



# OED REACH

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Based on *An Evaluation of World Bank Assistance to the Transition Economies*.

## Working with Transition Economies: What We Have Learned

- The challenges to the transition in Europe and Central Asia were formidable, including deep economic distortions, major trade disruptions, and the absence of market-oriented institutions. In the Central and Eastern European countries, the transition recession was relatively shallow, but in the CIS (Commonwealth of Independent States), GDP fell an average of over 40 percent, and poverty and inequality increased sharply. No CIS country has yet regained its pre-transition per capita GDP.
- Bank assistance to the transition countries was largely successful, following a period of learning and policy adjustment. Effectiveness of the initial strategy was limited by an underestimation of the need to focus on poverty alleviation and good governance and by the emphasis on rapid privatization without a supporting institutional framework. The approach to these issues improved substantially over time.
- This evaluation highlights the importance of holding lending at prudent levels in a new country context, or after a long hiatus in lending, until a solid knowledge base is established, with convincing evidence of government and societal ownership of the programs. Analysis of governance and poverty monitoring should be early features of the assistance program. Active programs of stakeholder inclusion should be widely replicated and country assistance strategies used to bolster reform capacity.

### Background

Much of Europe and Central Asia faced unprecedented political, economic, and social change after the break-up of the Soviet Union. Many transition countries quickly accomplished price and trade liberalization. Small-scale privatization is virtually complete, and large-scale privatization is under way in most countries. While progress has been slower in financial sector reform, public sector reform, social protection, enterprise restructuring, and competition policy, the trend is upward. The private sector share of GDP across the transition countries is nearly 70 percent, and eight Central and Eastern European and Baltic countries are poised to join the EU. In most countries, policy reform has progressed steadily, with few reversals. Much has been achieved, but much remains to be completed, especially in the CIS countries.

### Bank Assistance

In assessing the effectiveness of Bank assistance, it must be recognized that the collapse of the Soviet Union and the ensuing transition took place with little warning and on an unparalleled scale. Political pressures compelled the Bank to move quickly and lend large amounts. Staff were frequently confronted with the need to act, often under difficult circumstances, in the absence of relevant experience or country knowledge, learning along the way.

Overall, Bank assistance to the transition countries has been successful, but there were mistakes early on when the true nature of transition was not fully understood. Not unexpectedly, the Bank's evolving knowledge and the rapidly changing circumstances led to many mid-course corrections. The strategy was to promote macroeconomic stability and sound economic

management; reorient and strengthen public sector institutions; build the basic institutions of a market economy and an enabling environment for private sector initiatives; and cushion the social cost of the transition. These objectives were relevant, but effectiveness was limited by an initial underestimation of the need to focus on poverty alleviation and good governance and the use of rapid privatization to promote private sector development without a supporting legal and institutional framework. Lending was based on the expectation of a short, shallow transition recession; the prolonged recession in some CIS countries led to the accumulation of significant levels of indebtedness. The Bank internalized emerging lessons and shifted its emphasis accordingly: poverty monitoring and alleviation and good governance are now prominent objectives in both lending and analytical work, and the approach to privatization and private sector development has evolved considerably.

### **Recommendations from the Study of Five Areas of Bank Assistance**

The following recommendations emerged from a detailed study of private sector development, governance, public sector management (PSM) and institution building, the financial sector, social protection, and energy in the transition economies:

- Legal and judicial reform, with an emphasis on implementation, is critical for improvements in the business climate, the financial sector, social protection, and governance in general.
- Financial sector lending should be conditioned on progress in enforcing prudential regulations and international accounting standards, and increasing the effectiveness of bank supervision. Training of bank supervisors, judges, auditors, and other skilled professionals needed to make the system work should be a priority.
- In the energy sector improved commercial performance and corporate governance are priorities. The sequencing of reforms, including the feasibility of immediate privatization, depends on country circumstances.
- Privatization of large enterprises should focus on encouraging a carefully prepared, transparent, competitive process, open to foreign participation.

- A strategic approach, distinguished by the capacity of the country, is needed for pension reform and for better targeting of other social assistance programs.

### **Cross-Cutting Findings and Recommendations**

The study presents a number of findings that cut across sectors and lend themselves to recommendations that are broadly applicable, not only to the transition countries, but to many others as well:

- The rate of progress of any reform is largely determined by government ownership, and a well-informed civil society can become a major driver for change. Country assistance strategies should promote ownership and consensus for reform through capacity building for governments and civil society and through analysis of the political, social, and economic processes that affect stakeholder behavior. Recent Bank initiatives promoting stakeholder awareness and participation in several countries bear wider replication.
- A comprehensive, long-term approach is needed in developing strategies for institutional change and PSM reform. Analytical work on governance and PSM should precede large amounts of Bank lending, particularly where problems are likely to affect assistance programs.
- Economic and sector work can serve to increase knowledge and train local researchers; its quality in the transition countries has been high, but its impact on the country dialogue might have been greater if it had been more relevant and timely.
- Greater transparency can increase public accountability and discourage corruption. The Bank needs to implement fully its own disclosure policies and disseminate its analytical work, and encourage governments to report more regularly and fully to both their parliaments and the public.
- The Bank can be better prepared to identify and address rapidly growing poverty by giving high priority to the monitoring of poverty levels from the beginning of its involvement in a country.
- Aid coordination can increase the effectiveness of all assistance. Recipient governments should lead aid coordination, with donors helping them define clear development strategies, including monitorable action plans for implementation.