



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

**APPENDIX 3: PHASE-OUT APPLICATION**

USAID/E&E/PO  
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Bureau for Europe & Eurasia  
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## ***Introduction***

On January 13, 2004, the Executive Committee of State/USAID Joint Policy Council approved the use of a methodology to help determine the timeframe for the phase out of SEED and FSA assistance programs. This methodology uses the four *MCP* indices (of economic reforms, democratic reforms, economic performance, and human capital) to help determine when countries are likely to achieve benchmark standards based on the average of the scores that Romania and Bulgaria achieved in 2002. This degree of progress was sufficient for those two countries to earn NATO membership and receive positive indications from Western Europe that EU accession was likely. These standards are intended to be proxies for when the path to political and economic reform has become irreversible.

In EUR/ACE-chaired inter-agency reviews, target phase-out timeframes were estimated drawing from the empirical evidence. The four indices provided a basic framework of analysis; a basis to begin discussion. Oftentimes other key empirical evidence supplied by USAID missions and/or participants from other agencies entered into the decisions as well. Additional criteria often entered into the decision making process as well, including: (1) the strategic importance of the country to the United States; (2) the importance of the recipient country to U.S. citizens; and (3) effectiveness of particular assistance activities.

## ***The Case of Russia***

The charts below highlight the sequence of logic used in analyzing the *MCP* data to help determine phase-out dates for Russia. The starting point is to determine where Russia is in its progress in economic and democratic reforms vis-à-vis the economic and democratic reform thresholds as determined by the 2002 average progress of Romania and Bulgaria (*Figure 1*). Russia lags on both dimensions, though more so on democratization.

*Figure 2* is intended to provide a basis to begin discussion as to how long it might take Russia to cross both reform thresholds. It does so by estimating how long it took Romania and Bulgaria to progress from where Russia is currently (roughly) on economic and democratic reforms to where Romania and Bulgaria were in 2002. It took Bulgaria, for example, roughly 12 years to move from the level of democratic reforms in Russia as of end-2003 to the level of democratic reforms in Bulgaria in 2002; and six years in the case of economic reforms. The working hypothesis is that however long it took Romania and Bulgaria, it is likely that Russia (and all countries lagging behind the thresholds) will take longer.

*Figures 3* and *4* disaggregate the economic and democratic reform indices, and show Russia's progress by indicator vis-à-vis the Romania and Bulgaria threshold as well as compared to Russia's progress on these dimensions in the late 1990s. These figures allow us to see the gaps disaggregated by the components of the indices. They also give us a sense of the degree to which Russia is closing those gaps. Good progress has been

made in Russia on economic reforms and the key economic reform gaps do look to be closing (*Figure 3*). In contrast, backsliding in democratization has been the trend in Russia, and the democratization gaps are widening (*Figure 4*).

*Figure 5* shows how Russia compares to the economic performance and human capital thresholds. Russia's progress trails behind both thresholds, and shares a similar profile to that of Ukraine's on these dimensions. *Figure 5* also shows that Russia lags more on economic performance than on human capital relative to the thresholds. However, as suggested in *Figure 6*, a lower score does not necessarily translate into more time needed to cross the threshold.

*Figure 6* shows how long it took Romania and Bulgaria to "travel" from where Russia currently is on economic performance and human capital to where Romania and Bulgaria were in 2002. In both Bulgaria and Romania, the rate of progress in economic performance exceeded that of human capital. It took 5 years, for example, for Bulgaria to cross the economic performance threshold and more than 14 years to cross the human capital threshold, even though the economic performance gap was larger. It is also instructive to note that the rate of change has varied widely between Romania and Bulgaria. Bulgaria moved forward, e.g., on economic performance at a far faster clip than did Romania. These observations underscore the precariousness of trying to estimate how many years it might take a country to progress on a transition dimension on the basis of past experience in other countries, or on the basis of the size of a particular transition gap (e.g., in economic performance) relative to that of another (such as human capital).

*Figures 7* and *8* disaggregate the economic performance and human capital indices, and show Russia's progress by indicator vis-à-vis the Romania and Bulgaria threshold as well as compared to Russia's progress on these dimensions in the late 1990s. Russia's economic performance is skewed (*Figure 7*). Its economy is performing well in terms of macro-economic stability (low inflation and debt) and economic growth, but largely without key structural changes that are arguably needed to sustain the high growth. While its private sector is large, the SME sector remains small. Moreover, Russia's economy remains poorly integrated into the world economy, as evidenced by a small export sector and low foreign direct investment, despite the significance of oil to the economy. Since 1999, improvements in economic performance have occurred almost exclusively in macro-economic stability and growth indicators, to the exclusion of the economic structure indicators. Key economic structure gaps, in other words, remain. Sustaining the macro-economic gains may be difficult in the continued presence of such gaps.

The most significant human capital gap is in life expectancy (*Figure 8*). Further examination of this gap leads to at least two key observations: (1) the life expectancy gender gap is likely larger in Russia than anywhere else worldwide (i.e., Russian females live at least 12 years longer than do males); and (2) adult mortality rates in Russia are very high and, to date, have been primarily attributed to non-communicable diseases. *Figure 8* also reveals that the life expectancy gap has grown, as have public expenditures

on health and education.

As noted above, other empirical evidence is needed to supplement the basic MCP framework. For example, in the case of Russia, an additional key consideration (that is not captured in the human capital index) is the explosive growth of infectious diseases (HIV AIDS and TB in particular). Another important consideration for probably all the transition economies are various disparities, including by geographic sub-regions, by ethnic groups, and by age groups. *Figure 9*, for example, highlights how significant income disparities are between oblasts within Russia, ranging in magnitude in 1999 from \$1,660 (in Ingushetia) to \$22,780 (in Tuymen). This range is comparable to the difference between per capita income in Sub-Saharan Africa (\$1,750) and the European Monetary Union (\$23,800)

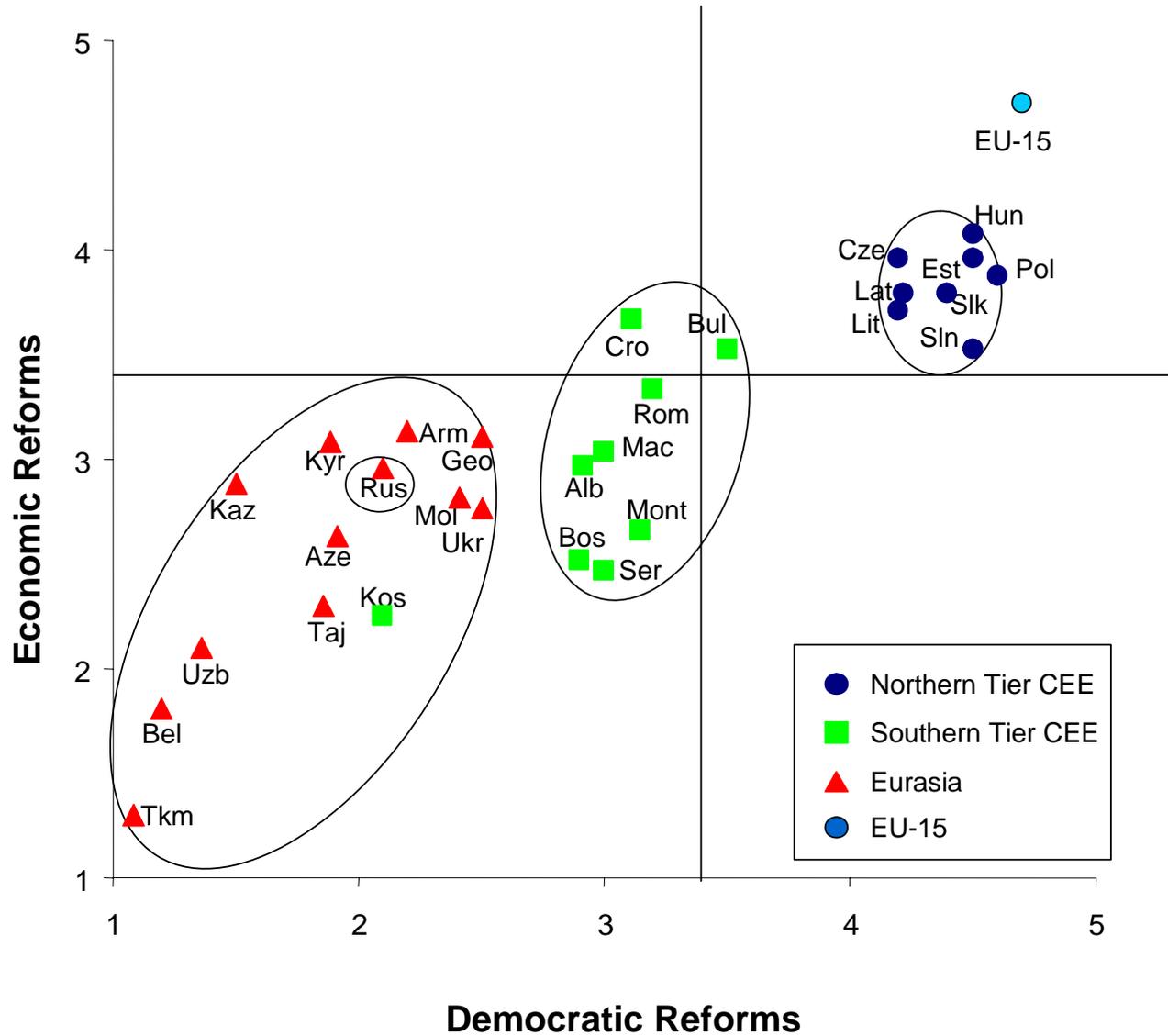
Finally, *Figure 10* shows the outcome of the discussions in the spring 2004 review in terms of the years to phase-out in Russia by the three sectors, and compares it to the outcome from similar reviews for Armenia, Moldova, and Tajikistan.<sup>1</sup> Consistent with the data and analysis, assistance to the economic sector in Russia is to be phased-out first, and democratization last. Overall, the years to phase out across the three sectors in Russia are fewer than in the three other Eurasian countries. This reflects a combination of considerations, including the empirical evidence (the years to phase-out in Tajikistan, e.g., are the greatest, reflecting that it is the poorest country in Eurasia and is among a handful of countries which have the farthest to go in the transition), as well as political considerations.

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<sup>1</sup> A fourth "sector", namely law enforcement, was also part of the deliberations. Estimates of years to phase-out from assistance in law enforcement were also made, though without the benefit of an empirical framework.

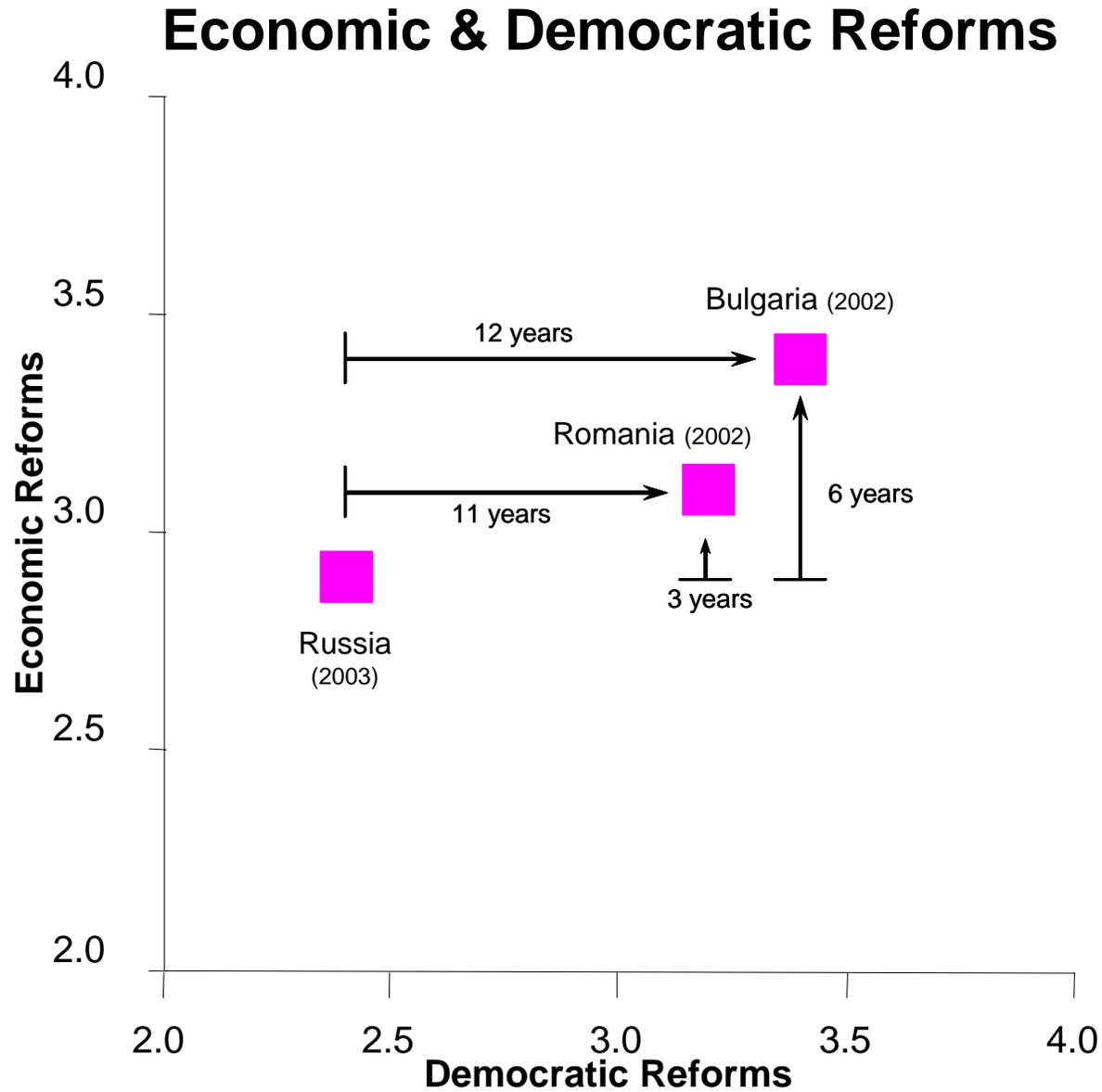
Figure 1

# Economic and Democratic Reforms in 2004



Ratings are based on a 1 to 5 scale, with 5 representing most advanced. USAID drawing from Freedom House, *Nations in Transit 2004* (2004), and EBRD, *Transition Report 2004* (November 2004). 2004 democratic reforms from Freedom House, *Freedom in the World* (December 2004) include forward movement in Bosnia, Czech Republic, Estonia, Georgia, Hungary, Poland, Slovakia and Ukraine; and backwards movement in Armenia, Belarus, Lithuania, Romania, and Russia.

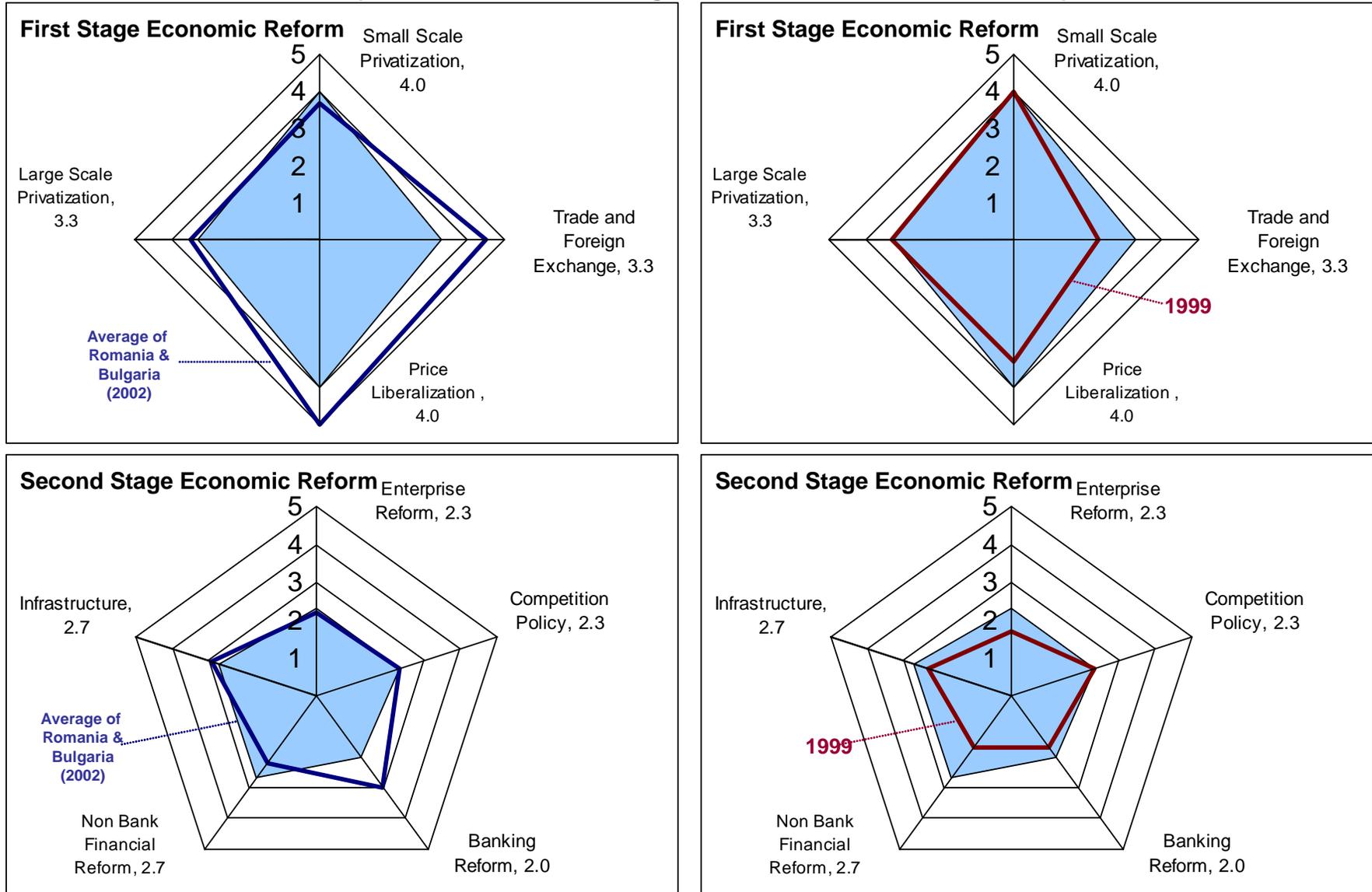
Figure 2



It took roughly 3 years for Romania to go from “where” Russia is today on economic reforms to where Romania was in 2002, and 11 years in democratic reforms. Ratings based on 1-5 scale with 5 representing most advanced. Source: Freedom House, *Nations in Transit 2003* (2003); EBRD, *Transition Report 2003* (Nov. 2003); and previous editions.

Figure 3

# Economic Reform in Russia in 2004 (versus Romania & Bulgaria in 2002 and Russia in 1999)

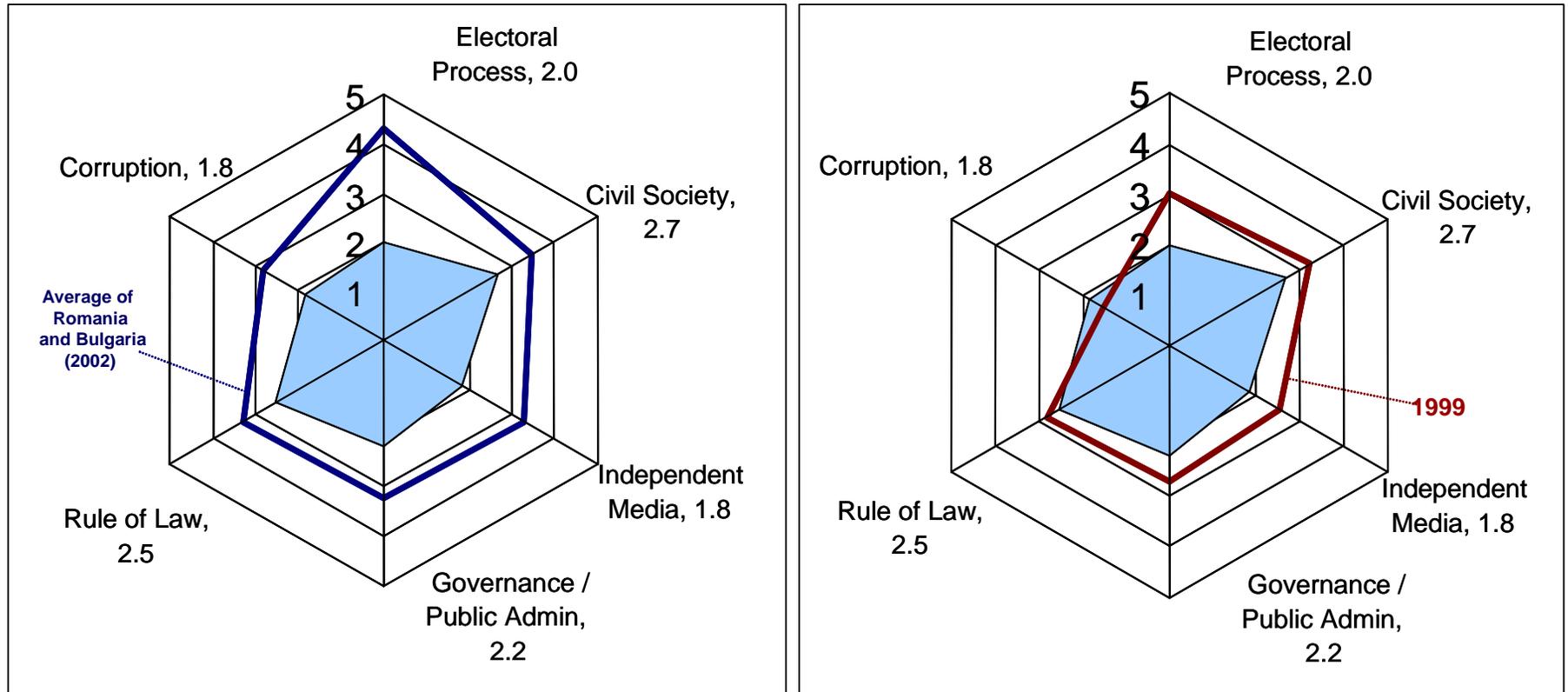


Ratings are based on a scale from 1 to 5, with 5 representing the best score. USAID, *Monitoring Country Progress in CEE & Eurasia #9* (2005) drawing from EBRD, *Transition Report 2004* (November 2004).

Figure 4

# Democratic Reforms in Russia in 2003

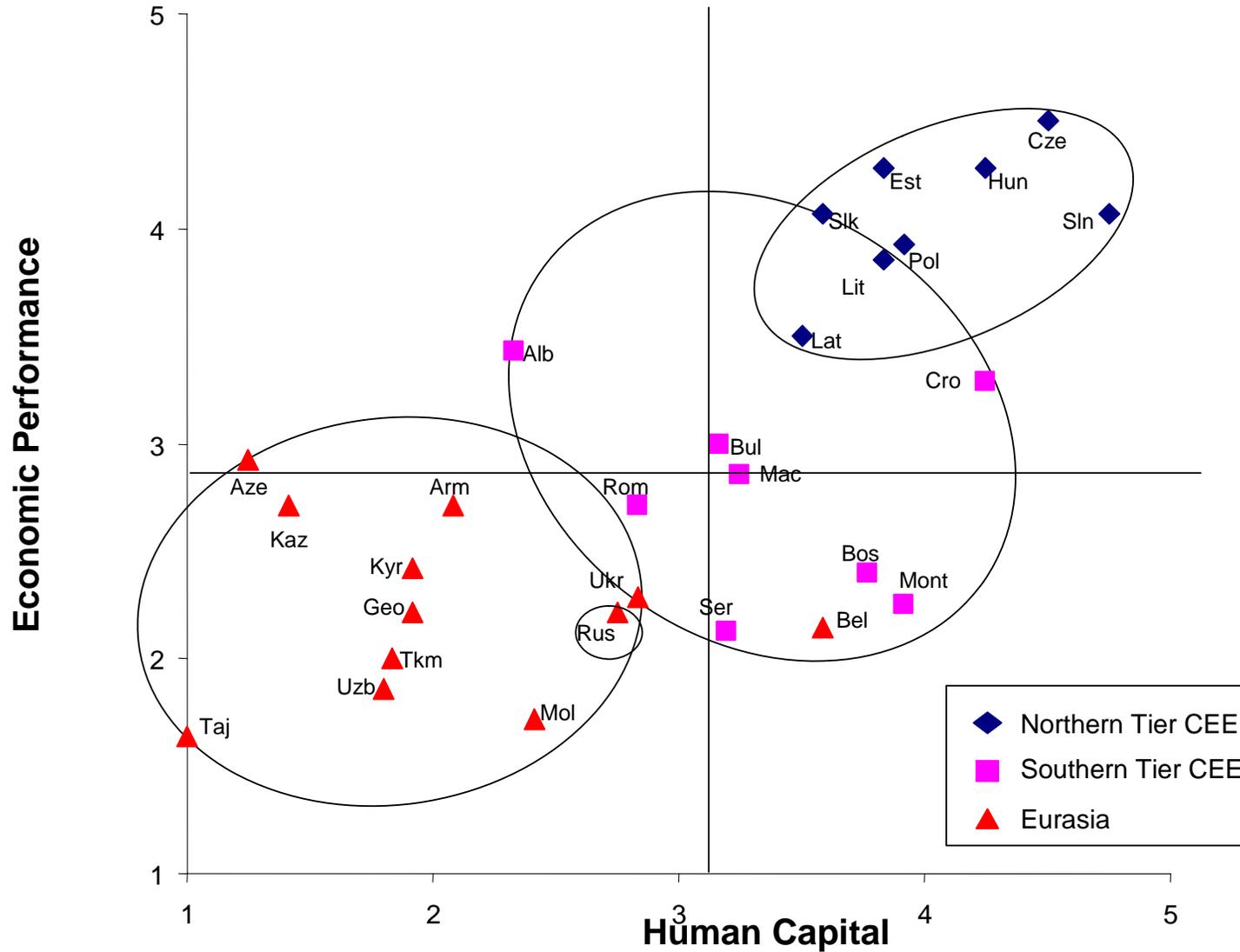
(versus Romania & Bulgaria in 2002 and Russia in 1999)



Ratings are based on a scale from 1 to 5, with 5 representing the best score. USAID, *Monitoring Country Progress in CEE & Eurasia #9 (2005)* drawing from Freedom House, *Nations in Transit 2004*.

Figure 5

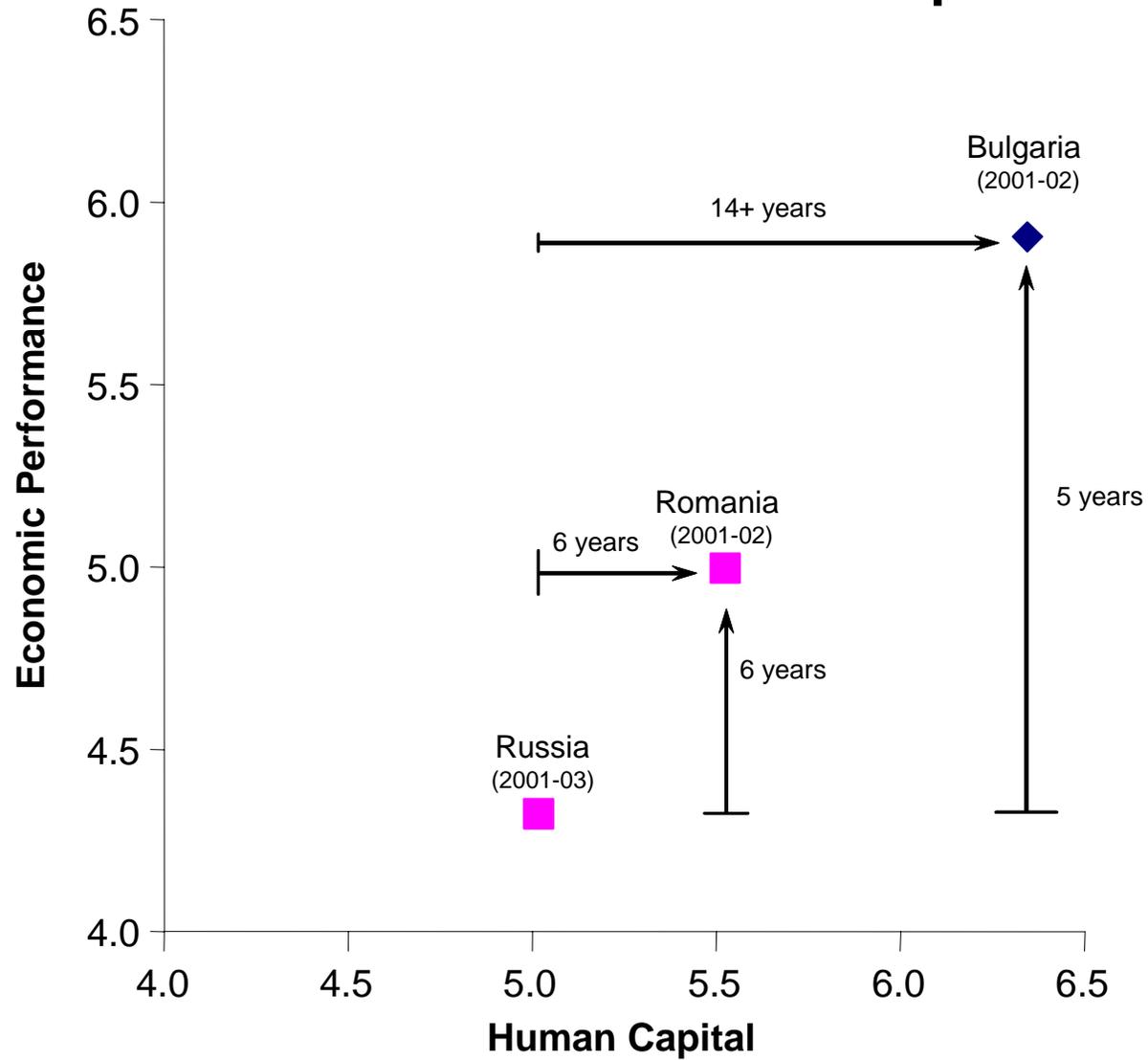
# Economic Performance and Human Capital in 2002-2004



USAID, MCP#9 (2005) drawing from World Bank, *World Development Indicators 2004* (2004); UNICEF, *Social Monitor 2004* (2004); EBRD, *Transition Report* (November 2004); Ayyagari, Beck, and Demircuc-Kunt, *Small and Medium Enterprises across the Globe: A New Database*, World Bank Policy Research Working Paper 3127, (August 2003).

Figure 6

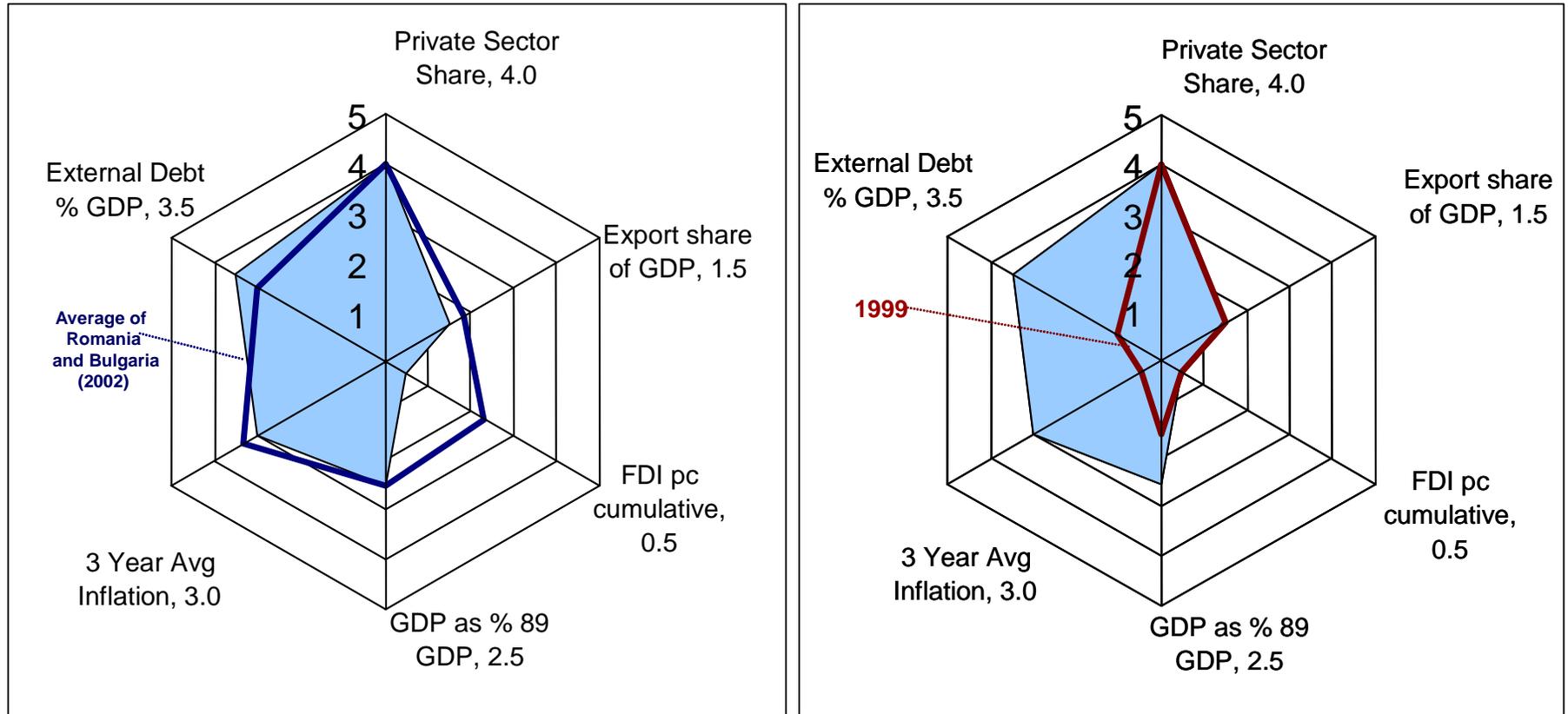
# Economic Performance & Human Capital in Russia



It took roughly 5 years for Bulgaria to go from “where” Ukraine is today on economic performance to where Bulgaria was in 2002, and more than 14 years in human capital. World Bank, *World Development Indicators 2003* (2003); UNICEF, *Social Monitor 2003* (2003); EBRD, *Transition Report* (Nov. 2003); Ayyagari, Beck, and Demircuc-Kunt, *Small and Medium Enterprises across the Globe: A New Database*, World Bank Policy Research Working Paper 3127, (August 2003), and UNDP, *Human Development Report 2003* (July 2003).

Figure 7

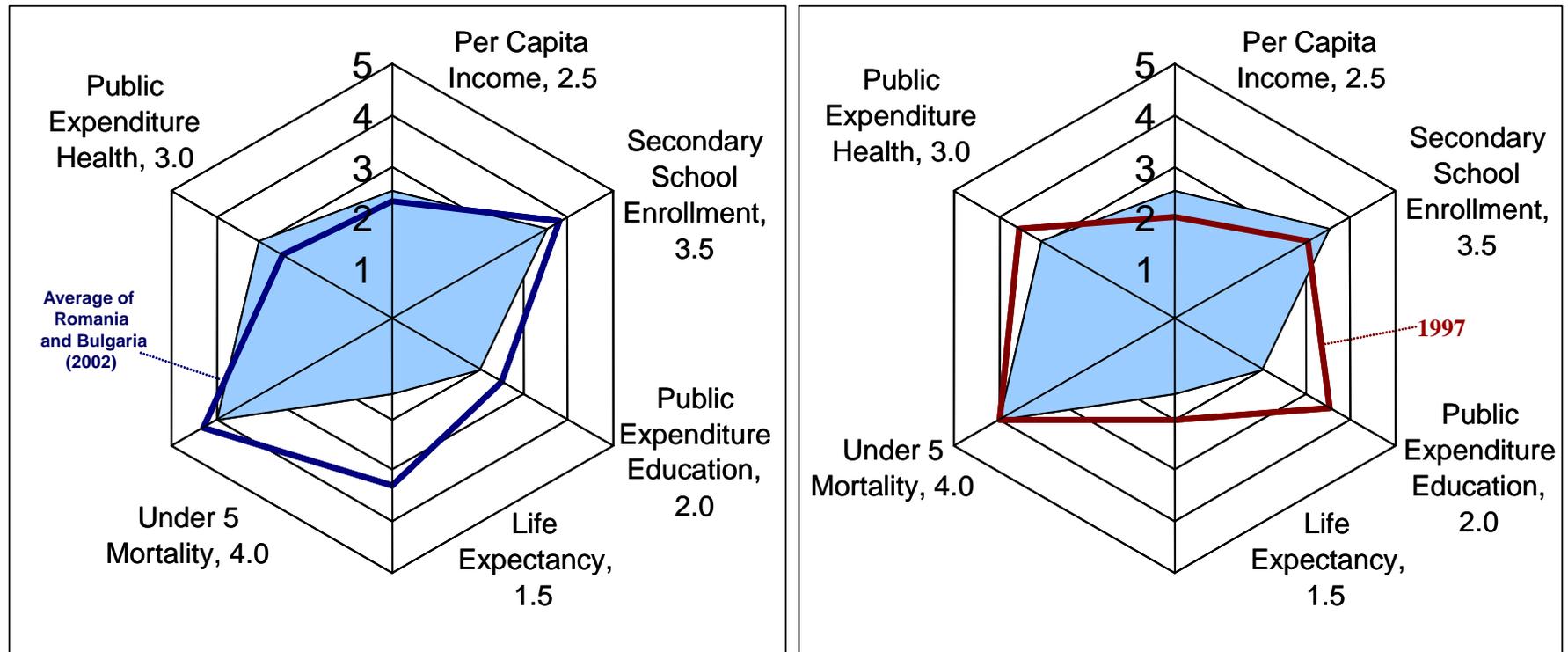
# Economic Performance Index in Russia in 2002 – 2004 (versus Romania & Bulgaria in 2002 and Russia in 1999)



Ratings are based on a scale from 1 to 5, with 5 representing the best score. USAID, *Monitoring Country Progress in CEE & Eurasia #9* (2004) drawing from World Bank, *World Development Indicators 2004* (2004); EBRD, *Transition Report* (November 2004), M. Ayyagari, T. Beck, and A. Demirguc-Kunt, *Small and Medium Enterprises across the Globe: World Bank Policy Research Working Paper 3127*, August 2003. SME data no later than 1998.

Figure 8

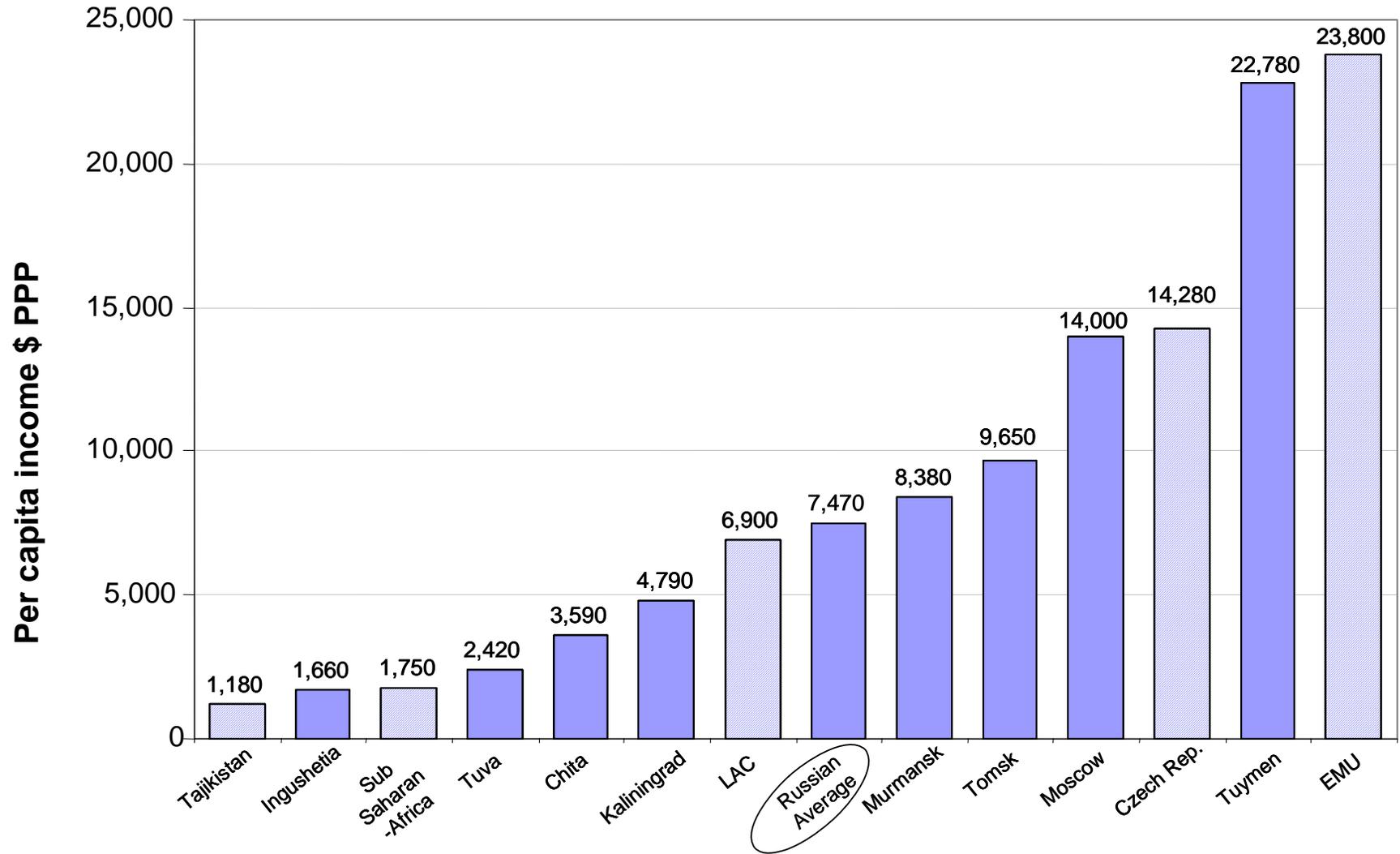
## Human Capital Index in Russia (versus Romania & Bulgaria in 2002 and Russia in 1997)



Ratings are based on a scale from 1 to 5, with 5 representing the best score. USAID, *Monitoring Country Progress in CEE & Eurasia #9 (2005)* drawing from World Bank, *World Development Indicators 2004 (2004)*; UNICEF, *Social Monitor 2004 (2004)*.

Figure 9

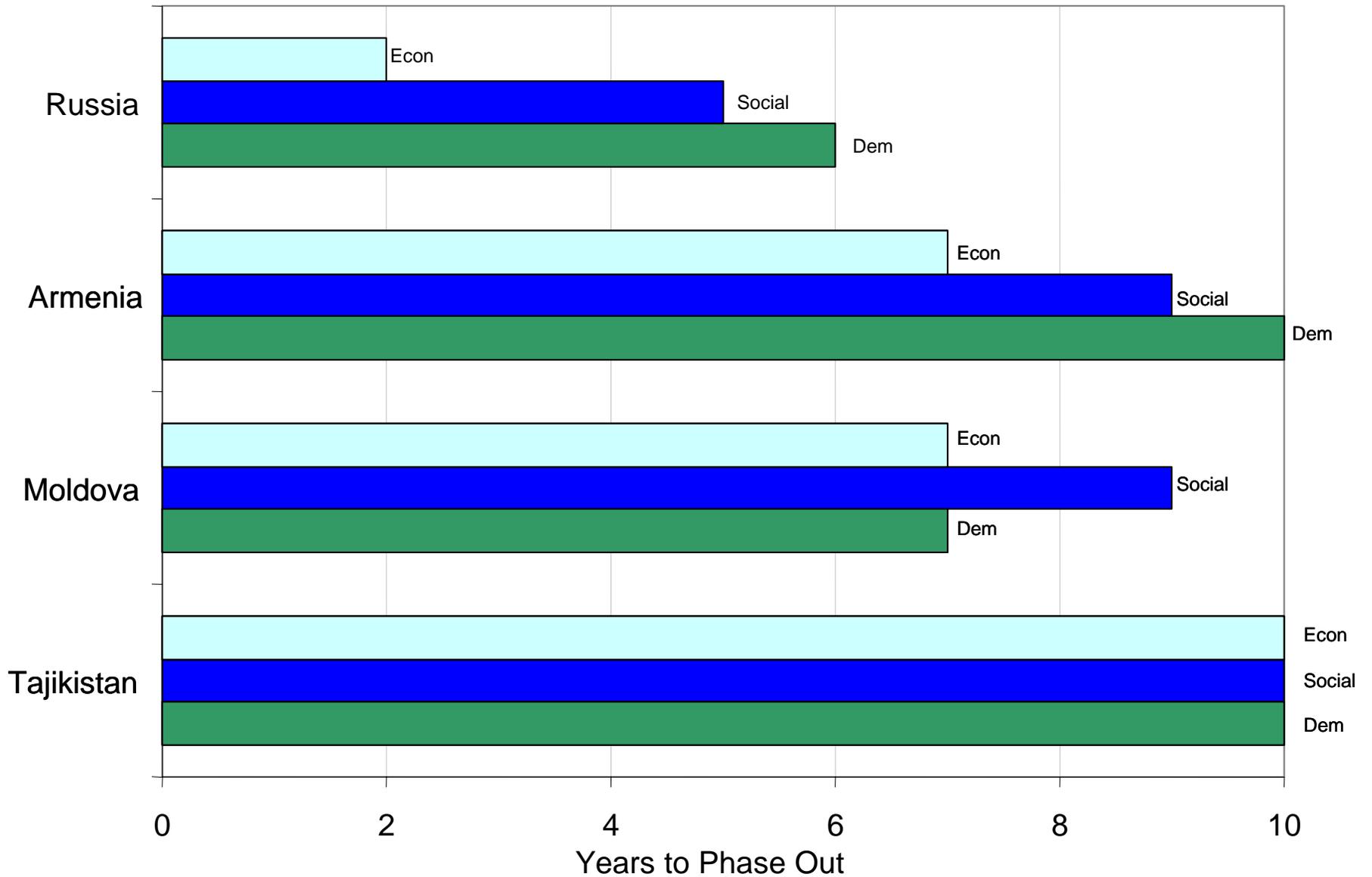
## Per Capita Income in Russia in 1999



UNDP, *National Human Development Report 2001 for the Russian Federation* (2001), and World Bank, *World Development Indicators 2003* (2003).

Figure 10

## Years to Phase-out in Eurasia



A score of 10 indicates phase out will begin in 10 or more years. FY05 is considered the first year in estimating phase-out dates. ACE estimated years to phase out.