



European Bank  
for Reconstruction and Development

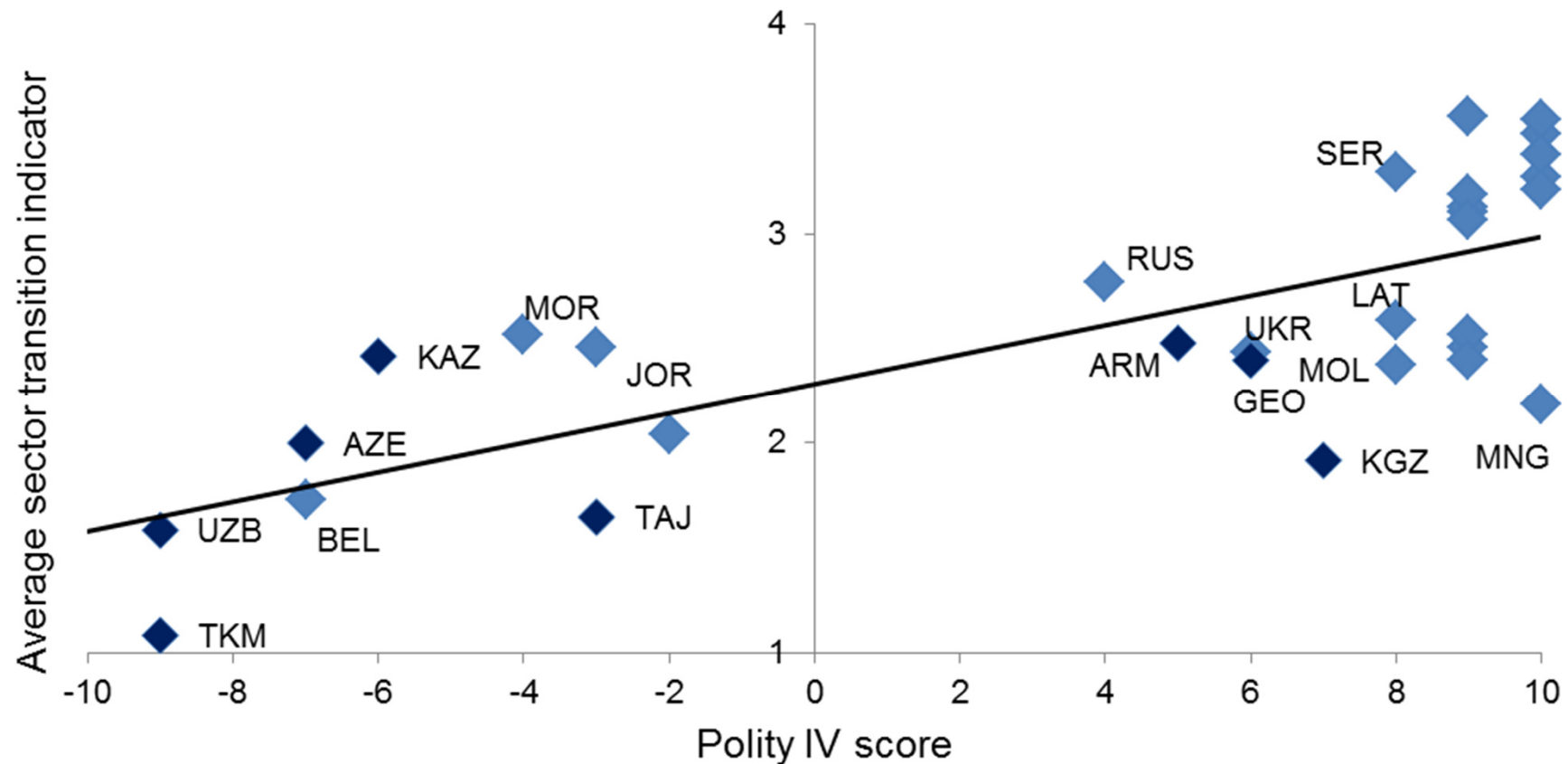
# **Transition without an outside anchor – the experience of Caucasus and Central Asia**

*Erik Berglof, Chief Economist  
European Bank for Reconstruction and Development*

# Economic and political transitions go hand in hand



European Bank  
for Reconstruction and Development



Sources: Democracy is measured using Polity IV; economic institutions -- using EBRD transition indicators.

# Main points



European Bank  
for Reconstruction and Development

- Economic and political transitions correlated – after initial successes “stuck in transit” applies to both – even “flawed democracies” are largely stuck
- Got stuck in market-deepening and market-sustaining reforms – facing entrenched interests
- Building a private sector constituency necessary but not sufficient – need state capable of implementing
- Outside anchors critical in central and southeast Europe – reinforced implementation capacity of state - but how credible in Caucasus and Central Asia?
- IFIs engage in private sector development and enabling state (transparency and accountability)



1. Political and economic transitions
2. Economic transition – system-wide
3. Economic transition – sector gaps
4. Stuck in "transit" – political economy
5. Breaking out – outside anchors and constituency building

# Concept of transition evolved over time



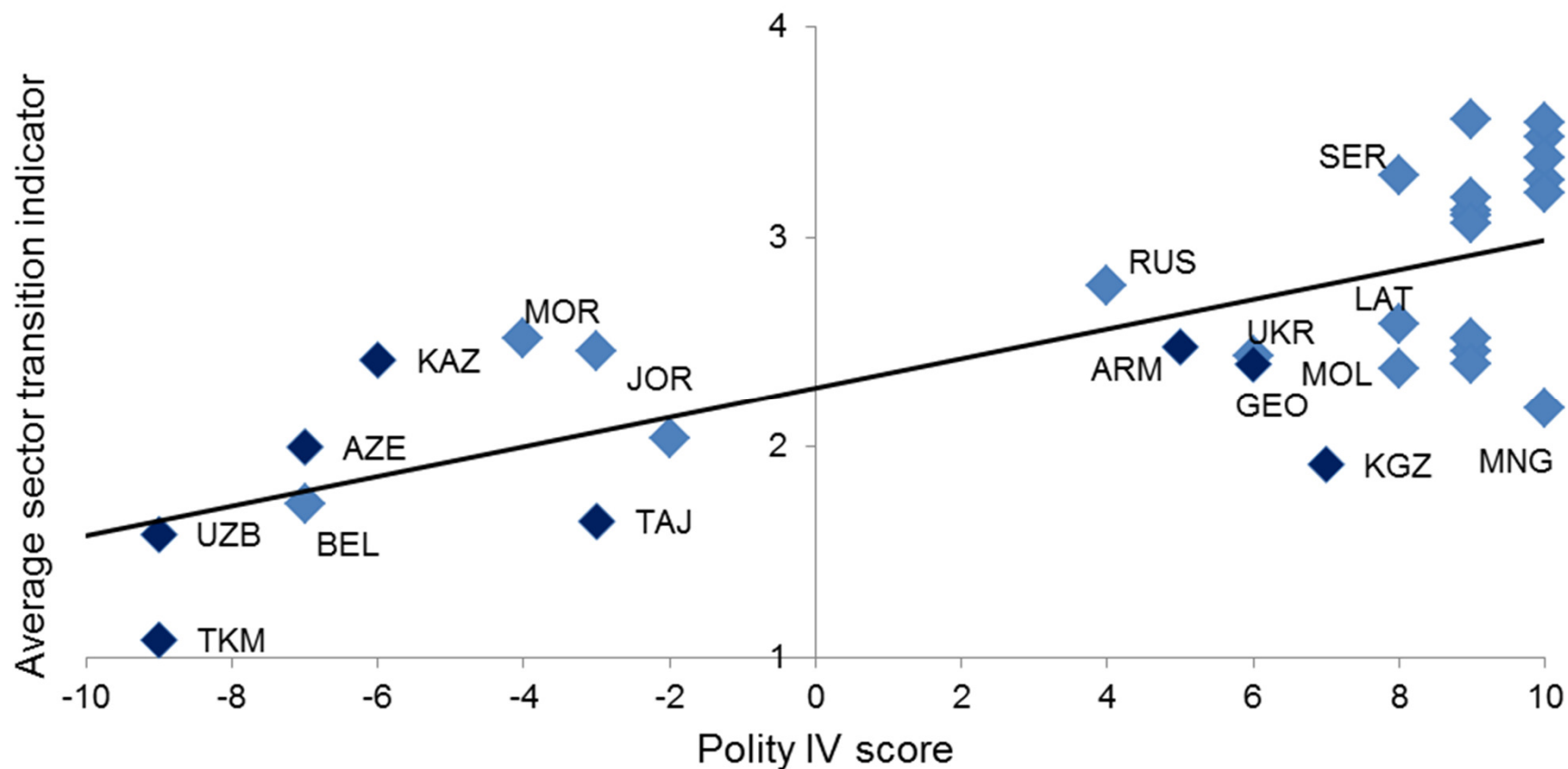
European Bank  
for Reconstruction and Development

- Two aspects of transition: economic and political transition – closely tied
  - Successful countries – converged in terms of systems (both democracy and markets)
  - Many countries less successful – stuck for different reasons, all with political economy elements
  - Markets and democracy correlated (Table 1)
- Changing role of the state – ownership and direct intervention to an “optimal” role as arbiter and enabler
- And building high-quality economic institutions

# Economic and political transitions go hand in hand

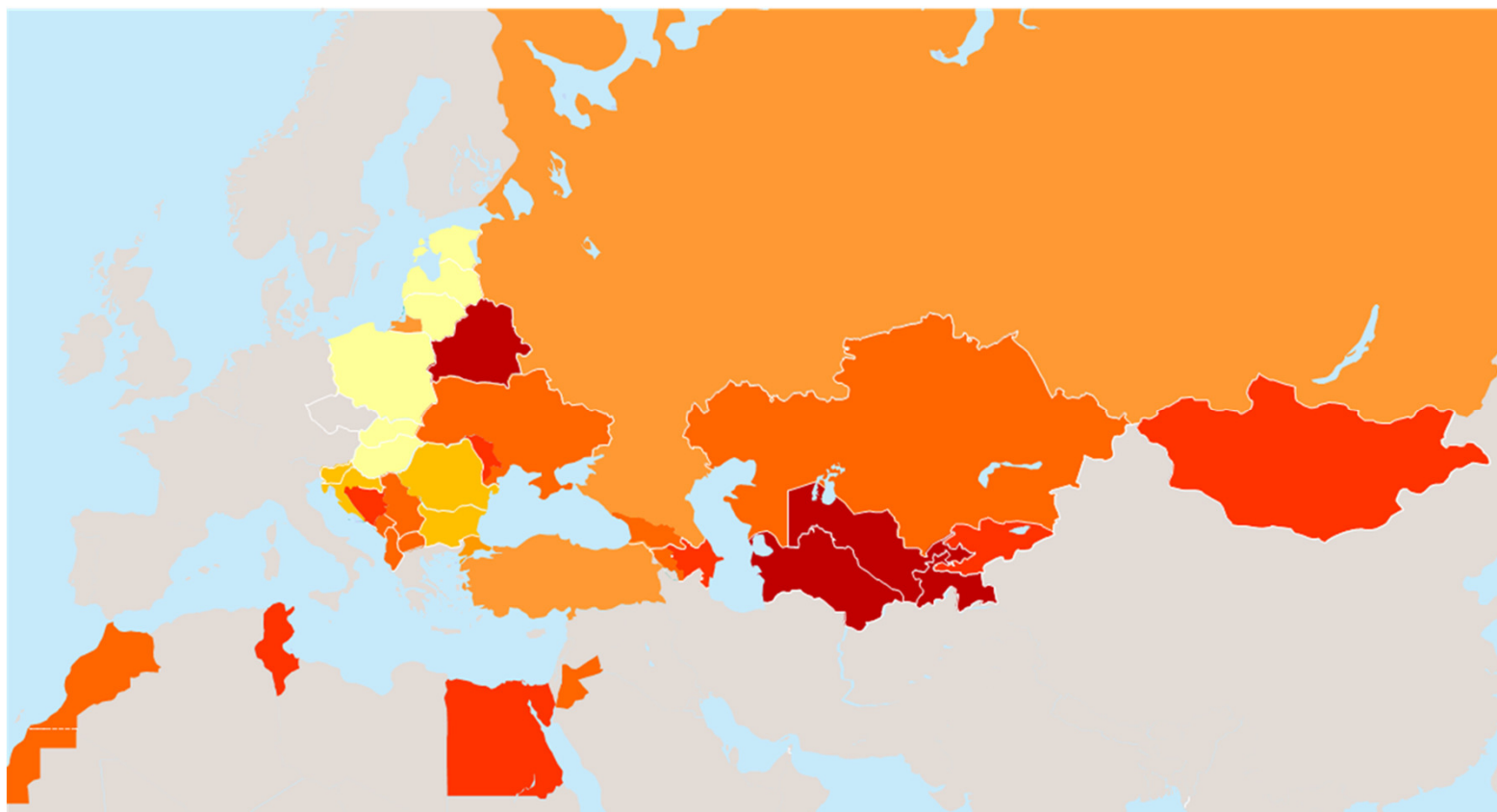


European Bank  
for Reconstruction and Development



Sources: Democracy is measured using Polity IV; economic institutions -- using EBRD transition indicators.

## Average Sector Transition Indicators, 2012



Note: Countries coloured according to the average of 16 sector transition indicator scores in 2012; darker colours correspond to more significant challenges.

# Medium to large transition gaps across sectors



European Bank  
for Reconstruction and Development

## EBRD Sector Transition Indicators 2012

	Corporate sector				Energy			Infrastructure				Financial sector				
	Agribusiness	General industry	Real estate	Telecoms	Natural resources	Sustainable Energy	Power	Water & wastewater	Urban transport	Roads	Railways	Banking	Insurance & fin services	MSME	Private equity	Capital markets
Armenia	3-	3	3-	3	3-	3-	3+	3-	2+	3-	2+	2+	2	2+	1	2
Azerbaijan	2+	2	2	2-	2+	2+	2+	2-	2	2+	2+	2	2	2	1	2-
Georgia	3-	3-	3-	3-	2	3-	3+	2	2+	2+	3	3-	2	3-	1	2-
Kazakhstan	3-	2	3	3	2-	2-	3	2+	2+	2+	3	3-	2+	2	2-	3
Kyrgyz Rep.	2+	2	2+	3	2+	2	2+	2-	2	2-	1	2	2-	2-	1	2-
Tajikistan	2	2-	2-	2+	1	2+	2	2	2	2-	1	2	2-	1	1	1
Turkmenistan	1	1	1	2-	1	1	1	1	1	1	1	1	2-	1	1	1
Uzbekistan	2	1	2	2	1	2-	2+	2-	2	1	3-	1	2	1	1	1

Source: Transition Report 2012. Scale from 1 (least progress) to 4+.



# And limited progress over the last decade

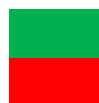


European Bank  
for Reconstruction and Development

- Upgrades in the corporate sector and infrastructure
- While financial sectors deeply impacted by the crisis

## Implied changes in EBRD sector indicators, 2005-2012

	Corporate sector				Energy			Infrastructure				Financial sector				
	Agribusiness	General industry	Real estate	Telecoms	Natural resources	Sustainable Energy	Power	Water & wastewater	Urban transport	Roads	Railways	Banking	Insurance & fin services	MSME	Private equity	Capital markets
Armenia	3-	3	3-	3	3-	3-	3+	3-	2+	3-	2+	2+	2	2+	1	2
Azerbaijan	2+	2	2	2-	2+	2+	2+	2-	2	2+	2+	2	2	2	1	2-
Georgia	3-	3-	3-	3-	2	3-	3+	2	2+	2+	3	3-	2	3-	1	2-
Kazakhstan	3-	2	3	3	2-	2-	3	2+	2+	2+	3	3-	2+	2	2-	3
Kyrgyz Rep.	2+	2	2+	3	2+	2	2+	2-	2	2-	1	2	2-	2-	1	2-
Tajikistan	2	2-	2-	2+	1	2+	2	2	2	2-	1	2	2-	1	1	1
Turkmenistan	1	1	1	2-	1	1	1	1	1	1	1	1	2-	1	1	1
Uzbekistan	2	1	2	2	1	2-	2+	2-	2	1	3-	1	2	1	1	1



Upgrade in market structure and/or market institutions score

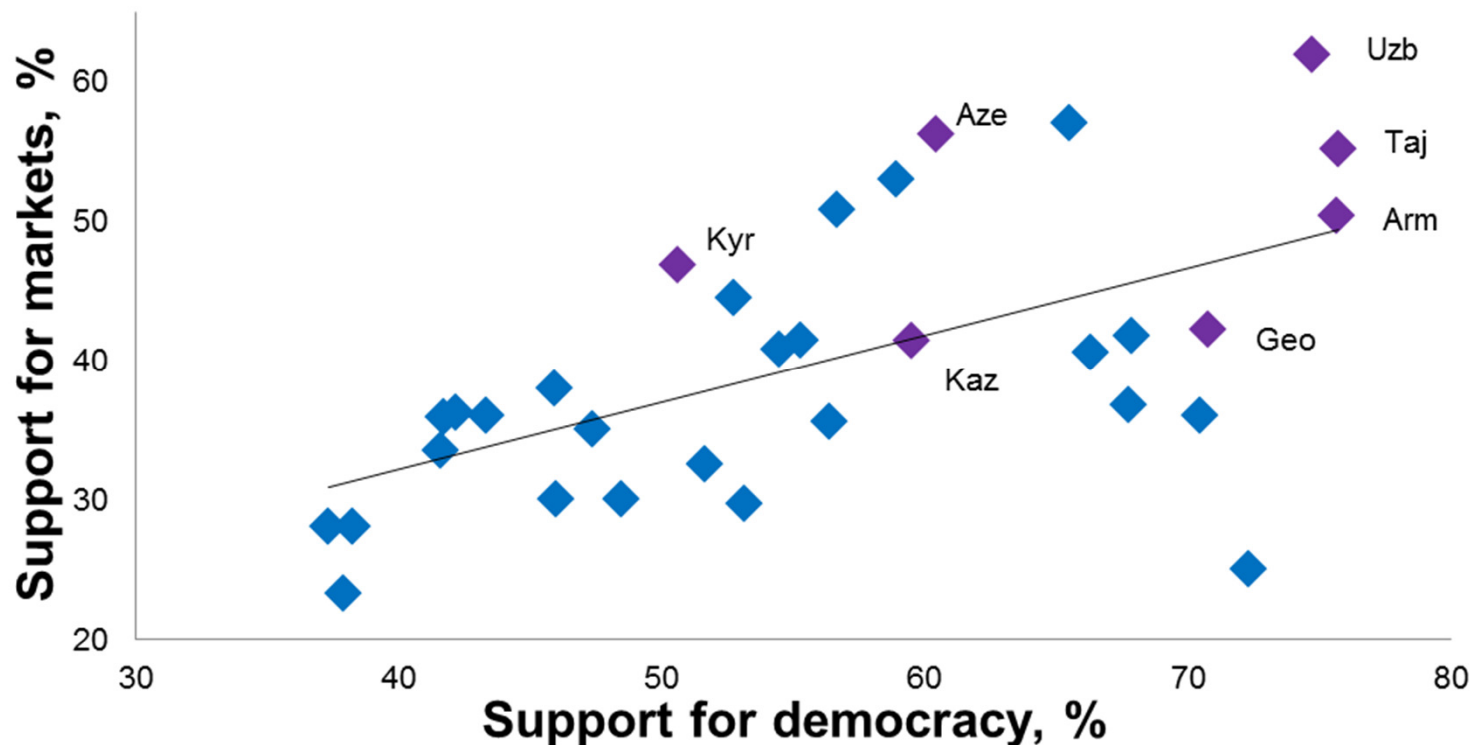
Downgrade in market structure and/or market institutions score

# Yet survey suggests strong support for democracy and markets



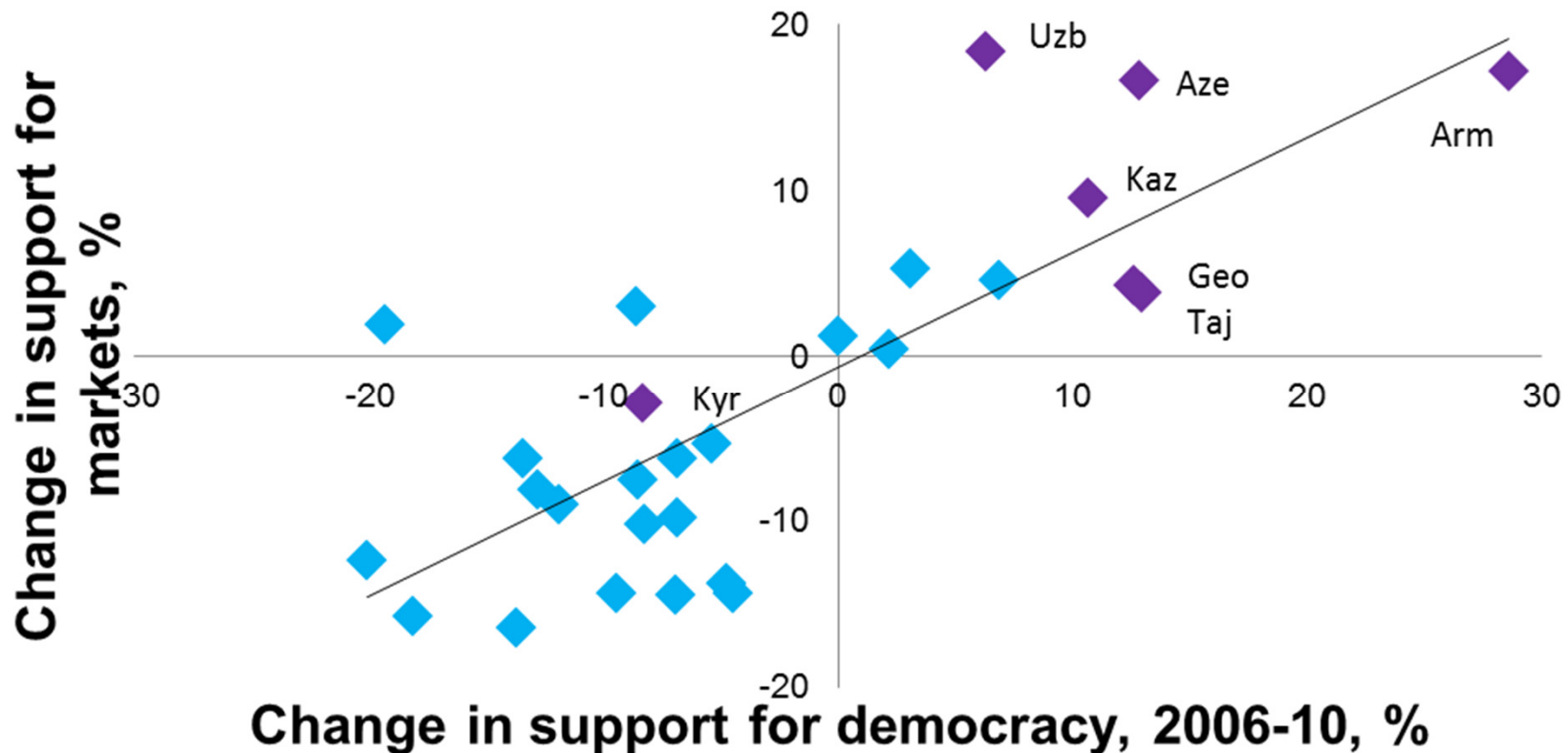
European Bank  
for Reconstruction and Development

- Self-assessed support is strong in Central Asia and Caucasus: Life in Transition Survey (LiTS), 2010
- Support for democracy and support for markets are strongly correlated



# And growing over time

- Support in the region increased between 2006 and 2010 on average
- Changes are also strongly correlated



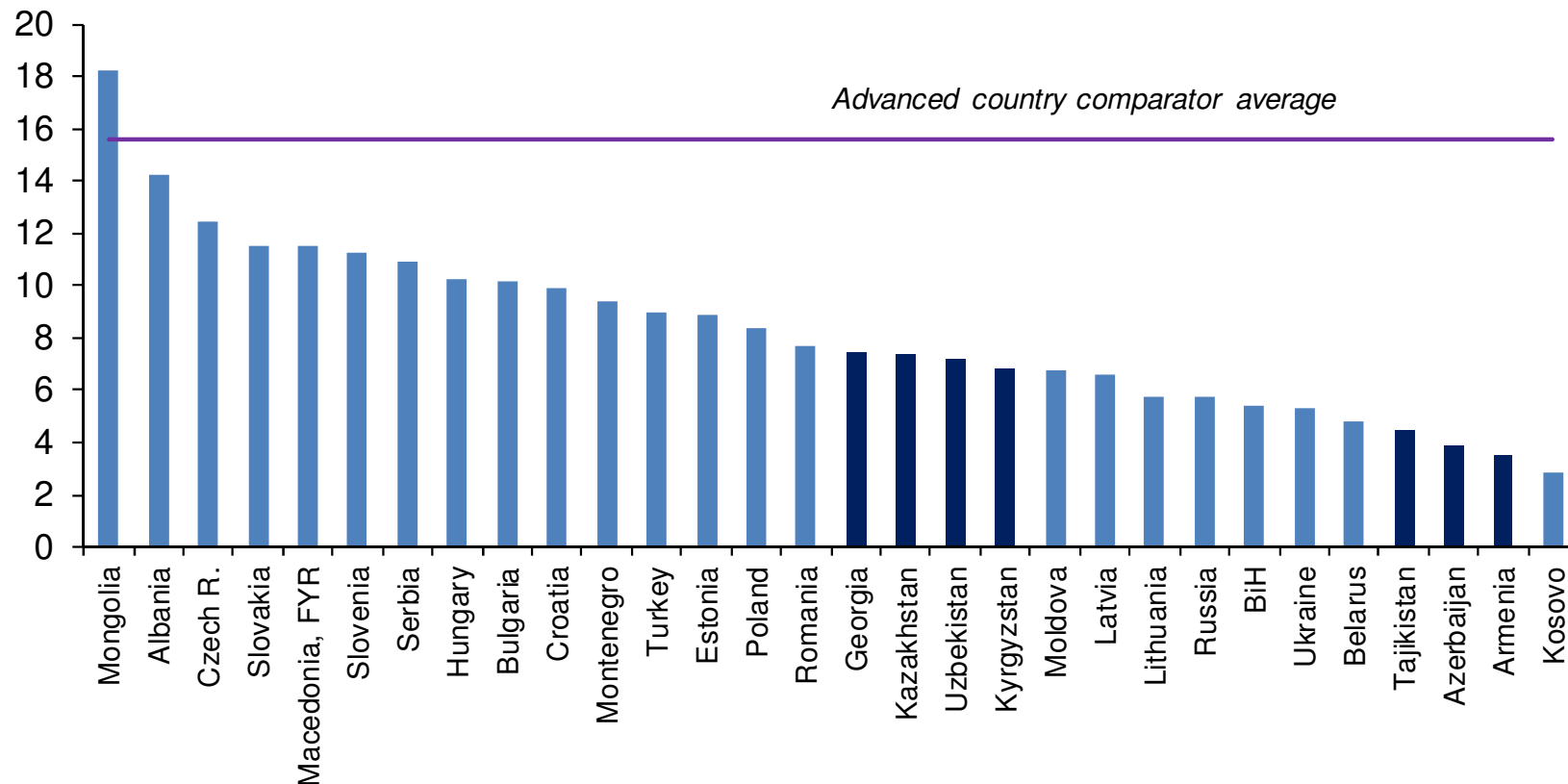
# Entrepreneurship rate low in the region



European Bank  
for Reconstruction and Development

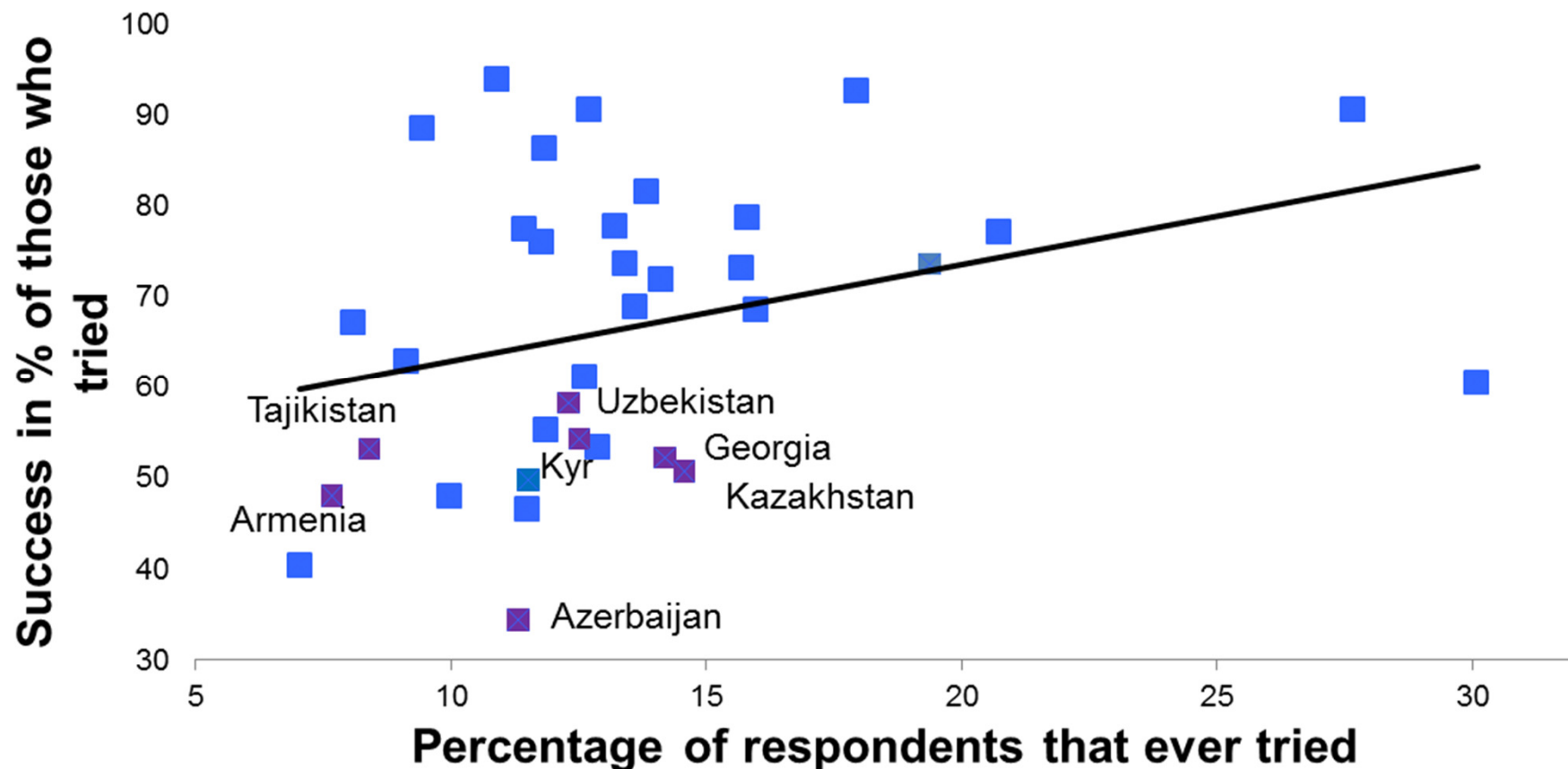
- Entrepreneurship is foundation of private sector led growth

Percentage of respondents who successfully set up a business



# Because success rate is low

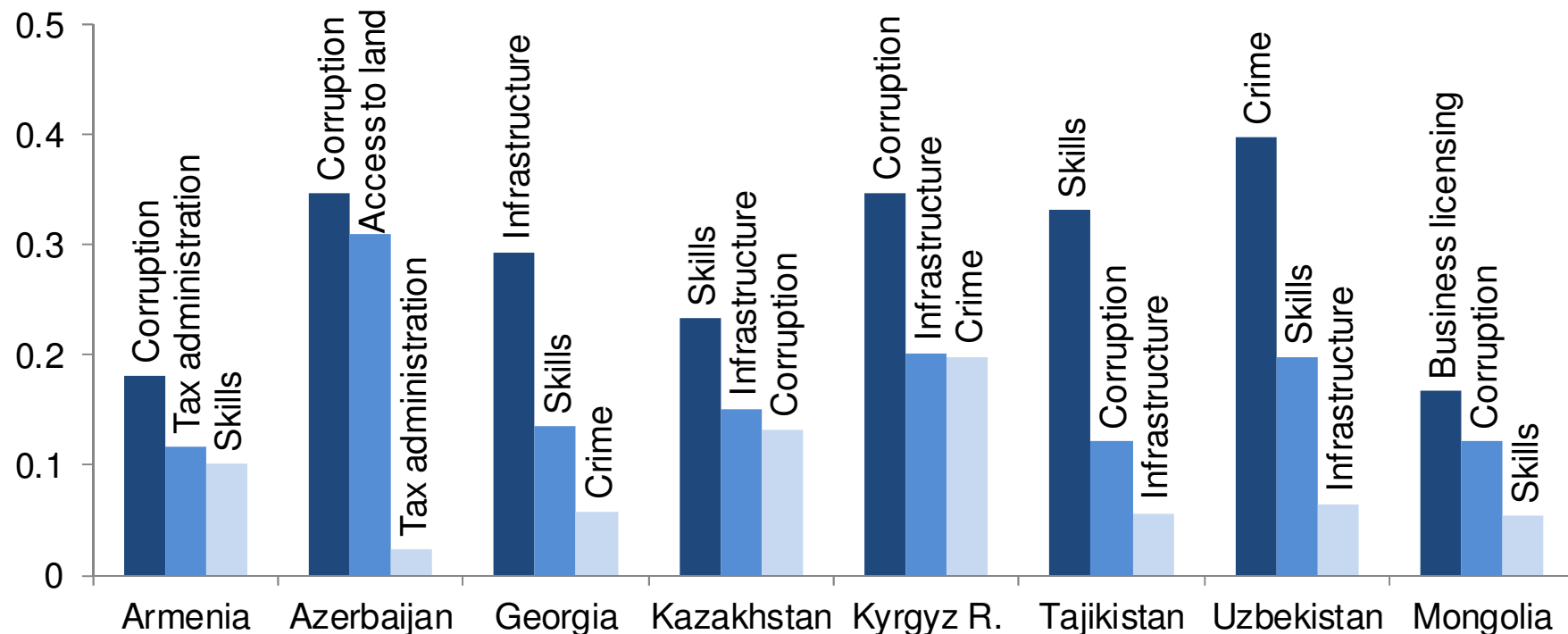
- Trial rates are in line with other countries or higher
- Need to improve business environment, access to finance



# Corruption, skills, infrastructure as top constraints

- According to the 2009 round of the Business Environment and Enterprise Performance Survey (BEEPS)

## Top 3 obstacles to firms' operations

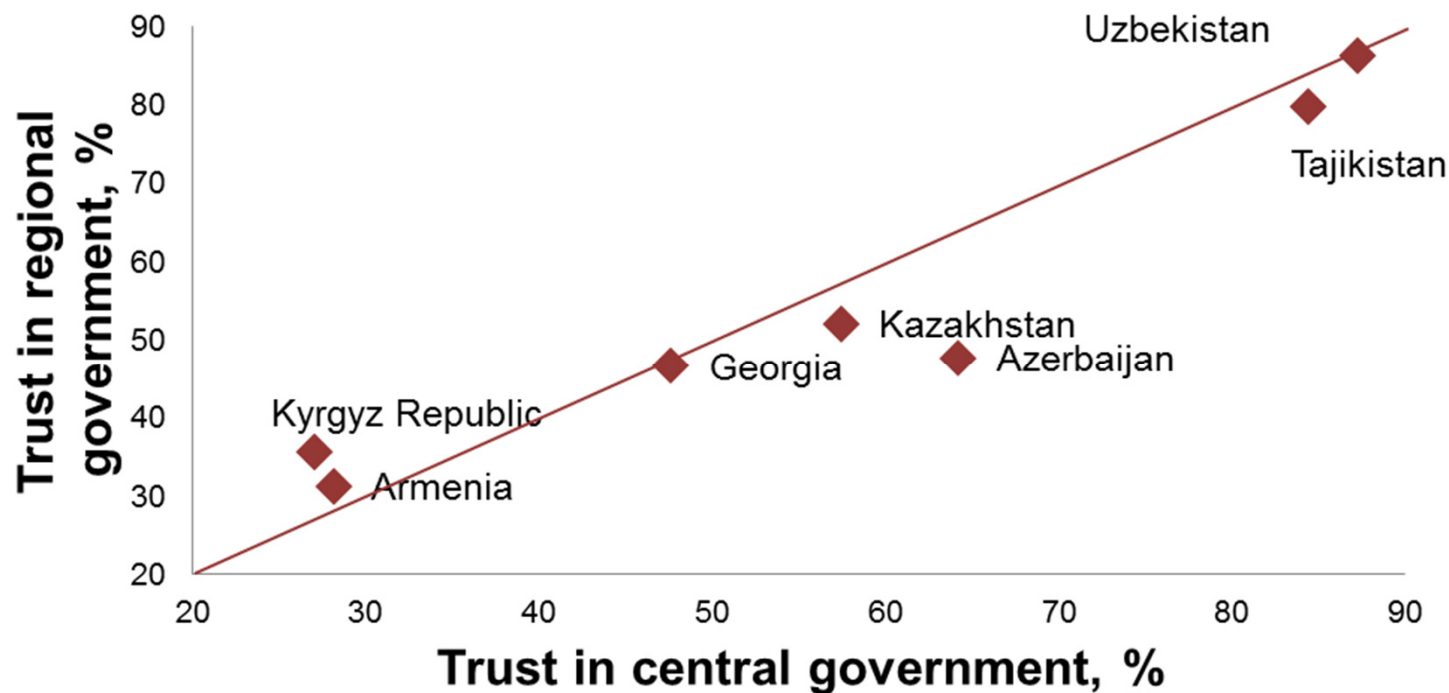


# Improving business environment in the regions



European Bank  
for Reconstruction and Development

- Improve business environment by leveraging multi-tiered government, healthy “competition” for investment
- Trust in national and regional government is strongly correlated; in Kyrgyz R. stronger trust in regional government



# Differences in regional business environment: Example of Kazakhstan



European Bank  
for Reconstruction and Development

- Top 3 constraints by region based on BEEPS 2009: skills common, the rest are different

Region	Skills	Business inspections	Access to finance	Electricity	Corruption	Crime	Transport	Tax administration	Access to land	Business licensing	Courts	Informal sector	Customs&trade	Compulsory certificates
<b>Kazakhstan</b>	Dark Blue	Dark Blue	Light Blue											
Akmola*	Dark Blue	Light Blue							Dark Blue					
Aktobe	Dark Blue			Dark Blue	Light Blue	Light Blue								
Almaty	Dark Blue			Dark Blue	Light Blue									
Almaty city	Dark Blue	Dark Blue			Light Blue									
Astana city	Dark Blue				Dark Blue					Light Blue				
Atyrau*	Dark Blue			Dark Blue		Light Blue								
East	Dark Blue	Dark Blue	Light Blue											
Karaganda		Dark Blue	Dark Blue		Light Blue									
Kostanai	Dark Blue			Light Blue		Dark Blue								
Pavlodar*	Dark Blue		Light Blue	Dark Blue										
South	Dark Blue	Dark Blue										Light Blue		
West			Dark Blue				Dark Blue	Light Blue						

Source: BEEPS IV: \* Denotes regions with fewer than 25 observations



# Concluding remarks



European Bank  
for Reconstruction and Development

- Countries in the region made progress in terms of private sector development and transition
- Key challenge is to advance market sustaining reforms, improve quality of economic institutions
- Create better business environment for private sector and entrepreneurs -- relaxing most binding constraints
- How to break out of "stuck in transit" traps:
  - Strengthen economic diversification constituencies
  - Outside anchors – matters what anchor
  - Improving business environment at the regional level
  - International financial institutions: private sector development – both state and private sector