

## **Monitoring Country Progress Methodology and Indicators November 2015**

The Monitoring Country Progress (MCP) system draws on publicly available, standardized (i.e., cross-country) data from a variety of sources including international organizations such as the European Bank for Reconstruction and Development (EBRD), the World Bank, the International Monetary Fund, the World Health Organization (WHO), the United Nations Office on Drugs and Crime (UNODC), and the United Nations Children Fund (UNICEF); various U.S. government sources and reports (such as from USAID, U.S. Department of State, U.S. Department of Commerce, U.S. Defense Department, and U.S. Trade Representative); as well as think tanks and universities such as Freedom House, Transparency International, Fund for Peace, Binghamton University, and George Mason University.

For assessing trends in Eastern Europe and Eurasia (E&E), the primary sources for macroeconomic and democratic reform progress are the E&E region-specific data from the European Bank for Reconstruction and Development (EBRD), *Transition Report* and Freedom House, *Nations in Transit*, respectively.

**Macroeconomic Reforms.** Nine indicators are tracked from the EBRD and go into the MCP's (equally-weighted) economic reform index: (1) small-scale privatization; (2) price liberalization; (3) trade & foreign exchange reforms; (4) large-scale privatization; (5) corporate governance & enterprise restructuring; (6) competition policy; (7) banking reform; (8) non-bank financial institutional reform (an index of four components, including MSME finance, capital markets, private equity, and insurance and other financial services); and (9) infrastructure reforms (an index of five components including electric power, telecommunications, railways, roads, and water & waste water). EBRD scores range from 1 to 4+. The MCP system rescales the EBRD scores from 1 to 5, where a 5 represents the most advanced standards worldwide (i.e., the standards of the advanced industrialized economies), and differentiates between first stage and second stage economic reforms (as shown below).

### **First Stage Macroeconomic Reforms**

#### **Small-scale Privatization**

- 1 Little progress;
- 2 Substantial share privatized;
- 3 Comprehensive program almost ready for implementation;
- 4 Complete privatization of small companies with tradable ownership rights;
- 5 Standards and performance typical of advanced industrial economies: no state ownership of small enterprises; effective tradability of land.

#### **Price Liberalization**

- 1 Most prices formally controlled by the government;

- 2 Some lifting of price administration; state procurement at non-market prices for the majority of product categories;
- 3 Significant progress on price liberalization, but state procurement at non-market prices remains substantial;
- 4 Comprehensive price liberalization; state procurement at non-market prices largely phased out; only a small number of administered prices remain;
- 5 Standards and performance typical of advanced industrial economies: complete price liberalization with no price control outside housing, transport and natural monopolies.

### **Trade & Foreign Exchange System**

- 1 Widespread import and/or export controls or very limited legitimate access to foreign exchange;
- 2 Some liberalization of import and/or export controls; almost full current account convertibility in principle, but with a foreign exchange regime that is not fully transparent (possibly with multiple exchange rates);
- 3 Removal of most quantitative and administrative import and export restrictions; almost full current account convertibility;
- 4 Removal of all quantitative and administrative import and export restrictions (apart from agriculture) and all significant export tariffs; insignificant direct involvement in exports and imports by ministries and state-owned trading companies; no major non-uniformity of customs duties for non-agricultural goods and services; full current account convertibility;
- 5 Standards and performance norms of advanced industrial economies: removal of most tariff barriers; membership in WTO.

### **Large-scale Privatization**

- 1 Little private ownership;
- 2 Comprehensive scheme almost ready for implementation; some sales completed;
- 3 More than 25 percent of large-scale state-owned enterprise assets in private hands or in the process of being privatized (with the process having reached a stage at which the state has effectively ceded its ownership rights), but possibly with major unresolved issues regarding corporate governance;
- 4 More than 50 percent of state-owned enterprise and farm assets in private ownership and significant progress on corporate governance of these enterprises;
- 5 Standards and performance typical of advanced industrial economies: more than 75 percent of enterprise assets in private ownership with effective corporate governance.

### **Second Stage Macroeconomic Reforms**

#### **Governance & Enterprise Restructuring**

- 1 Soft budget constraints (lax credit and subsidy policies weakening financial discipline at the enterprise level); few other reforms to promote corporate governance;

- 2 Moderately tight credit and subsidy policy but weak enforcement of bankruptcy legislation and little action taken to strengthen competition and corporate governance;
- 3 Significant and sustained actions to harden budget constraints and to promote corporate governance effectively (e.g., privatization combined with tight credit and subsidy policies and/or enforcement of bankruptcy legislation);
- 4 Substantial improvement in corporate governance and significant new investment at the enterprise level;
- 5 Standards and performance typical of advanced industrial economies: effective corporate control exercised through domestic financial institutions and markets, fostering market-driven restructuring.

### **Competition Policy**

- 1 No competition legislation and institutions;
- 2 Competition policy legislation and institutions set up; some reduction of entry restrictions or enforcement action on dominant firms;
- 3 Some enforcement actions to reduce abuse of market power and to promote a competitive environment, including break-ups of dominant conglomerates; substantial reduction of entry restrictions;
- 4 Significant enforcement actions to reduce abuse of market power and to promote a competitive environment;
- 5 Standards and performance typical of advanced industrial economies: effective enforcement of competition policy; unrestricted entry to most markets.

### **Banking Reform**

- 1 Little progress beyond establishment of a two-tier system;
- 2 Significant liberalization of interest rates and credit allocation; limited use of directed credit or interest rate ceilings;
- 3 Substantial progress in establishment of bank solvency and of a framework for prudential supervision and regulation; full interest rate liberalization with little preferential access to cheap refinancing; significant lending to private enterprises and significant presence of private banks;
- 4 Significant movement of banking laws and regulations towards BIS standards; well-functioning banking competition and effective prudential supervision; significant term lending to private enterprises; substantial financial deepening;
- 5 Standards and performance norms of advanced industrial economies: full convergence of banking laws and regulations with BIS standards; provision of full set of competitive banking services.

**Non-Bank Financial Institutional Reform.** Rating in four sectors (financial services, capital markets, private equity, and MSME finance) includes assessment of market structure development (e.g., degree of competition and market penetration) as well as market-supporting institutions and policies (such as the development of adequate legal and regulatory framework).

- 1 Little progress;
- 2 Formation of securities exchanges, market-makers and brokers; some trading in government paper and/or securities; rudimentary legal and regulatory framework for the issuance and trading of securities;
- 3 Substantial issuance of securities by private enterprises; establishment of independent share registries, secure clearance and settlement procedures, and some protection of minority shareholders; emergence of non-bank financial institutions (e.g. investment funds, private insurance and pension funds, leasing companies) and associated regulatory framework;
- 4 Securities laws and regulations approaching IOSCO standards; substantial market liquidity and capitalization; well-functioning non-bank financial institutions and effective regulation;
- 5 Standards and performance norms of advanced industrial economies: full convergence of securities laws and regulations with IOSCO standards; fully developed non-bank intermediation.

**Infrastructure.** This indicator averages EBRD ratings for reform progress in five infrastructure sectors (telecommunications, railways, electric power, roads, and water & waste water), and attempts to address development of market structures and market-supporting institutions and policies.

**Democratic Reforms.** Freedom House, in its annual *Nations in Transit*, measures progress in the transition region in seven democratic reform areas: (1) electoral process; (2) civil society; (3) independent media; (4) national democratic governance; (5) local democratic governance; (6) rule of law; and (7) anti-corruption. Freedom House rates the progress from 1 to 7, where 1 represents the most advanced standards worldwide. In the MCP system, these scores are reversed and re-scaled to range from 1 to 5, with 5 being the most advanced. Freedom House measures progress towards democratic reforms by assessing a series of questions in the seven democratization areas, and then provides rating guidelines on criteria towards policy and implementation (or “practice”).

**Electoral process.** Examines national executive and legislative elections, electoral processes, the development of multiparty systems, and popular participation in the political process.

**Civil Society.** Assesses the growth of NGOs, their organizational capacity and financial sustainability, and the legal and political environment in which they function; the development of free trade unions; and interest group participation in the policy process.

**Independent Media.** Addresses the current state of press freedom, including libel laws, harassment of journalists, and editorial independence; the emergence of a financially viable private press; and internet access for private citizens.

**National Democratic Governance.** Considers the democratic character and stability of the governmental system; the independence, effectiveness, and accountability of legislative and executive branches; and the democratic oversight of military and security services.

**Local Democratic Governance.** Considers the decentralization of power; the responsibilities, election, and capacity of local governmental bodies; and the transparency and accountability of local authorities.

**Rule of Law** (judicial framework and independence). Highlights constitutional reform, human rights protections, criminal code reform, judicial independence, the status of ethnic minority rights, guarantees of equality before the law, treatment of suspects and prisoners, and compliance with judicial decisions.

**Corruption.** Looks at public perceptions of corruption, the business interests of top policymakers, laws on financial disclosure and conflict of interest, and the efficacy of anticorruption initiatives.

**Other indicators used in the MCP system** include: (1) governance indicators from the World Bank; (2) business environment or microeconomic reform indicators from the World Bank; (3) the *Media Sustainability Index* from IREX; and (4) the *Civil Society Organizations Sustainability Index* from MSI.

**Governance indicators** from the World Bank. This includes: (a) *regulatory quality* which captures perceptions of the ability of the government to formulate and implement sound policies and regulations that permit and promote private sector development, calculated by taking the results from multiple sources and standardizing their results. (b) *rule of law* which is an index of surveys that rates countries on the extent to which the public has confidence in and abides by rules of society; incidence of violent and non-violent crime; effectiveness and predictability of the judiciary; and the enforceability of contracts; (c) *control of corruption*, an index of surveys that rates countries on various forms of corruption including petty and grand corruption and state capture (i.e., the private sector “capturing” the state by illegally influencing the implementation of laws); (d) *government effectiveness*, an index of surveys that rates countries on the quality of public service provision, the quality of the bureaucracy, the competence of civil servants, the independence of the civil service from political pressures, and the credibility of the government’s commitment to policies; and (e) *political stability and absence of violence*, which measures perceptions of the likelihood that the government in power will be destabilized or overthrown by possibly unconstitutional and/or violent means, including domestic violence and terrorism.

**Business environment indicators** (or microeconomic reforms) include ten business environment areas measured by the World Bank's *Doing Business*. Six areas address the complexity and cost of regulatory processes: (1) *starting a business* (procedures, time, cost, and paid-in minimum capital to start a limited liability company); (2) *dealing with construction permits* (procedures, time, and cost to complete all formalities to build a warehouse); (3) getting electricity (procedures, time, and cost to get connected to the electrical grid); (4) *registering property* (procedures, time, and cost to transfer a property); (5) *paying taxes* (payments, time, and total tax rate for a firm to comply with all tax regulation); and (6) *trading across borders* (documents, time, and cost to export and import by seaport). Four areas address the strength of legal institutions: (1) *getting credit* (movable collateral laws and credit information systems); (2) *protecting minority investors* (minority shareholders' rights in related-party transactions and in corporate governance); (3) *enforcing contracts* (procedures, time, and cost to resolve a commercial dispute); and (4) *resolving insolvency* (time, cost, outcome, and recovery rate for a commercial insolvency and the strength of the insolvency).

The *Doing Business* data are collected in a standardized way. A questionnaire is designed using a simple business case to ensure comparability across economies and over time, with assumptions about the legal form of the business (e.g., a limited liability company), its size, its location and the nature of its operations. Questionnaires are administered to more than 10,600 local experts.

**Media sustainability index** from IREX consists of five aspects or objectives of a sustainable media sector: (1) *freedom of speech* (legal and social norms protect and promote free speech and access to public information); (2) *professional journalism* (journalism meets professional standards of quality); (3) *plurality of news* (multiple news sources provide citizens with reliable, objective news); (4) *business management* (media are well-managed enterprises, allowing editorial independence); and (5) *supporting institutions* (such as professional associations, NGOs, training institutions, and information and communication technology infrastructure, function in the professional interests of independent media). A score ranging from 0 to 4 is attained for each aspect by rating between seven and nine indicators, which determine how well a country meets that objective. The primary source of information is a panel of local experts that IREX assembles in each country to serve as panelists.

**Civil Society Organizations Sustainability Index** from MSI consists of seven components: (1) *legal environment*; (2) *organizational capacity*; (3) *public image*; (4) *service provision*; (5) *advocacy*; (6) *financial viability*; and (7) *infrastructure*. The index uses a seven point scale with a seven indicating a low or poor level of development and a one indicating a very advanced NGO sector.