

# Executive summary

## Chapter 01 Progress in transition

The transition countries have made further progress in structural and institutional reforms over the past year but at a slower pace than in previous years. The pace of reform continues to be fastest in south-eastern Europe (SEE), with significant progress in the less advanced countries of the Western Balkans which are still catching up with the rest of the transition region.

In the Commonwealth of Independent States and Mongolia (CIS+M) there have been substantial advances in creating a private economy in countries with strong pro-market support, particularly in Mongolia and Georgia. In the western CIS countries, market developments and external economic factors triggered a number of reforms in the financial sector. Resource-rich countries in the CIS+M made limited progress. In central eastern Europe and the Baltic states, where transition has gone furthest, progress in the past year has been limited.

While first-phase market-enabling reforms are largely completed, recent reform progress has mostly focused on second-phase market-deepening reforms – privatisation and reforms in the financial sector – and third-phase market-sustaining reforms, particularly competition policy. Infrastructure reform remains a key challenge. Many transition countries need to improve the security of their gas supply by importing from a broader range of countries or by encouraging energy efficiency through tariff reform aimed at achieving full cost recovery.

Recent turbulence in international financial markets will lead to higher funding costs, impose credit constraints and increase risk aversion on the part of international investors. This is likely to have an impact on financial sectors throughout the transition region.

## Chapter 02 Macroeconomic overview

Average economic growth in the transition region reached 6.9 per cent in 2006, the fastest rate of economic expansion since the start of the transition process. Rapid growth has been underpinned by strong domestic demand, fuelled by high levels of foreign direct investment, significant remittances from workers living abroad and a rapid expansion in bank lending. Global demand and oil and gas prices remained high, as reflected in strong export growth. As a result, unemployment rates and poverty levels have fallen. Throughout the transition region, rising prosperity has triggered higher demand for housing, leading in turn to booming construction and sharp increases in house prices.

At the same time, signs that economies are overheating are becoming apparent throughout the region in the form of inflation and rising external imbalances. While exports have remained strong, the competitiveness of several Baltic states and countries in south-eastern Europe is at risk. Against this background, monetary policy has gradually been tightened. Fiscal policy has so far been unable to ease inflationary pressures and external imbalances, and is in many countries expected to fuel already overheating economies.

The global financial turmoil that started in August 2007 is making external finance dearer, which may help overheated economies in the transition region to cool down. In a less benign scenario, countries with high external funding needs may experience a stronger economic downturn.

## Chapter 03 People's attitudes to transition

Seventeen years of political and economic transition have had a profound effect on people's thinking and everyday lives. According to the 2006 EBRD/World Bank Life in Transition Survey, general life satisfaction is higher in the wealthier, more advanced countries in central eastern Europe and the Baltic states, lower in south-eastern Europe, where unemployment has spiralled, and mixed in the Commonwealth of Independent States and Mongolia. Those who have benefited most from transition – broadly the younger, the better educated, the better connected and the more mobile sections of society – tend to be more satisfied with their lives.

A majority of people feel that their living standards in absolute terms have improved since the transition began, but also feel that their household's wealth in relative terms has deteriorated. Income inequality, which has grown in most countries, may have fed the perception that people have been made worse off in relative terms by transition.

Support for democracy is quite strong in the transition region despite the fact that many people feel the political situation has deteriorated since the transition began. Support for the market economy is highest in the new EU member states but overall it is weaker than support for democracy. Evidence from the World Values Surveys suggests that attitudes and values regarding markets and democracy in the transition countries are not converging towards views held in mature market economies in western Europe and the United States.

## Chapter 04 People's attitudes and their experiences in the labour market

Labour markets in the transition countries have undergone a profound transformation in the past 17 years. A massive reallocation of labour from the state to the private sector and from manufacturing to services has occurred, leaving many people without jobs or in jobs below their skill level. Some have taken on more menial jobs and others, particularly women, have withdrawn from the labour force, often to care for children, since new employers have often been unable or unwilling to provide free or subsidised child care.

Unemployment levels rose quickly at the onset of transition, but have recently begun to fall across much of the region, partly as a result of increased migration into western Europe following EU accession. Movement between different types of employment – private, state and self-employment – has been brisk, suggesting more flexible labour markets and better matching of workers to jobs. However, major upheaval in the labour market leaves some workers worse off and can therefore have a negative impact on their attitudes towards the market and reform.

Those with less education and fewer skills have tended to face poorer prospects, leading to lower levels of life satisfaction and a more pessimistic view of the power of the market to improve people's lives. They tend to favour greater government involvement in the economy – in terms of setting prices for basic goods, guaranteeing employment and owning large enterprises. By contrast, the self-employed, whose numbers have increased rapidly during transition, along with skilled workers tend to be relatively satisfied and expect less from government. Increasing employment levels is clearly a priority for governments across the region. Improving the quality of education and training will help to address the skills shortage in many countries and will help people to return to the labour force.

## Chapter 05 Delivering public services

Policy-makers in transition countries face difficult choices as they respond to the pressure to improve the quality and efficiency of public services. According to the Life in Transition Survey, health care dominates people's concerns about public services. Those who regard health as the first priority for extra government investment are equally likely to be wealthy as poor.

The health care sector illustrates many of the issues facing policy-makers as they embark on ambitious programmes to raise the quality of public services. Satisfaction with the quality of services remains low despite the fact that standards of care and levels of public spending appear to be higher in the transition region than in countries with equivalent levels of GDP per head.

Involving the private sector helps governments to relieve the strain on government resources, to control costs and to provide the level of consumer service that responds to people's needs. The challenge is to build structures that introduce efficiency gains while continuing to meet the twin objectives of access for all and affordability. Private funding can be made available at both centralised and local levels but what can be achieved depends crucially on the quality of the legal and political frameworks.

Good procurement processes need to be in place to reduce the opportunities for "insiders" to gain privileged access to contracts and to avoid a re-run of some of the problems that emerged during the initial wave of privatisations in the 1990s. Community-based monitoring and greater transparency – through independent media and local non-governmental organisations – can help to reduce bureaucracy, corruption and the misuse of funds.