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PEOPLE IN TRANSITION: ASSESSING THE ECONOMIES OF CENTRAL AND EASTERN EUROPE AND THE CIS

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P R O C E E D I N G S

DR. BRAINARD: Well, good morning. And I think we'll get started.

We're delighted today to have with us Erik Berglöf, who is the Chief Economist at the European Bank for Reconstruction and Development. And Erik has also been a Senior Fellow here at Brookings, and is a member of the family, so to speak, and has been working on transition economies previously as Director of the Stockholm Institute of Transition Economies for many years.

So, in some respects he is delivering a report on the fruits of his own work, for his own recommendations many years later.

The report is particularly interesting to me in any case, because it pairs the traditional economic approaches of household surveys with a kind of newer set of surveys of perceptions. To ask not only, in terms of economic measures how are people doing relative to how they were prior to reforms, but also how they perceive their relative standing.

So I think this is quite a novel approach, and it seems like it may have some very rich outcomes from it.

And I think following Erik's discussion of the report, then Johannes Linn, who's Director of the Wolfensohn Center, will have some comments, and then we'll open up to a broader conversation.

DR. BERGLÖF: Well, Thank you, Lael. And it's very nice to be back. I feel a little bit distant from my family, standing up here, but it's very nice to be back home.

And, as you said, I have been thinking about these issues for quite some time, and this is the first big research project that I put in motion when I joined the Bank. And it tells you bit of the lead times in these kind of jobs that now, almost two years later, the first output is coming. Luckily, there's a lot more going on in various research groups based on this survey, but it's still a bit frustrating that it takes so long to get anywhere.

But what I'm going to present is not only that. And I'm going to focus on that, but I'll give you a broader presentation of the transition report. It's an annual report -- in a sense, a "state of the region," that we publish every year. It's very much a team work of my group at the Bank. It tries to give a sense of the macroeconomic situation, which I think is particularly interesting now in light of the international financial turmoil. It tries to give a sense of the pace of reform and the nature of reforms in the region.

And then every time, every year, it gives a special theme. And this year the theme is “People in Transition.” And it’s quite different from the normal focuses that we’ve had in the past, where it’s been on sector, or one particular issue. Here it’s a much broader take on what is the people’s perception and of the outcome of transition and, of course, what happened to them during transition.

This is not my team; it supposed to symbolize some of the people that were involved in this.

So let me just first summarize the main messages of the report.

This is a part of the world that’s growing very fast. This year it’s about 7 percent, on average. About the same, a little faster, in Russia and the CIS. We expect that this growth will be about the same next year or slightly lower, but it suggests to us that this region will deal quite well with the global market turmoil. And I’ll come back to why I think that is the case, and why this may not be -- certainly was not the view six months ago, that this region will deal so well with the financial squeeze like this.

But despite this growth and this resilience to financial turmoil, there's very little happening in terms of reform in the region. And true, in all the parts of the region but for Southeast Europe. And I will come back to why I think that is.

And the main messages from these surveys that we did, well, basically, from 29,000 people in the region, is that despite a lot of hardships, there's a very strong commitment to markets and to democracy. But there are important groups that are dissatisfied. And theses groups play a very important role in politics, and they're playing, I think, a bit of the political turbulence and turnovers that we have seen in the region.

(Slide.)

And, finally, we tried to see how these groups can be brought into reforms more, can be given a stake in reforms. And that's very much true, we think, through improved public services. And we spend one chapter trying to discuss some of the issues that we face in trying to improve public service delivery in these countries.

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But let me start with the macroeconomic situation. So this region is growing very fast. It's been growing fast for almost a decade now. And it's becoming an important market. It's now the largest market, export market, for the Euro zone which is, I think, quite a remarkable development. It's also particularly for the Central and Eastern European countries, they are very competitive in international markets. They are, even in markets where China is very successful, the Central and Eastern European countries are doing very well.

(Slide.)

I think this is the result of, you know, a decade of very intense reforms, particularly in Central and Eastern Europe. In Southeast Europe it came later, but it's also in the process of joining, or hoping to join the European Union.

In the CIS the story is, of course, a bit more based on raw materials and but also, I would argue, some results of earlier reform.

It's very much based on domestic demand, and very strong increase in consumption; but, also very high levels of investment, particular in Central and Eastern Europe and Southeast Europe. Southeast Europe there's a clear trend also towards rapid, continued rapid increases.

But the real story here is the increase in investment, particularly in Russia, but also in other parts of the CIS.

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And, of course, the concern here is: is this going too fast, or is it something that is just sort of a catching up story? And I think here, there is no simple answer. I just put here the two measures. One is the Domestic Credit to Private Sector, which we sometimes use as a measure of financial development, sometimes a measure of rapid credit growth.

And I think when we look at these numbers we should remember that these come from low levels. So these countries are still, all of them, compared to countries at the same level of economic development, financially underdeveloped. So they are essentially catching up in terms of financial development.

But still there is a concern, and not only we are concerned but, you know, many observers, or most observers, are concerned that this expansion is going too fast, and that the financial institutions are not capable of dealing with this growth. The supervisory institutions are not capable of dealing with this growth. And also it feeds into a very rapid increase in consumption, and it affects housing markets and so on.

On balance, I think I would emphasize the former: that this is really healthy growth in most cases. It doesn't mean that there have not been individual countries that have seen excessive growth, and should expect some cooling off now. But on balance, I think this is a very healthy development.

(Slide.)

The same thing with Foreign Direct Investments. They've been very highly levels in Central and Eastern Europe, and we see that also in the extent to which industries in these countries have become really restructured and become extraordinarily competitive.

(Slide.)

I mentioned the very rapid increase in foreign direct investment in Southeast Europe. But I think the most remarkable thing from this year is the clear trend in CIS and, as I mentioned, Russia, particularly. If you look at the last five years, and in dollar terms, it's about six times increase in investments, now talking about both domestic investment and foreign direct investment.

And this raises a lot of issues about the absorption capacity of Russia and its ability to ensure that these funds -- a lot of them invested in infrastructure -- really used in the proper way. I think we'll have a chance to talk about this later on.

(Slide.)

So what are the implications for the resilience of these countries, given the current situation in financial markets?

If you asked people about six months ago, assuming that there would be this kind of credit squeeze or, you know, which part of the world would be most affected, I think people generally would have said that this is the most vulnerable region in the world. And certainly, if you looked at the IMF's analysis of this, of the world, that's what -- even if you read the "World Economic Outlook," the latest issue, this is basically the message.

I think, given that, it's remarkable how little has actually happened in the region. It doesn't mean that nothing has happened, but very little has happened.

(Slide.)

Well, actually, as you see, the most important thing is this. So this is Ukraine, and this is Russia spread some sovereign bonds.

What I want to show here is just that, first of all, you see that stripe -- this is August, September -- July, August, September this year. Clearly, the spreads have gone up. And more in Ukraine than in Russia.

Down here in April there was almost no difference. So somehow the risks were perceived to be the same in Russia and Ukraine, which seems, you know, not really -- it's hard to explain that in sort of.

And I think what we see now is a much more accurate assessment of what the real risks are.

But if you look at the level, actually it's just the same level about a year ago and going further back you'll see that this is, you know, still quite low levels. So it's nothing that, you know, really dramatic. It does have an impact. It does influence, particularly, countries and institutions that have relied a lot on external financing. But, again, by historical standards these are rather low levels in what is actually was before was really artificially low levels.

But there are countries that are feeling the pinch. And, in a sense, you know, by looking at those countries I think we can get a better sense of why the region as a whole is not feeling it so much.

(Slide.)

And the best example, and the country that's really suffering right now, is Kazakhstan. Kazakhstan is essentially -- Kazakh banks are now locked out from international capital markets. Kazakh sovereign institutions have problem raising funds internationally.

I was in Kazakhstan about a month ago, and you talk to Kazakh companies, interest rates are more than doubled, you know, good companies are being forced to pay back early. Less good companies are basically locked out from funding.

You go look at the construction sector, it was very rapid expansion of construction. Foreign banks -- sorry, domestic banks invested very heavily in this sector. Now the construction sector is in deep trouble, and you see -- you walk around Almati and Astana, you see a lot of building sites that are on hold; basically these construction companies cannot raise funds.

And people, it's very common practice in these countries, to buy a house or an apartment before it's built. And so a lot of people have put their savings into these dreams and really have seen them not materialize.

And I think there's no question that companies, consumers and financial institutions in Kazakhstan are feeling something from this international turmoil.

So it's important to understand why.

(Slide.)

One thing is that Kazakh banks have been extraordinarily active internationally. So they raised a lot of funding internationally. They invested a lot outside Kazakhstan. They are, you know, very aggressive. And the financial sector is completely oversized compared to the rest of the economy. They were quite advanced, these banks. Actually, if you look at their margins and their business, they are quite, you know, well run banks, quite sophisticated banks by the regional standards.

But they were very heavily dependent on external finance. And, of course, when spreads and costs of borrowing go up, that affects them very badly. And some of them are now basically in default.

But, on the whole, they've been very aggressive. And it's not so strange that they are oversized, because that's what happens in many of these resource-rich economies; that the sort of resource sector and the financial sector sort of grew out of proportion relative also to domestic regulators and supervisors.

So, for example, you know, my bank is an investor in most of these institutions, these banks, and, you know, we have been trying to put pressure on them to do certain things in terms of transparency and so on. And we have tried to convince the financial supervisory agencies to help us. And they say, "Of course, we will try to do that," and they get essentially nowhere. So they have very little influence over these institutions.

And the same things with regulators. These banks are just too powerful, too sophisticated, and it's very difficult for the institutions in Kazakhstan and the government to do something about this.

(Slide.)

But maybe the most important single reason, I would say, why Kazakhstan is hit and most of the region is not hit, certainly by the liquidity aspect of this crisis, is the penetration of foreign banks. So in Kazakhstan there's essentially no foreign bank penetration, very limited.

And that's also the reason, I would argue, why Russia was hit. We didn't think that Russia would be much affected. And if you look at spreads, they were affected, but not that much. But there certainly has been a liquidity squeeze in Russia in the last three, four months.

And that, I would argue, is because, again, foreign bank penetration is still very marginal in Russia, unlike Central Europe and unlike Ukraine, which in the last two years, basically, the whole Ukranian banking system has been bought up by foreign banks. There are very few independent Ukranian banks now. And I think that has been, in a sense, a saving grace for Ukraine -- that, in combination with the fact that it was developed, less integrated, less exposed to this financial turmoil.

(Slide.)

We can discuss maybe later individual countries in Central and Eastern Europe and Southeast Europe, but the argument would be that, you know, most of the impact of this will be felt where there are very large external financing needs, both in terms of countries and individual institutions; that, you know, capital flows have declined to some, but also some countries have got new massive inflows. So Russia's seen renewed inflows.

And, in general, emerging markets have received a lot of inflows because, basically, global savings have nowhere else to go but to emerging markets.

(Slide.)

The, you know, risk (inaudible) on interest rates have gone up. Maturities that were on the rise in most countries -- and there was a very healthy development from a situation where it was very hard to borrow beyond one or two years, we saw a process, particularly in Russia where maturities were increasing. But in the last few months, these have started to shorten again, which is unfortunate but I think very much a result of this credit squeeze.

(Slide.)

So this will have an effect on consumption, and it will have an effect on investment -- and ultimately on growth. But we see this effect, you know, it will be substantial, but it will not be very big this year. And in looking at the coming year, and we think, in principle, these economies will withstand these pressures and come through it in quite good shape.

(Slide.)

Just to sort of end this part of the presentation, this is really the first big test of these financial systems since '98. So I think the fact that they have done so well tells a lot about what really has happened. And I think some of these assessments that were made sort of six months ago and before that, I think were not fully appreciating what has happened in terms of the improvements of these financial institutions. I mentioned the foreign banks -- but also what's happened in terms of the whole process of EU accession and the very broad institutional improvements that have happened in some of these countries.

And I think we need to have this institutional context when we look at these numbers of, you know, fiscal deficits, current account deficits and exposures in the financial sector. We must not forget that.

And, actually, when you look at the latest IMF report -- they just published the regional report for this region -- and I think that has a much more insightful analysis of the capacity of these economies to deal with structural change and sort of more rich, a richer framework for thinking about the vulnerabilities of these countries.

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They have come far, but they have not -- there's a lot left to do. And certainly there's a risk that you sort of take for granted that these, you know -- assuming that they will come through this in good shape, that they will not continue the reforms. And that is something that I think might be a real reason to be concerned about that.

(Slide.)

So that's the next topic. So what has been happening in terms of reforms?

Well, what we do is we look across nine sectors of the economy. We try to, every year, make an assessment of, you know, where are they in terms of reforms. This has probably been the main motivation for this publication in the first place, and why it's been used a fair amount, for example, by the U.S. government uses these indicators for a number of decisions on allocating aid and so on.

And what we do every year is to look at what happened, compared to a year ago. And if you look first across the different regions, so in Central and Eastern Europe not much happened. So most of it was, there were two upgrades, in Lithuania and Latvia.

There are several stories here that you can tell for why this is the case. First of all, they did a lot leading up to EU accession. And so there's less to do now. But there's also a sort of lack of enforcement, a lack of momentum once you join the European Union. It's clear that, you know, they have had serious trouble building a sort of a consensus around reform.

There is also, there was this hope that the additional step of joining the European Monetary Union, which they all have signed up to when they joined the EU, would give them additional incentives to continue reforms. The problem with that is that, first of all, partly because of other reasons, the likelihood that they will be able to meet these targets, or these criteria for joining the EMU seem less and less likely. So the prospect of the EMU membership is being pushed into the future and having less impact today on what's going on in terms of politics in these countries.

And also, EMU, as a sort of anchor is much more narrow, affecting, you know, some key macroeconomic variables, but you can't really compare it to the anchor of the EU accession, which was a very comprehensive list of, you know, political, legal and so on. It's, you know, a much more --

well, it's not easy to come and say, you know, "Our vision is to join the EMU," it's not the same thing as saying our vision is to go back to Europe.

And so I think all those things combine. And, I would argue, what this survey that I will present in a minute looks at, you know, very large groups in society that feel that they have lost out in the process of transition.

(Slide.)

There's much more happening in Southeast Europe. And here sort of the other side of the story, these are countries, with the exception of Rumania, which is already a member of the European Union, these countries have the prospect of joining. And that is very much affecting decisions in those countries.

And you see that very clearly. You know, what have they been doing? Well, they have been, for example, upgrading competition policies. So you see much more of effective enforcement of competition policy in terms of actual cases being brought forward, and also penalties being paid out.

This would never have happened had it not been for the EU accession process. I mean, these are economies that are very sort of oligarchic in their structures, very -- or corporatist, in a sense. You know, very close relationships between business and government. And the movements in competition policies are among the most difficult things to bring about. But we see movements in this area; I think it's a reflection of this EU accession process.

But we should remember when we look at all these cylinders there that they're coming from a lower base. They are -- it's easier, probably, to make these reforms, the first sort of early reforms. And I think we should not take it for granted, because there is now a lot of unease in Europe about further enlargements. And the more uncertainty we create around the prospect of an accession, the less incentive there will be for these countries to actually do the necessary things.

(Slide.)

If we look at the CIS -- well, this is the picture. You know, sort of some improvements.

Byelorussia -- we'll be happy to talk about Byelorussia later on. Things are moving in the Ukraine, a few things. Georgia. Moldavia, we have two upgrades, particularly for the financial sector.

But the star reformer here is Mongolia. And Mongolia -- the Russian paper wrote about, the reporter said, “We have nominated Mongolia to the economic Genghis Kahn.” -- the Genghis Kahn of economic reform.

Again, Mongolia, coming from a low level. But it’s a very interesting country -- you know, very poor, aid-dependent. It’s been in a country operation for (inaudible) for a little over a year. But tremendous momentum. In the survey it’s the most democratically-inclined country, the most market-supportive country across the whole region. So it’s a fascinating, fascinating country.

But maybe the most significant observation here is there’s no upgrade in Russia. So basically the view is that, you know, reforms are not making a lot of progress in Russia at the moment.

(Slide.)

Here is the same picture, but by sector. Well, basically, the story is here that -- a lot of the upgrade was in competition policies. A little movement in the financial sector. Here there was one upgrade, infrastructure, one upgrade in foreign exchange system.

Anyhow, I said there was no upgrade in these key sectors in Russia, but there's actually one upgrade in Russia, here in the railway sector. And this is because of increased private competition in the freight segment, and some privatization.

Just to give you a sense of how we work, we tried to -- under each of the nine sectors, we have several sub-sectors that we try to analyze independently, and then come to a view on the state of the sector as a whole. So there was one upgrade in the railways, but it was not sufficient to get an upgrade in infrastructure.

(Slide.)

But this is maybe the more interesting picture. And, luckily, here we can actually see the colors.

So here we tried to do the following thing.

We looked at these nine sectors, and we distinguished -- we called three phases of reform, the first phase being, you know, small privatization, liberalization and trade and prices; the second being large privatizations and financial sector development; and the fifth -- or the third phase, sorry -- the third phase we call "market sustaining reforms," governance, competition and infrastructure.

And here you can see part of the reason why it's difficult for Central and Eastern Europe to get more upgrade, because they've actually done, you know, a great deal in terms of the first phase of reform, and even on the second phase reform there is continued movement. And I would argue also for the third phase of reform movement is slower, but it's still happening.

But it is a difficult area that many of these countries still are struggling, particularly in the infrastructures. Management of infrastructure is a very difficult thing to reform.

But, and we look at Southeast Europe, again started from a lower level, started later, but there is movement, basically, in all areas of reform. They have further to go, but there is a sense of momentum.

But we look at CIS -- and you hear particularly Russia -- again, they've done a fair amount on the first phase of reform, some movement on the second phase, but when we look at the third phase of reforms, essentially nothing happened since 1998 -- for the last decade, more or less lost, in our view, in terms of improvements in governance, competition and infrastructure.

So here, I think -- you know, behind this is a complex picture of, you know, some advances in the private sector, but at the same time some, you know, regresses in other areas, particularly when it comes to state involvement, the lack of reform in the state sector and so on -- so behind that story.

(Slide.)

Okay, let me say a few words about this special theme.

So, I said we tried to do this for several reasons. We wanted to, first of all, I think it's a good thing to try to look at broader measures of outcome, not just GDP. But it's, maybe more importantly, it's also -- we know this that it does influence what people do. It influences, it's very accepted by now that perceptions and sort of attitudes influence business decisions. And in the same way, we think that it influences individuals as consumers, as voters, and it's important to understand that.

And, of course, the background, what really triggered, I think, this study was some of the trends in the region, the trends that we see in Russia, for example, some of the perceived dissatisfaction that causes so much political turnover in Central and Eastern Europe. Very few governments in Central and Eastern Europe have been reelected in the last 15 years.

So all this together, we thought it would be a good idea to get a better handle on, you know, to what extent is the transition, as such, influenced, and what aspects of transition.

So how is outcome affected by satisfaction and attitudes? And what has been the impact of experiences during transition? So we focused particularly on labor market experiences. And, of course, it was interesting to know what people really expect from the future.

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And so what we did was to do a survey that I think is quite unique in several respects. First of all, it’s the first time that we look at this across the entire region. So we did it in 28 of our 29 countries of operation. We couldn’t do it in Turkmenistan, and we did it in Turkey. We worked together with the World Bank.

But I think the most important aspect of this is the one that Lael emphasized at the start, which is, I think -- well, as far as I know, the first study that looks at both at a serious household component looking at the household consumption patterns, labor market data and that we typically collect in household surveys, and combining this with a perception-based. So both life satisfaction and attitudes on economic and social values and so on.

(Slide.)

I'm just going to give you -- it's a very rich material. I'm going to give you a few key variables. We're going to look at life satisfaction, what people perceived as their absolute and relative living conditions today, compared to 1989; look at their attitudes to democracy, attitudes to markets, and future aspirations.

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So this is a map -- and I'm glad it's not in turquoise -- it's a map of life satisfaction. And I don't think I have to explain, or motivate, why we -- "life satisfaction," I think by now it's commonly accepted that this is a useful thing that you can actually, that is you can make comparisons across individuals and even across countries. It's not a flawless method. There are still serious things to work out, and you have to be careful when you interpret it. But I think by now it's accepted that this is an informative methodology.

But what this does is -- so the darker you are here, the more unhappy, or the less satisfied you are. And we have data also for Western Europe here, so that you can see that, if you compare it to Western Europe -- we didn't have data for Norway, but we have data for the EU. So Norway's not -- if you're white, it doesn't mean you're particularly happy, but if you are very light green, like the rest of Scandinavia, Holland, Ireland, you are in the 90 percentile -- more than 90 percent of the people would say that they are satisfied.

But this really stands out as being very dark, very, relatively dissatisfied. And I think there are some immediate reasons for this.

So the first obvious reason is, and we know from a lot of work on life satisfaction and happiness, that this is correlated with income. But it's correlated only up to a certain level of income, but that level of income is higher than any of the countries in our region. So above a certain level there is no longer any correlation between life satisfaction and happiness -- or life satisfaction and income.

So that's the first thing. So these countries have lower levels of income. We also know that the level of provision of public services affects life satisfaction. And these countries are much lower on the provision of public services.

But I think the most important aspect, and that pertains particularly to transition, is the fact that we know from a lot of work on life satisfaction that what people are really sensitive to is volatility and changes. And there are sort of two fundamental changes -- or "shocks," if you want -- to people's lives during transition.

The first one is, of course, the income shock of the transitional recession that hit all the countries in the region -- to various degrees, but then you can actually -- the larger the shock, the more dissatisfied they are today.

The other shock, which is maybe not remembered so often, but it's the shock to human capital. So all these, a lot of people had human capital that is no longer really useful, and also we should remember that the university systems of these countries, or school systems, are not necessarily providing that useful human capital today. But in any case, there's been a major shock to those countries in terms of human capital.

And if you plug all this into a regression, you can actually explain most of the unhappiness. The only country that you really cannot explain is Hungary. So if you have some good explanations for Hungary, I'm very eager.

SPEAKER: (Inaudible.)

DR. BERGLÖF: Yes, high expectations -- possibly.

I think I could spend, you know, several hours just on this, on the individual countries there. And I would be happy to come back to that. But I think it raises a lot of questions.

So we asked those people, then, about how they feel today relative to 1989. And the first thing to observe is that when you ask people about their sort of absolute well-being -- so, you know, what is your well-being today in terms of material well-being, people would acknowledge that things have gotten better. They actually quite accurately assess their -- if you believe the GDP numbers, so we know that -- if you believe the 1989 GDP number and, you know, GDP today, many of the countries in the region have not reached the 1989 level. And when you actually, when we asked people, it's almost a perfect fit that when more than 50 percent say that they are better off today in material terms than they were in 1989, that fits with the GDP data.

So I must say I was very, I had been very skeptical to the GDP data, but somehow people seem to corroborate these GDP data to some extent.

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What I think is more striking, and possibly more important part of the story, is this chart, which gives you the relative -- your perception of your relative standing compared to 1989. So people here say that they have lost out relative to other households since 1989. And, of course, you can have many stories behind this, you know. It's about income redistribution and so on.

But this seems to be a very important part of the explanation for people's dissatisfaction, this sense of relative deprivation.

And it's uniform across the region. It's stronger in Southeast Europe, and maybe a little bit stronger in some of the CIS countries. It's particularly strong, by the way, in Georgia, which is interesting these days.

(Slide.)

But despite, you know, all this hardship and all these shocks that they have been exposed to, there's a very strong support for democracy across the region. And I think there's really one country that really stands out there as being different, and it's Russia. And we can talk about that later on. I think there are a number of ways of explaining that.

(Slide.)

Here, support for markets, people are not as enthusiastic about markets. They, you know, with some exceptions -- Albania and Mongolia stand out here as being very supportive of markets. But you can also there's a lot of remaining support for planned economy which is, you know, the previous picture said there was, in most countries, with the exception of Russia, not a lot of support for authoritarian forms of government. But here you can see there's still a lot of belief that the planned economy somehow can resolve people's life issues.

(Slide.)

Another thing that stands out from this work is the very low levels of civic activity. So here we asked people about, you know, "Would you ever consider being part of a local demonstration?" "Would you be part of strikes?" "Would you sign a petition?" These are things, when you ask people in Western Europe, you would have more than 90 percent saying yes to this.

In these countries, 50, 60 percent in Central and Eastern Europe, but when you come to CIS, you know, maybe 20 percent. So this is, I think, quite disturbing and something that I think is not always appreciated when you look at the political situation in these countries. And I'll come back a bit more to that when I look at the individual variations.

(Slide.)

So, here, you know, it's one thing to look at these national averages, and it just maybe doesn't tell you that much. I had a discussion with Yannis Kornei, and he said something that I thought was quite catchy. He said, "You know, looking at a national average, it's like going into a hospital and asking, you know, what is the average temperature of your patients." And, you know, a little bit -- my skepticism about national averages is, I think, captured by that statement.

But here, so what we really wanted to, in the end, to understand: who is holding these attitudes? And who is dissatisfied?

(Slide.)

And here we tried to, we looked here at how well off you are, you know, to what extent you have (inaudible) education, to what extent you are part of a profession; your age, whether you're poor or not.

And clearly, you know, better off people are much more likely to be pro-market, pro-democracy, against state intervention, more active in civic activities. Universities, the same thing; profession, more or less the same thing.

But the real source of these negative values, or negative attitudes, or negative values on life satisfaction is among older and poor people. And again it's not surprising, but it stands out very clearly from these results.

So the people who have sort of come out of this transition process reasonably well are much more likely to support the core elements of that, or what the objectives of that process.

Yes?

SPEAKER: (Inaudible)

DR. BERGLÖF: No, sorry -- the checks here mean when it's significant. So these are regression results, and sort of a primitive way of showing regressions results.

SPEAKER: (Inaudible)

DR. BERGLÖF: No. Exactly. So, and the same -- there's no significant relationship between age and pro-democracy. So it's not like older or younger people are more supportive of democracy.

(Slide.)

So, you know, EBRD has two things in its mandate. One is to promote markets and one is to promote democracy. But we really don't go out, you know, and invest in NGOs, or organize demonstrations in the streets and so on.

So the view has been that, you know, you achieve this by creating a market class of entrepreneurs and so on, and that would somehow be the bulwark of a sustainable democracy.

So we wanted to look at, you know, does this idea of sort of the middle class supporting democracy -- and you know there's a lot of literature on this -- does that hold out in our region?

So we looked at the size of the middle class. And here we could use the survey. We said, if you have a car, a second home and a computer at home, and you have a university education or are part of a profession, you'll be classified as middle class.

And then we correlated this with a sort of Freedom House Democracy Index. And you'll see for most of the countries it fits very well. So, you know, the larger the middle class, the more democratically you're ranked by Freedom House.

But the two outliers, again: Russia and Byelorussia. And I think that is something that is the real puzzle to try to understand.

In Russia today the people have got, you know, much better lives --

SPEAKER: (Inaudible)

DR. BERGLÖF: Pardon me?

SPEAKER: (Inaudible)

DR. BERGLÖF: Turkmenistan -- Turkmenistan was not in our -- I told you that initially. That was not in our -- but Uzbekistan, it's interesting here, because they came out as reasonably satisfied. I maybe should spend some time on trying to provide my justification for that.

But basically you can question whether you really can undertake these kinds of surveys in countries like Uzbekistan and Byelorussia. So you have to be a bit skeptical about the results.

But there is in one way, at least -- assuming that you can take them at face value, they have not gone through these two shocks -- you know, the shock to human capital, the shock to income -- that the other countries have experienced, because they have essentially had no transition, or very little of transition.

So in one way they are pushing these adjustment costs, these transitional costs in front of them. And so you can explain it well just from income and from the level of public service provision, their level of satisfaction and, to some extent, their attitudes. Actually, Uzbekistan came out as very democratically -- pro-democracy -- in our study, which is, you know -- again, you have to be careful to over interpret that. But it's sort of an interesting finding.

(Slide.)

So we also looked at what happened to people during transition. And I think it's very hard for us to fully understand the extent of upheaval that people experienced during this period. I mean we have, you know, shifts in and out of the labor force -- mostly out of the labor force. Shifts from state to private sector, to self employment, you know across sectors or industries, a lot of geographic displacement -- all those things happened in a relatively short period of time, and left many people outside the labor force or in long-term unemployment.

So we wanted to understand how has this affected -- to what extent does this explain current levels of satisfaction and attitudes.

(Slide.)

I'll just show you one set of data that I find quite interesting, and could provide some part of the story, also, for explaining the kind of attitudes we see in the region and particularly, maybe, in Russia.

So here you imagine sort of theoretical level of the work force -- basically everyone over 18 or something like that. And then you have some people who are in the theoretical work force but are outside the active labor force. And then you have some people who are unemployed. And then, here, we provide the share of the people in -- this for Central and Eastern Europe -- the share of people working in the state sector -- so that's the blue line coming down -- and the orange line going up is the private sector. And then, below, you have self employment.

And the points where they intersect, the state sector and private sector, is somewhere, 1997-98. So at that point more people are now employed by the private sector than by the -- after that point, more people are employed by the private sector than by the state sector.

If we do the same thing for Southeast Europe, you see that you have a similar pattern, you know, similar size of self-employed. But you have this crossing happens only in 2003-2004. And it happens at the lower level. So here you have many more people outside the work force, and you have also many more people unemployed.

So, again, you know unemployment and being outside the workforce is also associated with --

Yes?

SPEAKER: (Inaudible)

DR. BERGLÖF: Yes?

SPEAKER: (Inaudible)

DR. BERGLÖF: Either unemployed or outside, not part of the --

SPEAKER: (Inaudible)

DR. BERGLÖF: Yes, they could be informal sector, too. But actually, no, not really. Because informal sector should be captured by "self employment."

SPEAKER: (Inaudible)

DR. BERGLÖF: Yes. Yes.

So in self -- you know, we have a number of countries there that have very high levels of unemployment. And the most striking thing across the whole region has been how many people have moved out of -- participation ratios just really plummeted in the beginning of transition, yes --

SPEAKER: (Inaudible)

DR. BERGLÖF: Sorry -- 50 percent of?

SPEAKER: (Inaudible)

DR. BERGLÖF: That's right. So that is an extremely high number. So, you know, you question -- of course, these people are, they may be --

SPEAKER: (Inaudible)

DR. BERGLÖF: Pardon me?

SPEAKER: (Inaudible)

DR. BERGLÖF: No, no, no, no. No, no, no, no. We're not -- it's not that primitive. No.

No, no. So, these people answered to these questions, and also, as you always do in these kinds of surveys, you get an over-representation for certain groups of people are more likely to be there when you visit the homes. These are face-to-face interviews. So you have to re-balance the sample to take account of age and, you know, maybe you over-represent people who are unemployed because they're more likely to be home than people who are employed.

All this is taken care of here. So this is for the people who answered, and re-weighted for the data we have.

And actually, what -- I think this is actually one of the most interesting aspects of the survey, because we really didn’t know before. We had all the official labor market statistics, but we couldn’t really get a handle fully on this. And here this is at least self-reported and across the whole region.

But I think why I really brought up this was to show you what the situation is in these areas.

And here, this crossing point between when more people work in the private sector than in the state sector has not happened yet. So it’s still a very important part of CIS. And much of this is, for me, at least about Russia, Russia -- most people, or more people today are dependent on the public sector than the private sector in terms of for their employment. So this is, I think, a very important aspect of understanding their attitudes towards state intervention, toward authoritarian forms of government.

(Slide.)

So we did also, here, run some regressions to try to understand at the individual level could we say something. One thing behind this curve, also, is we asked people whether these transitions in labor markets were something positive or negative. So what's very striking is that when you, in the beginning, this is almost always perceived as negative. So people were forced out of the state sector, or forced into self-employment.

When you ask them towards the end of the process, most of these moves are by choice. And I think behind these curves is a tremendous development of labor markets, and labor market institutions that the people today have a much more reasonable chance of making their own choices.

And it shows up here, too. If you ask people who are now self-employed -- so in the beginning they were forced into self-employment, but today they are relatively satisfied. So these are people who did this by choice and are happy with that.

They have also, you know, a view of themselves in sort of economic terms as -- we asked people to rank themselves on a 10-graded scale, and these self-employed are more likely to rank themselves higher. They're also against state involvement.

Skilled people are more happy, which is maybe not surprising. They're also against re-nationalization, against state involvement.

"Moved to better job" -- you know, more higher economic self-ranking, against re-nationalization.

But when we look at life satisfaction for people who moved to worse jobs -- again, not surprising, that is correlated with lower life satisfaction, lower economic self-ranking. But it doesn't seem to at least be a significant impact on attitudes. So it seems like these are not people who become very active in civic life, or do not seem to hold very strong values on re-nationalization and state involvement.

SPEAKER: (Inaudible)

DR. BERGLÖF: We asked them about their attitudes. I don't exactly remember the exact question.

SPEAKER: (Inaudible)

DR. BERGLÖF: So your question is, if you asked them whether -- so going back to that --

(Slide.)

Yes, so that doesn't seem -- so, here at least, that doesn't -- nothing significant came up here for people who moved to worse jobs, and unemployed.

So you're asking sort of the opposite question. So it --

SPEAKER: (Inaudible)

DR. BERGLÖF: As I remember the question was asked, so it's basically whether you are pro-state involvement. I think that was the question. So I'm a bit uncertain here whether actually -- it's not, of course, the same thing to say you are anti-state.

But I think the basic, the gist of the message is the same, I think. But I agree that that could be some difference.

Well, I think it's obvious, you know, what you want to do here, and it's nothing, just some policy messages.

(Slide.)

But just two points here. You know, one is that there's almost no existing sort of lifelong learning institutions in these countries. I mean, that just doesn't exist, the idea that you can go back to university later in life, or you can upgrade your skills. Of course, individual companies may have this, but there are no public institutions to deal with this, and no private, you know, university institutions either.

And the other this is, you know, if you look at how universities are doing in this part of the world, it’s not a good story. They have expanded quite a bit, which is possibly a good thing. But in terms of quality, in terms of their ability to meet market demands, the picture is very bleak, and that’s something that I think is a very serious concern.

And maybe one last point is that, you know, many of these countries now, Central and Eastern Europe, seeing a very strong pressure in labor markets. You have some countries now where you have very strong wage pressures, high-skilled particularly, but even in low-skilled. So the Czech Republic, for example, had an immigration of a couple hundred thousand people last year. And they started importing people from Slovakia. But then Slovakia started growing. So then now it’s mostly the biggest group is Ukrainians. But it comes from many parts of the world. These are countries that have very little experience in this, in dealing with immigration.

But you still have pockets of deep unemployment and a lot of people outside the labor force in the Czech Republic. And the problem is that it's very expensive to move from a rural district in the Czech Republic into the major cities and into Prague. And, you know, dealing with this issue of, you know, finding housing solutions is a very important part of making improvements in labor market.

(Slide.)

Finally, we asked people about -- you know, if government had more money, what would you like them to use it for? And the overwhelming -- you know, more than -- 40 percent, which is more than the number two and three together -- responded "health care." And, you know, there are a number of, I think, reasons for that. One is that --

SPEAKER: (Inaudible)

DR. BERGLÖF: No, they were asked to choose three items, and they were asked to rank them. And so -- but here we just took whether they mentioned them.

So health care was -- and, I think, you know, anyone who has spent some time in the region knows that this is very high up on people's minds. And usually the most risky position to be in in a government is to be minister of health -- not because of your health, but it's very volatile position.

But one reason for why this concern for health case is that it's a very important part of people's -- you know, what people spend. Education is also an important part. And we shouldn't forget that, you know, it's becoming quite expensive. Certainly, in a country like Russia today a lot of people are locked out of university, or the university they want to go to, because of the cost of tuition and the cost of preparing for exams and so on.

(Slide.)

And another thing is corruption. So we asked people about whether they made unofficial payments and of course (inaudible) public health system stands out as being the most corrupt in this sense.

(Slide.)

And we actually -- so we spent the last chapter trying to -- so we took health care, not because EBRD is necessarily going to be very active in health care, but because it’s an area -- we thought public service is a way to reach these groups that have not benefited so much from transition, and give them a stake in future reforms.

And so health care seemed to be a good area to focus on, because it highlights a number of the issues that you’re facing when you’re trying to improve public service, and particularly when you try to involve private capital. So many of these countries have very severe fiscal constraints, very limited know-how, limited resources, experience of improving public services. So the private sector could play a very important role, and EBRD is all about private sector.

The problem was that I certainly felt there was too much optimism about what -- and maybe a naiveté about how you go about creating these kind of marriages between the private and the public sector, and these PPPs, public-private partnerships, was very much something that was supported by the bankers in my institution. And this chapter is very much talking to them. It’s about trying to see -- choosing a health care sector which is very regulation intensive, something that’s very high on people's minds, you have to be very careful when you go in and introduce private operators that maybe have experience from all around the world dealing with individual municipalities, but maybe have never done this in the past. Getting it right, and not getting a backlash against private participation is very important. And these municipalities often have very little experience, they don't have, you know, procedures for transparency, for consultation, for adjudication.

And in my daily work I have to look at a lot of these contracts, and its extraordinary what kind of contracts are being signed, both with international operators and Russian, for example, operators -- I have looked at some contracts recently that -- in water utilities that are extraordinary. Fifty years' concessions without any penalties for non-performance, and with no -- some federal regulation, but essentially not enforced. You know, very little power for these municipalities to really have an impact on what these operators do. And you can imagine, over time, this is not politically sustainable.

So this chapter is very much about, you know, what can we do? To what extent can we use these opportunities to also involve people more, end-users of public services? And health care is, of course, something that concerns everybody.

So if we can involve people in the process of monitoring what's happening inside these arrangements with private and public sector, we could also get people, stronger stands, sort of stronger involvement in politics more generally. That's the thinking behind this chapter. But, again, I think this is very much a chapter that speaks to an internal bank inside my institution.

Let me end with one picture.

(Slide.)

Here we take all our 29,000 interviews -- actually, 28,000. We excluded Turkey from this. We asked them -- so my three questions. We take out three questions.

And the first one is: "My household lives better nowadays than around 1989." Here more people disagreed. Actually only one-third agrees with this statement.

Then we take: "All things considered -- " -- and, again, "all things considered" includes a lot of things, democratic rights, right to travel, all those things -- " – "I'm satisfied with my life now." Now a majority, more people would say they agree than disagree with this statement.

But maybe the most encouraging answers are those to the question: "Children who are born now will have a better life than my generation." Here a clear majority say that this is the case.

So they recognize there have been a lot of costs. They themselves may not have benefited so far, but their children will -- which I think is, you know, if we ask ourselves, and I think we are not all that convinced that, you know, our children will have a better life than we have. So I think in this sense, this region stands out that there's some sense of hope and that the worst is over, and there are things to look forward to, particularly for their children.

Thank you very much.

(Applause.)

DR. LINN: Thank you very much, Erik. This was a very rich presentation. And I think none of us have read the report, so -- I haven't either, so I can only react to what you presented. And it certainly makes me look forward to reading the report.

As usual, I think you guys are very lucky to be here today, because you get it free of charge. You can't download it, you can only buy it.

DR. BERGLÖF: No, you can download it.

DR. LINN: You can now download it?

That must be your impact. Ahh. Excellent. Well, that's real good news. Wonderful.

SPEAKER: (Inaudible)

(Laughter.)

DR. LINN: Yeah -- exactly. So, wonderful. That's good news. You must have an impact already. That's great.

I -- you know, what can I say? So much -- let me just raise a few sort of groups of comments or questions. They're really more questions at this stage than comments.

One has to do sort of with this whole question of transition, where are we? And the reform process. And some of the dimensions that perhaps don't show up so much in the way you presented it.

Secondly, the Kazakh case, I think, is very interesting, and maybe separately we can talk more about it. I'll make just one or two quick comments. And then a few comments on sort of the main part, and the especially interesting part of the report, the survey-based analysis.

On the transitions and reform, I guess my perennial question, after 15 years of these reports now is: are you still in transition, Erik? Does it make sense to talk about transition? Are we really, now, these countries basically face a general development challenge. And this you can extend into the reform index, does it make sense to have a reform index that in a sense is based on the initial transition challenge and measures transition against a certain sort of optimal ideal outcome, or close to ideal outcome? How does the reform index compare with other indices that we now have many of? Have we done a systematic comparison? Those are the kind of questions I think one would face -- and, I don't know, maybe you've done that evaluation sort of the index and its role, how does it compare with others.

My sense is that we really are now talking about various development challenges rather than transition. I think, looking back, it's useful to talk transition but, looking forward, I just don't think the transition metaphor and, with it, the sort of transition reform perspective is very useful.

A very specific comment on Russia: I just don't believe that Russia stands still. I think Russia moved backwards. So I'd be interested in why you thought it's slow progress if any, or at least, why do you thing there's no regress?

I'm puzzled by this apparent contrast between reform intensity and growth intensity. I mean it seems like the CIS is growing much more rapidly than the CEB, and probably also -- I don't know about Southeast Europe. And I'd remind you of Anders Aslund who, you know, has been at least in the not so distant past has argued that actually the CIS, in terms of tax regime and reliance on private sector and so on is much more -- and also the size of the public sector in terms of expenditures as part of GDP -- is much more progressive and actually dynamic than Central and Eastern Europe, and has a better prospect.

So, I'm sort of a bit curious how you see that debate about how one measures, and how one sees the reform status, particularly when you talk about size of government, size of the tax sector and so on.

These are some random, quick comments. And maybe it’s not that important at this stage to deal with it.

Kazakhstan, I thought you might have some observations about its impact on Central Asia. I mean, I’ve recently been in Central Asia, and the impact of Kazakhstan banking sector, precisely because it has this heavy exposure in the rest of Central Asia, but perhaps also elsewhere in the CIS -- I assume, I think in Georgia, for example -- I think there is actually an important impact of the Kazakh banking crisis on parts of the CIS.

And it’s sort of interesting -- I think the Kazakh example as a mixture of an overheating resource-based economy on the one hand, and East Asia crisis kind of scenario is quite interesting and deserves more attention.

Now, coming to the survey-based analysis of life satisfaction and so on, one question is, is the data generally accessible? Can we go in and, say, for Central Asia download the data, analyze the survey results and so on? Because obviously --

DR. BERGLÖF: It's on our website.

DR. LINN: Okay, that would be great. And I assume there's sufficient explanation of what it all means.

DR. BERGLÖF: What's there right now is unfortunately only (inaudible).

Sorry -- what's on there right now --

DR. LINN: Sorry, I forgot to mention that when you ask questions and give answers you need to use the microphone, because we are recording.

DR. BERGLÖF: Because I'll be much more careful --

(Laughter.)

No, just on the point, the last point -- this is available on our website. In (inaudible) we are working to make it more user friendly.

DR. LINN: Great. I think that's terrific news, because that's obviously very helpful for country-specific or country group analysis, but also perhaps for comparing it with other parts of the world. Actually I wonder whether you've looked at this in the report, is to what extent, say, on the attitude towards the state involvement, how do your countries compare to Western Europe, for example. I mean, I could imagine, vis-à-vis the U.S., there would be quite a clear differential. But is it that clearly different from Western Europe?

On democracy, I -- you know, you raised issues about the usefulness of Uzbekistan. But, more generally, if you could say a bit more on how people were actually asked this democracy question? What does it mean? How do people understand democracy? Or, you know, what they -- or its opposite, whatever that is?

I think maybe this is just something I'm going to have to look at carefully, but how these questions are phrased and, of course, in what context they're being asked, Uzbekistan being a clear case, is, I think, an area where one can have a lot more discussion.

In one of your graphs you showed how old people react. Actually, I would have loved to see how young people react? Are they significantly different from, say, middle-aged people or old people? I assume they're different from old people, because you --

DR. BERGLÖF: (Inaudible) -- college age, not necessarily (inaudible).

DR. LINN: Okay. But I think it would be maybe useful to actually sort of -- maybe you've done it. I suspect somebody's done it in your group, and basically show, young, middle-age, sort of old because that could be quite useful characterization.

I would also suggest you put in Turkey, because one -- as an observation -- because you do have, at least in one of your maps you show Western Europe. Why not show Turkey? And, in fact, Turkey is, I think, sort of an interesting what we characterize as developing country generally, or maybe threshold country. So why not show Turkey?

Finally, I was reminded by of your graphs of the transition of labor market from state to private sector and self employed, of a graph that actually Marcel Uscilowski had, and Preli Metra in the World Bank's 2000 transition report, which looked at the last 10 years. And its section on political economy, where it linked, explicitly linked this transition, which you now have updated and, you know, very nicely quantified in the labor markets and in sort of what the business sectors to some extent to the political economy. And, in fact, the support for reform or lack thereof, I don't know how far you go into the economy which, of course, EBRD also analyzed at that point. But making that link between, you know, people's opinions in their different transition experiences and the political economy, that's -- you didn't talk a lot about that, but it would be very interesting to speak a bit more how you actually see that link, and if you didn't deal with, how one might push forward in thinking about it.

So that's my comments.

I'm supposed to be, I guess -- you're staying, so you can moderate.

SPEAKER: No, you can moderate.

DR. LINN: We're actually almost out of time, according to our schedule. So the questions -- do you have a little extra time, Erik?

DR. BERGLÖF: Well, I do, but --

DR. LINN: Well, why don't we go until at least until quarter past to start with and see how we're doing, and throw the floor open for comments, questions.

Do you want to respond to mine first? Or let's just go -- yes, okay. Let's -- fine.

I see Raj jumping right in. Raj, go ahead.

DR. DESAI: Just a quick question on the survey.

By the way, it's fantastic that it's publicly available, because it would be interesting -- if the questionnaire is available, as well, that would also be useful.

Because one of the questions I have is on a couple of issues in terms of these types of surveys there's always the problem of non-comparability between countries, in terms of how people understand value-laden terms like "democracy," or "free market." And I notice that, you know, for example, more people in Uzbekistan are satisfied with democracy, or pro-democracy than the Czechs, or something like that. Islam Karimov, and Nazarbayev and all these guys keep talking about democracy all the time. And so obviously there's an issue of how the populations understand the term.

But the other thing is that when it comes to ordinal response categories like, you know, "strongly agree," "agree," "strongly disagree," and so on, some people tend to just be more pessimistic or more optimistic -- right? So there's a kind of individual-specific systemic bias that people have.

So I guess the question is: what were the ways in which you thought about correcting for some of these things, in terms of dealing with these issues of non-comparability. I mean, for example, are the regressions that are, are they showing within-country effects? Does the questionnaire use some kind of what surveyors call “anchoring vignettes,” where you sort of tell a story and then tell another story and, you know, tell two extremes and say, “This is a person whose income has plummeted and is unemployed and lives off of a pension, and this is a person who’s working for a Western multinational and doing very well. Where do you fit in the middle?” Or, you know, that kind of thing.

So, just a question on how you dealt with some of these issues?

DR. BERGLÖF: (Inaudible)

DR. WU: I’m Wing Wu, you’re colleague. Welcome home, Erik.

This is a very fascinating study, and updates me on very important issues.

My one question has to do with how much should we worry about what you identify as continued slowdown in reform? How worried we should be depends on the reason why it is slowing down.

I would like to know is it because you have hit diminishing returns to reform? If that is true, then we should be less worried.

The second one: is it because the cost of these particular reforms are much higher than the previous reforms, or they are of the more unpopular kind?

And the third question has to do with I'd like to know if the reforms that they are stuck in are the same across -- mostly the same across the whole range of countries. In other words, are they all stuck on corporate governance? Or are they all stuck on competition policy? And so forth.

And the last question has to do with what Johannes has raised. When you said "slowdown in reform," could one paraphrase it as "slowdown in convergence to an EU-type market economy?" Or, "slowdown in convergence to EU-style administrative procedures?" In other words, we define reform as if they don't reach the same -- if they don't look like the German Republic, then they are not reformed.

DR. BERGLÖF: (Inaudible)

Many big issues here, so I'll -- the last one relates quite a bit to, you know, what Johannes was saying explicitly and I think also implicitly.

So is it meaningful, first of all, to talk about "transition" any longer, and are these indicators that we are using, could they be replaced by other --

SPEAKER: (Inaudible)

DR. BERGLÖF: Yeah -- well, I mean -- so that, I think, is a slightly separate debate, if we can find a set of more objective measures and things that, you know, capture -- you know, life expectancy is something is more result-oriented. We're not really looking at results so much, we're looking at these transition indicators look at reform, and then we hope that this results in growth and improvements in life expectancy or poverty alleviation. I mean, the links there are maybe not spelled out very carefully, but I think Johannes' question was about whether there is something distinct about transition that makes it different from, you know, applying -- if you were to apply this methodology to developing or emerging markets more generally, would you tell us a different story?

And the interesting thing is that we did this very recently. We did apply this to Turkey, because there is a discussion inside, and outside the EBRD whether Turkey should be a country operation of EBRD. And I think what is unique about these transition indicators -- and I'm certainly, I mean, we are in the process of actually revisiting these and very much in the spirit, I think, that Johannes had in mind.

But, to me, because they are so deep, in a sense, and looking inside these individual sectors, I don't know any other set of indicators or measures that does this. I was very skeptical about the process when I joined the Bank. And that was one of the first things (inaudible), they should throw out this and then bring on board, you know, something more like these quantified measures that people like Danny Kaufman and others have been working with.

From having seen the process that's used, and it's quite an elaborate process, bringing in specific sector expertise, having sort of an almost legal process around it in the sense of some people proposing an upgrade or a downgrade and having to defend this in front of a broader group of people, country specialists, sector specialists, country by country -- it's a very elaborate process.

And I've been quite impressed by it. I didn't invent it. I'm only taking it further. It involves a lot of quantifiable analysis.

I mentioned competition policy. We go out to ask all the competition agencies in the region, we ask them for all the cases they have brought in. Obviously, we asked about all the institutions in play, sort of "what do you have in terms of legal framework? What staffing and so on do you have?" But then we look at actual cases. We look at the decisions in these cases and enforcement of these cases.

And, you know, not all this is easily quantifiable. But it's, I think, a quite healthy process.

So it's a long answer, but I certainly think that it can be improved.

They did tell me something about Turkey that I would not have come out with had I followed the traditional measures. It gives me a deeper insight, inside measures. So I can get from these more established measures an idea of maybe kind of three or four measures of financial development.

But this process gives you a much deeper understanding of what the sort of regulatory, supervisory, enforcement aspects inside the sector. What is the level of development of the individual institutions? You know, the individual banks inside the Turkish economy. What do they do, you know, in terms of portfolio activities? And which segments of the economy are under-serviced -- and so on. So, very rich material.

Of course then when you collapse it into one measure, you lose something. But I think the underlying analysis is very helpful. But I'm the first to admit that this is something that -- I think the art here is to revisit the process and not lose the baby with the bath water. I mean, that's, I think, what should be done.

I think this is also, if someone is willing to put resources into it, I think this is something that should be done much more broadly, and with this same methodology.

It doesn't really answer Johannes' basic question: is transition different? The question we were asked, because -- so is Turkey a transition country? And I don't think you can give a simple answer to that question.

SPEAKER: (Inaudible)

DR. BERGLÖF: Pardon? (Inaudible) Islam -- yes. So you have the political transition is one aspect. The sort of economic transition is another.

The economic transition, there is, I mean there are elements of transition there. There is a very, if you go back in the '60s, you know very strong state control in the economy. But they took a different route, and it certainly was not part of this sort of transition economy.

So I think what's happening in the academic world is a merger of sort of these areas: development economics and transition economics. And where transition brings a stronger focus on political economy, a sort of more system thinking in terms of institutions, and more focus on institutions generally into development economics. And development economics is, you know, being driven very much now by sort of microeconometrics also. So I think these fields are coming together. And I think it will be quite natural to have indicators also coming together in this area.

I think there are still some hangovers from transition, unfortunately, that makes it a useful concept. But, as I said originally, you know, one answer to that question is to look at these to what extent life satisfaction can be explained by measures of income, public service provision seemed to be -- those explained part of it.

But these shocks that transition economies experience seem to be distinct in the sense of the -- both in terms of the shock to human capital and then to some extent the shock to income. But, again, you can certainly find other countries that have gone through similar things for different reasons.

That was a long -- we can discuss Russia for quite some time.

Let’s just mention Turkey. So you asked to put Turkey in here. We did this, actually. And Turkey is more satisfied that Southeast Europe, less satisfied than Central and Eastern Europe.

They have a level of income that’s approximately that of Bosnia in purchasing power parity. So it suggests that they are happier than their income would suggest, which is, you know, one answer to the question. So they have not gone through the same shocks as most transition countries have. I mean, certainly the transition from this sort of state-owned economy of the '60s has been more gradual and been exposed to a number of macro shocks, but not this very deep transition shock that most of our countries experienced.

So that's a short answer to the Turkey question.

Democracy question is a very difficult question: are these comparable across countries? We tried to do it in different ways. We tried to ask specifically about democracy, and then some sub-components. We have four sub-components to democracy.

I think you will never be satisfied with these. I mean, we tried to -- we also tried, we looked at other studies. So the World Value Survey, and tried to have reasonable comparability with that, and with also the Euro -- it's called the "European Social Survey," which I think is probably the most sophisticated of these. And we tried to have comparability with that, as well.

The regression is controlled for country effects. So hopefully that takes care of that.

Wing's question on what do we see a continued slowdown of reforms -- I would focus on the higher cost of reforms. I think these governance, competition policy and particularly infrastructure reforms are very difficult, very costly, and involves reform of the public sector, which is what really seems to be the most difficult thing. And we see -- look at Russia, has failed miserably, I think, in the public sector reforms on the whole. And we see also in Eastern Europe a lot of difficulties bringing this forward, and entrenched interests of state employees. You know, a lot of very difficult issues. I would focus on that.

Of course there are diminishing returns in the sense that, you know, many of the things have been done. But I still think that there are very considerable returns to these sort of third phase of market-sustaining reforms. Are we all slowing down, or are we all measuring convergence to EU style? I mean, supposedly these indicators are not, they are not benchmarked on EU institutions. They are supposed to be benchmarked on sort of broader set of recognized best practices. There may be some EU bias that I haven't picked up. But that goes to the sort of Anders Aslund theory of the world, which is basically that the smaller public sector you have, the less taxes you have, the better off you are.

I happen to think that this explains very little of what's going in the transition world. There may be something to this more generally. But we know the public sector is very closely -- first of all, it's very hard to measure, and in the particular paper that you refer to, I think it's measured very poorly and, you know, not in a generally accepted way.

It's also very correlated to income. So we know that the public sector develops later. And if you look at -- and the fact that countries that have lower levels of income grow faster, that's part of the convergence story. If you took this out, I think there would be very little left to this story. And I think we have gone through so much debates over transition and the reform of the state sector and, you know, where the idea is to get rid of the state, or whether it's about the quality of the state, what the state delivers, that I just find that this is a debate that's sort of 15, 20 years old.

And basically, you know, you get the state -- in one sense you get the tax system that your voters give you. You know, that's a very primitive way of saying it. But I think we are not -- you know, we are not going to get very far if we say that, you know, you should just lower your taxes.

I think there is some healthy competition now in Eastern Europe, where governments are, for various reasons, partly because they cannot collect taxes, but also because it seems to stimulate investment. And so there are some interesting experiments in tax policies. But on the whole I think this is a way too simplistic view of what transition and development is about. It's not about minimizing the public sector. It's about getting a public sector that supports markets and I think that's what makes markets sustainable.

They were long answers to short questions.

Yes, I think Kazakhstan, definitely, I should have mentioned this. It's a very clear impact on Central Asia. And we have many stories like the ones you alluded to (inaudible), people who are queuing up in microfinance schemes now because they cannot borrow from banks. And it's a delayed effect, but it's certainly there. And what these banks seem to be doing is that in order to save their liquidity in Kazakhstan they are cutting down on credits outside Kazakhstan.

DR. LINN: Okay, any other follow-up? Or, any other comments? Any explanation for why Hungarians are so unhappy? I think we have a representative from the Hungarian Embassy here.

SPEAKER: (Inaudible)

DR. LINN: If you can put your microphone on.

SPEAKER: Hungarian people are very pessimistic. And, of course, our reforms require sacrifice from both sides: from the people and for the government, as well.

Big changes were in 1989, and of course the life of the people is dramatically changed. Because before the reforms, everybody has a job, the health care and education was free of charge. And so nowhere is everything is free of charge. So somebody has to pay -- either the government or the people.

And, of course, it is not a popular decision from the government.

But otherwise, the Hungarian are very pessimistic. But if you, for instance, in the shopping center, so you can see huge cars full of things. People go abroad for skiing, holiday.

So in the everyday life, you cannot realize that the basic life is strong.

DR. BERGLÖF: I think there's one very important explanation for Hungary, which I should have mentioned, is that this measurement was done almost in the middle of the civil unrest that was in connection with these fiscal restraints and the big government crisis. So that could have influenced it.

But there are some other studies that also suggest that Hungary and -- which doesn't stand out so much in our study -- but Bulgaria is also supposedly a pessimistic country. But our study could have been influenced by these riots in the streets.

SPEAKER: I just had a quick question.

When you were talking about the correlation between the democracy-niks and the size of the middle class, and you said that Byelorussia and Uzbekistan, they didn't experience the human capital shock and the income shock.

Well, with the first, I think we can agree because there's still a big public sector. Whereas I was just wondering what's your explanation for them, that they didn't go through the income shock. Because if you look at the poverty statistics, I would think otherwise.

And the second question is -- I'm sure you're familiar with the last "Doing Business" report of the World Bank. And, for some countries -- it relates to Wing's question about the diminishing returns to reforms -- like for the Baltics and the Southeast Europe you can see that they're actually pursuing more reforms, whereas the economic growth is actually slowing down. But for some countries, particularly for the case of the Ukraine, is Ukraine has moved, I think it's second on the bottom in terms of reform, but you don't see that in terms of economic growth.

So is that a sign of overheating? And what is the explanation between the slowing down of the reform and economic growth still continuing on the high pace?

DR. BERGLÖF: That ties into one of Johannes' questions that I didn't answer, also.

First, on the income shock -- so I agree that there are, if you look at poverty measures, there certainly is poverty in Uzbekistan and to some extent in Byelorussia. I think I was talking about the transitional recession. I think neither of them have really had that. So that -- again, I think we should be careful and go to Raj's question about what the people in Uzbekistan think we mean when we ask "democracy." And, again, we asked about underlying things like the right to vote, and the freedom of speech and so on. But still that could mean different things across countries.

On the issue of -- sorry, what was the question? What was the second question? It was --

SPEAKER: (Inaudible)

DR. BERGLÖF: Yes, yes. Exactly.

So, doing business is quite different form of measurement. So there you focus primarily on the lowest on the book. And you ask people, you know, sort of an informed panel in each country. And what's very nice about doing business is that it sort of identifies things that you could do something about. So, you know, you can shorten the time to register a company, or you can presumably shorten the time to get resolution in a bankruptcy and so on.

It's quite different, because first it doesn't say that this necessarily happens, you know, in real life. But you can see in France, for example, was upgraded in terms of doing business this year because the government changed on the website the information about how long it takes to register a company, for example.

So they are easily manipulated, these numbers. I'm not saying that this is the case for the significant improvements that have been registered in Eastern Europe. Systematically they have come up as very strong reformers in this regard.

And it goes to the question as to the slowdown in reform, is that because we measured the wrong things? I think that's a good question. And in Russia, are we seeing -- you know, on balance are we seeing a retrenchment? Two years ago we downgraded Russia because of the increased state involvement in industry in particular. And certainly that trend continues.

But on the other hand, you see extraordinarily active private sector and, you know, massive improvements in individual banks, in individual companies coming closer to world standards. So I think it's in that balance, in the case of Russia at least, that we come that things are more or less -- this balances out the deterioration on the side of government, a very ambitious government, unreformed government, but also very active and dynamic private sector.

How to best measure this? I don't know. Maybe "Doing Business" is in some ways capturing some key elements, and these more aggregated measures or compiling many different measures, putting that into -- presumably, well "Doing Business" does enter into our analysis, but only as one component among many. But the nice thing about "Doing Business" is that it's very precise. Policy makers know what to do. You can tell your subordinates that, you know, this is what we want to achieve. And you can't do this with these transition indicators.

DR. LINN: Well, I think we're being told that this room is needed for another event.

So, with that, I thank you, Erik. And we will carefully, and with great interest read the report. And if we have any questions, we'll come back to you.

So -- thanks for coming today.

(Applause)

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