MONITORING COUNTRY PROGRESS IN EASTERN EUROPE & EURASIA

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Highlights

(1) 2005 progress in ***economic reforms*** in the transition region was comparable to the good pace of reforms in recent years. Eighteen of twenty-nine transition countries advanced in 2005 in at least one economic reform dimension. Serbia made the greatest advancement. In contrast, economic reforms in Russia largely stalled, with backsliding in large-scale privatization. In general, gains in second stage economic reforms exceeded first stage economic reform gains in the transition region. Most of the gains in first stage reforms occurred in Eurasia. Most of the gains in second stage reforms occurred in the Northern Tier CEE countries.

(2) 2005 data show a continuation of the growing ***democratization*** gap between CEE and Eurasia that has been evident since the early transition years. Data from Freedom House's *Nations in Transit* show six Eurasian countries backsliding on democratic reforms in 2005 and only three countries (Ukraine, Georgia, and Moldova) moving forward. In CEE, seven countries advanced in democratization in 2005 and only two countries (Hungary and Poland) regressed. Among the three sub-regions, the broadest gains occurred in the Southern Tier CEE countries, advancing in six of seven democracy areas. The most broad-based gains in democratization occurred in Bulgaria, Albania, and Ukraine; the countries which regressed the most in democratization in 2005 were Uzbekistan, Russia, and Tajikistan.

(3) The twenty nine transition countries generally fall into ***four fairly distinct reform groups:*** (a) Northern Tier CEE; (b) Southern Tier CEE; (c) Eurasian reformers; and (d) Eurasian non-reformers (Turkmenistan, Belarus, and Uzbekistan). The two salient outliers are Ukraine which has a reform profile closer to that found in the Southern Tier CEE, and Kosovo where reform progress is comparable to Eurasian norms.

(4) Econometric evidence suggests that ***economic and democratic reforms*** have been mutually reinforcing in the region since the collapse of communism, even in Eurasia (and notwithstanding the general trend of divergence between the two reform dimensions in Eurasia since the early 1990s).

(5) Since 2000, the transition region as a whole has witnessed annual ***economic growth*** rates in excess of global economic growth rates, averaging more than 5% annually. Of the three transition sub-regions, economic growth has been highest in Eurasia, averaging about 7% annually from 2000 to 2005. The evidence suggests that economic growth is driven in much of Eurasia by high and rising prices of key primary product exports (directly from rising prices and indirectly by robust demand in Russia for others' exports). In CEE, economic growth is increasingly driven by economic growth in Western Europe as CEE's share of exports to Western Europe increases.

(6) While poverty rates vary widely across the countries, some common observations regarding the trends between ***poverty and economic growth*** emerge: (a) rising economic growth corresponds to falling poverty; (b) there may be some minimum threshold of growth before poverty responds and declines, perhaps close to 5% annual economic

growth; and (c) in some but not all countries, urban poverty appears to be more responsive to economic growth than rural poverty. The extreme cases in this regard are Georgia and Armenia, where rural poverty rates actually increased in 2003 despite high and increasing economic growth.

(7) ***Labor markets*** have been adjusting very differently in CEE and Eurasia. In CEE, labor markets have been adjusting along both price and quantity dimensions. In contrast, most all of the labor market adjustments in Eurasia have taken place via the price mechanism; i.e., via real wages, with employment levels changing very little. Highest open unemployment rates are in the Southern Tier CEE countries (where the decrease in employment has been the greatest), while the lowest unemployment rates are in Eurasia (where the fall in employment rates has been the lowest).

A number of transition countries across the three sub-regions are (still) experiencing increasing unemployment rates. This includes Poland, the Czech Republic, and Slovakia in the Northern Tier CEE, Macedonia, Romania, and Serbia & Montenegro in the Southern Tier CEE, and Armenia and Moldova in Eurasia. In this key respect (and others), the transition in the labor markets continues to lag behind other dimensions of the transition.

(8) Of the three levels of ***education***, enrollments in secondary schools have generally been the most adversely affected in the transition region in the 1990s. Most of the deterioration in secondary school enrollments has occurred in Eurasia. However, these enrollment trends may have recently bottomed out in most Eurasian countries. Moreover, most of the deterioration in secondary school enrollments in Eurasia has been in vocational and/or technical schools.

Literacy rates as traditionally defined are uniformly high in the transition region by world standards: 98% male adult literacy rates and 94% for females in 2002. 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. Drawing from OECD's PISA surveys, there are roughly three levels of functional literacy in the transition sample (of eleven countries): (a) the five Northern Tier CEE countries are all OECD standard; (b) Russia followed by Bulgaria, Romania, and Serbia & Montenegro perform at a middle level, well below OECD standards, comparable to Thailand; and (c) Macedonia and Albania score much lower still, comparable to Tunisia, Indonesia, and Brazil.

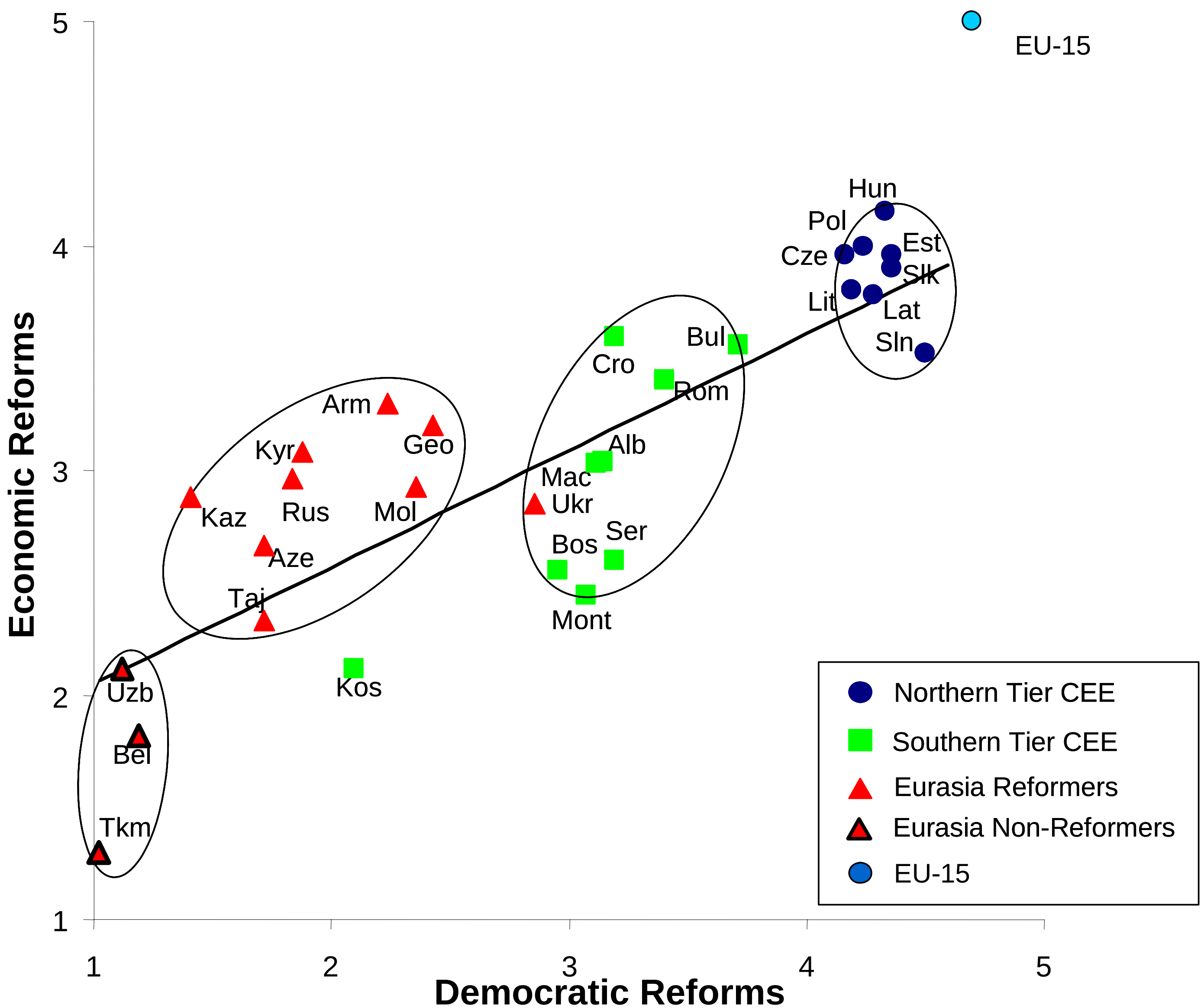
(9) The latest (2004) data on life expectancy suggest that the ***health gap*** between CEE and Eurasia continues to grow. In addition, the highest life expectancy gender gaps in the world are found in Eastern Europe and Eurasia. Males live eleven years less than females in Belarus, Estonia, Kazakhstan, and Ukraine, twelve years less in Latvia, Lithuania, and Moldova, and thirteen years less in Russia. Moreover, these gender gaps are larger today than they were in 1990.

(10) Key ***demographic trends*** in Eastern Europe and Eurasia are both unique and troubling. Some transition countries have among the highest crude death rates worldwide along with among the lowest fertility rates (and birth rates) worldwide. Eight countries characterized by both statistics stand out, and span all three sub-regions: Ukraine; Russia; Latvia; Estonia; Bulgaria; Belarus; Romania; and the Czech Republic. 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. During this time period, all other regions in the world have experienced expanding populations, ranging from a small increase in Western Europe (0.3% average annual) to closer to 2.5% increase in Sub-Saharan Africa.

(11) Assessing ***human capital and economic performance*** over time reveals three country groupings: (a) those which have made good progress on both dimensions; (b) those which have made good progress in economic performance and little on human capital; and (c) those which have made little progress in either dimension. Six Northern Tier CEE countries (the Czech Republic, Estonia, Poland, Hungary, Slovenia, and Lithuania) and Croatia comprise the first group. Most of the transition countries fall into the second group, Southern Tier CEE and Eurasia. The third group consists of three Eurasian countries: Moldova; Belarus; and Uzbekistan.

Summary Figure 1

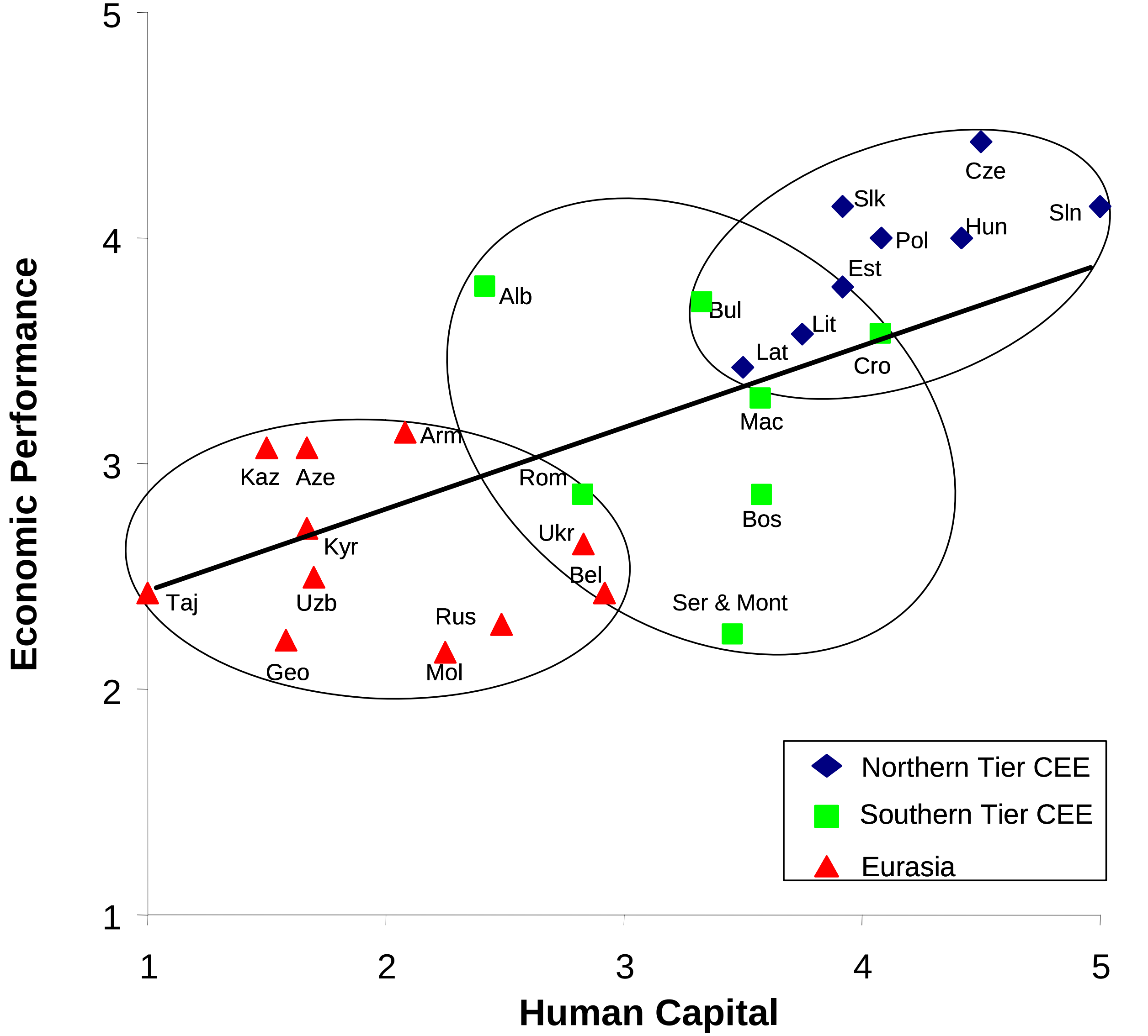
Economic and Democratic Reforms in 2005



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

Summary Figure 2

Economic Performance and Human Capital in 2003-2005



World Bank, *World Development Indicators 2005* (2005); UNICEF, *TransMONEE Database 2005* (December 2005); EBRD, *Transition Report* (November 2005); UNECE, *SME Databank* (2003).

Introduction

This paper presents USAID/E&E's system for monitoring country progress in the twenty-nine transition country region.[1] It is the ninth update of the original January 1997 report. As in past editions, transition progress is tracked along four primary dimensions: (1) economic reforms; (2) democratization; (3) economic performance (which includes economic structure and macroeconomic conditions); and (4) human capital (or social conditions). An important objective of this report and the *Monitoring Country Progress* (*MCP*) system is to provide criteria for graduation of transition countries from U.S. government assistance, and, more generally, to provide guidelines in optimizing the allocation of USG resources in the region.[2]

Salient findings for each of the four primary dimensions are articulated in the main body of the report below. Three appendices follow: *Appendix 1* provides elaboration of indicator definitions and sources; *Appendix 2* defines the transition country classification schemes that are used in the report; and *Appendix 3* includes a visual "gap analysis" for each of the twenty-nine countries.

Findings

Economic reforms

Progress in economic reforms is measured by the EBRD's transition indicators (*Tables 1* & *2* and *Figure 1*) and the World Bank's *Doing Business* indicators (*Table 3* and *Figure 2*). The former indicators attempt to measure macro policy reforms; the latter group of indicators attempts to address micro business environment reforms.

Nine indicators are drawn from the EBRD and grouped into two stages of reform. The first stage reforms consist of liberalization of prices, external trade and foreign currency reforms, and privatization of small-scale and large-scale units (*Table 1*).[3] The second stage reforms consist of enterprise restructuring (credit and subsidy policy), competition policy, financial sector reforms (including banking and capital markets), and reforms in infrastructure (*Table 2*). In general, whereas much of the first stage reforms focus on liberalizing the economy from government intervention or ownership, second stage reforms concentrate in large part on building a government's capacity to govern; that is, reconstructing a leaner and more efficient government capable of enforcing the rules and providing the public goods needed for a vibrant market economy to work.

Progress in 2005 in economic reforms was comparable to the pace of reforms in recent years. Eighteen of twenty-nine transition countries advanced in 2005 in at least one reform dimension. Serbia made the greatest advancement, moving forward on four indicators: trade liberalization; large-scale privatization; enterprise governance; and bank reform. Armenia advanced in three areas: large-scale privatization; competition policy; and bank reform. Seven other countries advanced in two dimensions.

In contrast, Russia backslid on large-scale privatization (though it also moved forward on banking reform). This was the only measurable backsliding in economic reform throughout the transition region in 2005 by EBRD's count. Nevertheless, given that it occurred in Russia, it is