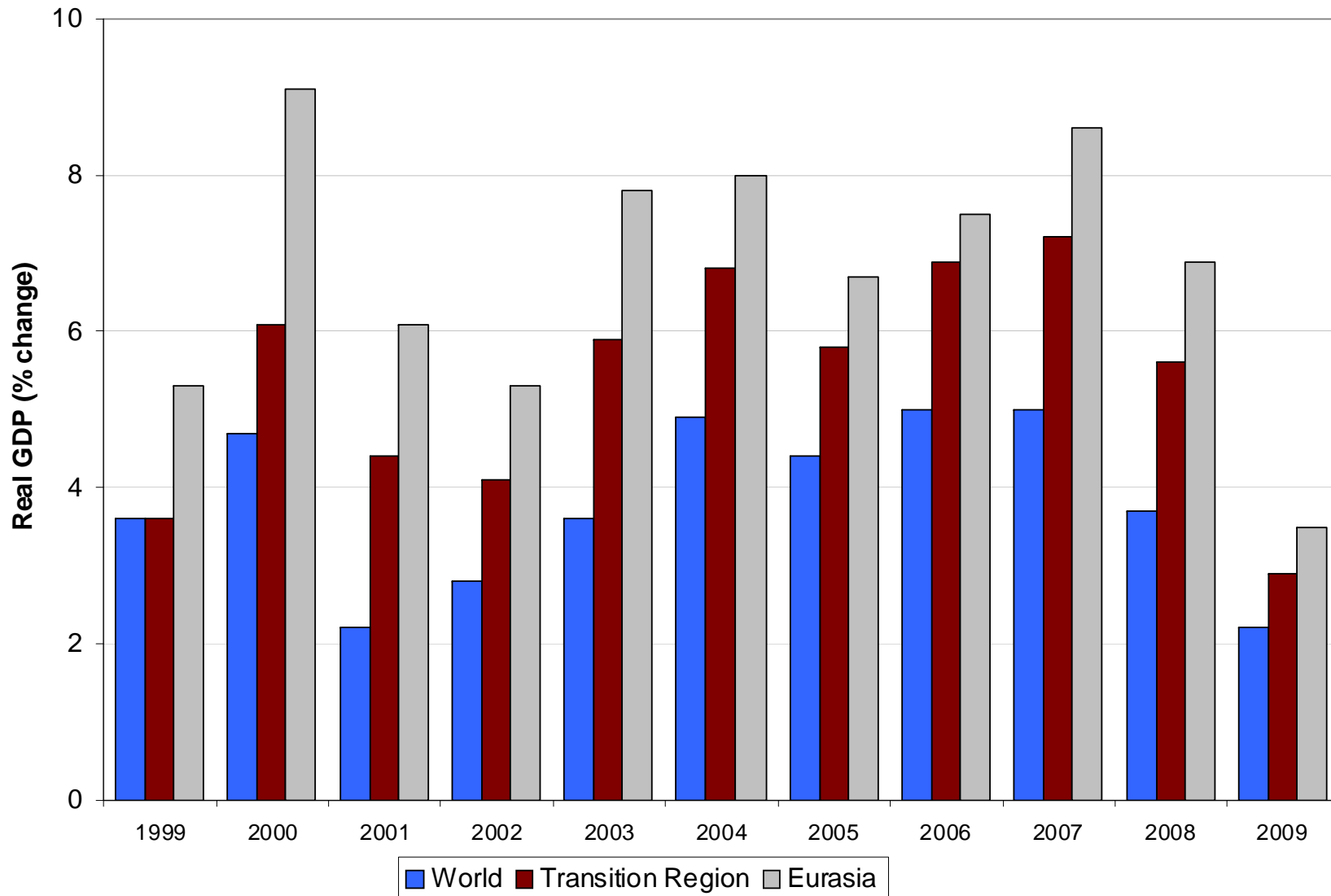
Table 12. Energy Security

	Dependency		Efficiency		Energy Security
	Net Energy Imports % Energy Use		GDP per unit of energy use		
	2005		2005 PPP \$ per Kilogram of oil equivalent		
ALBANIA	51	3.0	7.2	5.0	4.3
CROATIA	57	3.0	6.6	5.0	4.3
LATVIA	51	3.0	6.4	5.0	4.3
POLAND	15	4.0	5.6	4.0	4.3
ROMANIA	27	4.0	5.3	4.0	4.3
SLOVENIA	53	3.0	6.2	5.0	4.3
AZERBAIJAN	-97	5.0	2.8	2.0	3.5
BOSNIA & HERZEGOVINA	33	4.0	4.7	3.0	3.5
CZECH REPUBLIC	27	4.0	4.6	3.0	3.5
ESTONIA	27	4.0	4.3	3.0	3.5
LITHUANIA	54	3.0	5.6	4.0	3.5
MACEDONIA	47	3.0	5.5	4.0	3.5
RUSSIA	-83	5.0	2.6	2.0	3.5
BULGARIA	47	3.0	3.6	3.0	3.0
KYRGYZ REPUBLIC	48	3.0	3.2	2.0	3.0
UZBEKISTAN	-20	5.0	1.1	1.0	3.0
ARMENIA	66	2.0	4.9	3.0	2.5
GEORGIA	60	2.0	4.9	3.0	2.5
HUNGARY	63	2.0	6.2	5.0	2.5
KAZAKHSTAN	-132	5.0	2.5	1.0	2.5
SLOVAKIA	65	2.0	4.5	3.0	2.5
TAJIKISTAN	56	3.0	2.8	2.0	2.5
UKRAINE	43	3.0	1.8	1.0	2.0
BELARUS	86	1.0	3.1	2.0	1.5
MOLDOVA	98	1.0	2.4	1.0	1.0
MONTENEGRO	---	---	--	--	---
SERBIA	29	4.0	--	--	---
TURKMENISTAN	-274	5.0	--	--	---
KOSOVO	---	---	--	--	---
Northern Tier CEE	44	3.0	5.4	4.0	3.5
Southern Tier CEE	42	3.0	5.5	4.0	3.8
Eurasia	-12	5.0	2.9	2.0	2.5
R,B,C in 2006	44	3.0	5.2	4.0	3.8

World Bank, *World Development Indicators 2008* (April 2008).

Figure 25

Economic Growth Trends Worldwide



EBRD, *Transition Report 2007* (November 2007); and IMF, *World Economic Outlook* (November 2008). Country growth rates are weighted by GDP in the regional averages.

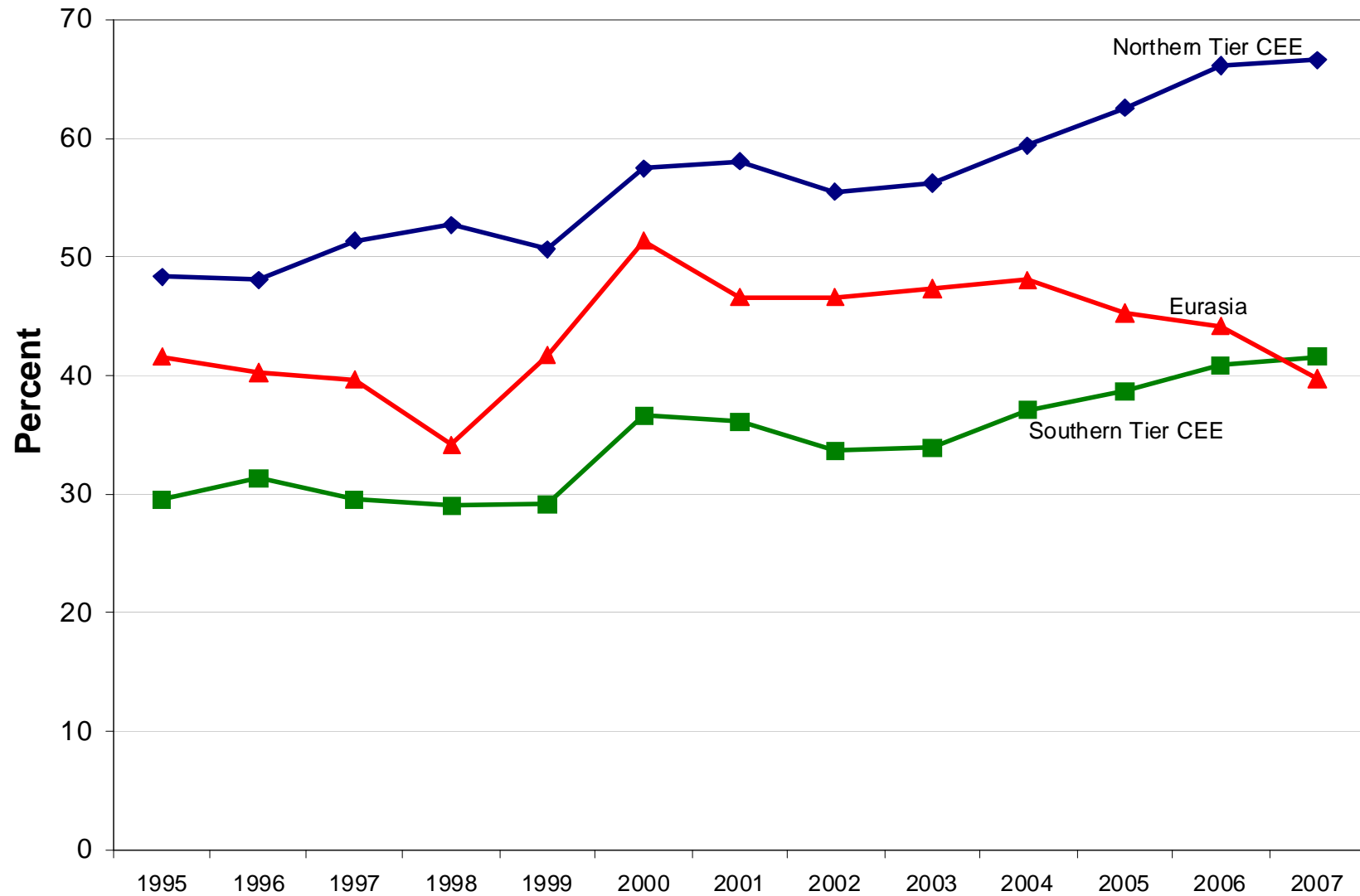
Table 13. Economic Growth Estimates

	2007	2009	2009	Change from 2007 to 2009
		October 2008 forecast	November 2008 forecast	
MOLDOVA	4.0	6.5	4.7	-0.7
HUNGARY	1.3	2.3	1.7	-0.4
MACEDONIA	5.0	5.0	3.7	1.4
ALBANIA	6.0	6.3	4.6	1.4
BELARUS	8.2	8.0	5.8	2.4
ROMANIA	6.0	4.8	3.5	2.5
TAJIKISTAN	7.8	7.0	5.1	2.7
SERBIA	7.1	6.0	4.4	2.7
CROATIA	5.6	3.7	2.7	2.9
BULGARIA	6.2	4.2	3.1	3.1
BOSNIA HERZ	6.8	5.0	3.7	3.2
KYRGYZ REPUBLIC	8.2	6.7	4.9	3.3
SLOVENIA	6.1	3.7	2.7	3.4
POLAND	6.6	3.8	2.8	3.8
UZBEKISTAN	9.5	7.5	5.5	4.0
TURKMENISTAN	11.6	10.3	7.5	4.1
RUSSIA	8.1	5.5	4.0	4.1
CZECH REPUBLIC	6.6	3.4	2.5	4.1
KAZAKHSTAN	8.9	5.3	3.9	5.0
UKRAINE	7.6	2.5	1.8	5.8
ESTONIA	6.3	0.5	0.4	5.9
MONTENEGRO	9.7	5.0	3.7	6.1
SLOVAKIA	10.4	5.6	4.1	6.3
ARMENIA	13.8	8.0	5.8	8.0
LITHUANIA	8.9	0.7	0.5	8.4
GEORGIA	12.4	4.0	2.9	9.5
AZERBAIJAN	23.4	16.4	12.0	11.4
LATVIA	10.3	-2.2	-2.8	13.1
KOSOVO	3.5	--	---	--
Northern Tier CEE	7.1	2.2	1.5	5.6
Southern Tier CEE	6.2	5.0	3.7	2.5
Eurasia	10.3	7.3	5.3	5.0

IMF, *World Economic Outlook* (November 2008), *Regional Economic Outlook, Europe* (October 2008) and *Regional Economic Outlook, Middle East and Central Asia* (October 2008). Country growth rates are equally weighted in the regional averages.

Figure 26

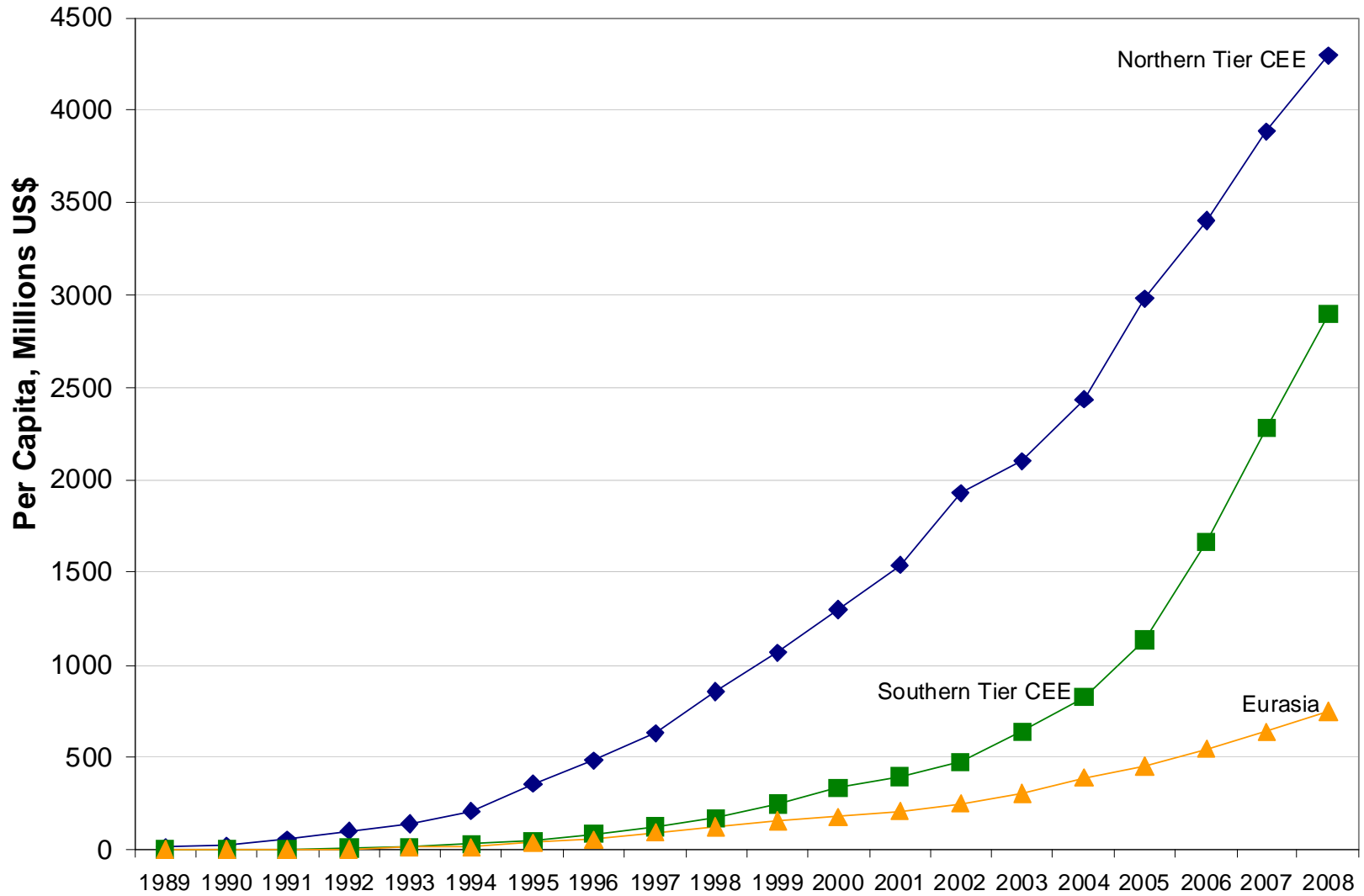
Exports as a % of GDP



World Bank, *World Development Indicators 2008* (April 2008).

Figure 27

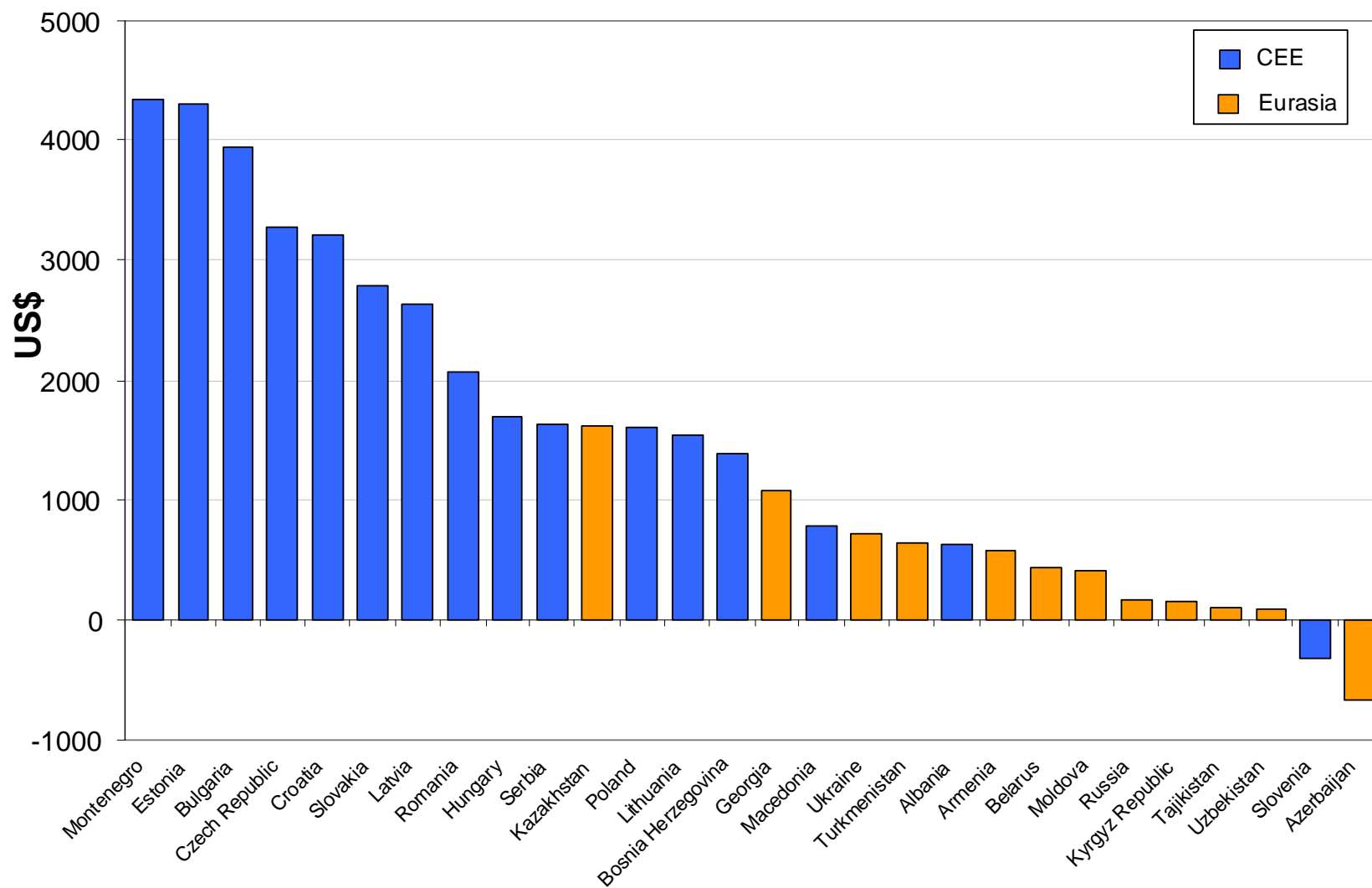
Cumulative Foreign Direct Investment



EBRD, *Transition Report 2008* (November 2008) and World Bank, *World Development Indicators 2008* (April 2008).

Figure 28

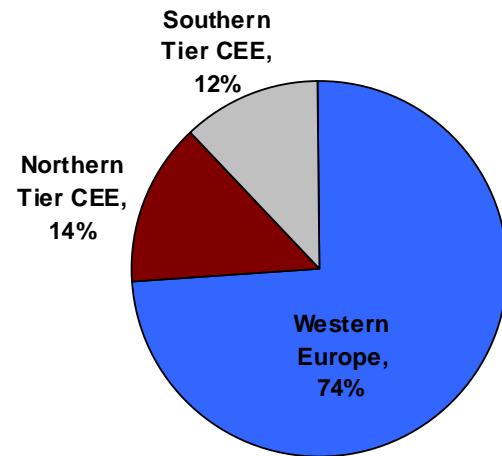
Foreign Direct Investment 5 year cumulative per capita, 2004-2008



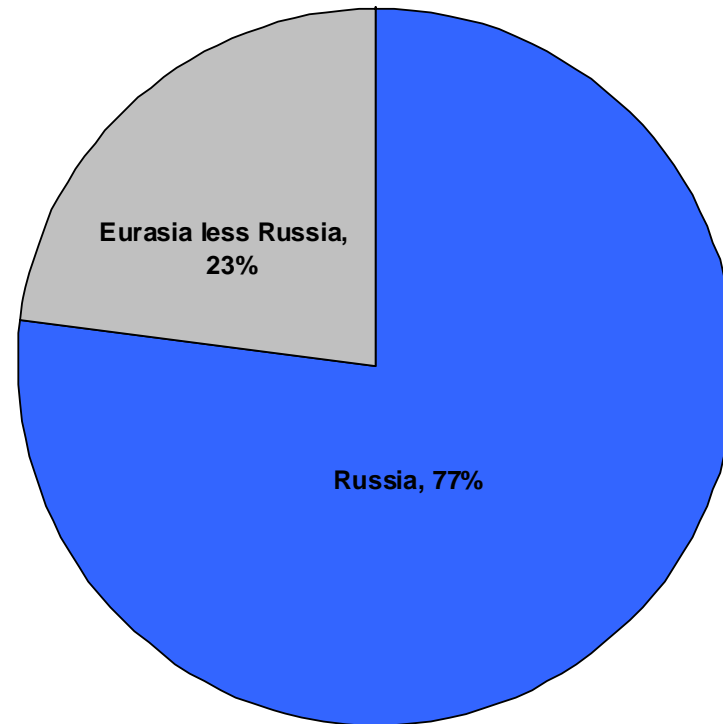
EBRD, *Transition Report 2008* (November 2008) and World Bank, *World Development Indicators 2008* (April 2008).

Area of Europe vs. Eurasia (square miles)

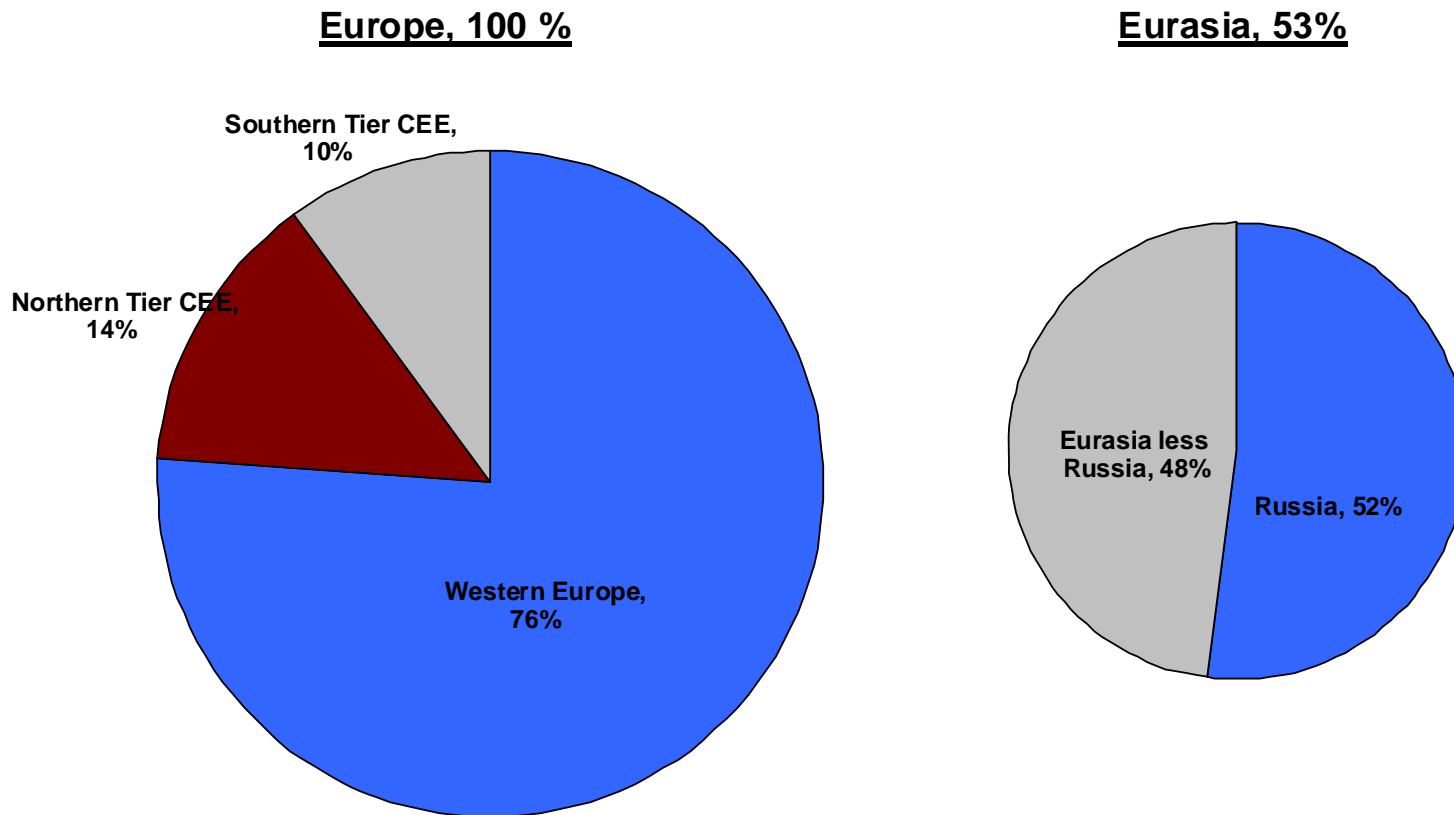
Europe, 23%



Eurasia, 100%



Population Size of Europe vs. Eurasia



Economic Size of Europe vs. Eurasia, PPP

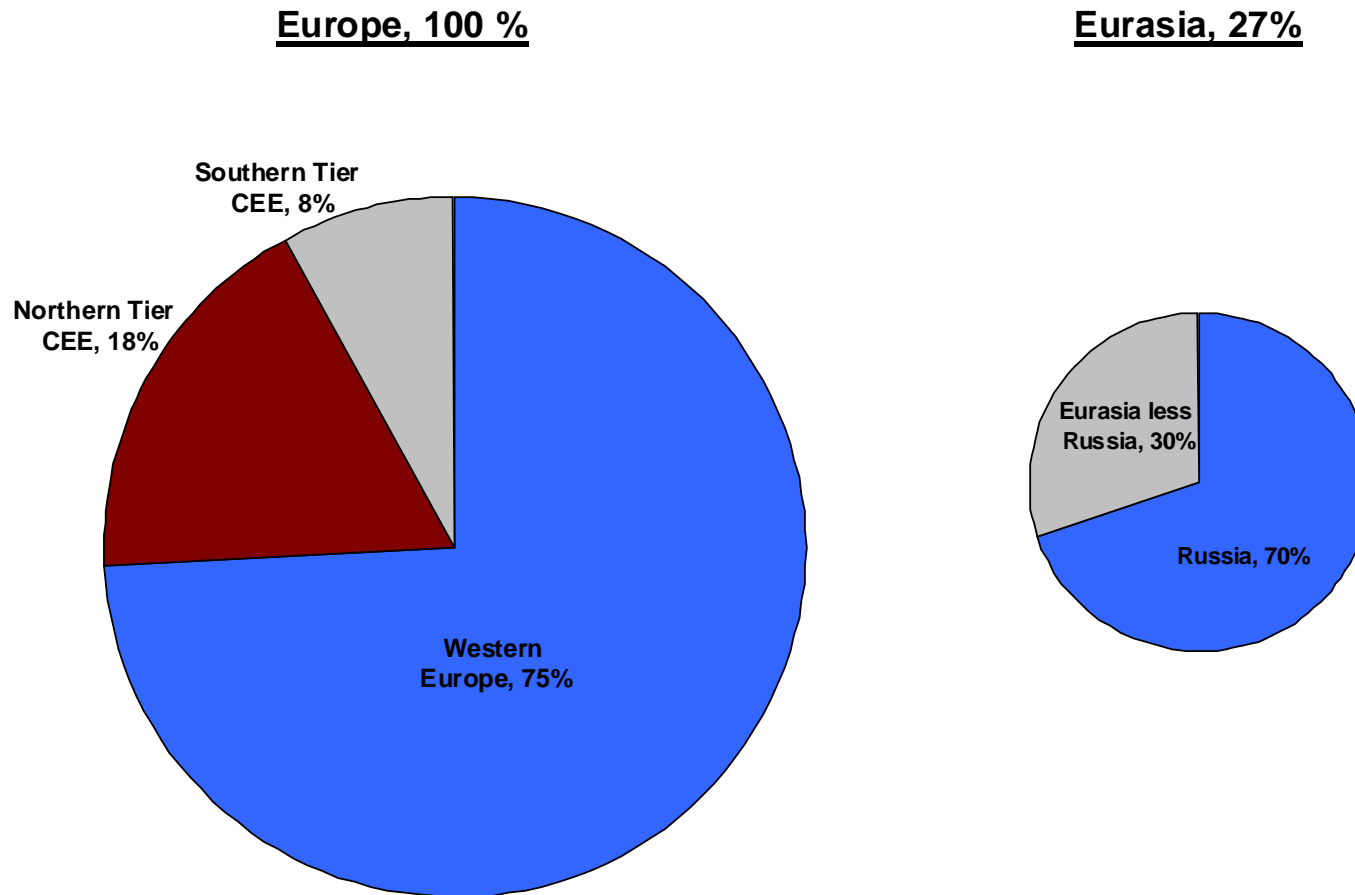
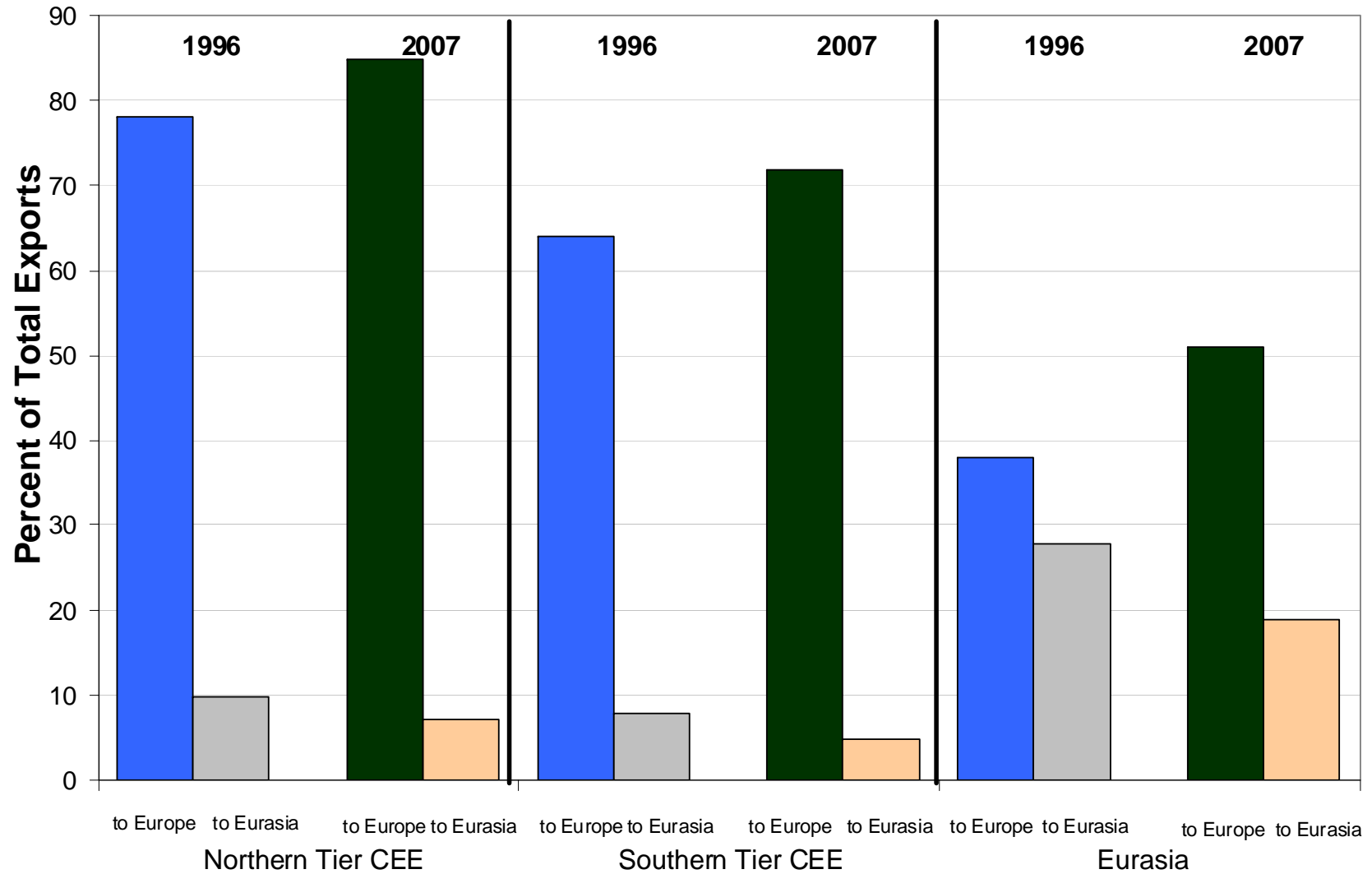


Figure 35

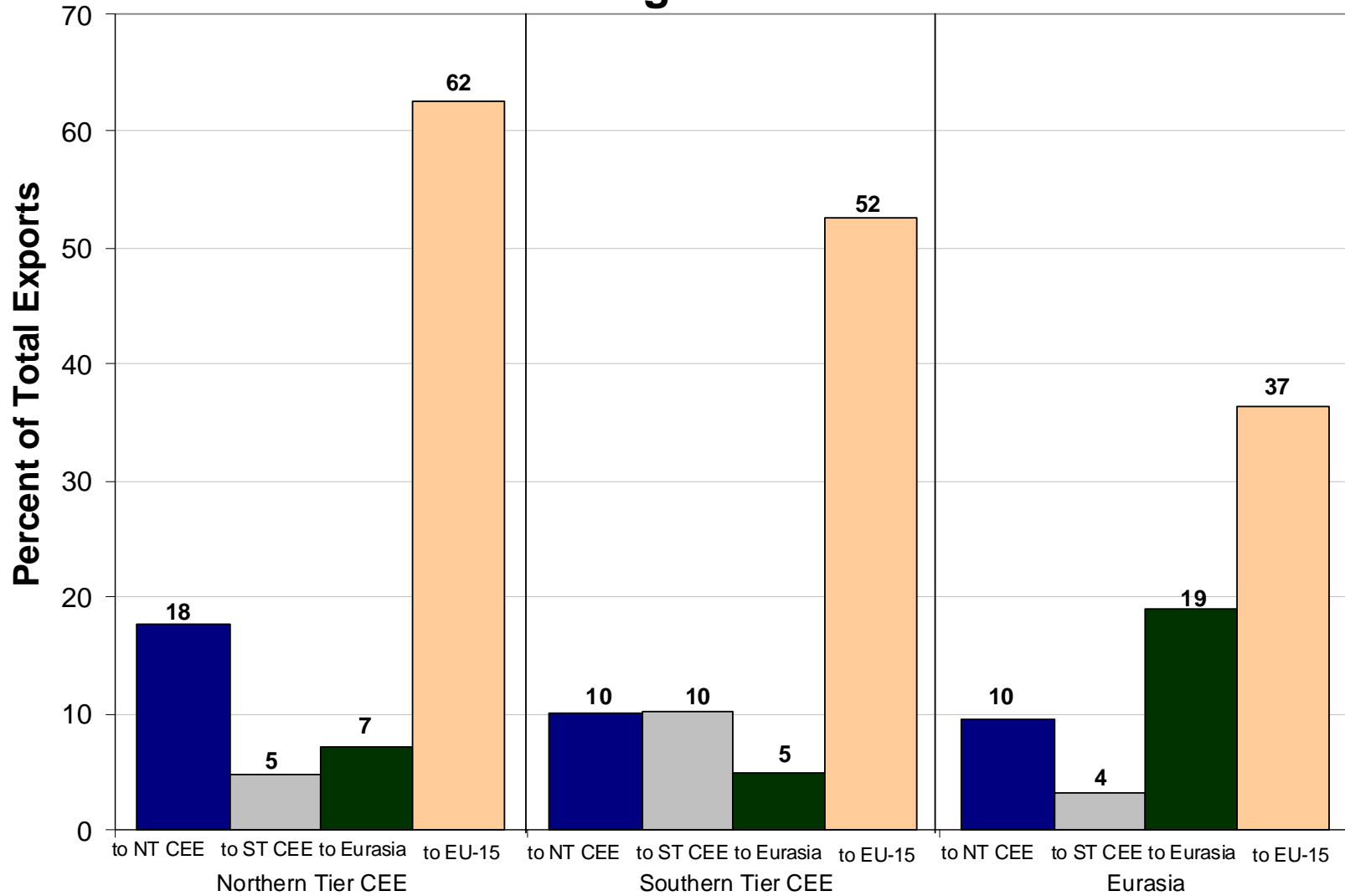
Percentage of Merchandise Exports Destined for Western Europe & CEE vs. for Eurasia



IMF, *Direction of Trade Database* (2008).

Figure 36

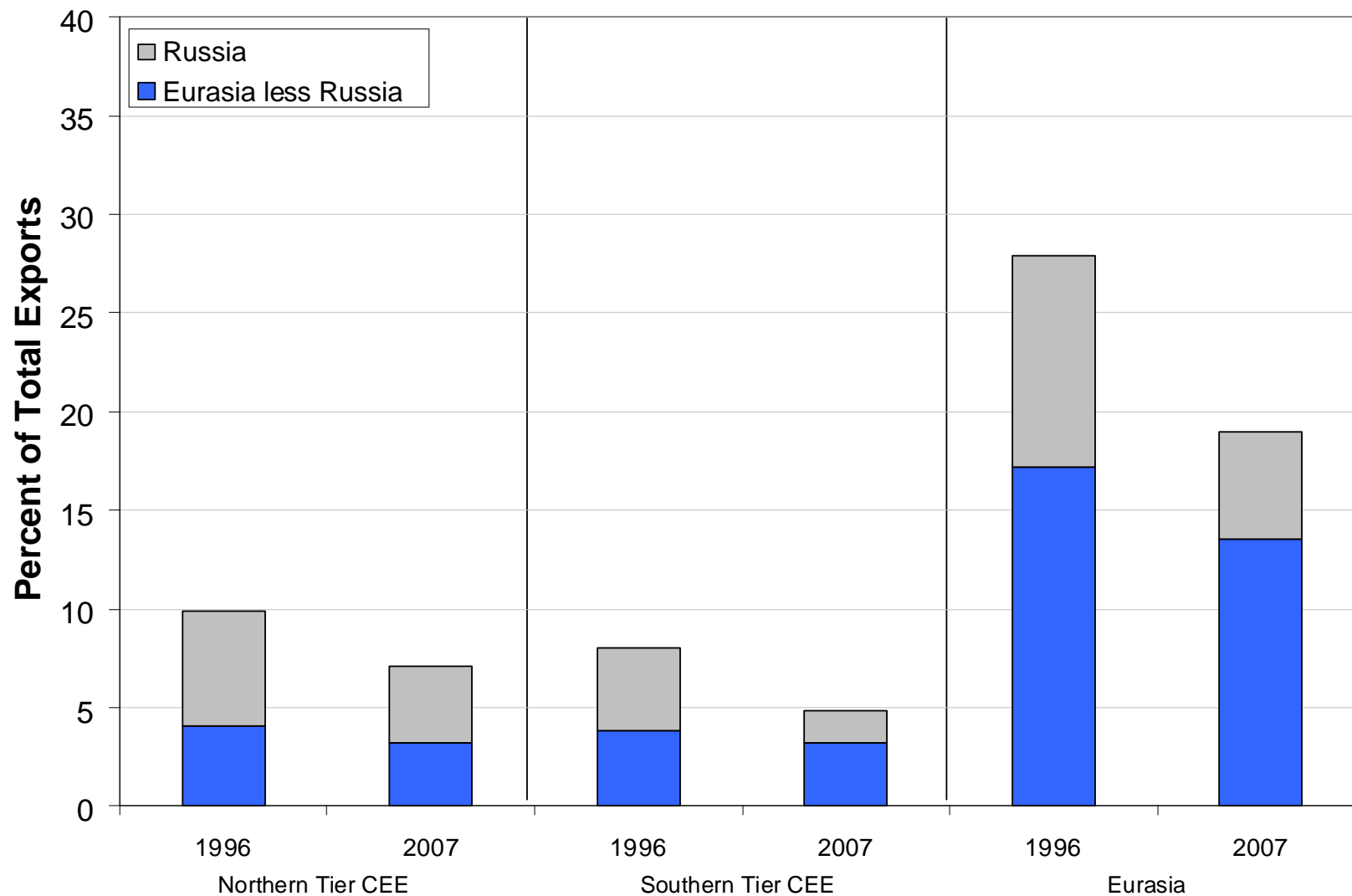
Percentage of Merchandise Exports Destined for Sub-Regions: 2007



IMF, *Direction of Trade Database* (2008).

Figure 37

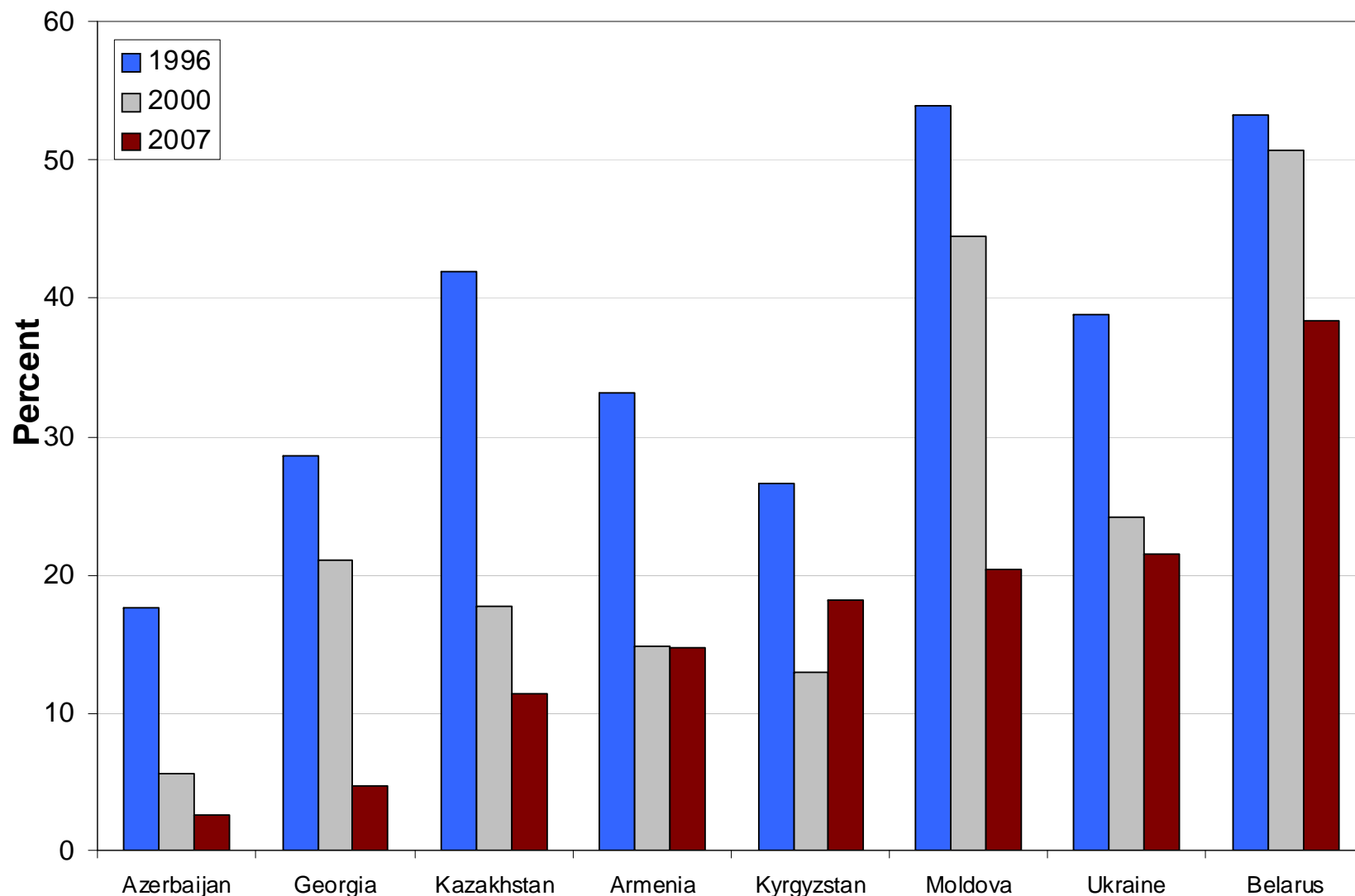
Percentage of Merchandise Exports to Eurasia



IMF, *Direction of Trade Database* (2008).

Figure 38

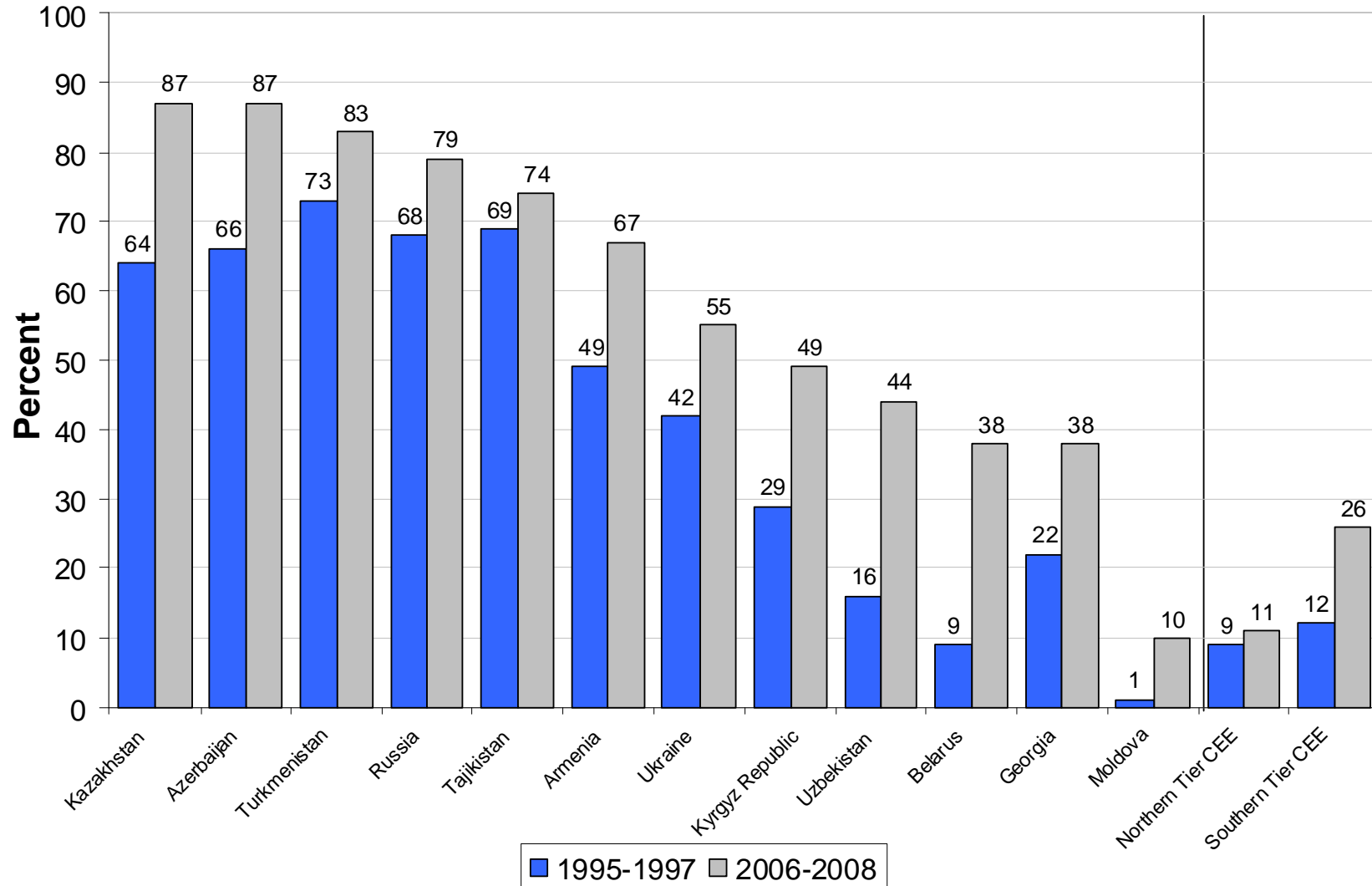
Percentage of Eurasian Merchandise Exports Destined for Russia



IMF, *Direction of Trade Database* (2008).

Figure 39

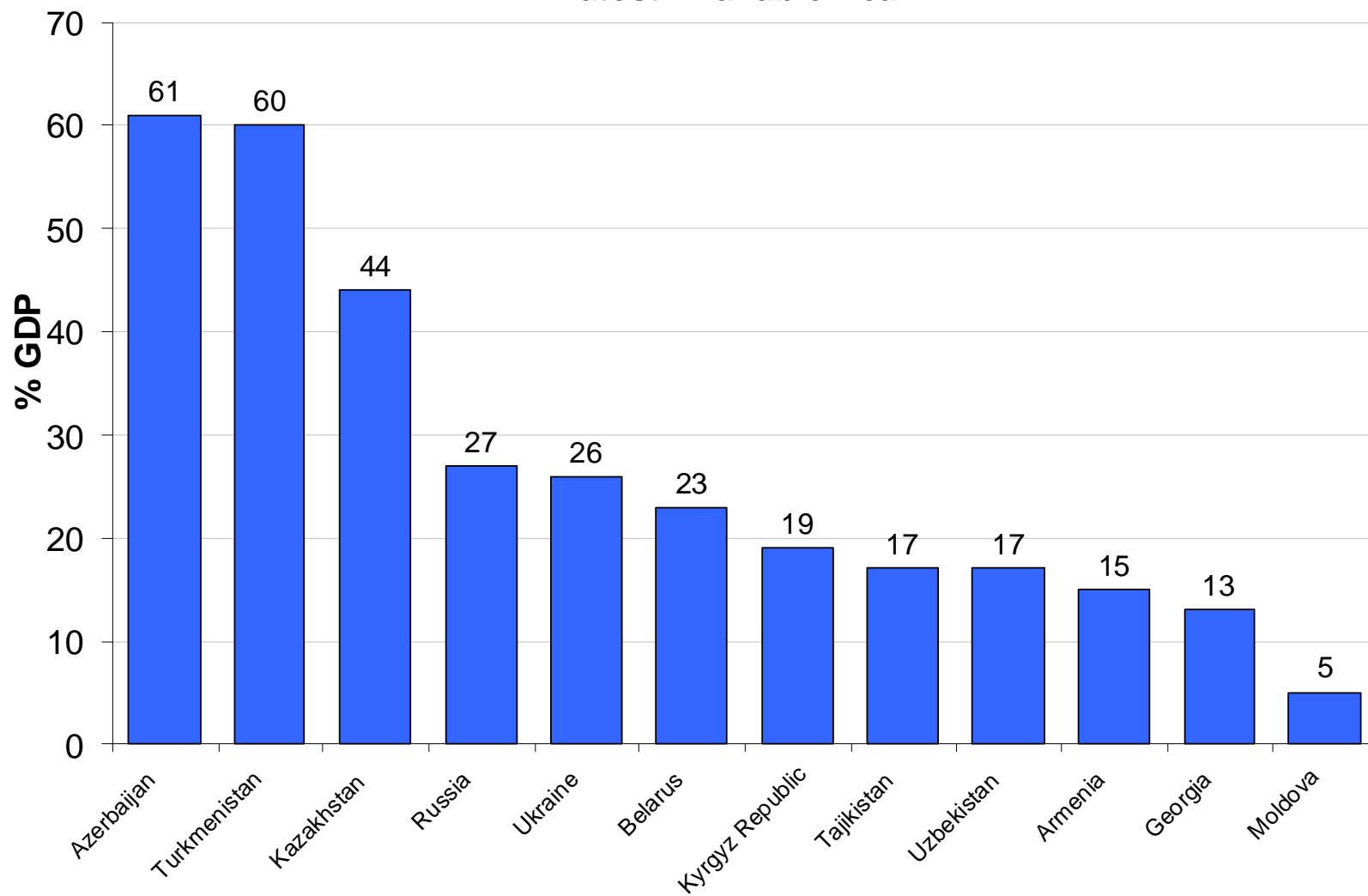
Fuels, Ores, Metals and Precious Stones Exports as % of Total Exports



Economist Intelligence Unit, various Country Reports and World Bank, *World Development Indicators 2008* (April 2008). Most recent data for Turkmenistan is 2001; Uzbekistan, 2005.

Figure 40

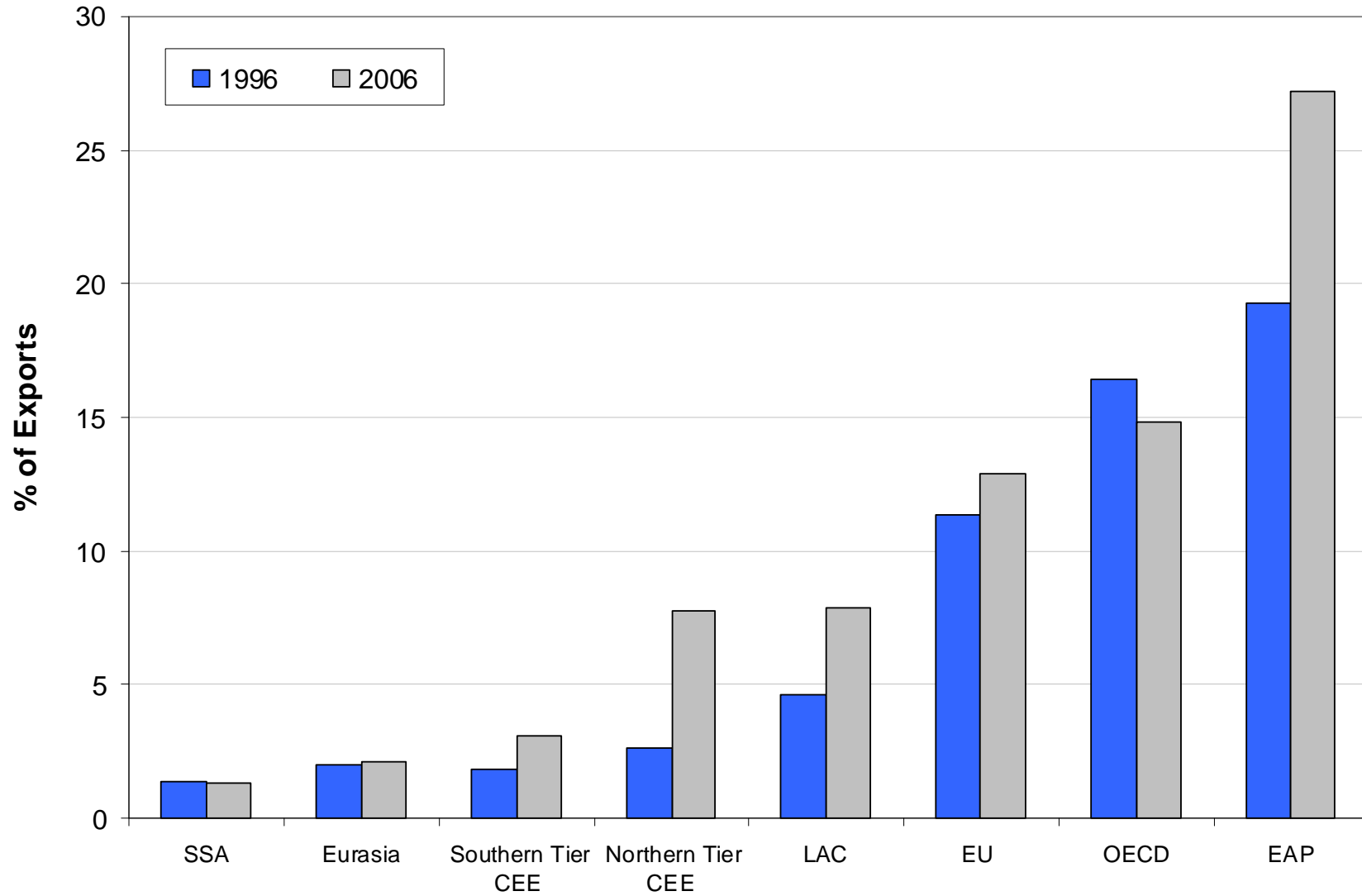
Fuels, Ores, Metals, Precious Stones as % of GDP Latest Available Year



Economist Intelligence Unit, various Country Reports and World Bank, *World Development Indicators 2008* (April 2008).

Figure 41

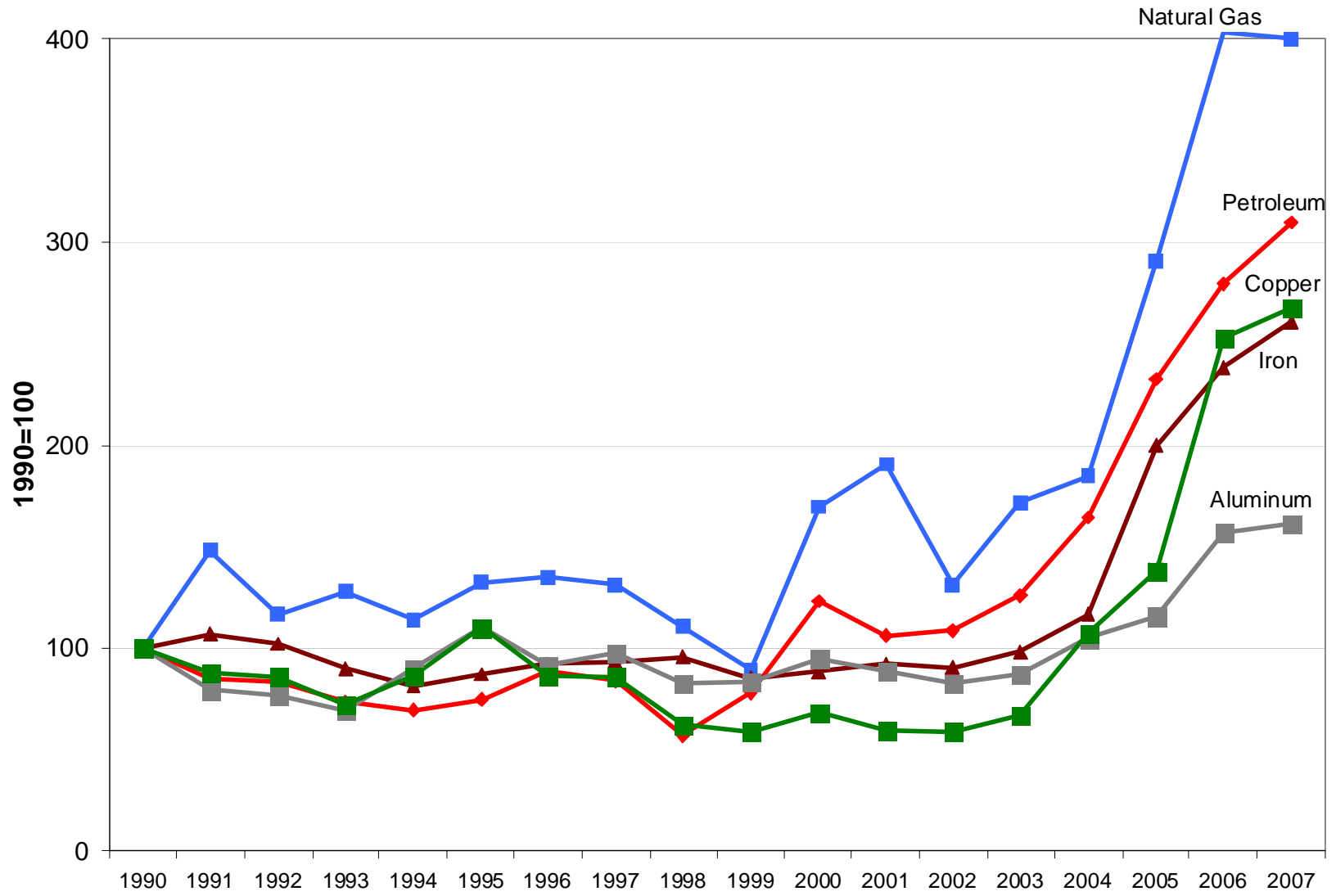
High Tech Exports % Total Exports



World Bank, *World Development Indicators 2008* (April 2008).

Figure 42

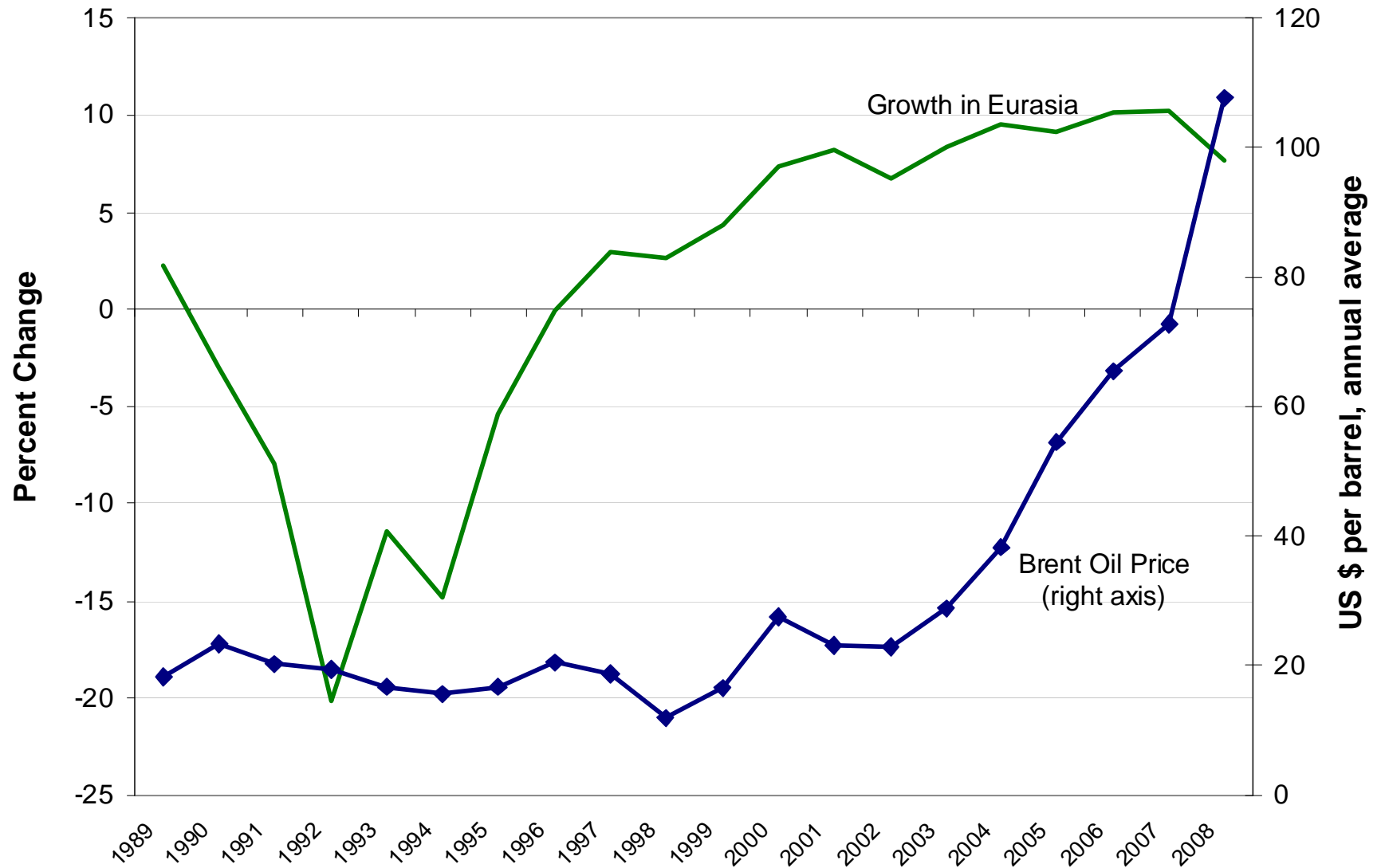
Commodity Price Growth



IMF, *World Economic Outlook* (2008).

Figure 43

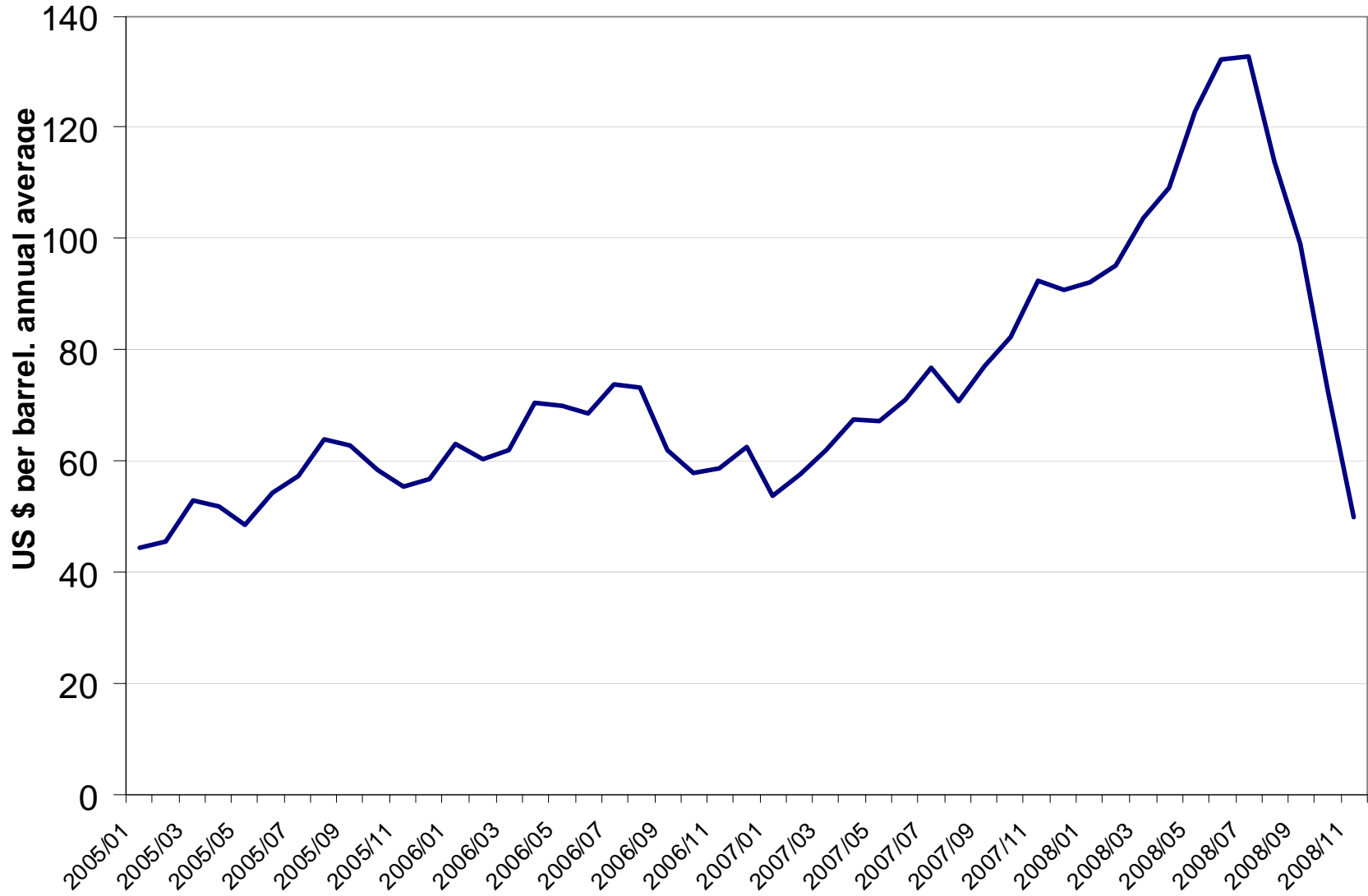
Oil Prices and Growth in Eurasia



EBRD, *Transition Report 2008* (November 2008); and World Bank, *Commodity Price Data, Pink Sheet* (November 2008).

Figure 44

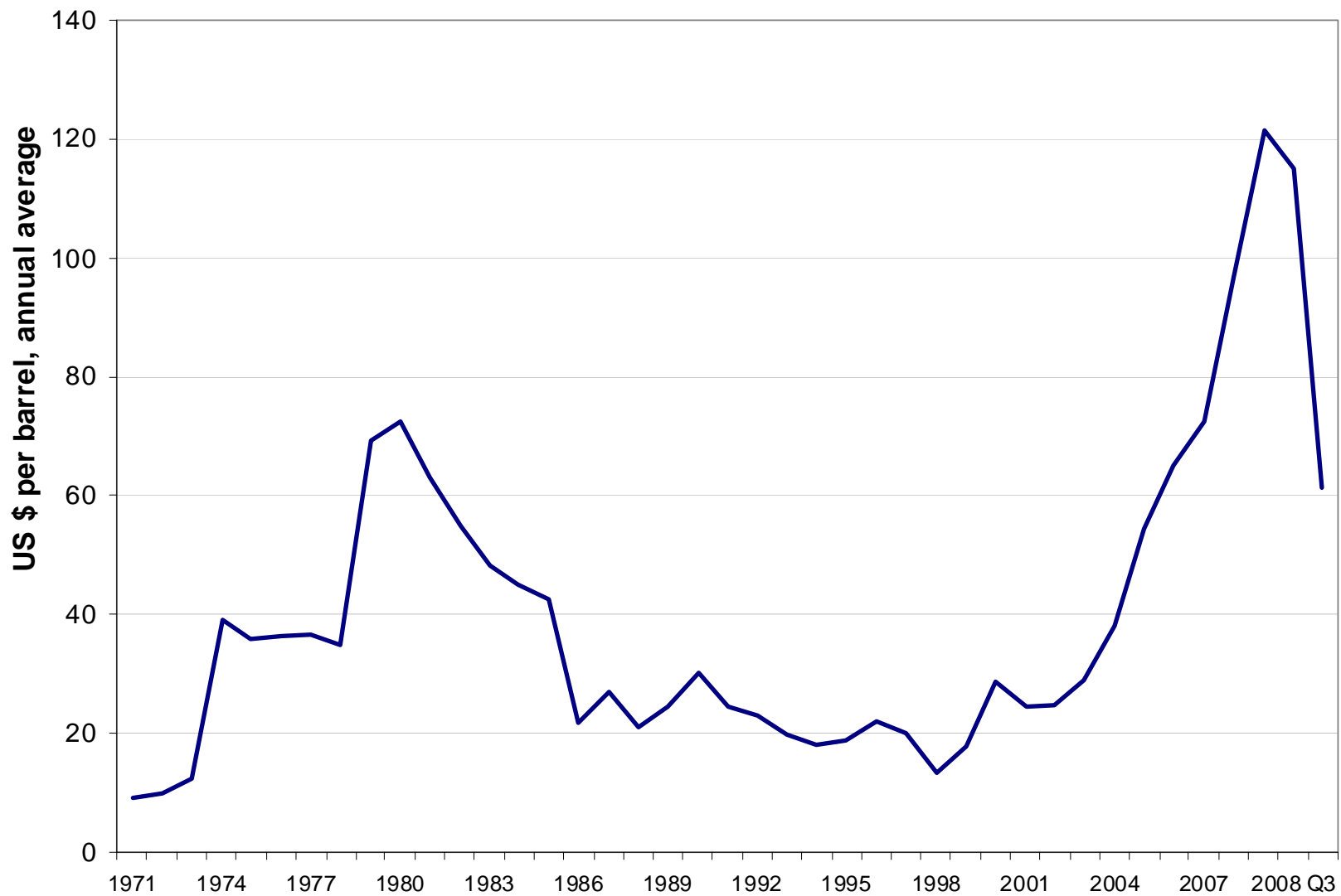
Brent Oil Price



World Bank, Commodity Price Data, Pink Sheet (November 2008).

Figure 45

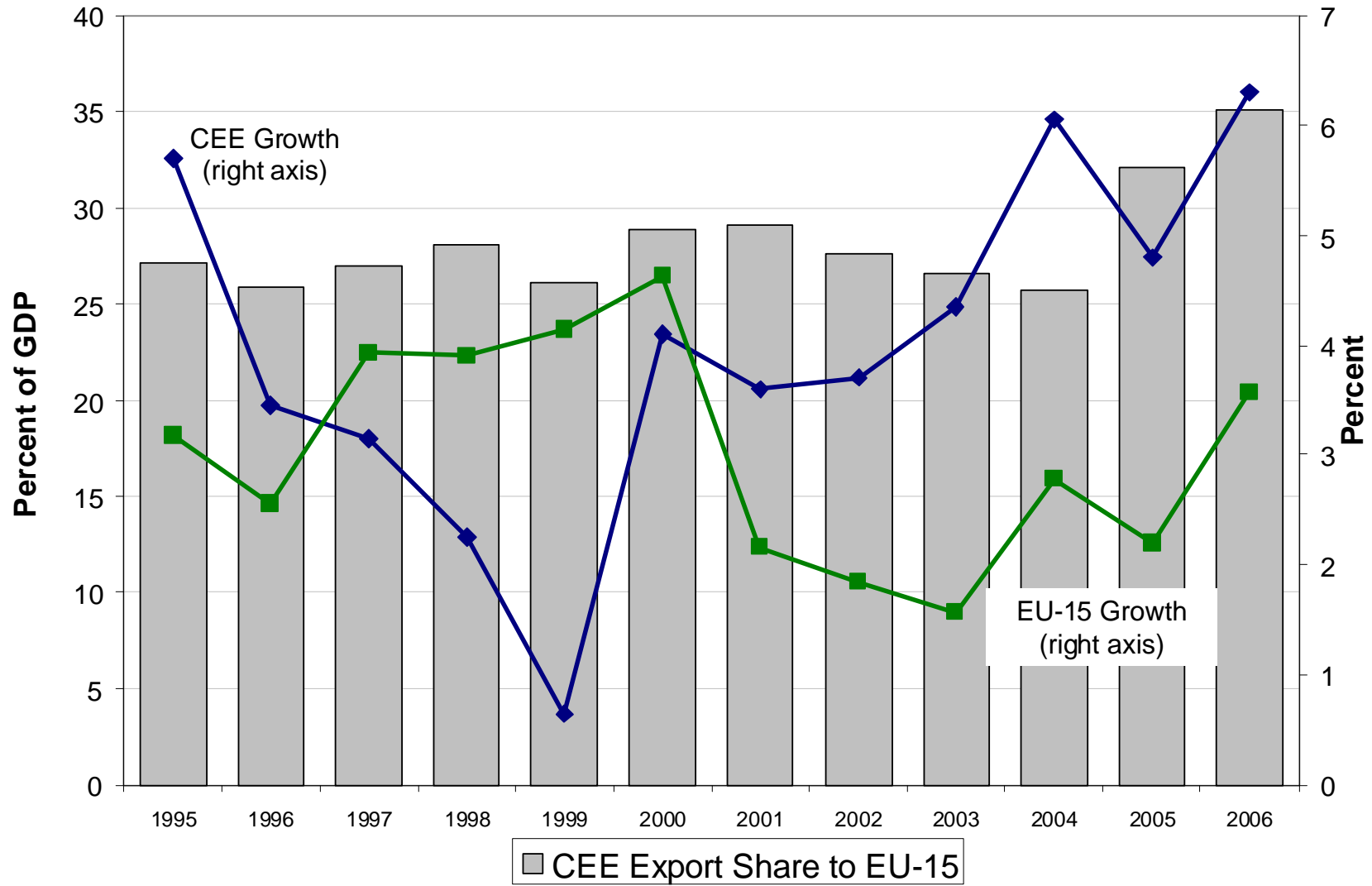
Brent Oil Price



World Bank, *Commodity Price Data, Pink Sheet* (November 2008).

Figure 46

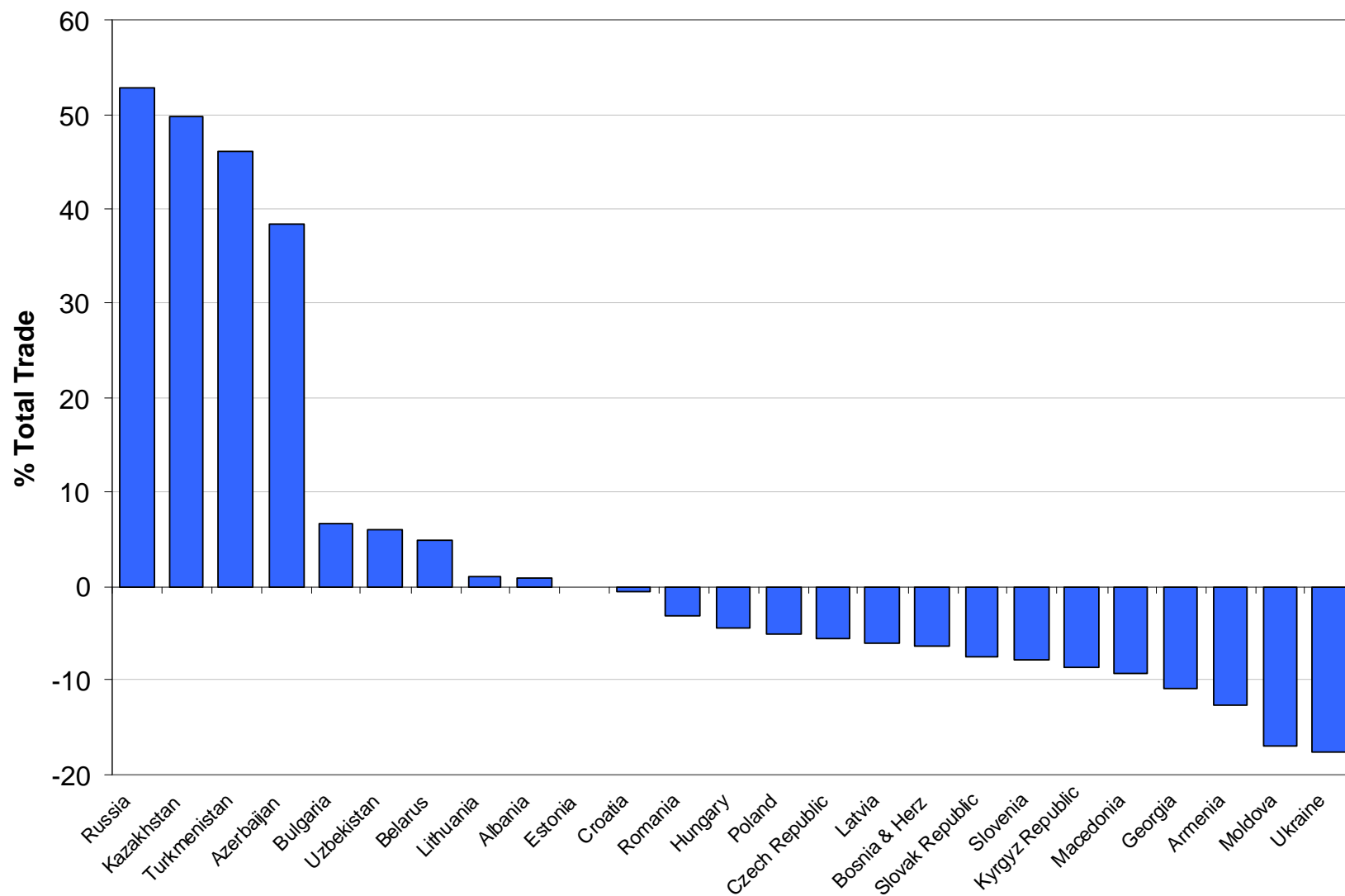
Trade and Growth in Central and Eastern Europe & EU-15



EBRD, *Transition Report 2007* (November 2007); World Bank, *World Development Indicators 2008* (April 2008); and IMF, *Direction of Trade Database* (2007).

Figure 47

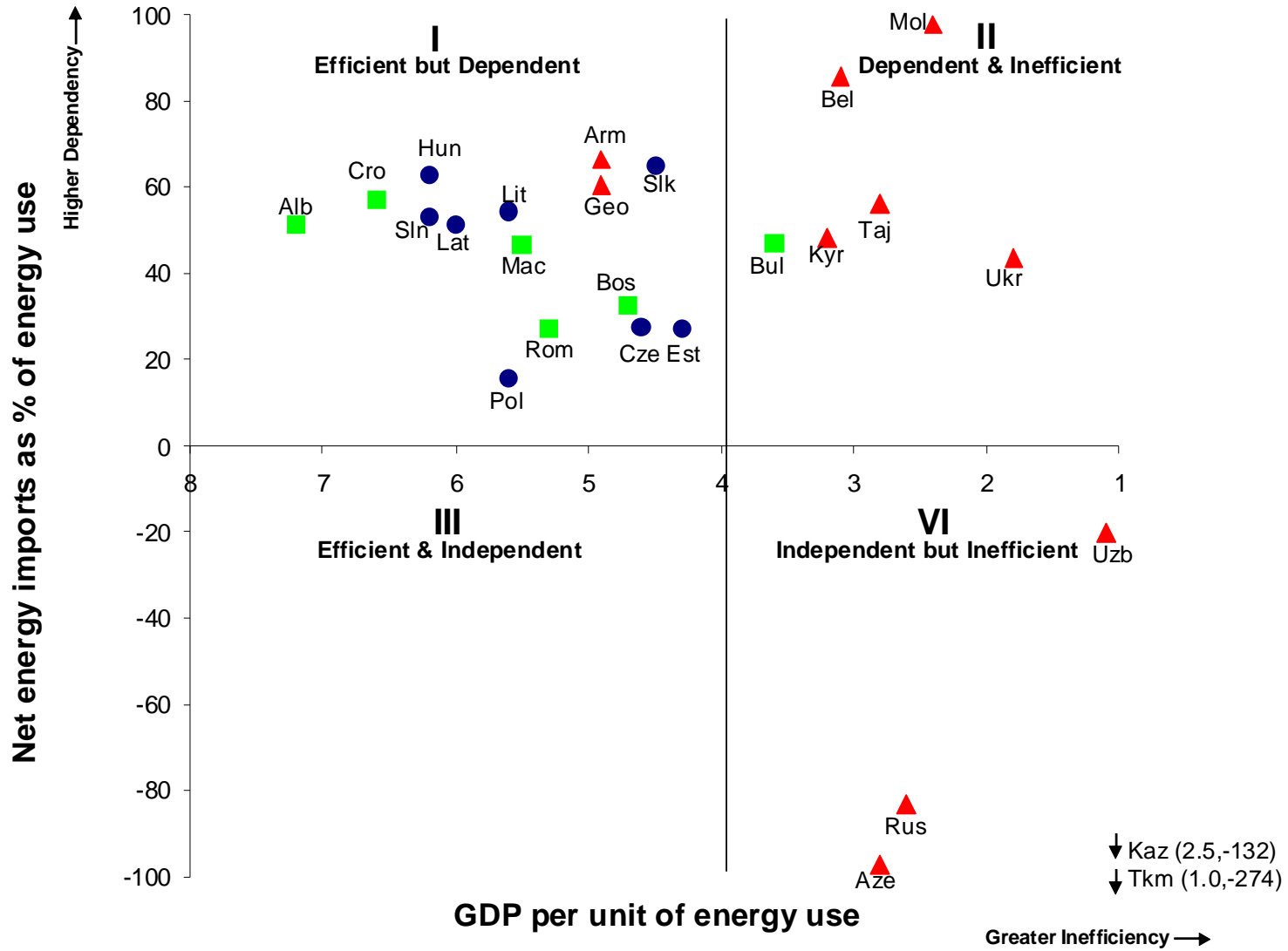
Net Fuel Exports as % of Merchandise Trade in 2006



World Bank, *World Development Indicators 2008* (April 2008).

Figure 48

Energy Dependency and Efficiency



World Bank, *World Development Indicators 2008* (April 2008).

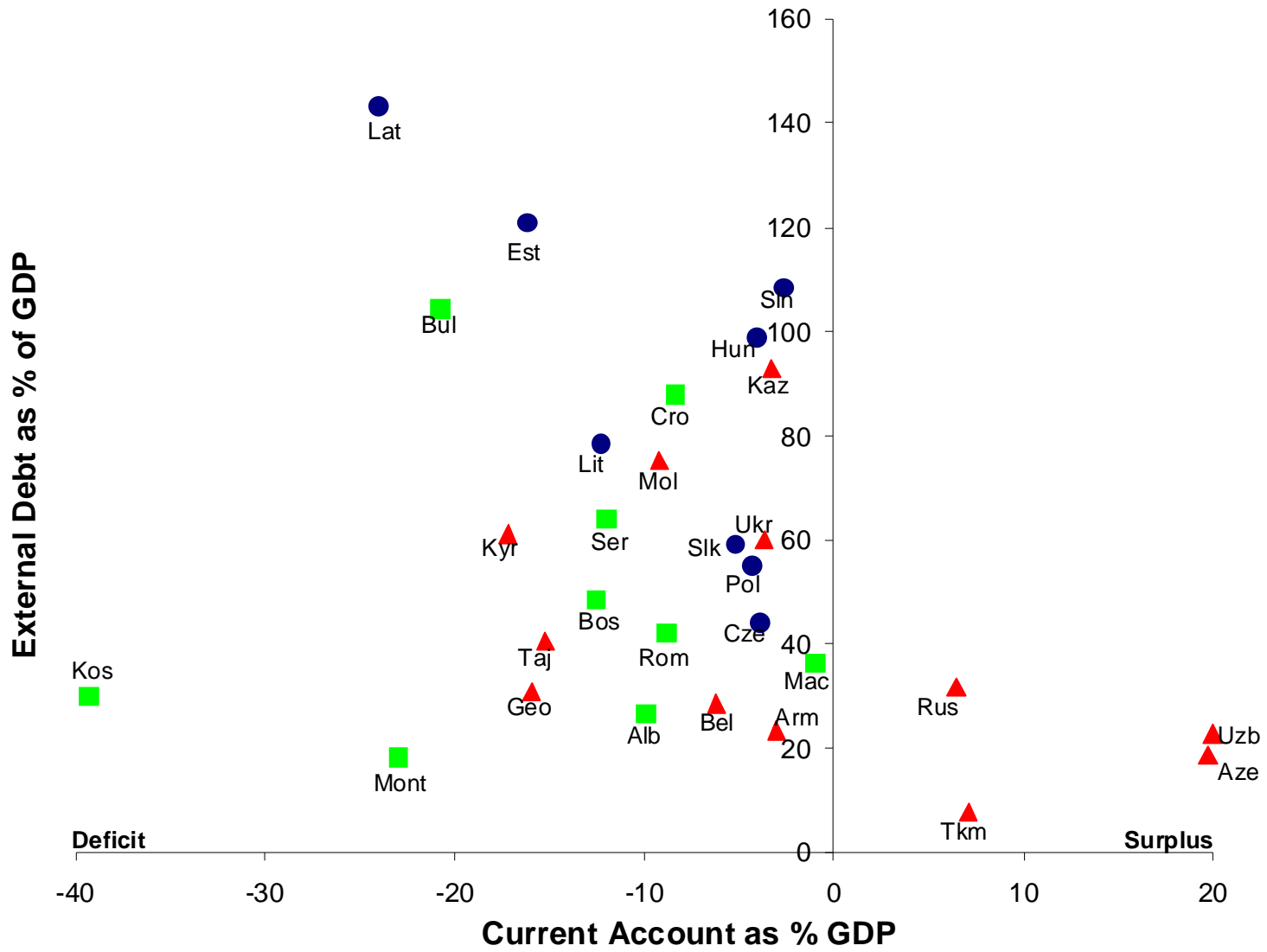
Table 14. Dependency on Russian Energy

	% of total Oil Imports from Russia	% of Total Gas Imports from Russia	% of Domestic Consumption of Gas from Russia	
	2005	2005	2005	2006
ROMANIA	63	63	23	28
AZERBAIJAN	---	---	36	35
CROATIA	---	---	--	37
POLAND	96	63	47	47
HUNGARY	97	77	62	54
SLOVENIA	95	51	--	64
UKRAINE	---	---	79	66
LITHUANIA	94	100	100	78
ESTONIA	95	100	100	78
LATVIA	95	100	100	78
CZECH REPUBLIC	69	75	84	79
SERBIA MONTENEGRO	---	---	57	87
BULGARIA	89	100	89	96
BELARUS	---	---	100	98
SLOVAKIA	99	100	108	100
MACEDONIA	---	---	--	100
GEORGIA	---	---	100	100
FRANCE	15	23	26	20
GERMANY	34	40	43	36
GREECE	29	84	96	82
UK	13	---	--	--
SPAIN	15	---	--	--

Department of Energy, *EIA Russia* (May 2008); Z. Baran testimony (July 2007); A Cohen, *Europe's Strategic Dependence on Russian Energy* (November 2007). Oil from Saudi Arabia and Venezuela combined comprises 25% of American total imports.

Figure 49

Current Account Balance & External Debt in 2007



World Bank, *World Development Indicators 2008* (April 2008).

Table 15. Financial Market Indicators

	Domestic Credit as% GDP	# Banks	Foreign Owned Banks	% of Foreign Owned to total	Asset Share of Foreign Owned Banks	Stock Market Capitalization % of gdp	Reserves of Imports in months
	2007-2008	2007	2007	2007	2007	2007	2006
ESTONIA	89.3	15	13	86.7	98.7	26.9	2.3
LATVIA	93.9	25	14	56.0	63.8	10.8	4.0
CROATIA	76.6	35	16	45.7	90.4	119.6	5.3
SLOVENIA	79.0	27	11	40.7	28.8	57.2	3.1
HUNGARY	59.2	40	27	67.5	64.2	32.4	3.0
KAZAKHSTAN	45.9	35	18	51.4	38.5	39.2	6.8
LITHUANIA	61.2	14	6	42.9	91.7	24.7	3.3
BULGARIA	78.4	29	21	72.4	82.3	51.3	5.0
UKRAINE	58.8	175	40	22.9	39.4	79.2	5.0
MONTENEGRO	127.6	11	8	72.7	78.7	99.1	1.5
CZECH REPUBLIC	39.9	37	15	40.5	84.8	37.4	3.6
SLOVAKIA	42.3	26	15	57.7	99.0	8.6	3.1
POLAND	33.4	64	54	84.4	75.5	44.1	4.0
MACEDONIA	36.4	18	11	61.1	85.9	32.8	5.5
RUSSIA	38.5	1136	86	7.6	17.2	111.8	16.9
MOLDOVA	39.5	16	7	43.8	24.8	--	3.0
ROMANIA	32.9	31	26	83.9	87.3	27.3	6.2
BOSNIA HERZEGOVINA	25.4	32	21	65.6	93.8	71.8	4.7
ALBANIA	36.4	17	15	88.2	94.2	--	4.3
BELARUS	25.0	27	16	59.3	19.7	--	0.5
GEORGIA	30.5	19	14	73.7	90.6	13.0	2.5
SERBIA	37.5	35	21	60.0	75.5	53.7	9.6
TAJKISTAN	16.0	11	4	36.4	6.6	--	1.8
AZERBAIJAN	15.2	44	6	13.6	7.5	--	3.8
KYRGYZ REPUBLIC	18.7	22	10	45.5	58.7	3.1	4.3
ARMENIA	8.7	22	12	54.5	49.0	1.0	5.7
TURKMENISTAN	1.4	11	4	36.4	1.1	--	13.0
UZBEKISTAN	15.9	29	5	17.2	--	4.3	12.6
Northern Tier CEE	62	31	19	60	76	30	3
Southern Tier CEE	56	26	17	69	86	65	5
Eurasia	26	129	19	39	32	36	6

EBRD, *Transition Report 2008* (November 2008) and World Bank, *World Development Indicators 2008* (April 2008).

Table 16. Global Financial Crisis Ratios & Vulnerabilities

	ST debt to reserves		CA deficit		Ratio of Domestic Credit to For. Bank		Stock Market Capitalization		% vulnerable
	2006-2007	vulnerable?	to FDI ratio	vulnerable?	Ownership	vulnerable?	% of GDP	vulnerable?	
ARMENIA	0.3	---	-0.6	---	17.8	---	1.0	---	0
MACEDONIA	0.2	---	-0.2	---	42.4	---	32.8	---	0
GEORGIA	0.1	---	-1.2	at risk	33.7	---	13.0	---	17
ROMANIA	0.6	at risk	-0.9	---	37.7	---	27.3	---	17
TURKMENISTAN	--	---	surplus	---	127.3	at risk	negligible	---	17
AZERBAIJAN	0.1	---	surplus	---	202.7	H vul.	negligible	---	17
SERBIA	0.2	---	-0.8	---	49.7	---	53.7	at risk	17
SLOVAKIA	1.2	H vul.	-0.7	---	42.7	---	8.6	---	25
BOSNIA HERZEGOVINA	0.3	---	-3.6	H vul.	27.1	---	---	---	25
ALBANIA	0.3	---	-2.8	H vul.	38.6	---	negligible	---	25
KYRGYZ REPUBLIC	0.1	---	-2.6	H vul.	31.9	---	3.1	---	25
CZECH REPUBLIC	0.8	at risk	-0.9	---	47.1	---	37.4	---	33
TAJIKISTAN	0.5	at risk	-1.3	at risk	242.4	---	negligible	---	33
HUNGARY	0.7	at risk	-0.8	---	92.2	at risk	32.4	---	33
POLAND	0.4	at risk	-0.8	---	44.2	---	44.1	at risk	33
KAZAKHSTAN	0.7	at risk	-0.4	---	119.2	at risk	53.9	at risk	50
RUSSIAN FEDERATION	0.1	---	surplus	---	223.8	H vul.	111.8	H vul.	50
ESTONIA	2.6	H vul.	-1.7	at risk	90.5	at risk	26.9	---	58
SLOVENIA	--	---	-1.5	at risk	274.3	H vul.	57.2	at risk	58
UKRAINE	0.7	at risk	-0.7	---	149.2	at risk	80.2	H vul.	58
CROATIA	0.5	at risk	-1.1	at risk	84.7	---	119.6	H vul.	58
MOLDOVA	1.1	H vul.	-1.3	at risk	159.3	at risk	negligible	---	58
LITHUANIA	1.3	H vul.	-2.0	H vul.	66.7	---	24.7	---	58
BELARUS	3.1	H vul.	-6.2	H vul.	126.9	at risk	negligible	---	58
LATVIA	2.3	H vul.	-2.9	H vul.	147.2	at risk	10.8	---	58
MONTENEGRO	--	---	-2.3	H vul.	162.1	at risk	99.1	H vul.	67
BULGARIA	0.7	at risk	-1.3	at risk	95.3	at risk	51.3	at risk	67
UZBEKISTAN	--	---	surplus	---	---	---	4.3	---	---

EBRD, *Transition Report 2008* (November 2008) and World Bank, *World Development Indicators 2008* (April 2008).

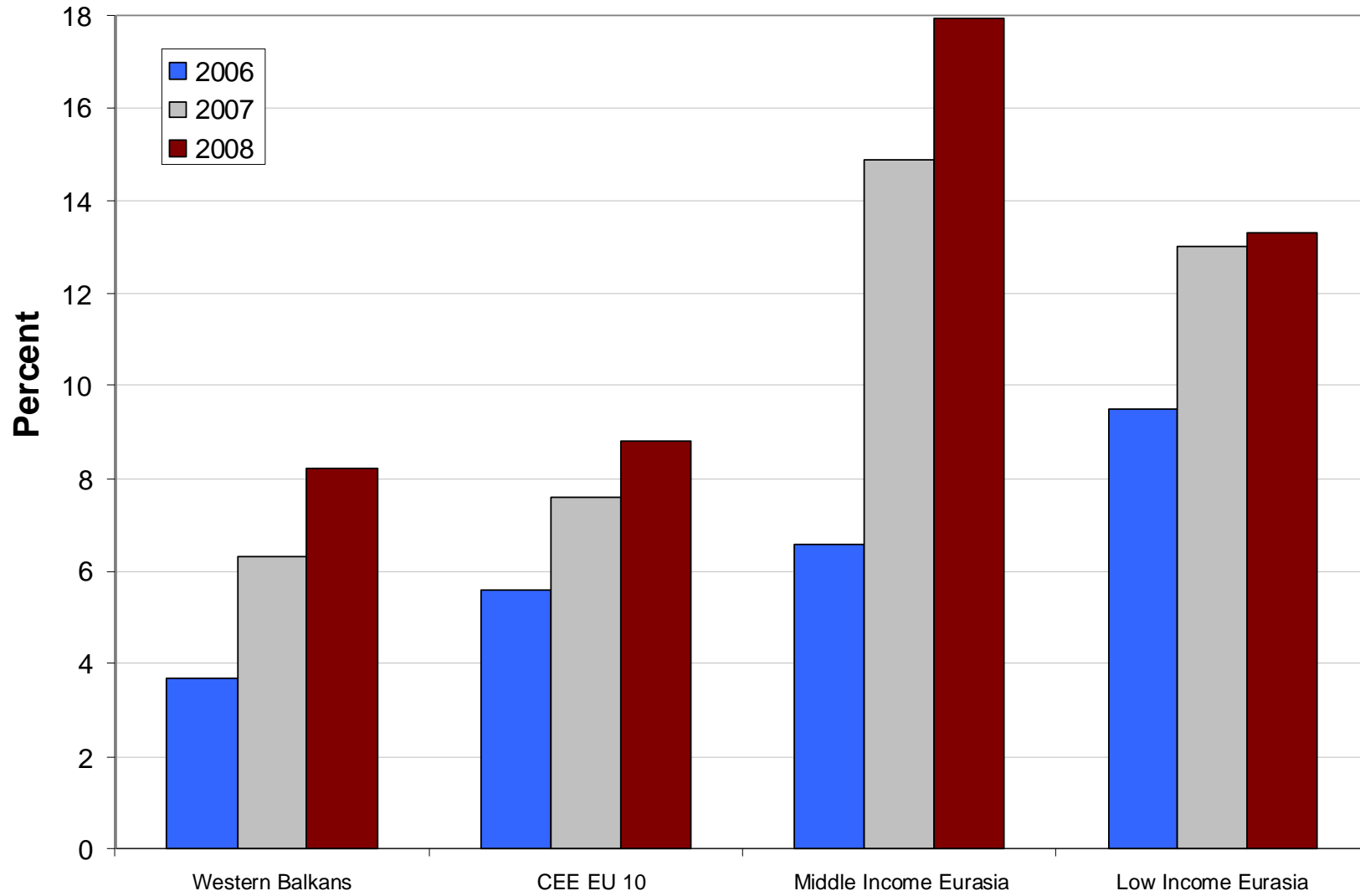
ST debt to reserves: Highly vulnerable: > 1.0; at risk: >0.4 and <1.0; CA def to FDI: highly vulnerable: > 2.0; at risk: > 1.0 and <2.0

Domestic credit to foreign bank ownership: highly vulnerable: >200; at risk: >90 < 200. Stock Mkt Capit: highly vulnerable: >80; at risk: >40 and < 80.

Percent vulnerable: highly vulnerable = "1.5"; at risk = to "1.0". Max score possible: 6

Figure 50

Total Inflation



World Bank (2008). 2008 data are estimated through August.

Human Capital

Table 17 provides the primary data (converted to a one to five score) for the seven indicators of the human capital index. *Tables 18* through *20* provide the disaggregated data that goes into *Table 17*.

Good macroeconomic performance needs to filter down to favorably affect social conditions. To improve the likelihood that reforms and good economic performance are sustained, economic growth needs to be broad-based and, more broadly, the gains at the macro level shared widely at the micro level. At the very least, from an economic standpoint, the deterioration of human capital (of health and education conditions) that has characterized much of the transition on some dimensions needs to stabilize or be prevented if the gains in other transition spheres are to continue.

One challenge of analyzing human capital trends is that the data tend to be less available and less timely (i.e., with a greater lag than the economic and democracy data), and perhaps less reliable. With that significant caveat as context, it has been more than two years since we systematically looked at the human capital indicators region-wide, i.e., since *MCP #10* in August 2006. Are there now stronger signs that more favorable human capital trends are following the largely favorable economic performance trends? To what extent does the CEE-Eurasia gap exist in the human capital dimension, and, to the extent that it does, are there signs that the gap is closing?

We start with an assessment of perceptions of well-being in the transition region (*Figures 51* and *52*). The World Bank and the EBRD produced the *Life in Transition Survey* in 2006 that included assessments of how people feel they are doing today relative to times prior to the onset of the transition from communism to capitalism.²⁴ The EBRD notes that “in most countries (and on average over the whole sample) a majority of respondents think that their living standards have improved since 1989.”²⁵ However, a closer look reveals that it is not a large majority. Similarly, the split by countries is roughly equal; i.e., in thirteen countries, there are more people who viewed a deterioration in living standards since 1989 than those who saw an improvement, while in another thirteen transition countries, the opposite held true. In Russia, the negative and positive responses virtually balanced out. (No data were available for Turkmenistan and separately for Kosovo).

Moreover, the responses by sub-regions varied substantially. The majority of persons in seven of the eight Northern Tier CEE countries felt their living standards were better in 2006 than in 1989. Hungarians were the salient exception: more than 60% of Hungarians felt their living standard was worse in 2006 than in 1989 vs. only slightly more than 20% who felt living standards were better.

In striking contrast, the majority of persons in seven of the eight Southern Tier CEE countries felt their living standards were worse in 2006 than in 1989. In parts of the

²⁴ The EBRD, *Transition Report 2007* (November 2007) provides elaboration of findings and methodology.

²⁵ *Ibid.*, p. 49.

former communist Yugoslavia, the imbalance of negative views over positive views is very large. In Bosnia-Herzegovina, more than 65% of persons viewed their living standards in 2006 as less favorable as what it was in 1989, while slightly less than 20% viewed their living standards in 2006 better than in 1989. Responses in Serbia and Montenegro were very similar. The Southern Tier CEE outlier is Albania where almost 80% of the population surveyed felt that their living standard was better in 2006 than in 1989 and only slightly more than 10% felt it was worse. In fact, no where else in the E&E region was the response so favorable as in Albania.

In Eurasia, the results are more mixed. More persons in the Central Asian Republics felt their living standards in 2006 were better than what it was in 1989 as compared to those who felt it was worse. However, perceptions were decidedly more negative in the Caucasus as well as in Ukraine and to a lesser extent Moldova. In Ukraine, e.g., slightly more than 50% of the population surveyed felt their 2006 living standard was worse than their 1989 living standards, while roughly 30% felt it was better. As previously noted, the negatives and positive perspectives roughly balanced out in Russia: 42% positive vs. 41% negative. Finally, many more Belarusians felt their living standards in 2006 were better than in 1989 (65%), than the reverse (15%).

Views on living standards presumably include broad considerations that include not just economic conditions, but also social and political changes (such as gains in political and social freedoms). *Figure 52* shows results from a question that looks at one aspect of living conditions, namely one's economic situation. The cross-country patterns are similar as that in *Figure 51*, as expected. Within each country, however, the negatives are more prominent (i.e., the present economic situation is worse) and the positive viewpoints are less prominent.

In general, these findings on perspectives do not seem to correlate closely with *levels* of development or per capita income or social conditions across countries. To what extent do they correlate with objective measures of *change* within countries?

Figure 53 provides some evidence as to why so many people in the transition region have viewed the economic situation, then vs. now, so unfavorably. It shows the current level of GDP across the region relative to what it was in 1989. Bearing in mind the clear data limitations of comparing economic output over this time period (and recognizing that output and incomes are likely underestimated some in these measures), it is nevertheless striking to observe that on average, the Southern Tier CEE countries and the Eurasian countries (less the oil producers) have only very recently obtained pre-transition levels of income. We estimate that economic output in seven transition countries will still be below 1989 levels by the end of 2008. In the Balkans, this includes Serbia (2008 GDP will be 73% of 1989 GDP), Bosnia-Herzegovina (85%), and Montenegro (86%). In Eurasia, this includes Moldova (54%), Georgia (62%), Ukraine (72%), and Tajikistan (90%). These GDP trends are certainly consistent with the observation that many people in the transition region have suffered considerable hardships and still today may be worse off economically (objectively as well as subjectively) than in pre-transition times.

Labor markets. Labor market trends also underscore these hardships (*Figure 55*). Open unemployment rates remain extraordinarily high in a handful of transition countries (i.e., close to 20% or higher), and are double-digit in almost one-half of the transition countries. The highest open unemployment rates are concentrated in the former communist Yugoslavia, with Slovenia (at 4.6% unemployment rate) the salient exception. Unemployment rates may be as high as 41% in Kosovo, followed by 34% in Macedonia, 27% in Bosnia-Herzegovina, 20% in Montenegro, 19% in Serbia, and 10% in Croatia. Of all the other transition economies, only Armenia, with an unemployment rate of 32%, has such a comparably high rate.

How do these unemployment rates compare with those of the advanced economies? The IMF estimated in October 2008 that the unemployment rate among the advanced economies (which consist of thirty-one countries) was 5.4% in 2007, forecast to rise to 5.7% in 2008 and possibly to 6.5% in 2009. According to the IMF's October 2008 forecast (which now may underestimate unemployment rates given the deepening global economic crisis), of all the thirty one countries which constitute the advanced economies, only Spain is likely to have an unemployment rate in the double-digits in this time period (11.2% in 2008 and 14.7% in 2009). The unemployment rate in the United States is currently 6.7% and is forecast to increase in the range of 8-10% in 2009. Unemployment rates in many transition countries dwarf such rates in the advanced economies.

Figure 54 (and *Table 10*) also underscores the high proportion of long-term unemployed of those who are without a job. In general, where unemployment rates are high, long-term unemployment rates constitute a disproportionate share of the unemployed. As a proportion of the unemployed, long-term unemployment is highest in Albania, at 92%. But it is also roughly 70% or higher in Armenia, Slovakia, Serbia, Bosnia-Herzegovina, Kosovo, Montenegro, and Macedonia.

Again, it is instructive to compare rates with countries outside the transition region. Long-term unemployment as a percentage of total unemployment rates in some Western Europe countries is high, though not of the order of magnitude found in the E&E countries with the highest shares. According to the OECD, long-term unemployment as a proportion of total unemployment rates in the EU-15 in 2006 was 44% on average.²⁶ In general, while unemployment rates in Western Europe have fallen quite substantially in recent years, the proportion of long-term unemployment has remained stubbornly high.²⁷ Long-term unemployment as a proportion of total unemployment in the United States was roughly only 10% in 2006, though more recent estimates have it increasing to 18%.

Accurately measuring labor market trends continues to be challenging. This is partly because of data reliability and data interpretation challenges. Estimates of unemployment rates in any one country can vary significantly depending partly on the method of calculation. Labor force surveys generally produce the more accurate (and generally, though not always, lower) estimates of unemployment rates as compared to registered

²⁶ OECD, *OECD Employment Outlook 2007*.

²⁷ Heinegg, A., R. Murphy, and R. Sprout, *Labor Markets in Eastern Europe and Eurasia* USAID/E&E Working Paper #6 (January 2007), *Table 12*, p. 39.

unemployment rates. Labor force survey rates are the numbers that we've tried to adhere to in this analysis.

Another challenge, however, is that labor markets have been adjusting in quite different ways in different parts of the transition region, via the price mechanism (i.e., real wages) or the quantity mechanism (employment) or different degrees of both. In addition, unofficial or informal economies have been very large in some economies (generally larger in Eurasia than in CEE). Similarly, underemployment has been a significant characteristic of some transition economy labor markets.

One implication of these trends is that a single labor market indicator, such as the unemployment rate, does not adequately address the significant labor market changes and costs that have been incurred in the region. The development of a labor market index, which would include price and quantity changes in the labor market, i.e., real wages as well as employment, unemployment, and underemployment rates, could be very helpful. We hope to pursue the creation of such an index, though are cognizant that the available data may (still) severely constrain its usefulness and viability.

In *MCP #10* (August 2006), we observed generally discouraging trends over time in unemployment rates. In particular, we noted that despite the resumption of economic growth in the late 1990s, there was still almost as many economies that were experiencing rising unemployment rates as those witnessing falling rates. On this barometer, labor market conditions in the region have clearly improved since then. We've been able to discern that at least nineteen transition countries have been experiencing falling unemployment rates (*Figures 55-56*). In another group of countries, there is little to no evidence of falling unemployment rates, though little evidence that rates are rising either (*Figures 57-58*). This is a very different picture than what we presented given the existing data in *MCP #10*.

Health and Demography. Infant mortality rates (*Figure 59*) and under five mortality rates (*Table 17*) continue to be far higher in the Caucasus and Central Asia than elsewhere in E&E. Infant mortality rates were forty to forty-one deaths per 1,000 live births in the Caucasus and Central Asia on average in 2006 (latest year of available data). In the rest of Eurasia, it was closer to fifteen deaths; in the Southern Tier CEE, twelve deaths; and in the Northern CEE countries, it was six deaths and close to Western Europe standards (of four deaths per 1,000 live births).

However, infant and under five mortality rates have been declining universally across the transition sub-regions. In fact, this pattern of decline pre-dated the beginning of the transition and has continued throughout the transition years. The proportionate declines have been very significant, ranging from a decline of roughly 30% in infant mortality rates from 1990 to 2006 in the Caucasus and the West NIS countries (of Ukraine, Moldova, and Belarus), to 40-50% declines in Russia, Central Asia, and the CEE countries.

Differences in life expectancy across the transition region are also relatively large, six years greater in CEE than in Eurasia on average (*Figure 60* and *Table 17*). Moreover, not only is life expectancy much lower in Eurasia, but the increase in these figures in Eurasia has been much slower than in CEE. In CEE, life expectancy has been increasing steadily since the mid-1990s. In Eurasia, life expectancy did not return to pre-transition level until 2006. Five countries still have the most recent estimates of life expectancy (in 2006) lower than what these numbers were in 1990; all five countries are in Eurasia: Belarus; Kazakhstan; Russia; Ukraine; and Uzbekistan.

Nevertheless, changes in life expectancy since *MCP #10* (i.e. in the past two years) have been at least as favorable in Eurasia as in CEE. Life expectancy from 2004 to 2006 increased in six Eurasian countries out of twelve and decreased in none; in the Southern Tier CEE, life expectancy increased in five countries out of seven; in the Northern Tier CEE countries, life expectancy increased in only three countries, and actually decreased in one country (Lithuania).

Of all the transition countries, life expectancy is highest in Slovenia, at seventy-eight years. This is equal to what it is in the United States, though less than in countries where it is highest worldwide; there are at least fifteen countries now with life expectancy from 80-82 years of age. Life expectancy in the transition region is lowest in Turkmenistan at 63 years. This is comparable to life expectancy in South Asia (64 years), and well above life expectancies in Sub-Saharan Africa (50 years on average in 2006).

What sets life expectancy patterns in the E&E region apart from the rest of the world is the region's very high life expectancy gender gap; that is the gap between longer living females and shorter living males (*Figure 61*). Life expectancy gender gaps tend to increase as economies develop and as the general population lives longer. Females live only three years longer than males on average among the low income economies of the world, in Sub-Saharan Africa and South Asia. Neither males nor females, in other words, live relatively long in these economies. The gender gap among the middle income developing countries is five years; the gap among the high income developed countries is six years.

In striking contrast, the life expectancy gender gap in the transition region is eight years. Within the transition region, this gap is highest among a group of countries that we refer to as the Northern Former Soviet Union (NFSU). This sub-region includes the three Baltic countries, Russia, and West NIS (or Ukraine, Belarus, and Moldova). All of these countries except Moldova have populations in which females live longer than males by at least eleven years. In Russia, where the gap is the largest in the world, it is fourteen years. Of the transition countries, Kazakhstan also has a gap of comparable size to the NFSU countries, of eleven years.

In the rest of the world, the two countries with life expectancy gender gaps that come closest to the NFSU gap of eleven years are Thailand and Puerto Rico, both with gaps of nine years. Argentina follows with eight years. Only five countries outside the E&E region have life expectancy gaps of seven years: Japan; South Korea; France; Colombia;

and Brazil. All other countries of the world outside the E&E region have life expectancy gender gaps of six years or less.

It is also notable that the life expectancy gender gap is higher in the transition region in 2006 than in 1990, and this gap among the NFSU countries has resumed an upward trend in recent years.

Why is the E&E region such an outlier in this health attribute? Why do males die so much earlier in life than females in much of the transition region? We examined this question in some detail in *MCP #10* and in our demography and health working paper by examining trends in lifestyle conditions, non-medical deaths such as suicide, homicides, and accidents, and infectious diseases such as TB and HIV/AIDS.²⁸ The explanations remain the same and we summarize briefly here.

The lion's share of deaths in Eastern Europe and Eurasia is due to non-communicable diseases, some of which are due to genetic attributes, though most stem from lifestyle choices (in particular, those related to alcohol, smoking, diet and exercise-related conditions). Drawing from the World Health Organization, 61% of deaths in the NFSU countries in 2003 can be attributed directly to lifestyle diseases vs. 40% in the EU-15. In contrast, only 4% of NFSU country deaths were due to infectious, parasitic, maternal and perinatal conditions, compared to 7% in the EU-15. A broader definition (which includes non-medical deaths including suicides and deaths from accidents and homicides, though also includes deaths due to fire and war) increases the proportion to 74% in the NFSU vs. 45% in the EU-15 countries (and 56% in the U.S.). Obesity and stress-related deaths, which are particularly high in Ukraine, Russia, Latvia, Belarus, and Estonia make up 71-91% of lifestyle deaths. Seventy-one percent of elderly Russian adults were either overweight or obese in 2003, an increase from 59% in 1992.

As noted, infectious diseases contribute to a small percentage of deaths in the region. Nevertheless, trends over time in parts of E&E are troublesome. *Figure 62* highlights such trends in tuberculosis incidence. It shows that with the exception of the Northern Tier CEE countries, tuberculosis in the transition region is notably higher than in Western Europe, and, in the countries of the former Soviet Union (i.e., Eurasia as well as the three Baltic countries), the incidence of TB is higher in recent years than what it was in the early 1990s. However, the most recent year of data show a decline in TB incidence in the large majority of countries in the transition, from 2005 to 2006. The exceptions are Georgia, Tajikistan, Ukraine, and Uzbekistan. While it is difficult to discern the longer term trend, it may be that most of the Eurasian countries have reached a maximum of TB incidence between 2003-2005.

The UNAIDS *2008 Report on the Global Aids Epidemic* finds that the HIV prevalence rate in much of E&E continues to increase, though from a very low level. In no E&E countries, was it reported that the prevalence has decreased. Data on the adult HIV prevalence rate in 2007 was compared with that of 2001. This rate worldwide was 0.8

²⁸ USAID/E&E, *MCP #10* (August 2006), pp. 53-56, and Heinegg, Murphy, and Sprout, *Demography and Health in Eastern Europe & Eurasia* #1 (June 2005).

percent in both time periods. In Sub-Saharan Africa, it was 5.0% in 2007, down from 5.7% in 2001. In the United States, it was 0.6% in both time periods. In the E&E region, sixteen of twenty-four countries for which data were available had an adult prevalence rate of 0.1% or less in 2007. The highest adult HIV prevalence rate in E&E in 2007 was in Ukraine (1.6%), followed by Estonia (1.3%), Russia (1.1%), Latvia, (0.8), and Moldova (0.4). All of these countries exhibited a notable increase in the prevalence since 2001.

Some demographic trends are also troubling. We noted in *MCP #10* that while the range in crude death rates and fertility rates is very large across the transition countries, some transition countries have among the highest crude death rates worldwide along with among the lowest fertility rates worldwide. This combined with emigration in many countries has contributed to the contraction of population.

The range in crude death rates across the transition countries is almost as high as the global extremes (*Figure 63*). In our demography and health working paper (June 2005), we defined and identified a Muslim-majority group of transition countries for analytical purposes. This group consists of four of the five Central Asian Republics (all except Kazakhstan, which consists of a Muslim population just short of a majority, 47%), Azerbaijan, and Albania (Kosovo is also Muslim-majority, though we had no data on the demographics of Kosovo). As a country grouping, the E&E Muslim-majority countries have among the lowest crude death rates worldwide, comparable to Middle East standards and to those in Latin America.

At the other extreme, the NFSU countries have among the highest crude death rates as compared to regional country groupings; i.e., comparable to Sub-Saharan Africa on average. In 2006, five transition countries had crude death rates equal to or greater than the Sub-Saharan Africa of fifteen deaths per 1,000 people: Russia; Belarus; Latvia; and Bulgaria all at fifteen deaths; and Ukraine at sixteen deaths.

Individual country crude death rates show greater variation than country groupings of course. Highest crude death rates worldwide are found in Swaziland (twenty-two), Angola (twenty-one) and Mozambique (twenty). Lowest crude death rates worldwide are found in the UAE (one), Kuwait (two), Oman, Syria, and the West Bank/Gaza (all three). Lowest crude death rates in the transition region are found in Tajikistan, Uzbekistan, Azerbaijan, and Albania (all at six).

In *MCP #10* we noted that crude death rates have held steady or fallen in much of the world since 1990 with the exception of two regions: Sub-Saharan Africa and the E&E region. Since then and with two more years of data, it is apparent that the trend of increasing crude death rates in E&E is continuing; it is less obvious in the case of Sub-Saharan Africa.

Fertility rates in E&E are among the lowest worldwide; on average, 1.6 births per woman in 2006, comparable to Western Europe at 1.5 births per woman (*Figure 64*). In fact, the only E&E countries that are above the replacement rate of 2.1 births per woman are five

of the six Muslim-majority countries: Tajikistan (3.4); Turkmenistan (2.6); Uzbekistan (2.4); the Kyrgyz Republic (2.4); and Azerbaijan (2.3). Kazakhstan has a fertility rate equal to the replacement rate of 2.1. The lowest recorded fertility rate worldwide in 2006 was 1.0 births per woman in Hong Kong and 1.1 in South Korea. Three countries worldwide have a fertility rate equal to 1.2, all E&E: Slovakia; Bosnia-Herzegovina; and Moldova.

A notable distinction between the fertility rates in Eastern Europe with Western Europe is that the low fertility rates in Western Europe have been maintained since at least the 1980s, while the fertility rates in the E&E region have dropped significantly since the 1980s, and particularly with the onset of the collapse of communism.

Both emigration and a natural decrease in population (i.e., death rates exceeding birth rates) have contributed to an overall contraction in population in Europe and Eurasia each year since 1995. Eighteen countries worldwide had their population contract from 1990 to 2006. All eighteen countries are transition countries. Twenty-four countries are forecast to have their population contract from 2006 to 2015. Of those twenty-four countries, the only countries that are not transition countries are Cuba, Germany, Italy, and Japan.

Seven E&E countries stand out in terms of shrinking populations. In other words, the most significant declines in population worldwide from 2006 to 2015 are forecast to take place in Bulgaria, Moldova, and Ukraine (all with a decline -0.8%), followed by Russia, Romania, Latvia, and Belarus (with a decline of -0.6%).

Education. High primary school enrollments have been maintained across the sub-regions, and tertiary enrollments have been increasing since the mid-1990s, though much more so in the Northern Tier CEE than in the Southern Tier CEE and Eurasia (*Figure 65*). Enrollment rates remain very low, however, in many Eurasian and Southern Tier CEE countries in tertiary education, around 30% on average (as of 2005, latest available data).

Secondary school enrollments in much of Eurasia and in some of the Southern Tier CEE countries are also low, certainly relative to Northern Tier CEE and OECD standards (*Figure 66*). Eurasian secondary school enrollment rates are only 57% on average; the Southern Tier CEE countries are at 79%; and the Northern Tier CEE at 97%. Secondary school enrollments have been increasing since the early to mid-1990s in the CEE countries. Secondary school enrollment rates in Eurasia remain much lower today than what they were at the outset of the transition (80% on average in 1989), and there is still no clear trend in Eurasia that these rates are recovering. There has been no increase in these rates in Eurasia in the past three years of available data (from 2004 to 2007).

The secondary school enrollment data allow us to differentiate between “general” secondary and “vocational/technical” secondary enrollment (*Figures 67 and 68*). We find that Eurasia lags considerably behind CEE in secondary school enrollments because of very low vocation/technical enrollments; in 2007, 12% in Eurasia vs. 40-45% in CEE.

In fact, general secondary school enrollments in Eurasia are very close to Northern Tier CEE standards (and had been higher than Northern Tier CEE rates through most of the transition years, until 2005). Hence, the ratio of general to vocation/technical secondary school enrollments is much higher in Eurasia (4.3 in 2007), than it is in the Northern Tier CEE countries (at 1.4) and the Southern Tier CEE (0.7). This ratio was much lower in all three sub-regions at the outset of the transition. In other words, most of the declines in secondary enrollments have been in vocational or technical schools and not general schools.

What is not clear is whether a disproportionate drop in vocational and technical school enrollments has been a good thing given the overspecialization that presumably took place prior to communism's collapse. Is this trend a necessary part of the transition to a market-oriented democracy? To what extent does the quality and appropriateness of vocational and technical training differ across countries? In addition, are there key differences between vocational schools and technical schools? We are not aware of an effort that has attempted to systematically address these key questions.

Literacy rates as traditionally defined are uniformly high in the transition region by world standards. The World Bank reports that male adult literacy rates in the transition region averaged 99% in 2005 (up from 98% in 2002 as reported in *MCP #10*) and 96% for females in 2005 (up from 94% in 2002). This compares with world averages of 87% male literacy and 77% female; and for low income developing countries of 72% male and 50% female.

However, "functional literacy," or how well students and adults can function in a market economy given their formal and informal education, may be a more relevant measure of the quality of education in the transition region. There have been two strands of contrasting conventional wisdom in terms of educational aspects of human capital in the former communist countries. One has been that the educational systems of the region were largely an asset going into the transition. The priority under the communist system for universal education was high, and hence so were enrollments. Moreover, performances in various global fora in the sciences and math among students from behind the "Iron Curtain" were impressive. However, it has also been widely perceived that the type of education promoted under communism (with emphases on memorization at the expense of analytical and critical thinking, and perhaps premature specialization if not over-specialization) was ill-suited to the needs of a market economy.

There are a handful of cross-country surveys of education performance that attempt to get at functional literacy. This includes the Trends in International Mathematics and Sciences Study (TIMSS), the International Adult Literacy Survey (IALS), the Progress in International Reading Literacy Study (PIRLS), and the Program for International Student Assessment (PISA).²⁹ These surveys attempt to test students' abilities to apply math, science, and reading to practical "real world" (market economy) problems. This includes

²⁹ The E&E Program Office earlier took stock of these cross-country surveys of education performance. See, Murphy, Petric, and Sprout, *Education in Eastern Europe and Eurasia*, Working Paper #2 (October 2005).

the basics towards financial literacy (the ability to balance a check book, e.g.), the ability to think critically (e.g., by analyzing a newspaper editorial), or practical aspects such as basic understanding of the science of global warming.

Figures 69 and 70 provide some evidence of the state of functional literacy in the region as compared to OECD standards and a handful of other countries. *Figure 69* standardizes the most recent scores for PISA (2006), TIMSS (2003) and PIRLS (2006) so that a score of “100” is equal to the OECD standard. *Figure 70* shows the change in scores from 2001 to 2006 in the PIRLS, which attempts to measure two aspects of reading literacy (literary and informative) in students in the fourth grade.

The first observation from the data is that there is still a significant proportion of transition countries which are not yet part of any of these surveys; eight of twenty-nine countries. However, each of the surveys continues to expand country coverage, and if tentative schedules to expand stay on track, all but three transition countries will have participated in at least one of these functional literacy surveys by end-year 2009.

Of the available data, what can be observed? First, all the Northern Tier CEE countries have scored on par with OECD standards in at least one test. Russia also scores very well; i.e., OECD standards on two of three surveys. Croatia and Georgia come close to this standard in one survey (i.e., a score of 96 vs. 100 for OECD). Bulgaria scores very high on PIRLS (above OECD average), though very poorly on PISA. Nine other countries all lag significantly behind OECD norms in at least one survey. Five countries are Southern Tier CEE: Albania; Macedonia; Serbia; Montenegro; and Romania. Four countries are Eurasia: Moldova; Azerbaijan, the Kyrgyz Republic; and Armenia.

Time series data on functional literacy are scarce. Ten transition countries have participated in PISA 2003 and PISA 2006. Eight countries had stable scores between the two years; only Bulgaria and Romania had notable change from 2003 and 2006, both showing significant backsliding. A somewhat different set of ten transition countries have participated in PIRLS 2001 and PIRLS 2006. Again, eight countries had relatively stable scores between the two years. Russia and Romania were the exceptions. While scores in Russia showed significant improvements from 2001 to 2006, scores in Romania regressed considerably.

	UNDER 5		PER CAPITA		LIFE		PUBLIC EXPENDITURE			Education		Vulnerable		TB incidence		Human
	MORTALITY	(per 1,000)	INCOME	(PPP, \$)	EXPECTANCY	(Years)	Health & Education	(% GDP)	Gap	%	Populations	per 100,000	per 100,000	per 100,000	per 100,000	per 100,000
	2006	2006	2007	2007	2006	2006	2006-2007	2006-2007	2003-2007	2002-2007	2002-2007	2006	2006	2006	2006	Index
CZECH REPUBLIC	4	5.0	22,071	5.0	76	5.0	5.2	4.0	0	5.0	4.0	10	5.0	4.8		
CROATIA	6	4.5	14,612	4.0	76	5.0	5.2	4.0	0	5.0	5.0	24	4.0	4.6		
SLOVENIA	4	5.0	25,288	5.0	78	5.0	6.0	5.0	0	5.0	5.0	13	4.5	4.9		
POLAND	7	4.5	15,176	4.5	75	4.5	4.7	3.5	11	4.5	5.0	22	4.0	4.4		
HUNGARY	7	4.5	17,394	5.0	73	4.0	5.3	4.0	9	4.5	5.0	18	4.0	4.4		
SLOVAKIA	8	4.5	18,510	5.0	74	4.0	4.5	3.5	9	4.5	5.0	13	4.5	4.4		
ESTONIA	7	4.5	19,628	5.0	73	4.0	4.5	3.0	0	5.0	4.0	36	3.0	4.2		
MONTENEGRO	10	4.5	9,555	3.0	74	4.0	5.5	4.5	20	3.5	3.0	10	5.0	3.9		
SERBIA	8	4.5	9,879	3.0	73	4.0	4.5	3.0	10	4.5	4.0	43	3.0	3.8		
LATVIA	9	4.5	16,176	4.5	71	3.0	4.7	3.5	9	4.5	4.0	61	2.0	3.8		
LITHUANIA	8	4.5	15,598	4.5	71	3.0	4.8	3.5	0	5.0	3.0	62	2.0	3.8		
BELARUS	13	4.5	10,525	3.0	69	2.5	5.3	4.0	17	4.0	4.0	54	2.5	3.6		
BULGARIA	14	4.5	10,886	3.0	73	4.0	4.1	3.0	36	3.0	4.0	42	3.0	3.4		
BOSNIA & HERZEGOVINA	15	4.5	7,187	2.5	75	4.5	5.0	3.5	50	2.0	4.0	54	2.5	3.2		
MACEDONIA	17	4.0	8,282	2.5	74	4.0	4.4	3.0	73	1.0	4.0	29	3.5	2.9		
RUSSIA	16	4.5	13,657	4.0	66	1.5	3.6	2.5	27	3.5	2.0	89	1.5	2.9		
UKRAINE	24	4.0	6,525	2.0	68	2.0	5.1	4.0	33	3.0	--	84	1.5	2.8		
ROMANIA	18	4.0	10,810	3.0	72	3.5	3.8	2.5	40	2.5	3.0	121	1.0	2.8		
ALBANIA	17	4.0	6,360	2.0	76	5.0	2.6	1.5	63	1.5	2.0	16	4.0	2.7		
MOLDOVA	19	4.0	2,793	1.0	69	2.5	5.1	4.0	38	3.0	1.0	143	1.0	2.4		
GEORGIA	32	3.5	4,268	1.5	71	3.0	2.4	1.0	17	4.0	1.0	103	1.0	2.4		
ARMENIA	24	4.0	5,371	2.0	72	3.5	2.3	1.0	43	2.5	1.0	69	2.0	2.3		
KOSOVO	42-55	3.0	4,200	1.5	74	4.0	3.8	2.5	50	2.0	1.0	77**	0.5	2.1		
UZBEKISTAN	43	3.0	2,394	1.0	67	2.0	4.3	3.0	40	2.5	1.0	82	1.5	2.1		
AZERBAIJAN	88	1.0	7,059	2.5	72	3.5	1.9	0.5	71	1.0	4.0	72	2.0	1.9		
KAZAKHSTAN	29	3.5	9,527	3.0	66	1.5	2.4	1.0	50	2.0	1.0	170	0.5	1.8		
TURKMENISTAN	51	2.5	4,389	1.5	63	0.5	4.3	3.0	60	1.5	--	66	2.0	1.8		
KYRGYZ REPUBLIC	41	3.0	1,924	1.0	68	2.0	3.7	2.5	57	2.0	0.5	124	1.0	1.8		
TAJKISTAN	68	2.0	1,693	1.0	67	2.0	2.3	1.0	50	2.0	0.5	79	1.5	1.5		
Northern Tier CEE	7	4.6	18730	4.8	74	4.1	5.0	3.9	5	4.8	4.4	29	3.6	4.3		
Southern Tier CEE	13	4.3	9696	2.9	74	4.3	4.3	2.7	38	2.8	3.6	42	3.3	3.4		
Eurasia	37	3.3	5844	2.0	68	2.2	3.5	3.2	42	2.6	1.6	95	1.5	2.2		
R,B,C in 2006	13	4.3	12103	3.3	74	4.2	4.3	3.2	32	3.2	4.0	62	2.7	3.5		

Education gap is double weighted in the human capital index. World Bank, *World Development Indicators 2008* (April 2008) and *Kosovo Health Financing Reform Survey* (May 2008); UNICEF, *TransMONEE Database* (August 2008); World Health Organization *European Health For All Database* (2008); and Murphy, Petric and Sprout, *Education in Eastern Europe & Eurasia*, USAID/E&E Working Paper #2 (October 2005) and IEA, *PIRLS 2008 International Report* (2008).

Table 18. Public Spending on Health and Education

	Public Expenditure on Health (% GDP)	Public Expenditure on Education (% GDP)	AVERAGE	1 to 5
	2006	2007	2006-2007	
SLOVENIA	6.0	6.0	6.0	5.0
MONTENEGRO	5.6	5.5	5.5	4.5
HUNGARY	5.4	5.2	5.3	4.0
BELARUS	5.0	5.5	5.3	4.0
CROATIA	6.0	4.5	5.2	4.0
CZECH REPUBLIC	5.9	4.4	5.2	4.0
MOLDOVA	4.4	5.8	5.1	4.0
UKRAINE	3.8	6.3	5.1	4.0
BOSNIA & HERZEGOVINA	4.8	5.2	5.0	3.5
LATVIA	3.8	5.6	4.7	3.5
LITHUANIA	4.4	5.2	4.8	3.5
POLAND	4.3	5.0	4.7	3.5
SLOVAKIA	5.2	3.9	4.5	3.5
ESTONIA	3.7	5.2	4.5	3.0
SERBIA	5.4	3.5	4.5	3.0
BULGARIA	4.1	4.0	4.1	3.0
MACEDONIA	5.9	2.9	4.4	3.0
TURKMENISTAN	3.2	5.3	4.3	3.0
UZBEKISTAN	2.4	6.3	4.3	3.0
ROMANIA	4.1	3.5	3.8	2.5
RUSSIA	3.4	3.8	3.6	2.5
KOSOVO	3.1	4.5	3.8	2.5
KYRGYZ REPUBLIC	2.8	4.7	3.7	2.5
ALBANIA	2.2	3.0	2.6	1.5
KAZAKHSTAN	2.4	2.3	2.4	1.0
ARMENIA	1.9	2.7	2.3	1.0
GEORGIA	1.8	3.0	2.4	1.0
TAJIKISTAN	1.1	3.4	2.3	1.0
AZERBAIJAN	1.1	2.7	1.9	0.5
Northern Tier CEE	4.8	5.1	5.0	3.6
Southern Tier CEE	4.6	4.1	4.3	3.1
Eurasia	2.8	4.3	3.5	2.9
R,B,C in 2006	4.9	3.8	4.3	3.2

UNICEF, *TransMONEE Database* (August 2008) and World Bank, *Kosovo Health Financing Reform Survey* (May 2008).

	Education Spending 2005-2007	Enrollment (most recent)				PISA 2006	PISA disparities 2003	PISA hindered 2006	TIMSS 2003	PIRLS 2006	Brain Drain 2006	*/Available	% 2006	Education Gaps 1 to 5
		Primary	Pre-Primary	Total Secondary	Tertiary									
		2007	2007	2007	2005									
CROATIA	4.5	95.0	55.3	88.0	31.5	479	---	---	---	---	6	0/7	0	5.0
CZECH REPUBLIC	4.4	103.0	79.4	94.3	35.1	502	small	little	530	537	34	0/11	0	5.0
ESTONIA	5.2	104.0	86.0	95.9	53.2	516	---	---	542	---	2	0/8	0	5.0
LITHUANIA	5.2	102.0	69.2	108.2	56.5	481	---	---	511	543	-5	0/9	0	5.0
SLOVENIA	6.0	96.5	79.5	101	69.3	506	---	---	507	502	5	0/9	0	5.0
LATVIA	5.6	103.3	81.8	98.7	58.9	485	small	*	509	545	16	1/11	9.1	4.5
POLAND	5.0	100.1	58.5	85.7	52.4	500	small	little	---	---	*-10	1/9	11.1	4.5
SERBIA	3.5	99.5	49.1	81.6	40	*424	small	little	473	---	-5	1/10	10	4.5
HUNGARY	5.2	100.4	83.9	97.0	44.6	492	*	little	536	543	14	1/11	9.1	4.5
SLOVAKIA	3.9	99.9	73.7	94.9	32	482	small	little	*513&B	518	-5	1/11	9.1	4.5
BELARUS	5.5	92.5	88.9	67.2	34.3	---	---	---	---	---	*-10	1/6	17	4.0
GEORGIA	3.0	101.3	38.2	65.4	38.4	---	---	---	---	---	*-31	1/6	16.7	4.0
MONTENEGRO	5.5	97.1	33.4	84.2	---	*401	---	---	---	---	---	1/5	20	3.5
RUSSIA	3.8	106.1	70.0	*52.2	43.7	465	small	**	*511&B	528	-9	3/11	27	3.5
UKRAINE	6.3	99.6	71.1	*58.7	38.7	---	---	---	---	---	*-10	2/6	33	3.0
BULGARIA	4.0	98.0	73.9	91.9	33.9	*416&B	*	little	*478&B	550	*-23	4/11	36	3.0
MOLDOVA	5.8	92.0	68.5	*48.3	* 24.1	---	---	---	466	492	*-68	3/8	38	3.0
ROMANIA	3.5	101.1	75.0	83.4	32.5	*410&B	*	*	473	---	*-32	4/10	40	2.5
UZBEKISTAN	6.3	96.0	*21.2	79.3	*7.9	---	---	---	---	---	---	2/5	40	2.5
ARMENIA	*2.7	94.9	*26.3	86.7	*21.8	---	---	---	473	---	-1	3/7	43	2.5
KYRGYZ REPUBLIC	4.7	96.3	*12.4	*50.1	35	*306	---	---	---	---	*-16	4/7	57	2.0
TAJKISTAN	3.4	96.5	*7.0	*53.4	*13	---	---	---	---	---	15	3/6	50	2.0
KOSOVO	4.5	95.4	---	75.2	*16.2	---	*	*	---	---	---	3/6	50	2.0
KAZAKHSTAN	*2.3	105.7	*20	*48.5	38	---	---	---	---	---	-4	3/6	50	2.0
BOSNIA & HERZ	---	92.3	*7.8	62.4	*25	---	---	---	---	---	---	2/4	50	2.0
ALBANIA	3.0	*90.0	50.2	68.1	*14.3	* 369	***	**	---	---	---	5/8	62.5	1.5
TURKMENISTAN	5.3	*86.7	*22.8	*10	*2.6	---	---	---	---	---	---	3/5	60	1.5
MACEDONIA	*2.9	95.7	39.6	74.7	*22.5	*385	**	**	**442&B	*442	*-10	8/11	72.7	1.0
AZERBAIJAN	*2.7	99.6	*22.9	66.6	*13.5	*404	---	---	---	---	*-35	5/7	71.4	1.0
Vulnerable Threshold	* < 3%	* < 91%	* < 30%	* < 60%	* < 25%	* < 450			* < 450	* < 450	* > -10%			

PISA disparities: by subject; gender; region (subject:* => 7.5%; gender:* > 5%; region:* > 10%); PISA hindered: by heating, etc.; instructional materials (heating:* > 25%; instructional mat:* > 35%)
TIMSS: level and/or trend (level: * < 450; trend: backsliding since 1995); Brain drain: change in R&D persons from 1994 to 2001 (* > 10% decrease)
UNICEF, *TransMONEE Database* (August 2008); World Bank, *World Development Indicators 2008* (April 2008); IEU, *Montenegro 2007 Progress Report* (November 2007); IEA, *TIMSS 2003 International Mathematics Report* (2004), *TIMSS 2003 International Science Report* (2004) and *PIRLS 2001 International Report* (2003); OECD, *Assessing Scientific, Reading and Mathematical Literacy: A Framework for Pisa 2006* (2007); *Literacy Skills for the World of Tomorrow: Further Results from PISA 2000* (2003), *First Results from PISA 2003* (2004); *International Adult Literacy Survey* (2000) and IEA, *PIRLS 2008 International Report* (2008).

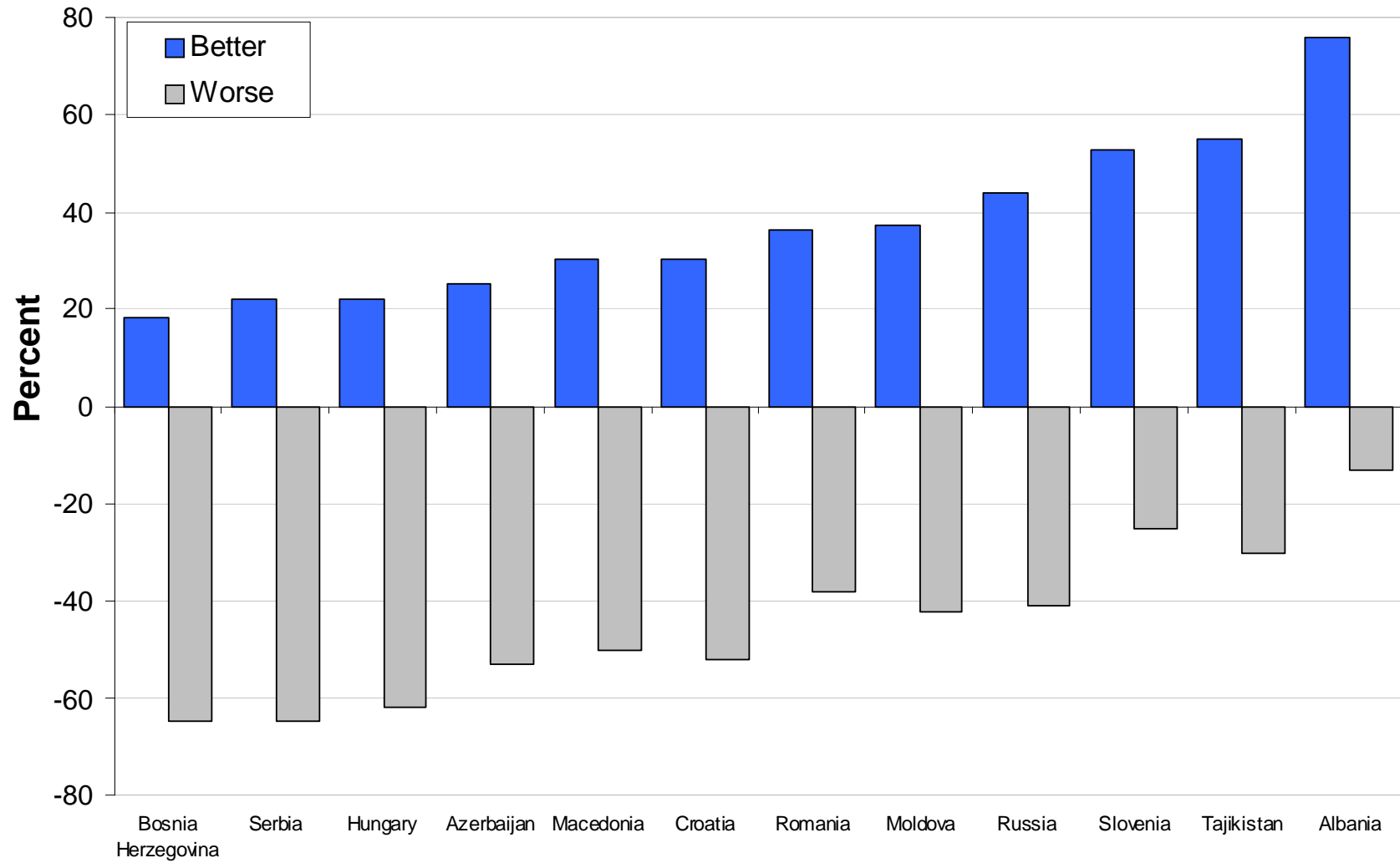
Table 20. Vulnerable Populations

	<u>Poverty Among Elderly and Children</u>				<u>Rate of Children in Residential Care</u>		<u>Vulnerable Populations</u>
	<u>% in poverty, \$PPP 2.15/day</u>				<u>(per 100,000 population aged 0-17)</u>		
	2002-2004				2005		
	Children	Elderly	Average	1 to 5	Rate	1 to 5	1 to 5
CROATIA	1	1	1	5.0	489	4.0	5.0
HUNGARY	1	0	1	5.0	418	4.0	5.0
POLAND	5	1	3	5.0	709	3.0	5.0
SLOVAKIA	1	1	1	5.0	792	3.0	5.0
SLOVENIA	1	1	1	5.0	450	4.0	5.0
AZERBAIJAN	5	4	5	4.0	887	2.0	4.0
BELARUS	3	1	2	5.0	1,318	1.0	4.0
BOSNIA & HERZ.	6	5	6	4.0	247	5.0	4.0
BULGARIA	8	2	5	4.0	769	3.0	4.0
CZECH REPUBLIC	1	1	1	5.0	1,241	1.0	4.0
ESTONIA	6	4	5	4.0	590	4.0	4.0
LATVIA	5	2	4	4.0	688	3.0	4.0
MACEDONIA	6	2	4	4.0	182	5.0	4.0
SERBIA	7	8	8	4.0	---	---	4.0
LITHUANIA	6	2	4	4.0	1,377	1.0	3.0
MONTENEGRO	15	15	15	3.0	---	---	3.0
ROMANIA	21	7	14	3.0	672	3.0	3.0
ALBANIA	30	19	25	2.0	84	5.0	2.0
RUSSIA	13	8	11	3.0	1,384	1.0	2.0
ARMENIA	54	47	51	1.0	714	3.0	1.0
GEORGIA	57	53	55	1.0	790	3.0	1.0
KAZAKHSTAN	28	11	20	2.0	1,776	1.0	1.0
MOLDOVA	53	38	46	1.0	1,410	1.0	1.0
UZBEKISTAN	50	40	45	1.0	317	5.0	1.0
KOSOVO	---	---	30-45	0.5	---	---	0.5
KYRGYZ REPUBLIC	80	51	66	0.5	1,096	1.0	0.5
TAJIKISTAN	76	72	74	0.5	416	4.0	0.5
TURKMENISTAN	---	---	---	---	43	5.0	---
UKRAINE	---	---	---	---	509	4.0	---
Northern Tier CEE	3.3	1.5	2.4	4.6	783.1	2.9	4.4
Southern Tier CEE	11.8	7.4	9.6	3.6	407.2	4.2	3.6
Eurasia	41.9	32.5	37.2	1.9	888.1	2.6	1.6
R,B,C in 2006	10.0	3.3	6.7	4.0	643.4	3.3	4.0

World Bank "Growth, Poverty, and Inequality: Eastern Europe and the Former Soviet Union" (2005); and UNICEF, TransMONEE Database (August 2008).

Figure 51

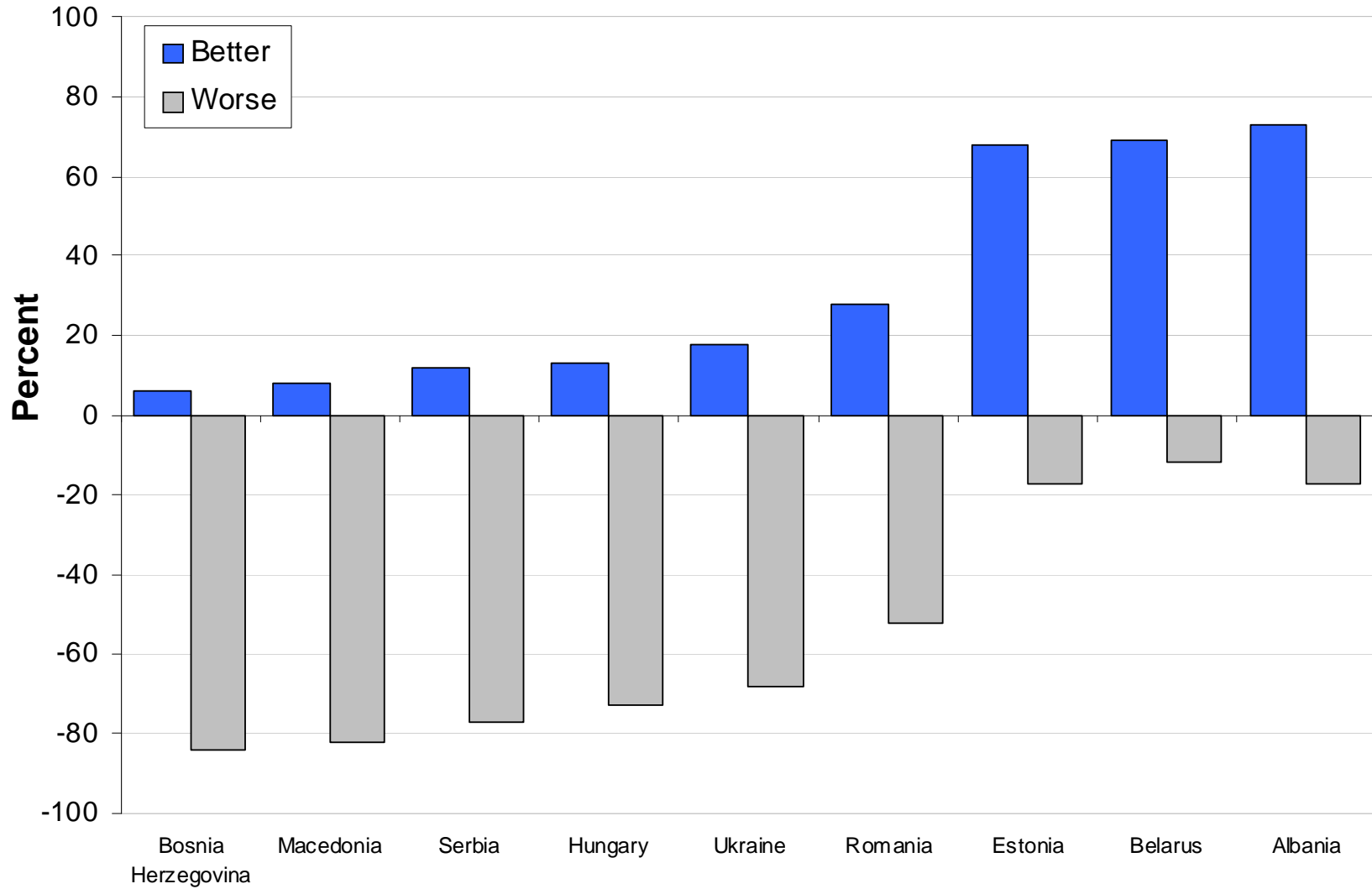
Views on Living Standards 2006 compared with 1989



EBRD and World Bank, *Life in Transition Survey 2006* from EBRD, *Transition Report 2007* (November 2007).

Figure 52

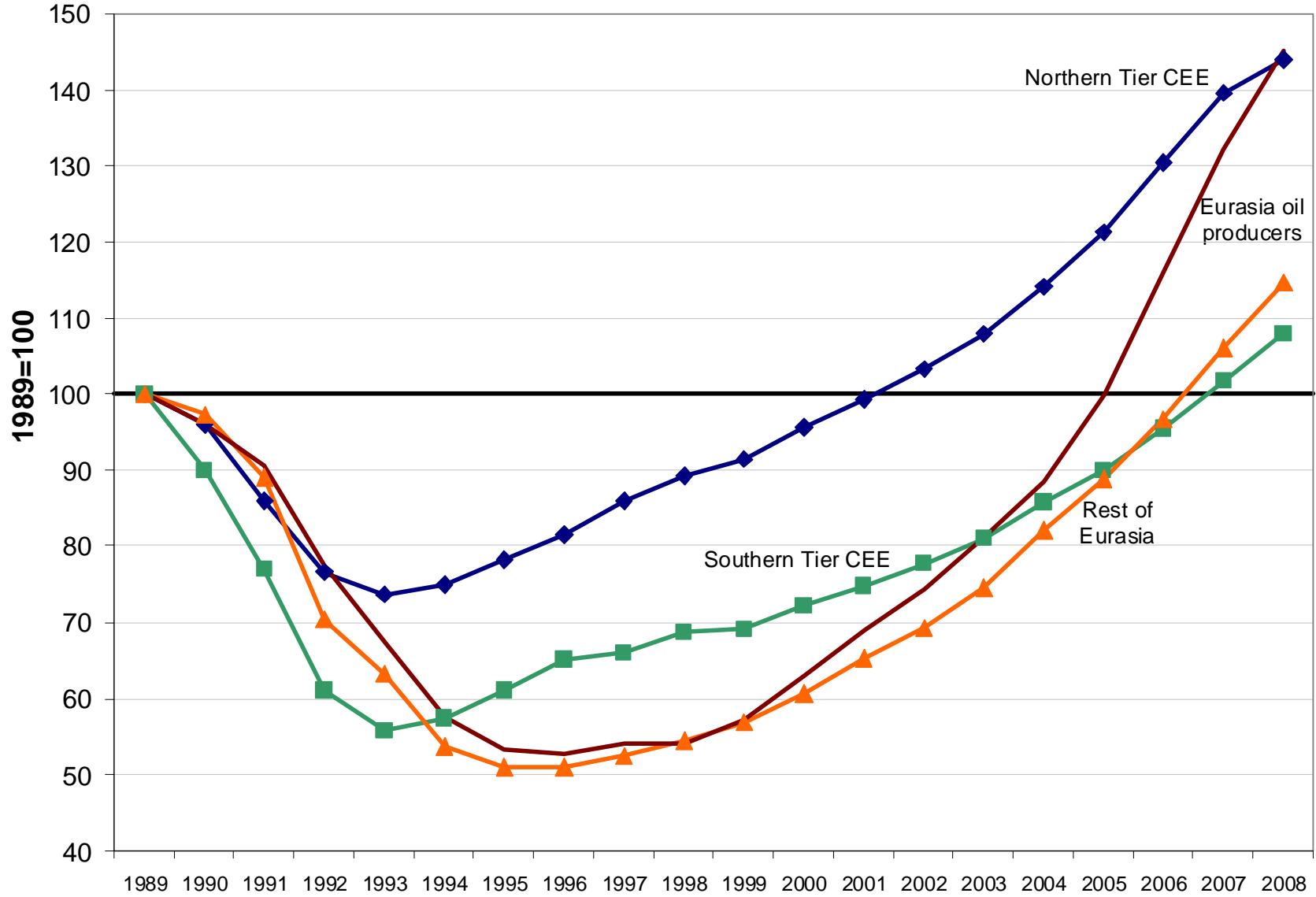
Views on Present Economic Situation 2006 compared with 1989



EBRD and World Bank, *Life in Transition Survey 2006* from EBRD, *Transition Report 2007* (November 2007).

Figure 53

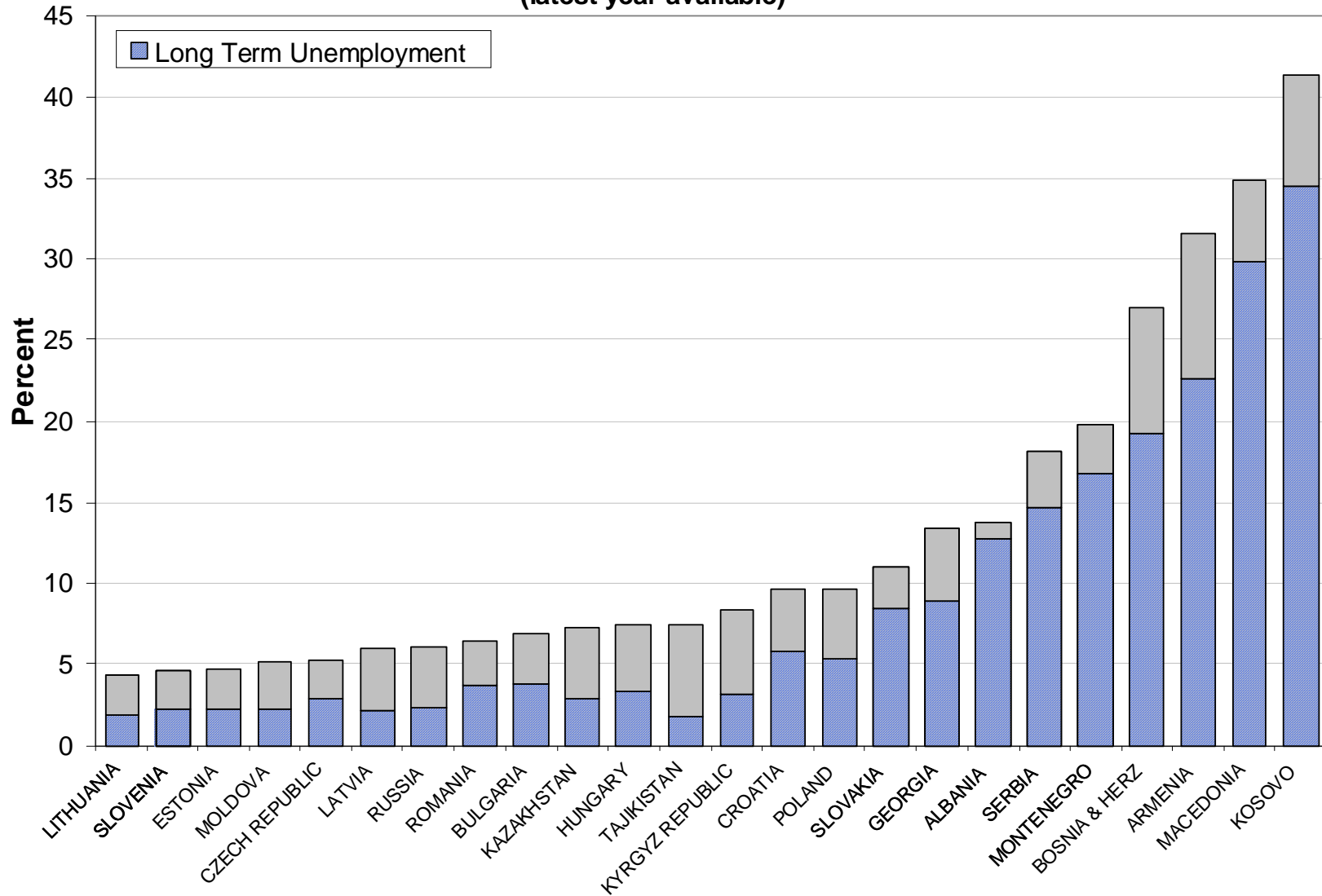
GDP as % 1989 GDP



EBRD, *Transition Report 2008* (November 2008). Eurasia oil producers include Russia, Kazakhstan and Azerbaijan.

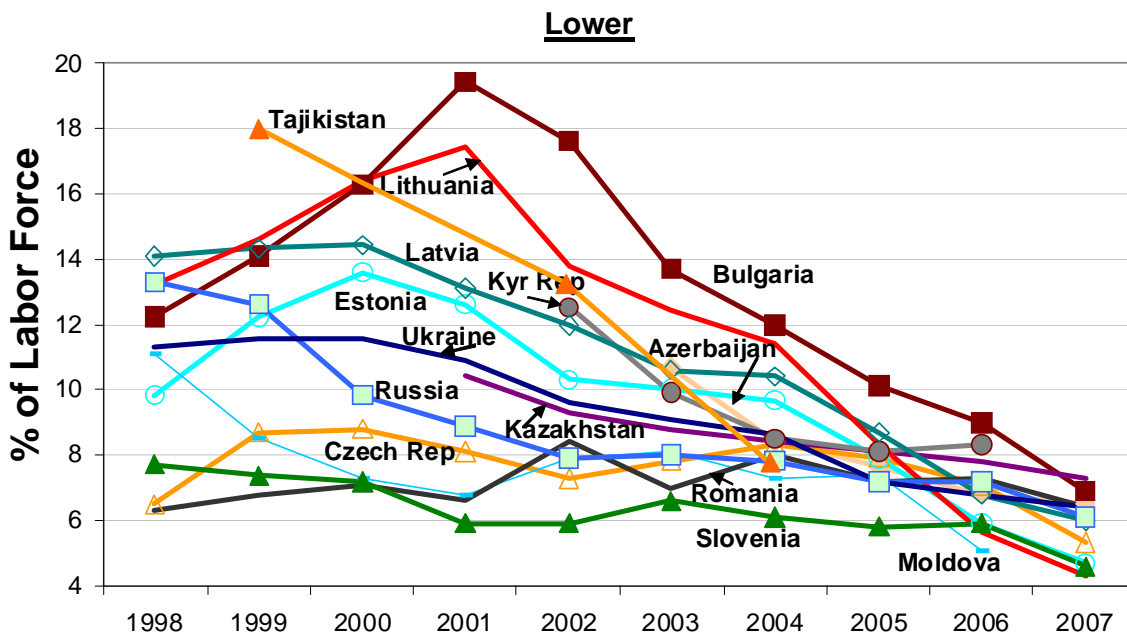
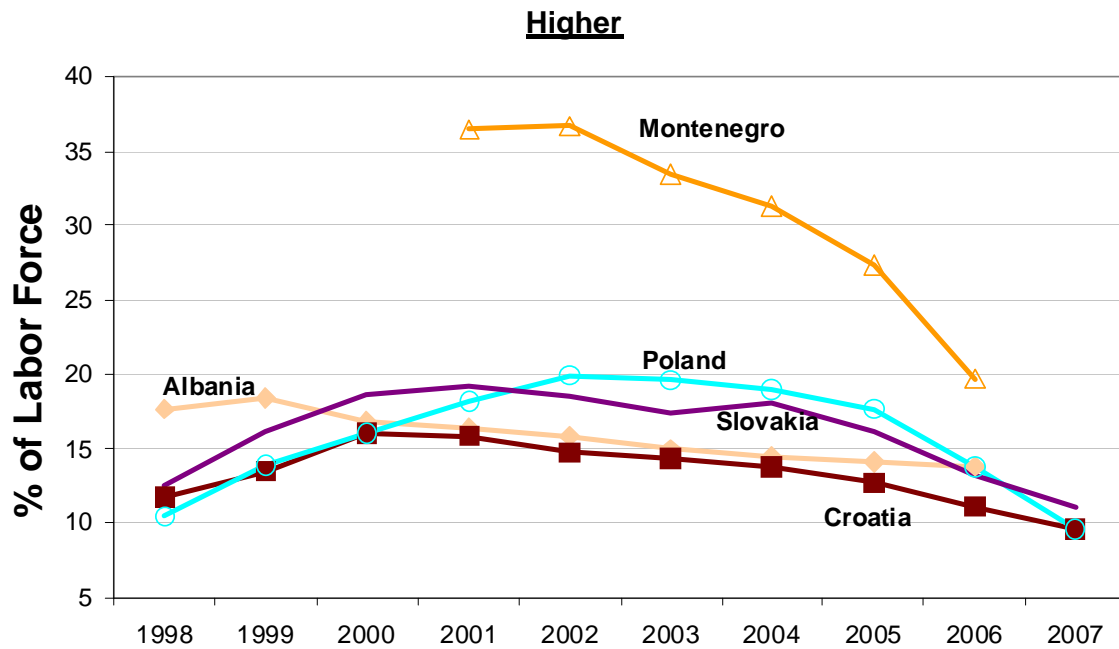
Figure 54

Unemployment Rate (latest year available)



ILO, *Labor Statistics* (2008) and UNECE, *Statistical Division Database* (2007).

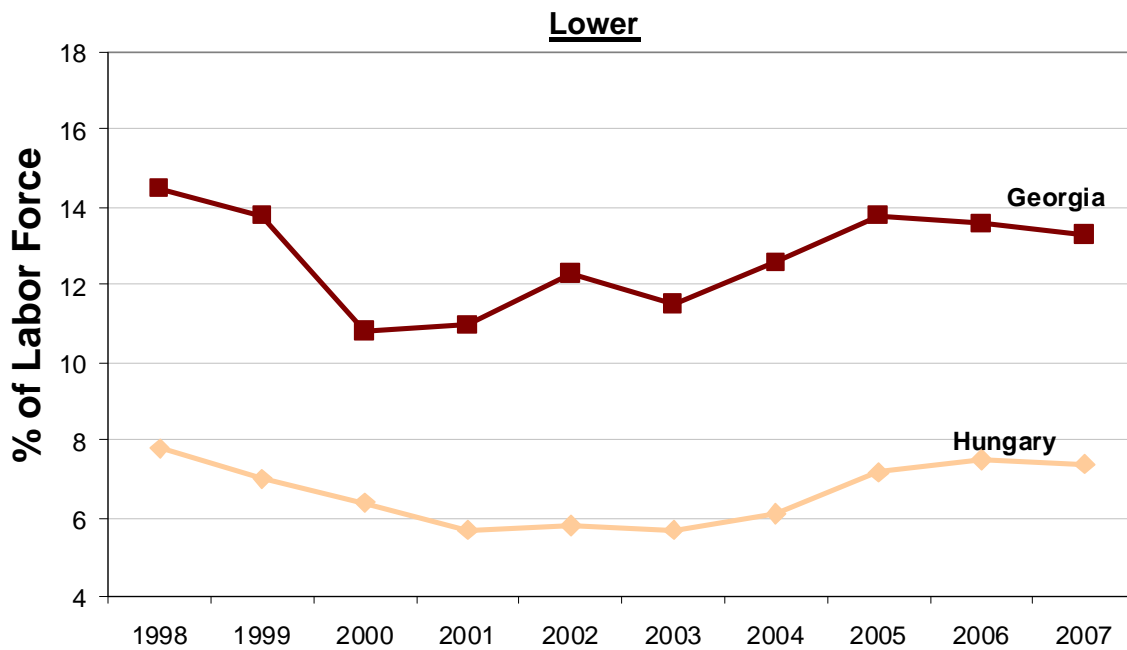
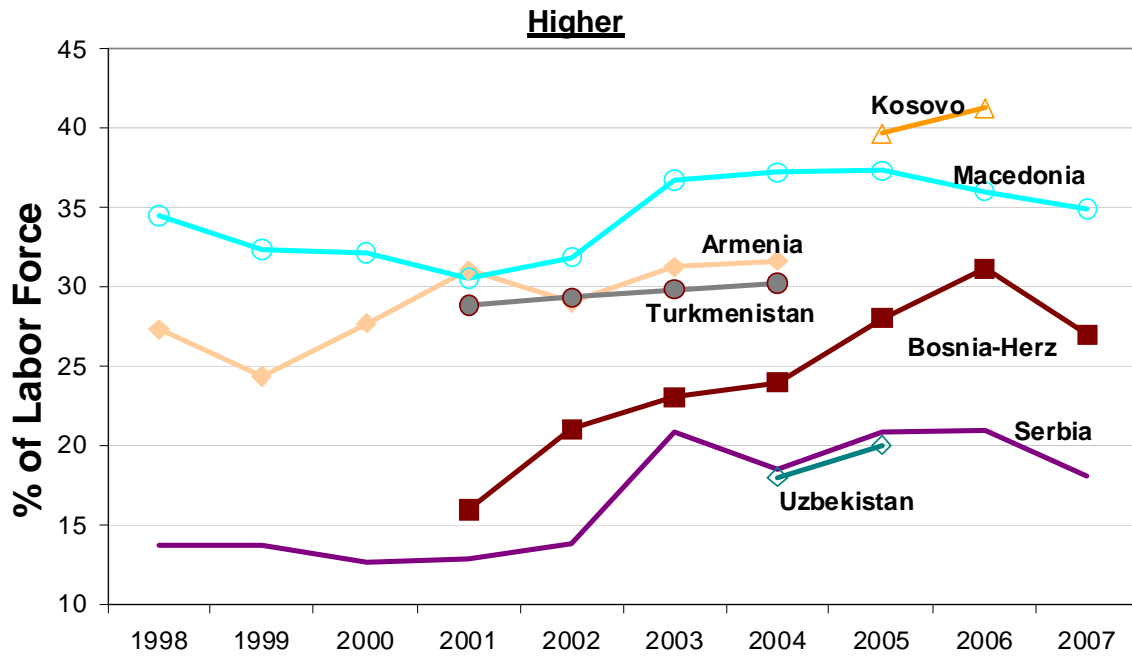
Falling Unemployment Rates



ILO, *Labor Statistics* (2008); EBRD, *Transition Report 2008* (November 2007); UNECE, *Statistical Division Database* (2008).

Unemployment Rates

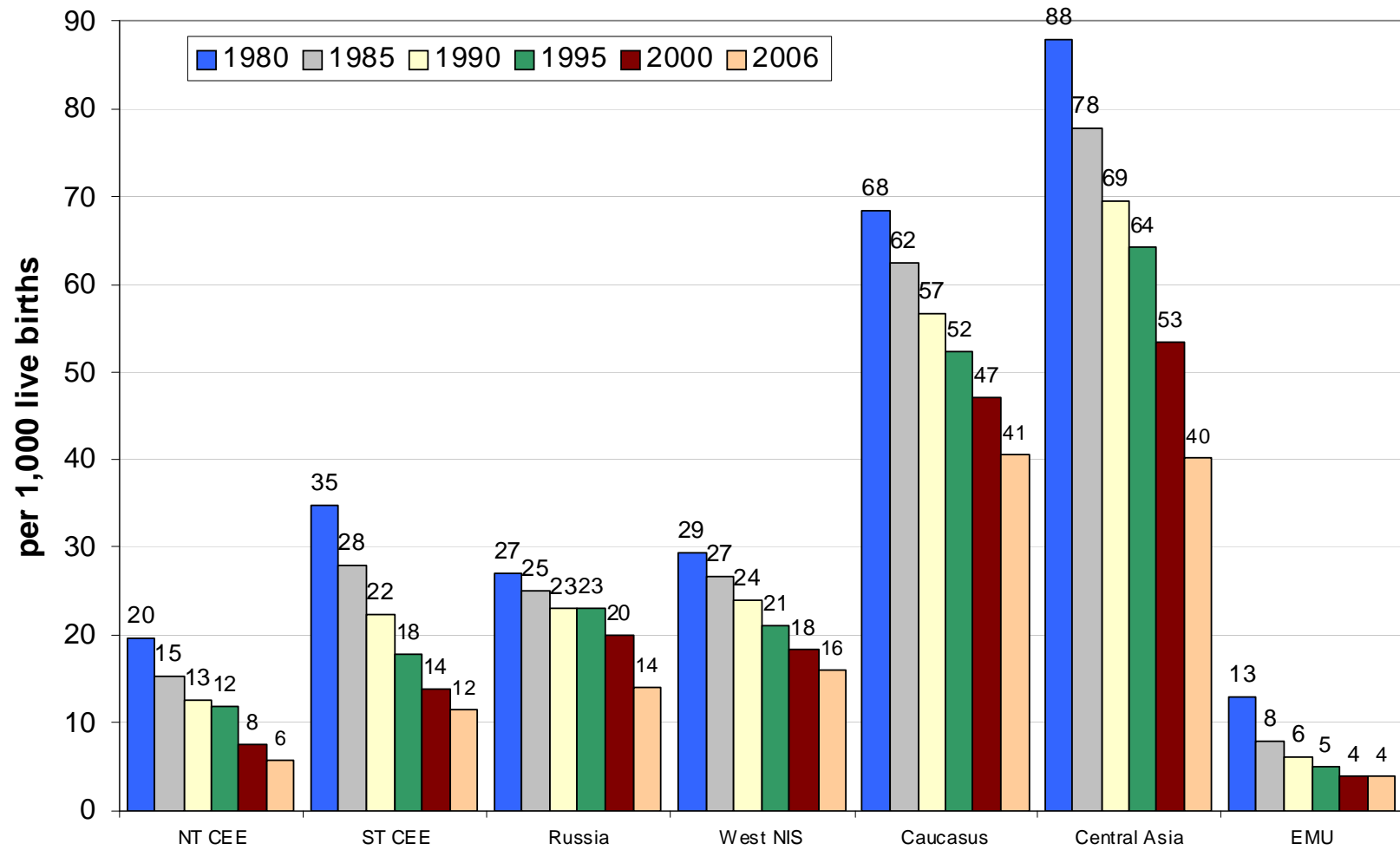
Little to no evidence of falling rates



ILO, *Labor Statistics* (2008); EBRD, *Transition Report 2008* (November 2007); UNECE, *Statistical Division Database* (2008).

Figure 59

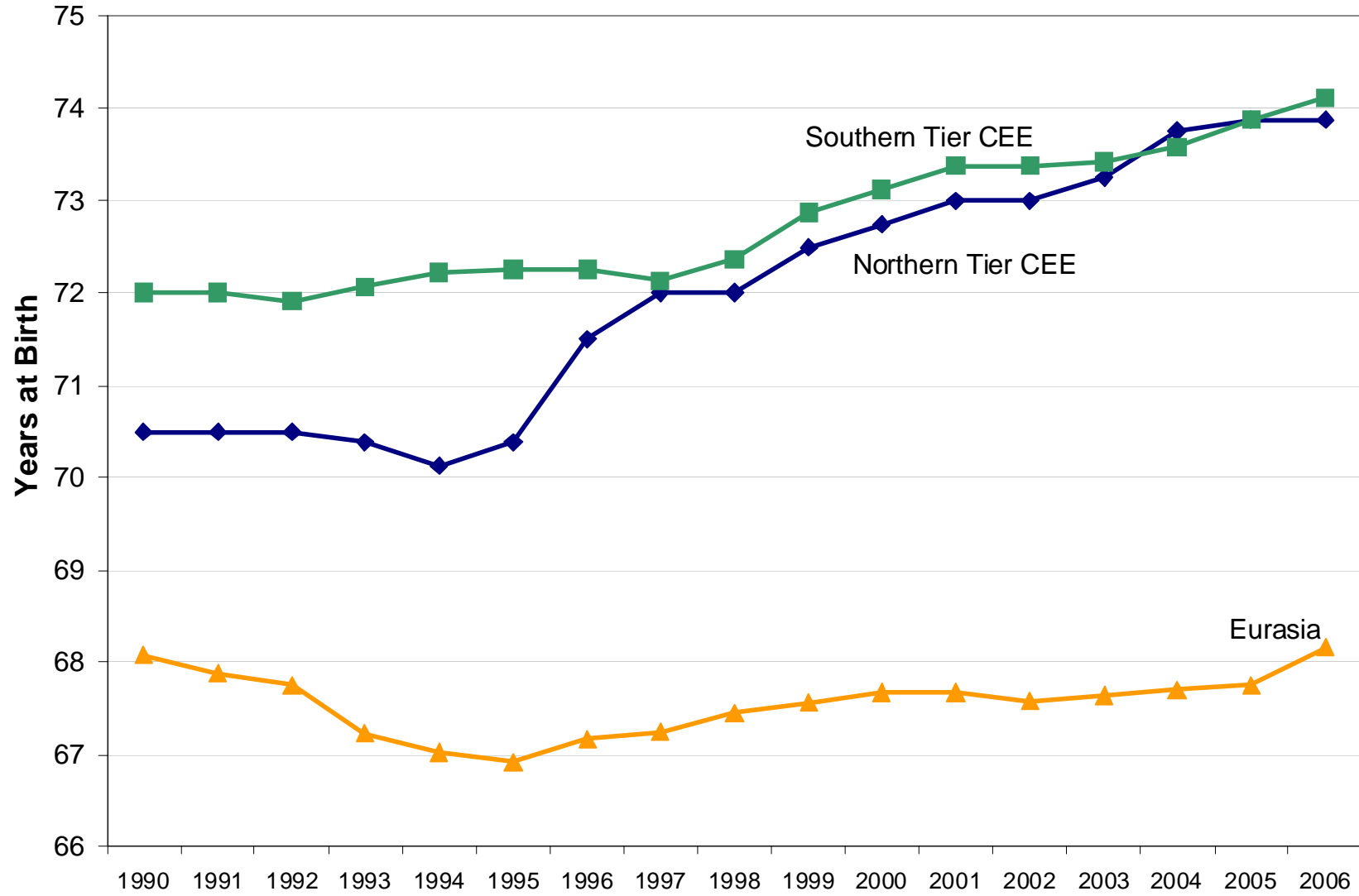
Infant Mortality Rates



World Bank, *World Development Indicators 2008* (April 2008). West NIS consists of Belarus, Moldova, and Ukraine.

Figure 60

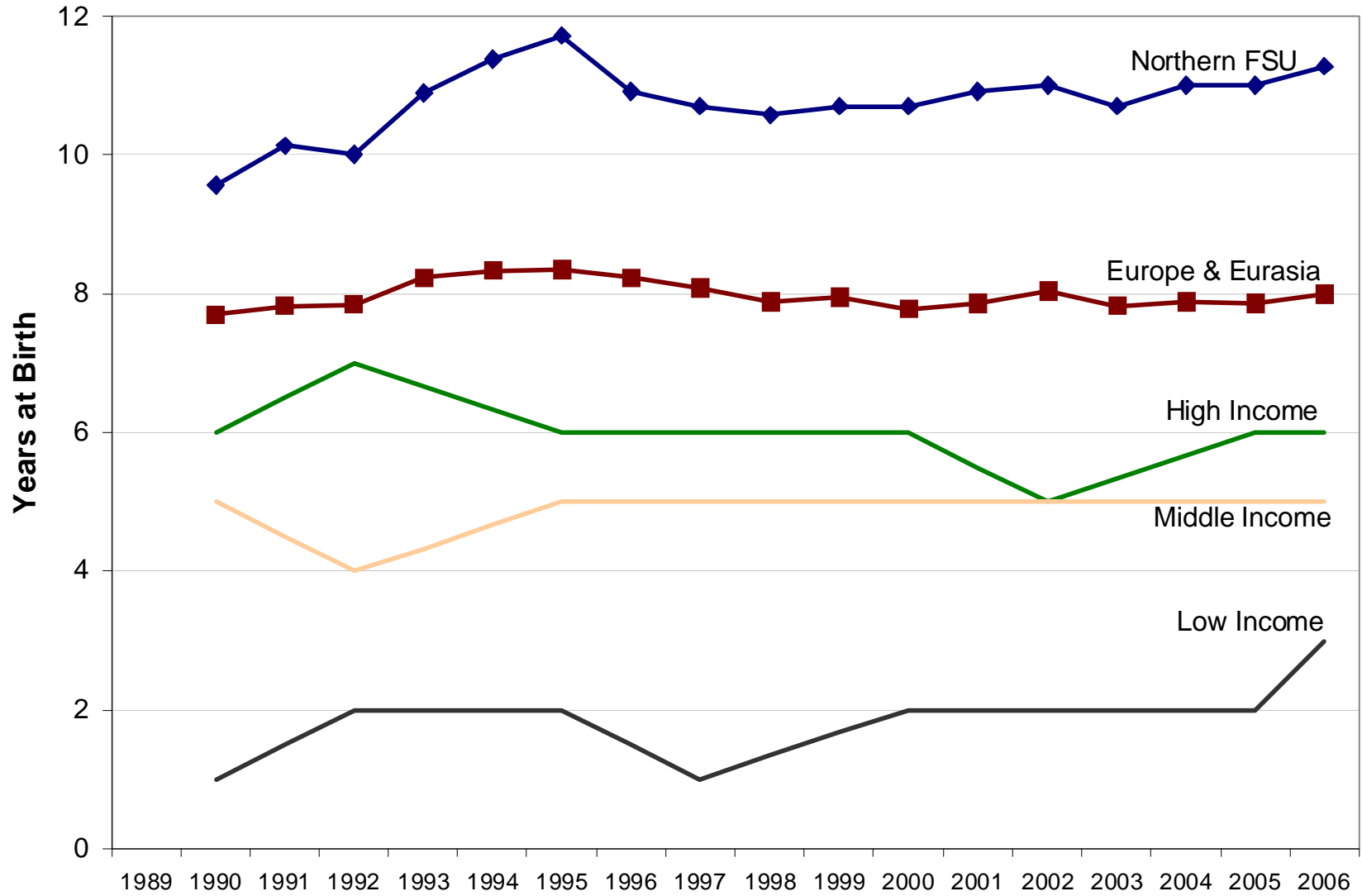
Life Expectancy at Birth



World Bank, *World Development Indicators 2008* (April 2008).

Figure 61

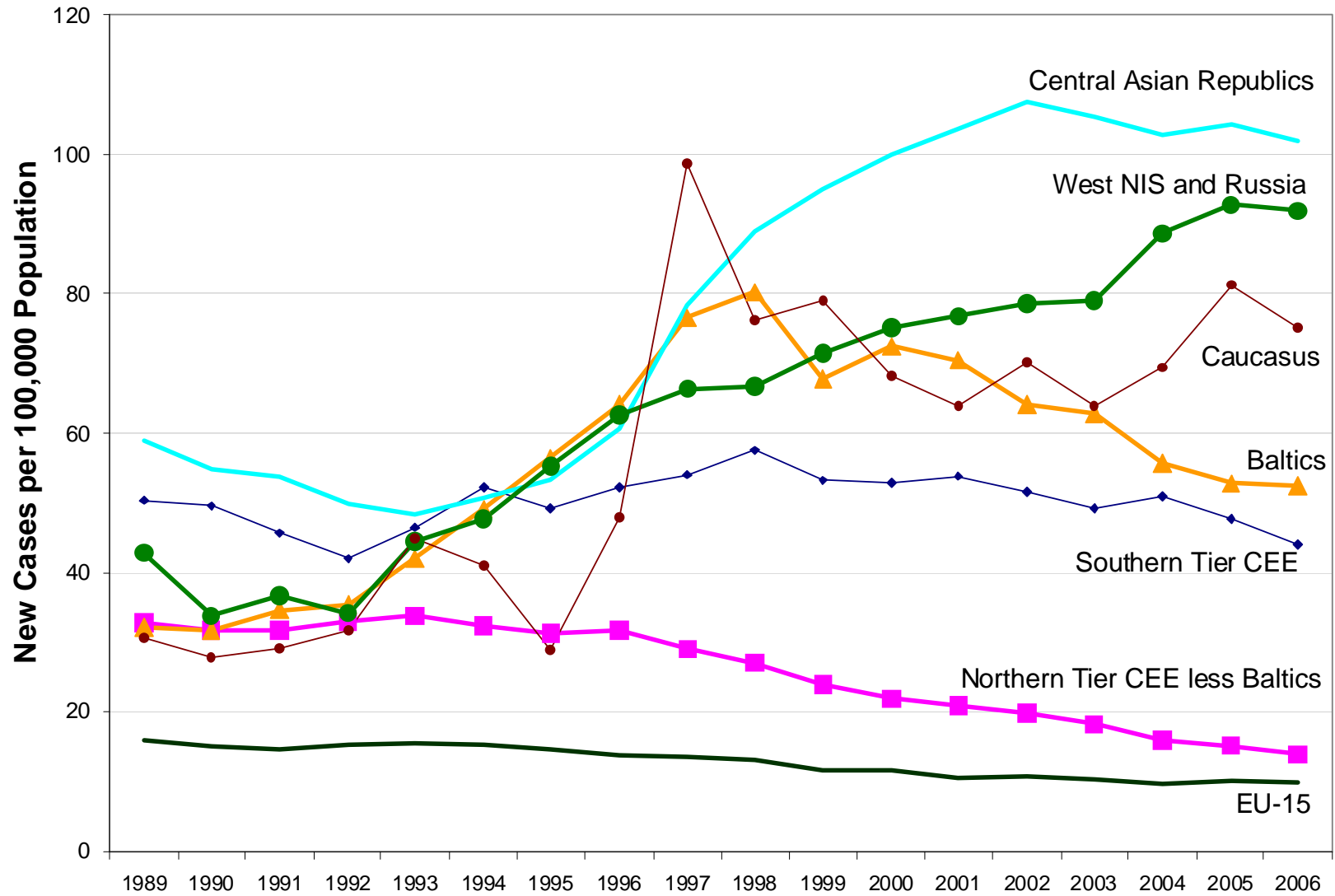
Life Expectancy Gender Gap



World Bank, *World Development Indicators 2008* (April 2008). The life expectancy gender gap is female life expectancy minus male life expectancy.

Figure 62

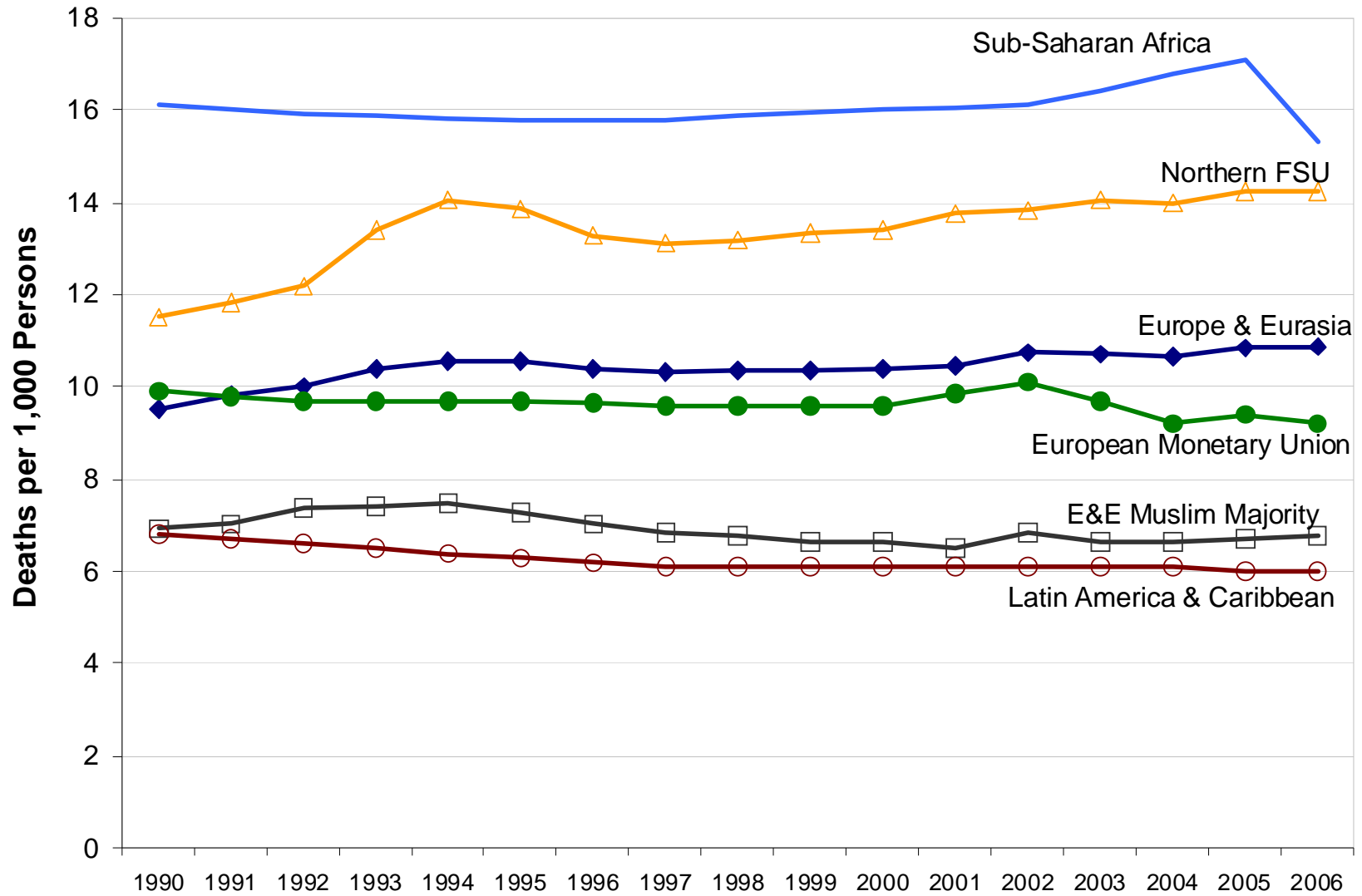
Tuberculosis Incidence



World Health Organization European Health For All Database (2008).

Figure 63

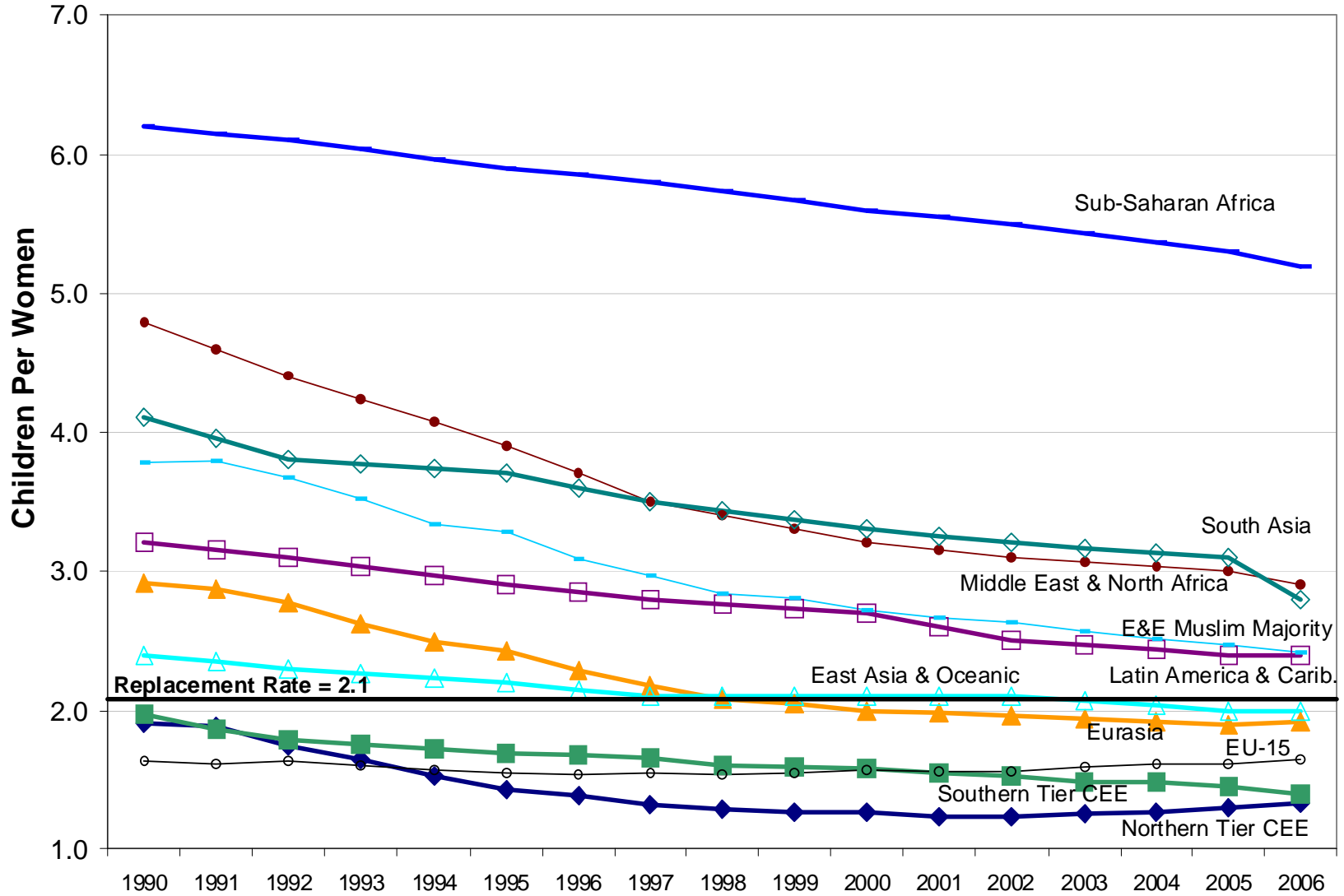
Crude Death Rates in the World



World Bank, *World Development Indicators 2008* (April 2008). Missing data were estimated by interpolation.

Figure 64

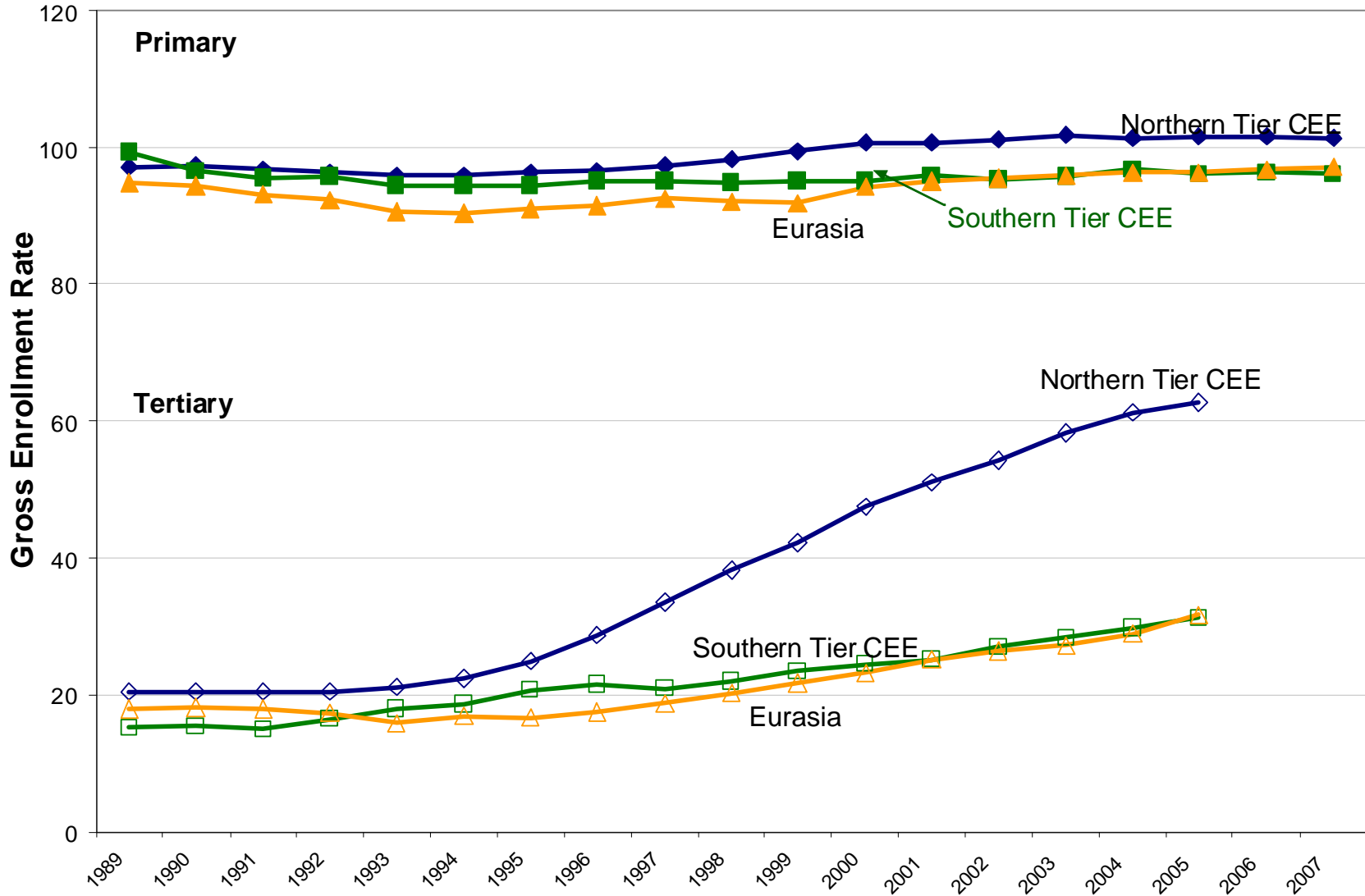
Fertility Rates in the World



World Bank, *World Development Indicators 2008* (April 2008). Missing data were estimated by interpolation.

Figure 65

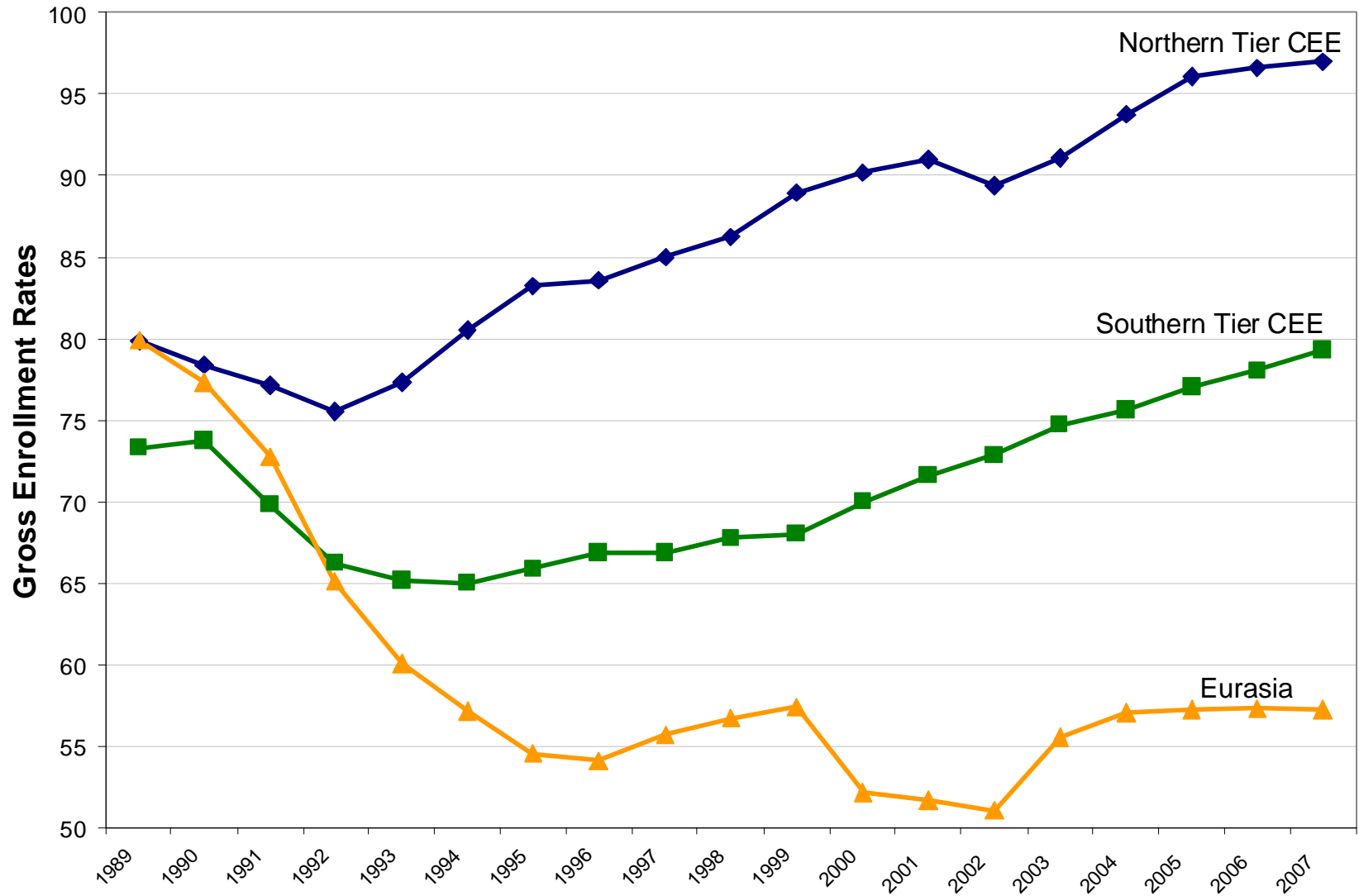
Primary & Tertiary Enrollment



UNICEF, *TransMONEE Database* (August 2008).

Figure 66

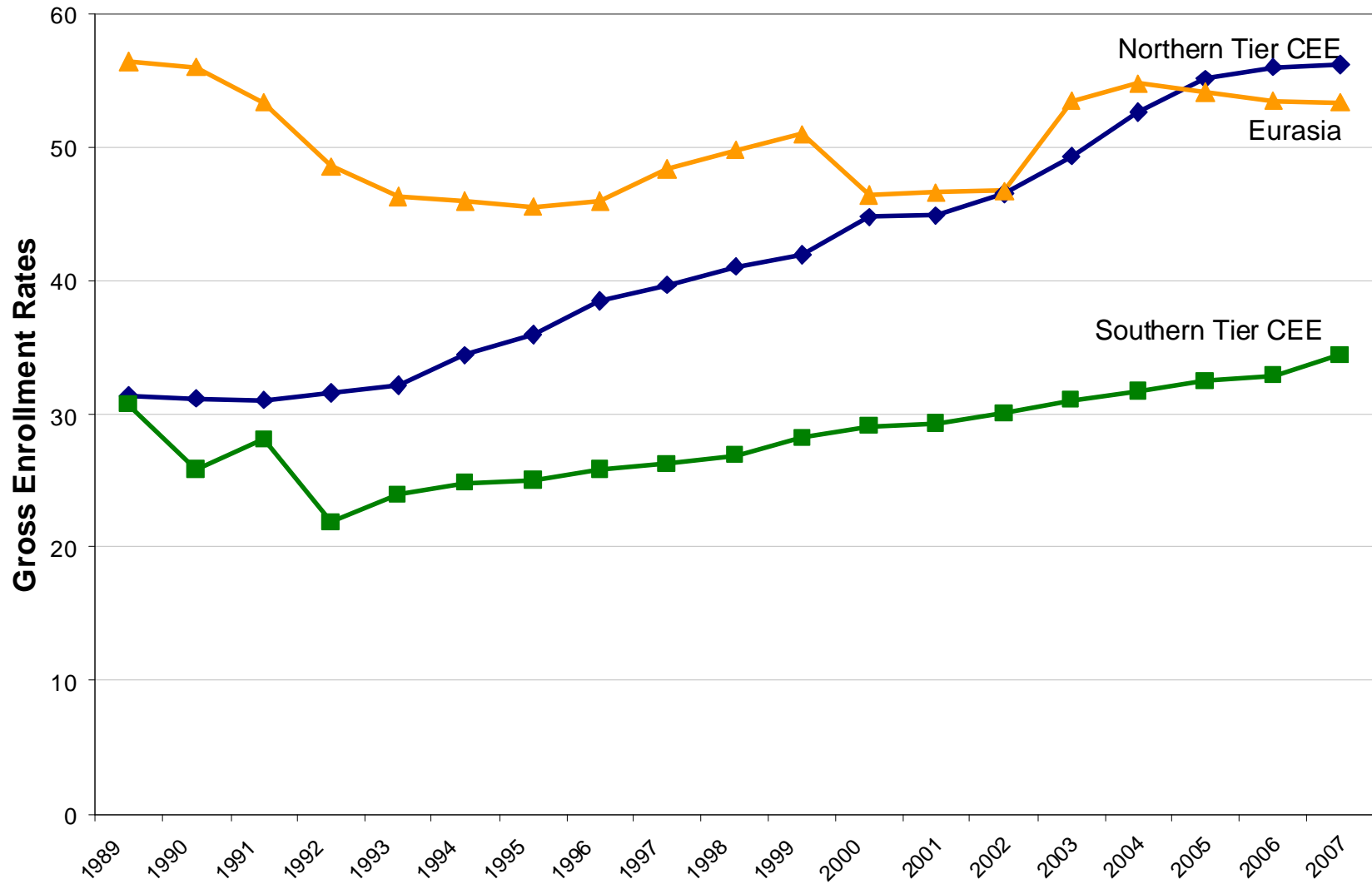
Total Secondary Enrollment



UNICEF, *TransMONEE Database* (August 2008 and earlier editions).

Figure 67

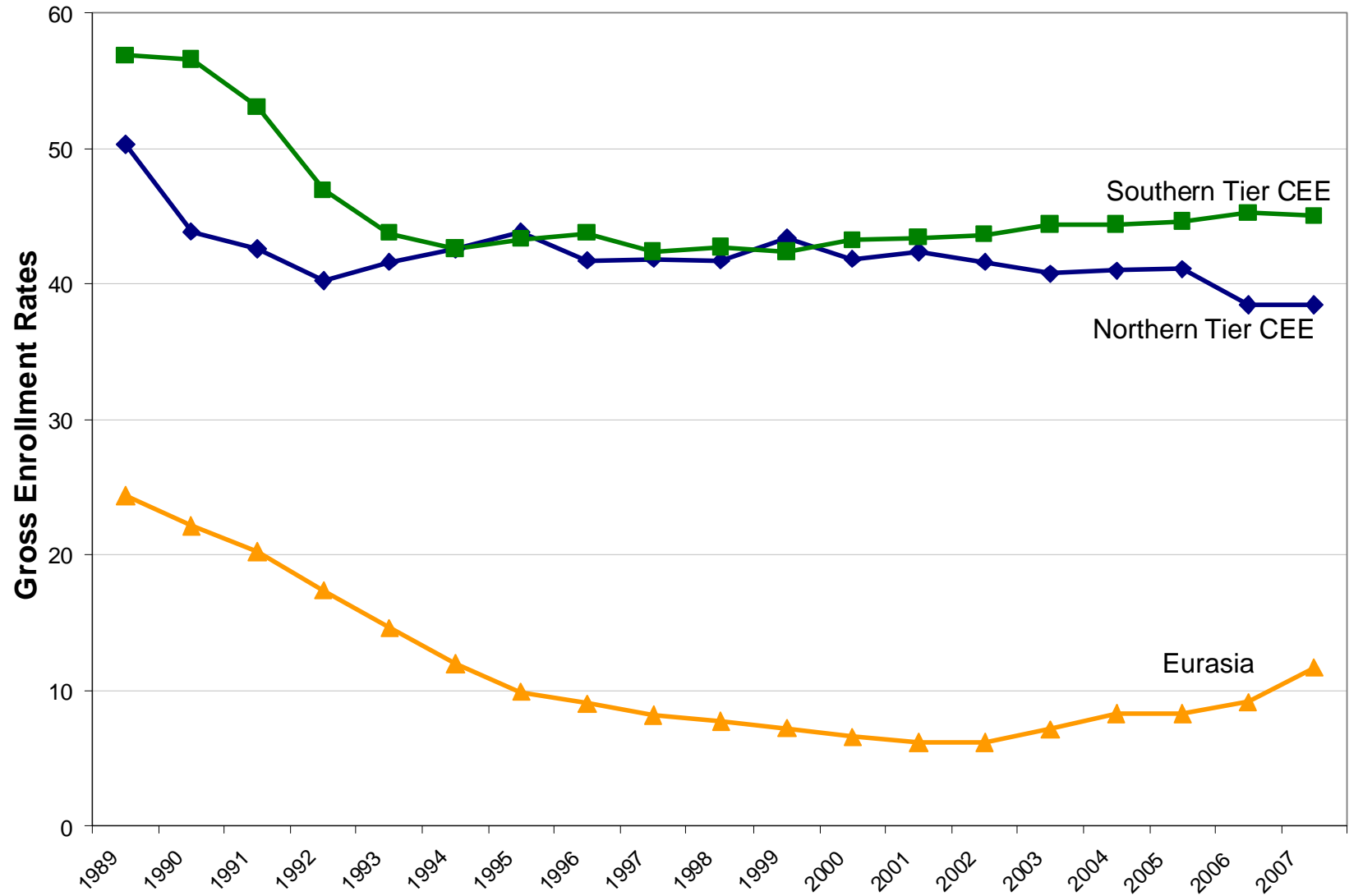
General Secondary Enrollment



UNICEF, *TransMONEE Database* (August 2008).

Figure 68

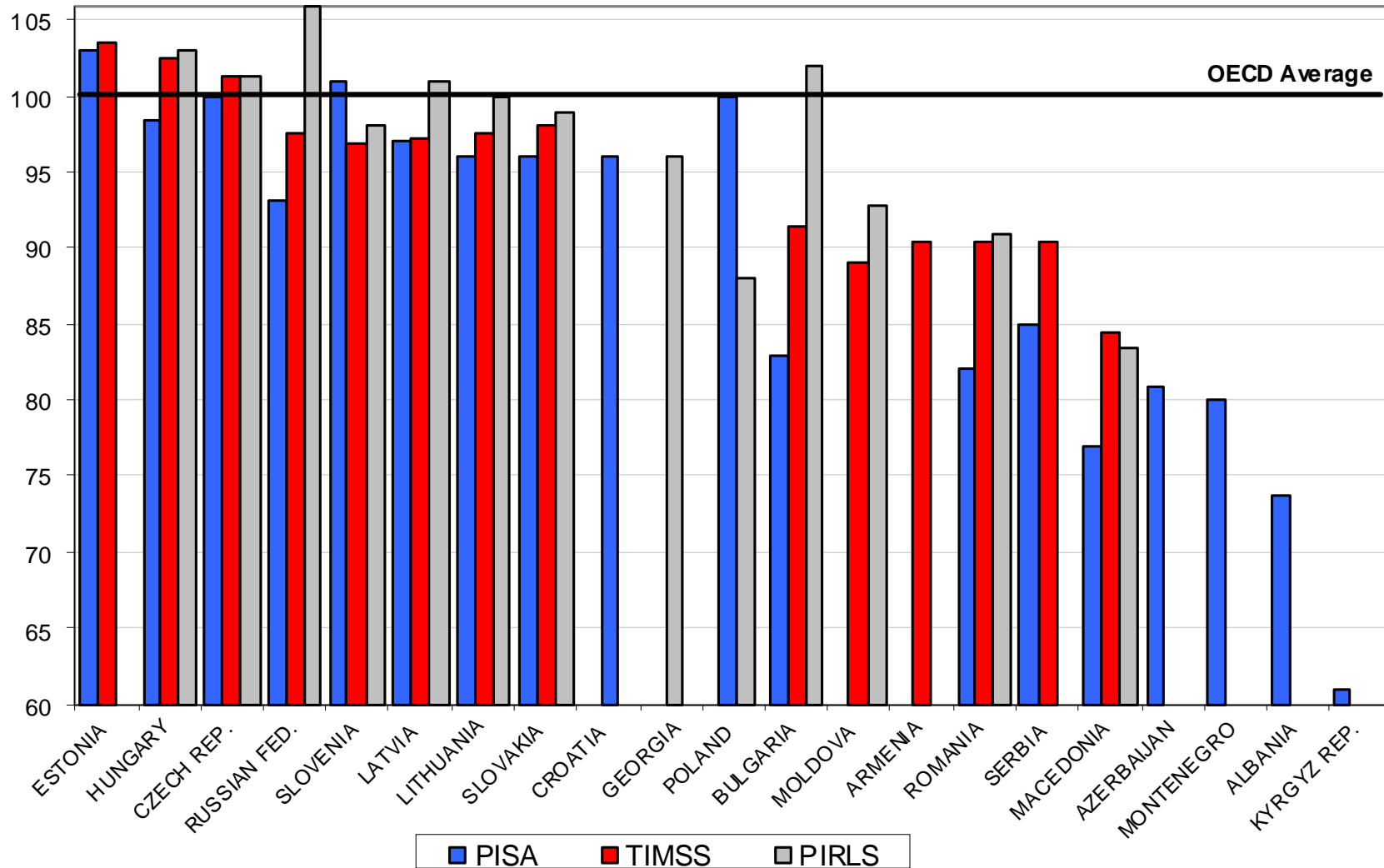
Vocational/Technical Enrollment



UNICEF, TransMONEE Database (August 2008).

Figure 69

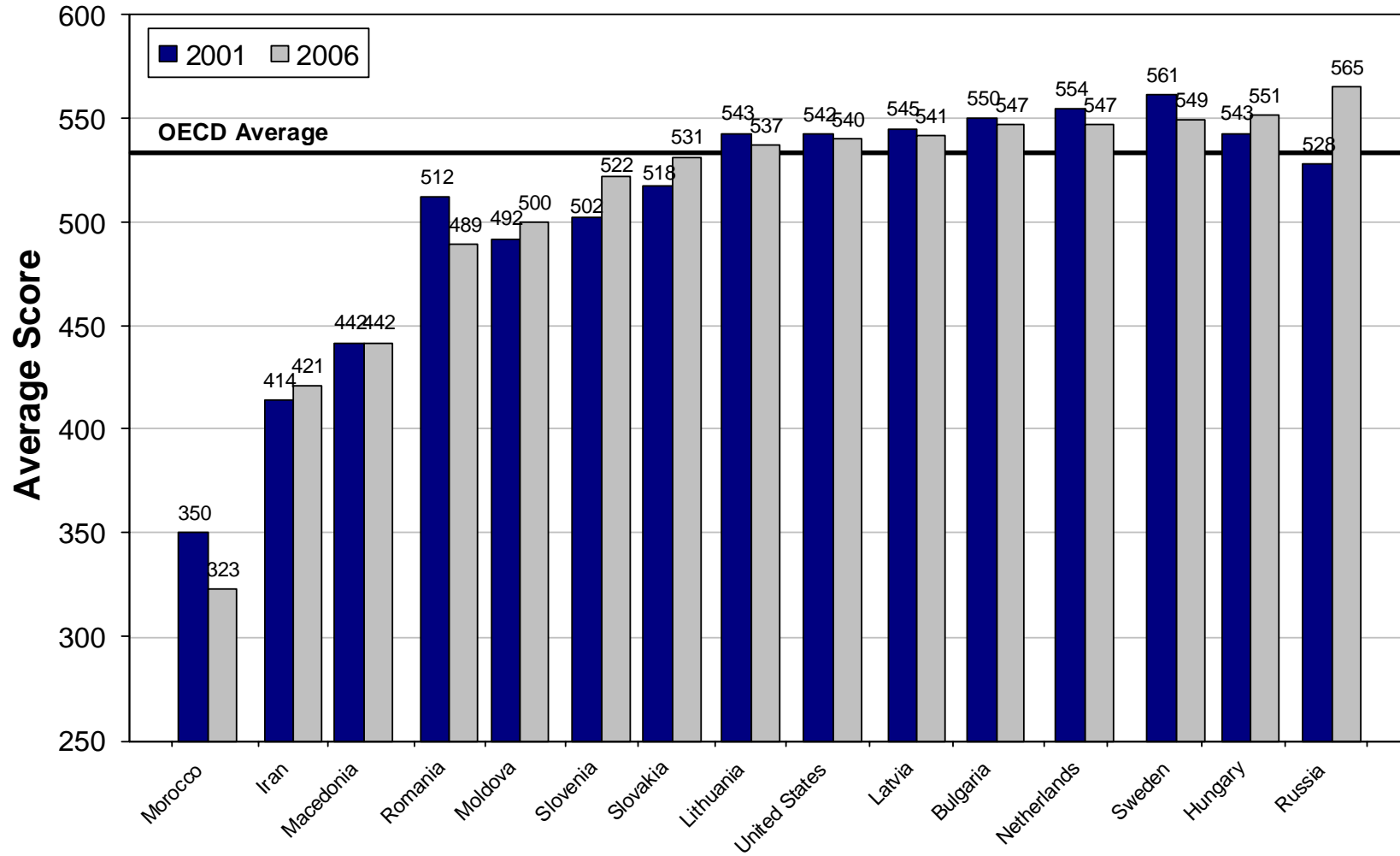
Functional Literacy PISA vs. TIMSS vs. PIRLS (2003 – 2006)



Murphy, Petric and Sprout, *Education in Eastern Europe & Eurasia*, USAID Working Paper #2 (October 2005) drawing from OECD, *PISA 2006 Science Competencies for Tomorrow's World* (December 2007); IEA, *TIMSS 2003 International Mathematics Report* (2004) and *PIRLS 2006 International Report* (2007).

Figure 70

PIRLS, 2001 vs. 2006



PIRLS assesses students at approximately grade 4. The OECD average is 535 in 2006 and 530 in 2001.. IEA, *PIRLS 2001 International Report* (2003), *PIRLS 2006 International Report* (2007).

Bibliography

Baran, Z. *Central and Eastern Europe: Assessing the Democratic Transition*. Hudson Institute. Hearing of the U.S. House of Representatives Committee on Foreign Affairs (July 2007).

Broadman, H. (editor). *From Disintegration to Reintegration: Eastern Europe and the Former Soviet Union in International Trade*. World Bank (2005).

Cohen, A. *Europe's Strategic Dependence on Russian Energy*. Heritage Foundation (November 2007).

Creative Associates International and the Aguirre Division for JBS International. *Education Vulnerability Analysis for the E&E Region* (April 2008).

EBRD (European Bank for Reconstruction and Development). *Transition Report 2008* (November 2008).

_____. *Transition Report 2007* (November 2007).

_____. *Transition Report 1999: Ten Years of Transition* (November 1999).

Economist Intelligence Unit. Various country reports.

Freedom House. *Freedom in the World 2008* (2008).

_____. *Nations in Transit 2008* (2008).

_____. *Freedom of the Press* (2008).

Fund for Peace. *Failed States Index* (2008).

Heinegg, A., R. Murphy, J. Pickett, and R. Sprout. *Demography and Health in Eastern Europe and Eurasia*. USAID/E&E Working Paper #1 (June 2005).

Heinegg, A., R. Murphy, and R. Sprout. *Labor Markets in Eastern Europe and Eurasia*. USAID/E&E Working Paper #6 (January 2007).

IFC (International Finance Corporation) and World Bank. *MSME Database* (2008).

ILO (International Labor Organization). *Labor Statistics* (2008).

IMF (International Monetary Fund). *World Economic Outlook* (November 2008).

_____. *World Economic Outlook* (October 2008).

- _____. *Regional Economic Outlook, Europe* (October 2008).
- _____. *Regional Economic Outlook, Middle East and Central Asia* (October 2008).
- _____. *Direction of Trade Database* (2008).
- IREX. *Media Sustainability Index* (2008).
- Kaufmann, D., A. Kraay, and M. Mastruzzi. *Governance Matters VII: Aggregate and Individual Governance Indicators 1996-2007*. Policy Research Working Paper. World Bank and World Bank Institute. (June 2008).
- Mullis, I., M. Martin, A. Kennedy, P. Foy. *PIRLS 2006 International Report*. International Study Center. Lynch School of Education. Boston College
- Murphy, R., M. Petric, and R. Sprout. *Education in Eastern Europe and Eurasia*. USAID/E&E Working Paper #2 (October 2005).
- Murphy, R. and R. Sprout. *Divergence & Convergence in Eastern Europe & Eurasia: One Transition Path or Two?* USAID/E&E Working Paper #8 (February 2007).
- National Academy of Sciences. *Improving Democracy Assistance* (2008).
- OECD (Organization for Economic Cooperation and Development). *OECD Employment Outlook 2007* (2007).
- Peters, C., R. Sprout and R. Melzig. *The Impact of Regional Disparities on Economic Performance in Eastern Europe and Eurasia* USAID/E&E Working Paper # 5 (October 2008).
- Ross, M. "Does Oil Hinder Democracy?" *World Politics* 53 (April 2001), pp. 325-361.
- Swedberg, J. and R. Sprout. *Democracy and Governance in Eurasia: A Global Comparison*. USAID/E&E Working Paper #9 (September 2008).
- United Nations. *Com Trade Database* (2008).
- UNAIDS. *2008 Report on Global Aids Epidemic*. (2008).
- UNECE (United Nations Economic commission for Europe). *Statistical Division Database* (2007).
- UNESCO (United Nations Educational, Scientific, and Cultural Organization). *Science and Technology Database* (2008)
- UNICEF (United Nations Children's Fund). *TransMONEE Database*.

USAID/E&E (U.S. Agency for International Development, Europe & Eurasia Bureau). *Monitoring Country Progress in Eastern Europe & Eurasia*. Number 10 (August 2006).

_____. *The Monitoring Country Progress in Eastern Europe & Eurasia System: Some Analysis and Proposed Changes* (June 2008).

_____. *The Monitoring Country Progress in Eastern Europe & Eurasia. Appendix II*. Number 5 (July 1999).

_____. *The Global Financial Crisis and the Transition Countries* (March 1999).

_____. *E&E Graduation Criteria Working Group: Issues and Parameters* (October 2007).

USAID/E&E/DGST and MSI. *The NGO Sustainability Index* (June 2008).

USAID/E&E/DGST, Creative Associates, and Aquirre. *Education Vulnerability Analysis for the E&E Region* (April 2008).

U.S. Department of Energy. Energy Information Administration. *Russia: Country Analysis Brief* (May 2008).

U.S. Department of State. EUR/ACE. *Sub-PCC Discussion of Proposed Changes to How the USG Measures Reform in Europe & Eurasia* (March 2008).

World Bank. *World Development Indicators*. (2008).

_____. *Doing Business* (2008).

_____. *Growth, Poverty, and Inequality: Eastern Europe and the Former Soviet Union* (2005).

World Health Organization. *European Health for All Database* (2008).



Monitoring Country Progress in E&E

#11 (December 2008)

Appendix 1

Primary indicator definitions, sources, and scales

I. Economic Reforms Index

The economic reform index is derived from the European Bank for Reconstruction and Development's (EBRD) annual *Transition Report*, from the Office of the Chief Economist. Nine indicators are included: (1) small-scale privatization; (2) price liberalization; (3) trade & foreign exchange reforms; (4) large-scale privatization; (5) governance & enterprise restructuring; (6) competition policy; (7) banking reform; (8) non-bank financial institutional reform; and (9) infrastructure reforms (which is itself an index of reform progress in 5 infrastructure sectors: telecommunications; railways; roads; electric power; and water & waste water). Scoring ranges from "1" to "5", where a "5" represents the most advanced standards worldwide (i.e., the standards of the advanced industrialized economies).

II. Democratic Reforms Index

Freedom House, in its annual *Nations in Transit*, measures progress in the transition region in seven democratic reform areas: (1) electoral process; (2) civil society; (3) independent media; (4) national democratic governance; (5) local democratic governance; (6) rule of law; and (7) anti-corruption. Freedom House rates the progress on a seven-category scale where "1" represents the most advanced standards worldwide. In the Monitoring Country Progress system, these scores are reversed and re-scaled to range from "1" to "5", with "5" being the most advanced.

III. Economic Performance Index

The economic performance index includes: (1) private sector share of GDP; (2) share of employment in micro, small, and medium enterprises; (3) export share of GDP & composition of exports (the average of the 1 to 5 ratings of: (a) exports as a percent of GDP; (b) manufactured exports as a percent of total exports; and (c) high technology exports as a percent of total exports; with export share weighted two times); (4) foreign direct investment per capita, cumulative 5 year, 2003-2007; (5) the most recent 5 year average annual economic growth rate; (6) macro stability (the average of the 1 to 5 ratings of: (a) 3 year inflation rates; (b) external debt as a percent of GDP; (c) current account balance as a percent of GDP; and (d) fiscal balance as a percent of GDP); (7) domestic inequality (the rating based on the average rank of three types of inequalities: (a) ethnic or religious inequalities; (b) income inequality of the ratio of the top population quintile to the bottom population quintile; and (c) urban-rural inequality of poverty rates); (8) long term unemployment as % of the labor force; (9) services as % of GDP; and (10)

energy security (the average of the 1 to 5 ratings of: (a) energy dependency or net energy imports as a percent of energy use; and (b) energy efficiency or GDP per unit of energy use). These indicators are drawn from the World Bank *World Development Indicators*, EBRD *Transition Report*, IFC & World Bank, *Micro Small and Medium Database*, Fund for Peace's *Failed States Index* and UNECE, *Statistical Division Database*. Data are converted to a "1" to "5" scale with "5" representing the most advanced standards worldwide. The five year economic growth rate is given twice the weight of each of the other indicators.

IV. Human Capital Index

Seven indicators go into the human capital index: (1) per capita income (in purchasing power parity); (2) education gaps (the percent of education indicators with "vulnerable" results to total education indicators); (3) public expenditures on education and health as a percent of GDP; (4) life expectancy; (5) under five mortality rate; (6) TB incidences per 100,000; and (7) vulnerable populations (the proportion of children and elderly in poverty at \$2.15 per day; this score is then adjusted to account for the rate of institutionalized children).

The education gap indicator is drawn from Murphy, Petric, and Sprout, *Education in Eastern Europe & Eurasia*, Working Paper No. 2, E&E/USAID (October 2005) and updated. It consists of twelve indicators: (1) public spending on education as a percent of GDP; (2) pre-primary school enrollment; (3) primary school enrollment; (4) secondary enrollment; (5) tertiary enrollment; (6) test results from the Program for International Student Assessment or PISA; (7) country regional disparities in PISA scores; (8) the extent to which education infrastructure hinders learning, from the PISA survey; (9) test results from the Trends in International Mathematics and Sciences Study or TIMSS; (10) test results from the International Adult Literacy Survey or IALS; (11) test results from the Progress in International Reading Literacy Study or PIRLS; and (12) a proxy for brain drain (percent change in research and development personnel per million inhabitants).

The other indicators from the human capital index are drawn from World Bank, *World Development Indicators*; UNICEF, *TransMonee Database*; World Health, *Organization European Health For All Database*; and World Bank, *Growth, Poverty, and Inequality in Eastern Europe and the Former Soviet Union* (2005). The raw indicators are converted to a "1" to "5" scale with "5" representing the most advanced standards worldwide. The education gap is given twice the weight of each of the other indicators of the human capital index to more equally balance the importance of education issues with health issues.

Rating scales defined

I. Economic Reforms Index

The EBRD differentiates and defines 5 main thresholds for the nine indicators (below). The EBRD's scoring ranges from a "1" to a "4.3"; we've converted the "4.3" to a "5". The disaggregation into first and second stage reforms is our designation.

First Stage Reforms

Small-scale Privatization

- 1 Little progress
- 2 Substantial share privatized
- 3 Comprehensive program almost ready for implementation.
- 4 Complete privatization of small companies with tradable ownership rights
- 5 Standards and performance typical of advanced industrial economies: no state ownership of small enterprises; effective tradability of land

Price Liberalization

- 1 Most prices formally controlled by the government
- 2 Some lifting of price administration; state procurement at non-market prices for the majority of product categories
- 3 Significant progress on price liberalization, but state procurement at non-market prices remains substantial
- 4 Comprehensive price liberalization; state procurement at non-market prices largely phased out; only a small number of administered prices remain
- 5 Standards and performance typical of advanced industrial economies: complete price liberalization with no price control outside housing, transport and natural monopolies

Trade & Foreign Exchange System

- 1 Widespread import and/or export controls or very limited legitimate access to foreign exchange
- 2 Some liberalization of import and/or export controls; almost full current account convertibility in principle, but with a foreign exchange regime that is not fully transparent (possibly with multiple exchange rates)
- 3 Removal of most quantitative and administrative import and export restrictions; almost full current account convertibility
- 4 Removal of all quantitative and administrative import and export restrictions (apart from agriculture) and all significant export tariffs; insignificant direct involvement in exports and imports by ministries and state-owned trading companies; no major non-uniformity of customs duties for non-agricultural goods and services; full current account convertibility
- 5 Standards and performance norms of advanced industrial economies: removal of most tariff barriers; membership in WTO

Second Stage Reforms

Large-scale Privatization

- 1 Little private ownership
- 2 Comprehensive scheme almost ready for implementation; some sales completed
- 3 More than 25 percent of large-scale state-owned enterprise assets in private hands or in the process of being privatized (with the process having reached a stage at which the state has effectively ceded its ownership rights), but possibly with major unresolved issues regarding corporate governance
- 4 More than 50 percent of state-owned enterprise and farm assets in private ownership and significant progress on corporate governance of these enterprises
- 5 Standards and performance typical of advanced industrial economies: more than 75 percent of enterprise assets in private ownership with effective corporate governance

Governance & Enterprise Restructuring

- 1 Soft budget constraints (lax credit and subsidy policies weakening financial discipline at the enterprise level); few other reforms to promote corporate governance
- 2 Moderately tight credit and subsidy policy but weak enforcement of bankruptcy legislation and little action taken to strengthen competition and corporate governance
- 3 Significant and sustained actions to harden budget constraints and to promote corporate governance effectively (e.g., privatization combined with tight credit and subsidy policies and/or enforcement of bankruptcy legislation)
- 4 Substantial improvement in corporate governance and significant new investment at the enterprise level
- 5 Standards and performance typical of advanced industrial economies: effective corporate control exercised through domestic financial institutions and markets, fostering market-driven restructuring

Competition Policy

- 1 No competition legislation and institutions
- 2 Competition policy legislation and institutions set up; some reduction of entry restrictions or enforcement action on dominant firms
- 3 Some enforcement actions to reduce abuse of market power and to promote a competitive environment, including break-ups of dominant conglomerates; substantial reduction of entry restrictions
- 4 Significant enforcement actions to reduce abuse of market power and to promote a competitive environment
- 5 Standards and performance typical of advanced industrial economies: effective enforcement of competition policy; unrestricted entry to most markets

Banking Reform

- 1 Little progress beyond establishment of a two-tier system
- 2 Significant liberalization of interest rates and credit allocation; limited use of directed credit or interest rate ceilings
- 3 Substantial progress in establishment of bank solvency and of a framework for prudential supervision and regulation; full interest rate liberalization with little preferential access to cheap refinancing; significant lending to private enterprises and significant presence of private banks
- 4 Significant movement of banking laws and regulations towards BIS standards; well-

- functioning banking competition and effective prudential supervision; significant term lending to private enterprises; substantial financial deepening
- 5 Standards and performance norms of advanced industrial economies: full convergence of banking laws and regulations with BIS standards; provision of full set of competitive banking services

Non-Bank Financial Institutional Reform

- 1 Little progress
- 2 Formation of securities exchanges, market-makers and brokers; some trading in government paper and/or securities; rudimentary legal and regulatory framework for the issuance and trading of securities
- 3 Substantial issuance of securities by private enterprises; establishment of independent share registries, secure clearance and settlement procedures, and some protection of minority shareholders; emergence of non-bank financial institutions (e.g. investment funds, private insurance and pension funds, leasing companies) and associated regulatory framework
- 4 Securities laws and regulations approaching IOSCO standards; substantial market liquidity and capitalization; well-functioning non-bank financial institutions and effective regulation
- 5 Standards and performance norms of advanced industrial economies: full convergence of securities laws and regulations with IOSCO standards; fully developed non-bank intermediation

Infrastructure. This indicator averages EBRD ratings for reform progress in five infrastructure sectors: telecommunications, railways, electric power, roads, and water & waste water.

(a) Telecommunications

- 1 Little progress in commercialization and regulation, i.e., minimal degree of private sector involvement, strong political interference in management, lack of cost-effective tariff-setting principles and extensive cross-subsidization. Few other institutional reforms to encourage liberalization envisaged, even for mobile phones and value-added services.
- 2 Modest progress in commercialization, i.e., corporatization of the dominant operator and some separation of operation from public sector governance, but tariffs still politically determined.
- 3 Substantial progress in commercialization and regulation. Full separation of telecommunications from postal services, with reduction in the extent of cross-subsidization. Some liberalization in the mobile segment and in value-added services.
- 4 Complete commercialization (including the privatization of the dominant operator) and comprehensive regulatory and institutional reforms. Extensive liberalization of entry.
- 5 Implementation of a coherent and effective institutional and regulatory framework (including the operation of an independent regulator) encompassing tariffs, interconnection rules, licensing, concession fees and spectrum allocation. Existence of a consumer ombudsman function.

(b) Railways

- 1 Monolithic organizational structures. State railways still effectively operated as government departments. Few commercial freedoms to determine prices or investments. No private sector involvement. Cross-subsidization of passenger service public service obligations with freight service revenues.
- 2 Laws distancing rail operations from the state, but weak commercial objectives. No budgetary funding of public service obligations in place. Organizational structures still overly based on geographic/functional areas. Separation of ancillary businesses but little divestment. Minimal encouragement of private sector involvement. Initial business planning, but targets general and tentative.
- 3 Laws passed to restructure the railways and introduce commercial orientation. Separation of freight and passenger marketing groups grafted onto tradition structures. Some divestment of ancillary businesses. Some budgetary compensation for passenger services. Design of business plans with clear investment and rehabilitation targets. Business plans designed, but funding unsecured. Some private sector involvement in rehabilitation and/or maintenance.
- 4 Laws passed to fully commercialize railways. Creation of separate internal profit centers for passenger and freight (actual or imminent). Extensive market freedoms to set tariffs and investments. Medium-term business plans under implementation. Ancillary industries divested. Policy development to promote commercial (including private) rail transport operations.
- 5 Railway law exists allowing for separation of infrastructure from operations, and/or freight from passenger operations, and/or private train operations. Private sector participation in ancillary services and track maintenance. Establishment of rail regulator and/or implementation of access pricing and/or plans for a full divestment and transfer of asset ownership, including infrastructure and rolling stock.

(c) Electric power

- 1 Power sector operated as a government department; political interference in running the industry. Few commercial freedoms or pressures. Average prices below costs, with external and implicit subsidy and cross-subsidy. Very little institutional reform with monolithic structure and no separation of different parts of the business.
- 2 Power company is distance from government. For example, established as a joint-stock company, though there is still political interference. Some attempt to harden budget constraints, but management incentives for efficient performance are weak. Some degree of subsidy and cross-subsidy. Little institutional reform; monolithic structure with no separation of different parts of the business. Minimal private sector involvement.
- 3 Law passed which provides for full-scale restructuring of the industry, including vertical unbundling through accounting separation, setting up of regulator with some distance from the government, plans for tariff reform if effective tariffs are below cost, possibility of private ownership and industry liberalization. Little or no private sector involvement.
- 4 Law for industry restructuring passed and implemented providing for: separation of the industry into generation, transmission and distribution; setting up of a regulator,

with rules for setting cost-reflective tariffs formulated and implemented.
Arrangements for network access (negotiated access, single buyer model) developed.
Substantial private sector involvement in distribution and/or generation.

- 5 Business separated vertically into generation, transmission and distribution. Existence of an independent regulator with full power to set cost-reflective tariffs. Large-scale private sector involvement. Institutional development covering arrangements for network access and full competition in generation.

(d) Roads

- 1 There is minimal degree of decentralization, and no commercialization has taken place. All regulatory, road management and resource allocation functions are centralized at ministerial level. New investments and road maintenance financing are dependent on central budget allocations. Road user charges are based on criteria other than relative costs imposed on the network and road use. Road construction and maintenance are undertaken by public construction units. There is no private sector participation. No public consultation or accountability take place in the preparation of road projects.
- 2 There is a moderate degree of decentralization, and initial steps have been taken in commercialization. A road/highways agency has been created. Initial steps have been undertaken in resource allocation and public procurement methods. Road user charges are based on vehicle and fuel taxes but are only indirectly related to road use. A road fund has been established but it is dependent on central budget allocations. Road construction and maintenance is undertaken primarily by corporatized public entities, with some private sector participation. There is minimal public consultation/participation and accountability in the preparation of road projects.
- 3 There is a fairly large degree of decentralization and commercialization. Regulation, resource allocation, and administrative functions have been clearly separated from maintenance and operations of the public road network. Road user charges are based on vehicle and fuel taxes and fairly directly related to road use. A law has been passed allowing for the provision and operation of public roads by private companies under negotiated commercial contracts. There is private sector participation either in road maintenance works allocated via competitive tendering or through a concession to finance, operate and maintain at least a section of the highway network. There is limited public consultation and/or participation and accountability in the preparation of road projects.
- 4 There is a large degree of decentralization of road administration, decision-making, resource allocation and management according to government responsibility and functional road classification. A transparent methodology is used to allocate road expenditures. A track record has been established in implementing competitive procurement rules for road design, construction, maintenance and operations. There is large-scale private sector participation in construction, operations and maintenance directly and through public-private partnership arrangements. There is substantial

public consultation and/or participation and accountability in the preparation of road projects.

- 5 A fully decentralized road administration has been established, with decision-making, resource allocation and management across road networks and different levels of government. Commercialized road maintenance operations are undertaken through open and competitive tendering by private construction companies. Legislation has been passed allowing for road user charges to fully reflect costs of road use and associated factors, such as congestion, accidents and pollution. There is widespread private sector participation in all aspects of road provision directly and through public-private partnership arrangements. Full public consultation is undertaken in the approval process for new road projects.

(e) Water and Waste water

- (1) There is a minimal degree of decentralization, and no commercialization has taken place. Water and waste-water services are operated as a vertically integrated natural monopoly by a government ministry through national or regional subsidiaries or by municipal departments. There is no, or little, financial autonomy and/or management capacity at municipal level. Heavily subsidized tariffs still exist, along with a high degree of cross-subsidization.
- (2) There is a moderate degree of decentralization, and initial steps have been taken in commercialization. Water and waste-water services are provided by municipally owned companies, which operate as joint-stock companies. There is some degree of financial autonomy at the municipal level but heavy reliance on central government for grants and income transfers. Partial cost recovery is achieved through tariffs, and initial steps have been taken to reduce cross-subsidies. General public guidelines exist regarding tariff-setting and service quality but these are both still under ministerial control. There is some private sector participation through service or management contracts or competition to provide ancillary services.
- (3) A fairly large degree of decentralization and commercialization has taken place. Water and waste-water utilities operate with managerial and accounting independence from municipalities, using international accounting standards and management information systems. A municipal finance law has been approved. Cost recovery is fully operated through tariffs and there is a minimum level of cross-subsidies. A semi-autonomous regulatory agency has been established to advise on tariffs and service quality but without the power to set either. More detailed rules have been drawn up in contract documents, specifying tariff review formulae and performance standards. There is private sector participation through performance standards. There is private sector participation through the full concession of a major service in at least one city.
- (4) A large degree of decentralization and commercialization has taken place. Water and waste-water utilities are managerially independent, with cash flows—net of

municipal budget transfers—that ensure financial viability. A municipal finance law has been implemented, providing municipalities with the opportunity to raise finance. Full cost recovery exists and there are no cross-subsidies. A semi-autonomous regulatory agency has the power to advise and enforce tariffs and service quality. There is substantial private sector participation through build-operate-transfer concessions, management contracts or asset sales to service parts of the network or entire networks. A concession of major services has taken place in a city other than the country’s capital.

- (5) Water and waste-water utilities are fully decentralized and commercialized. Large municipalities enjoy financial autonomy and demonstrate the capability to raise finance. Full cost recovery has been achieved and there are no cross-subsidies. A fully autonomous regulator exists with complete authority to review and enforce tariff levels and performance quality standards. There is widespread private sector participation via service management/lease contracts, with high-powered performance incentives and/or full concessions and/or divestiture of water and waste-water services in major urban areas.

II. Democratic Reforms Index

Freedom House measures progress towards democratic reforms by assessing a series of questions in the seven democratization areas, and then provides rating guidelines on criteria towards policy and implementation (or “practice”).

Electoral process

- (1) Is the authority of government based upon universal and equal suffrage and the will of the people as expressed by regular, free, and fair elections conducted by secret ballot?
- (2) Are there fair electoral laws, equal campaigning opportunities, fair polling, and honest tabulation of ballots?
- (3) Is the electoral system free of significant barriers to political organization and registration?
- (4) Is the electoral system multiparty based, with viable political parties, including an opposition party, functioning at all levels of government?
- (5) Is the public engaged in the political life of the country, as evidenced by membership in political parties, voter turnout for elections, or other factors?
- (6) Do ethnic and other minority groups have sufficient openings to participate in the political process?
- (7) Is there opportunity for the effective rotation of power among a range of different political parties representing competing interests and policy options?
- (8) Are the people’s choices free from domination by the specific interest of power groups (the military, foreign powers, totalitarian parties, regional hierarchies, and/or economic oligarchies)?
- (9) Were the most recent national legislative elections judged free and fair by domestic and international election-monitoring organizations?
- (10) Were the most recent presidential elections judged free and fair by domestic and

international election-monitoring organizations?

Civil Society

- (1) Does the state protect the rights of the independent civic sector?
- (2) Is the civil society vibrant? (Consider growth in the number of charitable, nonprofit, and nongovernmental organizations; improvements in the quality of performance of civil society groups; locally led efforts to increase philanthropy and volunteerism; the public's active participation in private voluntary activity; the presence of effective civic and cultural organizations for women and ethnic groups; the participation of religious groups in charitable activity; or other factors)
- (3) Is society free of excessive influence from extremist and intolerant nongovernmental institutions and organizations (such as racists, groups advocating violence or terrorism, xenophobes, private militias and vigilante groups, or other groups whose actions threaten political and social stability and the transition to democracy)?
- (4) Is the legal and regulatory environment for civil society groups free of excessive state pressures and bureaucracy (consider ease of registration, legal rights, government regulation, fund-raising, taxation, procurement, and access-to-information issues)?
- (5) Do civil society groups have sufficient organizational capacity to sustain their work (that is, management structures with clearly delineated authority and responsibility; a core of experienced practitioners, trainers, and the like; access to information on NGO management issues in the native language; and so forth)?
- (6) Are civil society groups financially viable, with adequate conditions and opportunities for raising funds that sustain their work (for example, sufficient organizational capacity to raise funds; option of nonprofit tax status; freedom to raise funds from domestic or foreign sources; legal or tax environment that encourages private sector support; ability to compete for government procurement opportunities; ability to earn income or collect cost recovery fees)?
- (7) Is the government receptive to policy advocacy by interest groups, public policy research groups, and other nonprofit organizations? Do government officials engage civil society groups by inviting them to testify, comment on, and influence pending policies or legislation?
- (8) Are the media receptive to civil society groups as independent and reliable sources of information and commentary? Are they positive contributors to the country's civic life?
- (9) Does the state respect the right to form and join free trade unions?
- (10) Is the education system free of political influence and propaganda?

Independent Media

- (1) Are there legal protections for press freedoms?
- (2) Are journalists, especially investigative reporters, protected from victimization by powerful state or nonstate actors?
- (3) Does the state oppose onerous libel laws and other excessive legal penalties for "irresponsible" journalism?
- (4) Are the media's editorial independence and new-gathering functions free of interference from the government or private owners?
- (5) Does the public enjoy a diverse selection of print and electronic sources of

information that represent a range of political viewpoints?

- (6) Are the majority of print and electronic media privately owned and free of excessive ownership concentration?
- (7) Is the private media's financial viability subject only to market forces (that is, is it free of political or other influences)?
- (8) Is the distribution of newspapers privately controlled?
- (9) Are journalists and media outlets able to form their own viable professional associations?
- (10) Does society enjoy free access to the Internet?

National Democratic Governance

- (1) Is the governmental system democratic?
- (2) Is the country's governmental system stable?
- (3) Is the legislature independent, effective, and accountable to the public?
- (4) Is the executive branch independent, effective, and accountable to the public?

Local Democratic Governance

- (1) Are the principles of local democratic government enshrined in law and respected in practice?
- (2) Are citizens able to choose local leaders in free and fair elections?
- (3) Are citizens ensured meaningful participation in local government decision-making?
- (4) Do democratically elected local authorities exercise their powers freely and autonomously?
- (5) Do democratically elected local authorities have the resources and capacity needed to fulfill their responsibilities?
- (6) Do democratically elected local authorities operate with transparency and accountability to citizens?

Rule of Law

- (1) Is there an effective system of checks and balances among legislative, executive, and judicial authorities?
- (2) Is the legislature the effective rule-making institution?
- (3) Does the constitutional framework provide for human rights (including freedom of expression, religious freedom, freedom of association, and business and property rights), and does the state protect those rights in practice?
- (4) Is there independence and impartiality in the interpretation and enforcement of the constitution?
- (5) Is there equality before the law?
- (6) Has there been effective reform of the criminal code/criminal law? (Consider presumption of innocence until proven guilty, access to a fair and public hearing, introduction of jury trials, access to independent counsel/public defender, independence of prosecutors, and so forth.)
- (7) Are suspects and prisoners protected in practice against arbitrary arrest, detention without trial, searches without warrants, torture and abuse, and excessive delays in the criminal justice system?
- (8) Are judges appointed in a fair and unbiased manner, and do they have adequate legal

training before assuming the bench?

- (9) Do judges rule fairly and impartially, and are courts free of political control and influence?
- (10) Do legislative, executive, and other governmental authorities comply with judicial decisions, and are judicial decisions effectively enforced?

Corruption

- (1) Has the government implemented effective anticorruption initiatives?
- (2) Is the government free from excessive bureaucratic regulations, registration requirements, and other controls that increase opportunities for corruption?
- (3) Are there significant limitations on the participation of government officials in economic life?
- (4) Are there adequate laws requiring financial disclosure and disallowing conflict of interest?
- (5) Does the state enforce an effective legislative or administrative process—particularly one that is free of prejudice against one’s political opponents—to prevent, investigate, and prosecute the corruption of government officials and civil servants?
- (6) Do executive and legislative bodies operate under effective audit and investigative rules that are free of political influence?
- (7) Do whistle-blowers, anticorruption activist, investigators, and journalists enjoy legal protections that make them feel secure about reporting cases of bribery and corruption?
- (8) Are allegations of corruption given wide and extensive airing in the media?
- (9) Does the public display a high intolerance for official corruption?

Democratization Ratings Guidelines

- 1** Policy criteria: existence of policies that adhere to basic human rights standards, democratic norms, and the rule of law; Practice criteria: existence of best practices that adhere to basic human rights standards, democratic norms, and the rule of law.
- 2** Policy criteria: existence of policies that adhere to basic human rights standards, democratic norms, and the rule of law; Practice criteria: existence of most practices that adhere to basic human rights standards, democratic norms, and the rule of law
- 3** Policy criteria: existence of many polices that adhere to basic human rights standards, democratic norms, and the rule of law; Practice criteria: existence of many practices that adhere to basic human rights standards, democratic norms, and the rule of law
- 4** Policy criteria: existence of many policies that adhere to basic human rights standards, democratic norms, and the rule of law; Practice criteria: existence of some practices that adhere to basic human rights standards, democratic norms, and the rule of law
- 5** Policy criteria: existence of many policies that adhere to basic human rights standards, democratic norms, and the rule of law; Practice criteria: absence of many practices that adhere to basic human rights standards, democratic norms,

- and the rule of law
- 6 Policy criteria: existence of some policies that adhere to basic human rights standards, democratic norms, and the rule of law; Practice criteria: absence of most practices that adhere to basic human rights standards, democratic norms, and the rule of law
 - 7 Policy criteria: absence of policies that adhere to basic human rights standards, democratic norms, and the rule of law; Practice criteria: absence of practices that adhere to basic human rights standards, democratic norms and the rule of law.

III. Economic performance Index.

The economic performance and human capital indices are derived by converting “raw scores” (such as percentages and growth rates) into scores which range from “1” to “5”:

(1) ***Private Sector Share of GDP*** (EBRD *Transition Report*): “0.5”: 30% of GDP or less; “1.0”: >30-40%; “1.5”: >40 to 45%; “2.0”: >45 to 50%; “2.5”: >50 to 55%; “3.0”: >55 to 60%; “3.5”: >60 to 65%; “4.0”: >65 to 70%; “4.5”: >70 to 75%; “5.0”: 80% or greater.

(2) ***Employment in MSME Sector as % of Total Employment*** (IFC, MSME Database). “0.5”: 10% or less; “1.0”: >10-23%; “1.5”: >23-30%; “2.0”: >30-45%; “2.5”: >45-49%; “3.0”: >49-55%; “3.5”: >55-60%; “4.0”: >60-65%; “4.5”: >65-75%; “5.0”: greater than 75% of total employment.

(3) ***Export Sector*** (the average of the ratings of three components below, weighting export share times two; World Bank, *World Development Indicators*).

(3a) *Export share*: “0.5”: 25% or less; “1.0”: greater than 25% to 37%; “1.5”: >37-43%; “2.0”: >43-46%; “2.5”: >46-51%; “3.0”: >51-58%; “3.5”: >58-61%; “4.0”: >61-66%; “4.5”: >66-77%; “5.0”: greater than 77%.

(3b) *Manufactured exports to total exports*: “0.5”: 25% or less; “1.0”: greater than 25% to 35%; “1.5”: >35-40%; “2.0”: >40-45%; “2.5”: >45-50%; “3.0”: >50-55%; “3.5”: >55-65%; “4.0”: >65-70%; “4.5”: >70-75%; “5.0”: greater than 75%.

(3c) *High-tech exports as % of exports*: “1.0”: >1%; “2.0”: 1->3%; “3.0”: 3->5%; “4.0”: 5->10%; “5.0”: 10% or greater.

(4) ***Foreign Direct Investment*** (per capita, cumulative, most recent five year average, net in \$; EBRD *Transition Report*). “0.5”: \$100 or less; “1.0”: >\$100-200; “1.5”: >\$200-400; “2.0”: >\$400-600; “2.5”: >\$600-800; “3.0”: >\$800-1,000; “3.5”: >\$1,000-1,200; “4.0”: >\$1,200-1,500; “4.5”: >\$1,500-2,000; “5.0”: >\$2,000.

(5) ***GDP Growth*** (most recent five year average; EBRD, *Transition Report*). “0.5”: 0% or less; “1.0”: greater than 0% to 2.0%; “1.5”: >2.0-2.5%; “2.0”: >2.5-3.0%; “2.5”: >3.0-

4.0%; “3.0”>4.0-5.0%; “3.5”>5.0-6.0%; “4.0”>6.0-7.5%; “4.5”>7.5-9.0%; “5.0”>greater than 9.0%.

(6) **Macro Stability** (the average of the ratings of the four indicators below):

(6a) *3 year average annual inflation rate* (EBRD, *Transition Report*). “0.5”>30%; “1.0”>26-30%; “1.5”>22-26%; “2.0”>10-22%; “2.5”>7-10%; “3.0”>6-7%; “3.5”>4-6%; “4.0”>3-4%; “4.5”>2.5-3%; “5.0”>2.5% inflation rate or less.

(6b) *external debt as % of GDP* (EBRD, *Transition Report*). “0.5”>95%; “1.0”>85% to 95%; “1.5”>75-85%; “2.0”>50-75%; “2.5”>40-50%; “3.0”>30-40%; “3.5”>20-30%; “4.0”>10-20%; “4.5”>5-10%; “5.0”>5% or less.

(6c) *fiscal balance as % of GDP* (World Bank, *World Development Indicators*). “0.5”>-15% or less; “1.0”><-10.0% to -15.0%; “1.5”><-7.0 to -10.0%; “2.0”><-3.0 to -7.0%; “2.5”><-2.5 to -3.0%; “3.0”>-1.5 to <-2.5%; “3.5”>-1.0 to <-1.5%; “4.0”>0.0 to <-1.0%; “4.5”>1.0 to <2.0%; “5.0”>2.0% or greater.

(6d) *current account balance as % of GDP* (World Bank, *World Development Indicators*). “0.5”>-20% or less; “1.0”><-10 to -20%; “2.0”><-6.0 to -10%; “3.0”><-3.0 to -6.0%; “4.0”><0.0 to -3.0%; “5.0”>greater than 0%.

(7) **Domestic Inequality**. A 1 to 5 rating was assigned from an average of three rankings of each of three measures of inequality: (a) ethnic or religious inequalities (the “uneven development” indicator from the Fund for Peace’s *Failed States Index*); (b) income inequality of the top population quintile to the bottom population quintile (from UNESCO, *Statistical Division Database*); and (c) urban-rural inequality of poverty rates (from E&E/USAID, *Domestic Disparities in Eastern Europe & Eurasia*, Working Paper # 5, July 2007 draft, drawing from A. Alam et. al, *Growth, Poverty, and Inequality: Eastern Europe and the Former Soviet Union*, World Bank, 2005).

(8) **Long Term Unemployment as % of the Labor Force** (UNECE, *Statistical Division Database*). “0.5”>20.0%; “1.0”>10.0 to 20.0%; “2.0”>7.0 to 10.0%; “3.0”>5.0 to 7.0%; “4.0”>3.5 to 5.0%; “4.5”>3.0 to 3.5%; “5.0”>≤3.0%.

(9) **Services as % GDP** (World Bank, *World Development Indicators*). “1.0”>less than 40%; “2.0”>40 to 50%; “3.0”>50 to 60%; “4.0”>60 to 64%; “4.5”>64 to 65%; “5.0”>greater than 65%.

(10) **Energy Security** (the average of the ratings of the two components below):

(10a) *energy dependency* (net energy imports as percent of energy use in 2005, World Bank, *World Development Indicators*). “1.0”>greater than 79%; “2.0”><59 to 79%; “3.0”><39 to 59%; “4.0”><10 to 39%; “5.0”>less than or equal to 10%.

(10b) *energy efficiency* (GDP per unit of energy use, 2005 PPP \$ per kilogram of oil equivalent, World Bank, *World Development Indicators*). “1.0”: less than 2.6; “2.0”: >2.6 to 3.5; “3.0”: >3.5 to 5 “4.0”: >5.0 to 6.0; “5.0”: greater than 6.0.

IV. Human capital Index.

(1) **Per Capita Income** (gross national income, purchasing power parity, World Bank, *World Development Indicators*). “0.5”: \$1,000 or less; “1.0”: >\$1,000 to \$3,000; “1.5”: >\$3,000-5,000; “2.0”: >\$5,000-7,000; “2.5” >\$7,000-9,000; “3.0”: >\$9,000-11,000; “3.5”: >\$11,000-13,000; “4.0”: >\$13,000-15,000; “4.5”: >\$15,000-17,000; “5.0”: >\$17,000 per capita.

(2) **Education Gaps** (the percent of education indicators with “vulnerable” results to total education indicators, E&E/USAID Working Paper No. 2, October 2005). “0.5”: 80% or greater of education indicators with vulnerable outcomes; “1.0”: 70 to 79%; “1.5”: 60 to 69%; “2.0”: 50 to 59; “2.5”: 40 to 49%; “3.0”: 30 to 39%; “3.5”: >20 to 29%; “4.0”: >13 to 19%; “4.5”: >6 to 12%; “5.0”: 5% or less.

(3) **Public Expenditure on Education and Health as % of GDP** (average, World Bank, *World Development Indicators*). “0.5”: 2% or less; “1.0”: >2% to 2.5%; “1.5”: >2.5-3%; “2.0”: >3-3.5%; “2.5”: >3.5-4%; “3.0”: >4-4.5%; “3.5”: >4.5-5%; “4.0”: >5-5.5%; “4.5”: >5.5-6%; “5.0”: greater than 6% of GDP.

(4) **Life Expectancy** (years, World Bank, *World Development Indicators*). 0.5: less than 64 years; 1: 64 years to <65.5; 1.5: 65.5 to <67 years; 2: 67 to <68.5 years; 2.5: 68.5 to <70 years; 3: 70 to < 71.5 years; 3.5: 71.5 to <73 years; 4: 73 to < 74.5 years; 4.5: 74.5 to < 76 years; 5: 76 years or greater.

(5) **Under Five Years Mortality Rate** (per thousand live births, World Bank, *World Development Indicators*). 0.5: greater than 93 deaths; 1: <82 to 93 deaths; 1.5: <71-82 deaths; 2: <60-71 deaths; 2.5: <49-60 deaths; 3: <38-49 deaths; 3.5: <27-38 deaths; 4: <16-27 deaths; 4.5: <5-16 deaths; 5: 5 deaths or less.

(6) **TB Incidences** (per 100,000 persons, World Health Organization, *European Health For All Database*) “0.5”: greater than 150 incidences; “1.0”: >100 to 150; “1.5”: >75 to 100; “2.0”: >59 to 75; “2.5”: >45 to 59; “3.0”: >35 to 45; “3.5”: >25 to 35; “4.0”: >15 to 25; “4.5”: >11 to 15; “5.0”: 11 incidences or less.

(7) **Vulnerable populations** (the proportion of children and elderly in poverty at \$2.15 per day; World Bank, *Growth, Poverty, and Inequality: Eastern Europe and the Former Soviet Union* (2005) and UNICEF, *TransMONEE Database*; Countries are down-graded a “1” on the “1” to “5” scale on the poverty rates of the vulnerable population if the countries also have a high rate of institutionalized children (and if the score is not already a “1”)) “0.5”: greater than 60%; “1.0”: >30 to 60%; “2.0”: >19 to 30%; “3.0”: >10 to 19%; “4.0”: >3 to 10%; “5.0”: 3% or less.