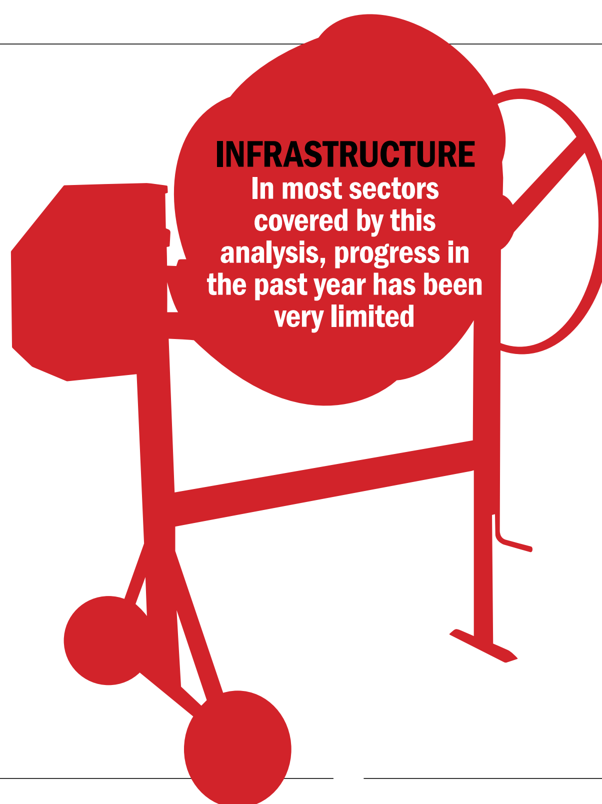
CHAPTER 1
PROGRESS IN STRUCTURAL REFORMS

A review of structural reforms over the past year presents a mixed picture. On the positive side, it remains the case that, as in previous years, there has been more progress in reforms than reversals. However, major reforms at the sector and country level are still needed in order to return the region to a sustainable growth path. There are no signs of this happening yet in the region. Although, irreversible backsliding in reforms has not happened, the risk is stalled or feeble reforms will keep the region's growth well below potential for the foreseeable future.

THE FACTS AT A GLANCE



17

In terms of sector transition indicators, there were one-notch upgrades this year in 17 cases

FINANCIAL

One of the more positive features to emerge from the crisis has been the resilience of the financial sector throughout the transition region. Over the past year, there have been a number of modest improvements that have warranted an upgrade in sector scores, although downgrades have also occurred.

CORPORATE

Sector reforms warranting an upgrade have been limited over the past year.

ENERGY

The energy category – comprising natural resources, sustainable energy and electric power – is unusual this year in that, for the first time since the EBRD started scoring transition progress by sector, there are more downgrades than upgrades.

PROGRESS IN STRUCTURAL REFORMS

The year to end-September 2012 has been another difficult one for reform in the transition region as growth prospects have again weakened and the economic outlook has worsened. Some countries have not yet fully recovered from the impact of the 2008-09 crisis, and a few have slipped into recession again. There have also been isolated signs of populist dissatisfaction with painful economic adjustments. At the same time, and as a consequence of the deterioration in growth performance, governments have faced difficult fiscal challenges and rising levels of public debt. Inflation has not been a primary policy concern in most transition countries, but there are renewed pressures from increases in agricultural and other commodity prices. In much of the region, levels of unemployment and poverty are rising and adding to social stresses. It is no surprise, therefore, that the overall pace of reform has stalled.

Despite an exceptionally difficult few years, most of the reforms introduced in the previous two decades are still intact. There has not been a wholesale reversal of transition in any country in response to the crisis. Policy-makers are still broadly committed to the principles of markets, competition and open trade; Montenegro and Russia have joined the World Trade Organization (WTO) in the past year, and Croatia is on the verge of accession to the European Union (EU). However, there has been more regression in certain respects than in previous years, especially in the energy and financial sectors where state involvement has extended beyond what can be justified in the context of crisis response. Most importantly, there is no sign of the major reform drive that is still needed in most countries to boost growth rates towards their long-term potential.

This chapter provides an overview of some of the main reform themes since mid-2011 at the sectoral and country levels. As in previous years, the summary is based on an analysis of recent transition achievements and reversals along the path towards a well-functioning market economy and of the remaining "gaps", or challenges. Updated numerical scores provide a snapshot of where each country stands in the transition process.

This *Transition Report* includes, for the first time, a detailed assessment of transition progress and challenges in the four countries of the southern and eastern Mediterranean (SEMED) region: Egypt, Jordan, Morocco and Tunisia. In the wake of the events of the Arab uprising in the first half of 2011, Jordan and Tunisia have recently become shareholder countries of the EBRD (Egypt and Morocco have been members since 1991). The following review aims to assess the economies of the four member countries of the SEMED using the same sector- and country-level methodology that the EBRD uses in its countries of operations.

PROGRESS IN TRANSITION

SECTOR TRANSITION INDICATORS

The EBRD's numerical assessment of progress in transition has become a recognised indicator of the challenges facing each country across 16 sectors of the economy. The sectoral methodology underlying the assessment was explained in Chapter 1 of the *Transition Report 2010*, and the Methodological Notes on page 160 provide further technical detail. The EBRD's economists draw on a range of public data, as well as laws "on the books" and regulations, to assess the size of transition gaps in a given sector, in terms of market structure and market-supporting institutions, to be bridged to reach the standards of a well-functioning market economy. Transition gaps are classified as "negligible", "small", "medium" or "large", and gap scores are then combined to give an overall numerical rating for the sector, on a scale of 1 to 4+.

It should be noted that the sectoral methodology, although a significant advance on the more traditional country-level approach (discussed later in this chapter) in terms of transparency and rigour, is not an exact science. The numerical scores necessarily involve a significant element of judgement on the part of EBRD economists, mainly because laws on the books are not always implemented in the way intended. They can therefore complement other cross-country measures of reform that reflect legislative changes or the subjective perceptions of individual economic agents.[1]

SECTOR SCORES

Table 1.1 shows the transition scores for all sectors and countries, including for the SEMED region (discussed later in the chapter). Annex 1.1 contains the component ratings for market structure and market-supporting institutions and policies, respectively.[2] The extent of the transition gaps are represented in a "heat map", with the dark red colour indicating major gaps and, therefore, low scores. Upgrades and downgrades (higher and lower scores) in Table 1.1 are highlighted by the upward and downward arrows, respectively. This year there have been 17 upgrades and 9 downgrades, the reasons for which are outlined in the rest of this section. (See also the Country Assessments later in this Report.)

ENERGY

The energy category – comprising natural resources, sustainable energy and electric power – is unusual this year in that, for the first time since the EBRD started scoring transition progress by sector, there are more downgrades than upgrades. In the electric power sector there have been downgrades for Bulgaria, Kazakhstan and Romania. In the case of Bulgaria and Romania, both EU members since January 2007, the downgrades partly reflect the slow progress of institutions and policies to meet EU commitments to deliver competition and encourage new private sector entrants to the market. Both countries have incurred EU action over delays in implementing liberalisation measures

[1] The annual World Bank *Doing Business* report is an example of a cross-country ranking exercise based mainly on laws on the books and formal regulations, while the EBRD/World Bank Business Environment and Enterprise Performance Survey (BEEPS), carried out across the transition region every three to four years, elicits subjective impressions of enterprise owners and managers about the quality of the business environment.

[2] Some sector scores differ from those reported last year, not because of upgrades or downgrades but because of historical revisions to reflect information that was either not available or not fully taken into account last year.

Table 1.1
Sector transition indicator scores, 2012

	Corporate sectors				Energy			Infrastructure				Financial sectors				
	Agri-business	General industry	Real estate	Telecom-munica-tions	Natural resources	Sustainable energy	Electric power	Water and waste-water	Urban transport	Roads	Railways	Banking	Insurance and other financial services	MSME finance	Private equity	Capital markets
Central Europe and the Baltic states																
Croatia	3	3+	3+	4	4-	3-	3	3+	3+	3+↑	3-	3+	3	3-	2+	3
Estonia	3+	4+	4+	4	4	3-	4	4	4-	3	4	4-	3+	3	3-	3
Hungary	4	4-	4-	4	4-↓	3	4-	4	3+	4-	3+	3+	3	3	3	3+
Latvia	3	4-	4-	3+	3+	3+	3+	3+	4-	3	4-	3+	3+	3	3-	3
Lithuania	3+	4-	4-	4-	3+	3+	3+	3+	4-	3	3	3+	3+	3	2+	3
Poland	3+	4-	4-	4	3	3	3+	4-	4-	4-	4	4-↑	4-	3	3+	4↑
Slovak Republic	3+	4+	4	4-	3+	3	4	3+	3+	3-	3+	4-	3+	3+	2+	3
Slovenia	4-	3+	4	3+	3+	3+	3	3+	3+	3	3	3	3	3	3-↑	3
South-eastern Europe																
Albania	3-	2+	3-	3+	3-	3+	3	2+	3-	3-	2	3-	2	2+	1	2-
Bosnia and Herzegovina	3-	2	2-	2+	2	2	2+	2	2+	3	3+	3-	2+	2+	2-	2-
Bulgaria	3	3+	3+	4-	3+	3-	3+↓	3	3+	3-	3+	3	3+	3-	3-	3
FYR Macedonia	3-	3	3-	4-	2+	2+	3	2+	3-	3-	3-	3-	3-↑	2+	1	2-
Montenegro	2+	2+	2+	3+	3+	2	2+	2	3	2+	2+	3-	2+	2+	1	2+↑
Romania	3↑	3+	3+	3+	4-	3+	3+↓	3+	3+	3	3+	3	3+	3-	3-↑	3
Serbia	3-	3-	3-	3	2	2+↑	2+	2+	3-	3-	3	3-	3	3↑	2-	3-
Turkey	3-	3	3+	3+	3+	3↓	3+	3	3+	3-	3-	3+	3↓	3-	3-↑	4-
Eastern Europe and Caucasus																
Armenia	3-	3	3-	3	3-	3-	3+	3-	2+	3-	2+	2+	2	2+	1	2
Azerbaijan	2+	2	2	2-	2+	2+↑	2+	2-	2	2+	2+	2	2	2	1	2-
Belarus	2+↓	2	2	2	1	2	1	2-	2	2	1	2	2	2	1	2-
Georgia	3-	3-	3-	3-	2	3-	3+	2	2+	2+	3	3-	2	3-↑	1	2-
Moldova	3-	2-	2+	3	3	2+	3	2	3-	3-	2	2+	2+↑	2	2-	2+
Ukraine	3-	2+	3-	3-	2-	2+	3	2+	3-	3-	2+↑	3-	2+↓	2	2	3-
Russia	3-	3-	3-	3+	2	2	3+	3↑	3	3-	4-↑	3-	3-	2	2+	4-
Central Asia																
Kazakhstan	3-	2	3	3	2-	2-↓	3↓	2+	2+	2+	3	3-	2+	2	2-	3
Kyrgyz Republic	2+	2	2+	3	2+	2	2+	2-	2	2-	1	2	2-	2-	1	2-
Mongolia	3-	2+	2	3	2	2	2+	2	2	2-	3-	2+	2	2	2-	2+
Tajikistan	2	2-	2-	2+	1	2+	2	2	2	2-	1	2	2-	1	1	1
Turkmenistan	1	1	1	2-	1	1	1	1	1	1	1	1	2-	1	1	1
Uzbekistan	2	1	2	2	1	2-	2+	2-	2	1	3-	1	2	1	1	1
Southern and eastern Mediterranean																
Egypt	2	2	2+	3	1	2+	2+	1	2	2+	2-	2+	2+	2-	2	2+
Jordan	2	2+	3-	3+	2+	2+	3	2-	2+	3-	2	3	3-	2+	2	3-
Morocco	2+	3-	3-	3+	2-	3	2	2+	3	3-	2	3-	3-	2+	2+	3-
Tunisia	3-	3+	3-	3	2	3-	2	2	2+	2+	2+	2+	2+	2	2-	2+

Source: EBRD.

Note: The transition indicators range from 1 to 4+, with 1 representing little or no change from a rigid centrally planned economy and 4+ representing the standards of an industrialised market economy. For a detailed breakdown of each of the areas of reform, see the Methodological Notes on page 160. There were one-notch upgrades this year in 17 cases: agribusiness (Romania), sustainable energy (Azerbaijan and Serbia), water and wastewater (Russia), roads (Croatia), railways (Russia and Ukraine), banking (Poland), insurance and other financial services (FYR Macedonia and Moldova), MSME (Georgia and Serbia), private equity (Romania, Slovenia and Turkey) and capital markets (Montenegro and Poland). There were nine downgrades: agribusiness (Belarus), natural resources (Hungary), sustainable energy (Kazakhstan and Turkey), electric power (Bulgaria, Kazakhstan and Romania) and insurance and other financial services (Turkey and Ukraine). In addition, there were historical revisions in the following cases to take account of new data and to achieve greater cross-sector consistency: railways (Montenegro and Romania), banking (Turkey), insurance and other financial services (Tajikistan) and private equity (Ukraine).

and the failure to eliminate regulated prices. A further troubling development in Bulgaria has been the government's intervention to discourage more investment in renewable generation. In Romania a leading state-owned hydroelectric company was declared insolvent in July 2012, delaying attempts at partial privatisation. In both countries, however, changes were made to energy legislation in mid-2012 that, if implemented, should address some EU concerns. Kazakhstan's downgrade reflects the introduction of legislation in July 2012 creating a centralised investment incentive system, which is a significant retreat from a market-based regime.

Lack of competition and the dominance of state-owned companies also persist in Ukraine, as evidenced by the fact that recent tenders for shares in distribution companies attracted only two bidders. In Hungary the market institutions transition gaps in respect of the power and natural resources sectors have been raised from "negligible" to "small", reflecting a significant decline in private investment. This has been attributed to the introduction of a tax on energy groups in 2010 and state interference with the regulator's independence in the gas sector. In the natural resources sector Hungary's transition score has been downgraded from 4 to 4-.

In the sustainable energy sector, the picture is a little more encouraging. Azerbaijan and Serbia have received upgrades in recognition of the registration of Clean Development Mechanism (CDM) projects (one in Azerbaijan and four in Serbia), while in Mongolia a national action programme on climate change has been developed. However, new data on climate change emissions point to a growing problem in Latvia, consequently raising the transition gap for market structure.

FINANCIAL SECTOR

One of the more positive features to emerge from the crisis has been the resilience of the financial sector throughout the transition region. Over the past year, there have been a number of modest improvements that have warranted an upgrade in sector scores, although downgrades have also occurred. The only banking upgrade has been in Poland, where Financial Supervision Authority regulations have been strengthened and the systemically important PKO bank has become majority privately owned. In Latvia the market structure gap has been lowered from "medium" to "small" following the progress in resolving the portfolio problems of Parex Bank.

Another encouraging development in the past year has been the rise, if often from a low base, of private equity markets in the region. Three countries – Romania, Slovenia and Turkey – have been upgraded in this respect, reflecting increases in fund activity and strategies available in net committed capital. However, local capital market development across the region remains at a generally low level, and the only changes to the scores for this sector were an upgrade in Montenegro from 2 to 2+, following improvements in the functioning and monitoring of the stock exchange, and one for Poland (4- to 4) for progress in the legal and regulatory framework. In the insurance and other financial services sector, there were upgrades in FYR Macedonia, as a result of a significant increase in pension fund assets, and in Moldova, where leasing legislation has been improved. Leasing penetration has decreased substantially in Turkey, however, warranting a downgrade from 3+ to 3, while Ukraine was also downgraded in this sector, in part because it is no longer a member of the International Association of Insurance Supervisors (as of 2012). In respect of finance to micro, small and medium-sized enterprises (MSMEs), there were upgrades for Georgia, where the civil code was amended to broaden the range of assets that can be used as collateral, and for Serbia, reflecting improvements to the credit information and land registry systems.

A common theme across financial sectors in the transition region, which is not fully apparent in this sectoral assessment, has been the development of local currency financing and local capital markets more generally. This reflects an increasing awareness that the growth model on which much of the region had relied in the pre-crisis period, based on cheap inflows of foreign capital to fund credit booms, was inherently risky and unsustainable, and that developing local sources of funds and greater lending in local currency could lead to "safer" growth in the future.

There were notable developments in this regard in Hungary, Poland, Russia, Serbia and Ukraine, although in Hungary and Poland the large stock of foreign-currency mortgages remains an area of concern. In Hungary the government and the main banks reached agreement in December 2011 on burden sharing and alleviating bank losses arising from a previous provision that allowed mortgage holders to repay loans at preferential exchange rates. Meanwhile, the authorities in Poland have strengthened bank supervision, especially with regard to foreign currency mortgages, and the financial regulator has initiated a number of working groups to develop long-term bond issuance, including that of covered mortgage bonds. The Russian authorities have made progress towards establishing Moscow as an international financial centre through further liberalisation of the domestic sovereign rouble bond market, making it easier for non-residents to trade in Russian securities. In Serbia the central bank has been pursuing a "dinarisation" strategy and signed a Memorandum of Understanding with the previous government in April 2012 on the promotion of dinar use in financial transactions. In Ukraine amendments to the law on the securities market will, following parliamentary adoption, enable international financial institutions to issue bonds denominated in the local currency (the hryvnia).

INFRASTRUCTURE

In most infrastructure sectors covered by this analysis, progress in the past year has been very limited, although Russia achieved two upgrades in the railways and the water and wastewater sectors, respectively. The former reflects cumulative progress

over the years to the point where reforms are comparable to, or go beyond, those in many EU countries. In particular, the private sector provides well over half of all freight wagons and traffic, and competition in wagon provision (including through leasing) is intense. The water and wastewater upgrade is the result of an improved regulatory system (transferring functions from municipalities to a regional regulator) and the wider availability and use of commercial funds. There was also an upgrade for Ukraine's railways sector, although from a low level (2 to 2+), as a long-awaited restructuring and corporatisation law was finally adopted by parliament and private provision of wagons increased to about one-quarter of the market. The only other infrastructure upgrade was in the roads sector in Croatia, reflecting cumulative improvements over time, better procurement practices and the introduction of automatic tolling in the past year.

CORPORATE SECTORS

Corporate sector reforms warranting an upgrade have been limited over the past year. There were noticeable improvements in productivity in the agribusiness sector in Bulgaria and Romania, sufficient in the latter case to merit an upgrade from 3- to 3 (level with Bulgaria). However, Belarus was downgraded because of restrictions introduced in mid-2011 on the trade of agricultural goods, which (unlike other restraints – see below) have not been reversed. Other developments were mainly in the information and communications technology sector. Although scores remained unchanged in all cases, the market institutions gap was reduced in Bulgaria, Georgia and Poland, to reflect improved alignment of the regulatory framework with EU standards, and in Serbia, following the introduction in 2012 of full liberalisation of the fixed-line telecommunications service.

COUNTRY TRANSITION INDICATORS

One disadvantage of the sectoral transition assessment described in the previous section is that it may not fully capture reform progress or backtracking in broader, cross-cutting indicators such as trade policy, privatisation or the enforcement of corporate governance standards and competition policy. The EBRD has been tracking developments in these areas for many years and has been publishing annual transition indicator scores since the Transition Report was first published in 1994. However, the weaknesses of these indicators, in terms of their strong subjective element and failure to take sufficient account of the institutional framework, prompted the development of the sector-based methodology discussed earlier in this chapter. Nevertheless, the traditional indicators still constitute a useful snapshot of where a country stands in some important aspects of transition. It was decided therefore to retain the country-level scores for one more year; future years are likely to see a significant modification to the methodology and coverage of these indicators.

Table 1.2 contains the scores for six transition indicators (large-scale privatisation; small-scale privatisation; governance and enterprise restructuring; price liberalisation; trade and foreign exchange system and competition policy) on the same 1 to 4+ scale as in Table 1.1, but with arrows representing upgrades and downgrades in this instance. There were no upgrades or downgrades in small-scale and large-scale privatisation, signalling a lack of appetite for buying or selling state-owned assets. In the governance and enterprise reform category, there was an upgrade for Latvia, reflecting significant efforts by the government to enhance the transparency of state-owned companies. The decision by the energy company, Latvenergo, to have its long-term bonds quoted on the local exchange and to comply with the resulting listing requirements was a positive step in this respect.

There was a competition policy downgrade for Slovenia because of the significant drop in recent years in the number of cartel cases, the failure to issue any fines in 2011, and continuing staff and budget reductions. Some countries demonstrated progress in implementing competition policy, although not sufficiently to justify an upgrade at present. In Armenia, for example, a number of changes improved the functioning of the law, including the reinforcement of sanction measures. Moldova's new competition law, passed by parliament in July 2012, has been aligned with standards prevailing in the European Union (which provided technical assistance), while in Russia the government approved a so-called "third antimonopoly package", which entered into force in January 2012. This reform is aimed at liberalising the antimonopoly regulatory framework and reducing administrative barriers. It contains important clarifications and refinements, for example, with regard to cartel agreements.

There were several upgrades in trade and foreign exchange liberalisation. In the case of Montenegro and Russia this was mainly due to their long-awaited accession to the WTO. Montenegro had originally applied as part of the Federal Republic of Yugoslavia (subsequently the State Union of Serbia and Montenegro) and then in its own right after independence in June 2006. A further achievement for Montenegro in the past year was the launch of EU accession negotiations, which should lead to even greater integration into EU and global trade structures. Meanwhile, Russia's WTO accession completed a process that began back in 1993 and took effect in August 2012. Many of the provisions of entry include transition periods of up to nine years.

There were also upgrades in trade and foreign exchange liberalisation for Belarus and Turkmenistan, two of the traditional laggards in reform. They were, however, either from a very low base and/or reversed previous downgrades. In Belarus the multiple exchange rates that had emerged as a consequence of regulatory administrative measures and large external imbalances were unified in October 2011 as the government agreed to devalue the official exchange rate. In addition, restrictions on exports of most consumer goods, introduced during last year's crisis, were lifted in February 2012. Turkmenistan passed a new law on foreign exchange regulations in October 2011, abolishing the requirement of pre-payments

for exports and imports and allowing banks to conduct foreign exchange transactions with enterprises and individuals without seeking prior approval from the central bank. In another important step towards liberalisation, the Turkmen government decided in July 2012 to cancel the rationing of flour and loosen controls over meat prices.

TRANSITION CHALLENGES IN THE SEMED REGION

This section attempts to position the SEMED countries on the transition spectrum, based on the same criteria used for the other countries covered in this Report.

The economic histories of the former communist countries of eastern Europe and Central Asia and those in the SEMED region have common elements, including a decades-long experience of centralised state control (beginning in the 1950s in the SEMED case) followed by a progression to market-oriented reform. However, there are also significant differences. Reforms started a decade earlier in the SEMED countries, but were more gradual and remain incomplete. Another distinguishing SEMED feature has been the preponderance of young people in the population (unlike in post-communist eastern Europe), putting pressure on labour markets and creating alarming levels of youth unemployment, especially among the educated. In addition, the SEMED region continues to score worse than eastern European countries on most social indicators, including literacy and education.

The rest of this chapter outlines the reform histories of the SEMED countries and then considers their current structural and institutional development, including at the sector level. The analysis indicates that the region is in "mid-transition", defined as ahead of most Central Asian countries but behind most in central and eastern Europe, and on a rough par with the Caucasus countries, Kazakhstan and Ukraine. Trade and capital flows in the SEMED region have been largely liberalised, and large parts of the economy are in private hands, albeit with important exceptions. However, subsidies for basic foods and fuels tend to be more pervasive, distorting markets and placing heavy burdens on state budgets. At the sector level, power and energy stand out as the least reformed areas.

REFORM EFFORTS

Egypt, Jordan, Morocco and Tunisia embarked on a process of market-oriented structural reform in the mid-1980s in order to create legal and institutional frameworks conducive to investment, entrepreneurship and market-driven growth, and to promote privatisation in their inflated and unproductive public sectors. Although these reforms were partly successful in achieving higher growth, unemployment remained chronically high, especially (and unusually) among the educated youth, and the benefits of growth were not evenly distributed. The reform agenda remains incomplete and the SEMED

Table 1.2
Country transition indicator scores, 2012

	Enterprises			Markets and trade		
	Large-scale privatisation	Small-scale privatisation	Governance and enterprise restructuring	Price liberalisation	Trade and foreign exchange system	Competition policy
Albania	4-	4	2+	4+	4+	2+
Armenia	4-	4	2+	4	4+	2+
Azerbaijan	2	4-	2	4	4	2-
Belarus	2-	2+	2-	3	2+	2
Bosnia and Herzegovina	3	3	2	4	4	2+
Bulgaria	4	4	3-	4+	4+	3
Croatia	3+	4+	3+	4	4+	3
Estonia	4	4+	4-	4+	4+	4-
FYR Macedonia	3+	4	3-	4+	4+	3-
Georgia	4	4	2+	4+	4+	2
Hungary	4	4+	4-	4+	4+	4-
Kazakhstan	3	4	2	4-	4-	2
Kyrgyz Republic	4-	4	2	4+	4+	2
Latvia	4-	4+	3+	4+	4+	4-
Lithuania	4	4+	3	4+	4+	4-
Moldova	3	4	2	4	4+	2+
Mongolia	3+	4	2	4+	4+	3-
Montenegro	3+	4-	2+	4	4+	2
Poland	4-	4+	4-	4+	4+	4-
Romania	4-	4-	3-	4+	4+	3+
Russia	3	4	2+	4	4	3-
Serbia	3-	4-	2+	4	4	2+
Slovak Republic	4	4+	4-	4+	4+	4-
Slovenia	3	4+	3	4	4+	3-
Tajikistan	2+	4	2	4	3+	2-
Turkey	3+	4	3-	4	4+	3
Turkmenistan	1	2+	1	3	2+	1
Ukraine	3	4	2+	4	4	2+
Uzbekistan	3-	3+	2-	3-	2-	2-
Egypt	3	4-	2	3+	4	2-
Jordan	3	4-	2+	4-	4+	2
Morocco	3+	4-	2+	4	4-	2
Tunisia	3	4-	2	4	4	3-

Source: EBRD.

Note: The transition indicators range from 1 to 4+, with 1 representing little or no change from a rigid centrally planned economy and 4+ representing the standards of an industrialised market economy. For a detailed breakdown of each of the areas of reform, see the Methodological Notes on page [160]. ↑ and ↓ arrows indicate one-notch upgrades or downgrades from the previous year. ↑↑ arrows indicate a two-notch upgrade.

countries face significant challenges in improving their business environments, consolidating fiscal positions and increasing institutional capacity.

In ***Egypt*** comprehensive reforms were introduced in two waves during 1991-98 and 2004-08. In the first round one-third of state-owned enterprises were privatised, many investment and production controls were abolished and tariffs and capital account restrictions were reduced. The second wave saw significant financial sector reforms (including the privatisation of the third-largest bank) and some improvements in the business environment, including an easing of conditions for enterprise start-ups and the creation of a competition agency. On the fiscal side, reforms aimed at modernising tax administration (coupled with increases in energy retail prices in 2005-06) led to a reduction in the fiscal deficit although it remained above 6 per cent of GDP for the budget sector.

However, major elements were lacking from the reforms, such as an effective strengthening of state institutions and a correction of key market distortions. The state's role as regulator, guarantor of competition and enforcer of contracts remains weak and judicial capacity is low, posing significant obstacles to private-sector development.

Jordan's first wave of structural economic reforms through the 1990s was characterised by fiscal consolidation and exchange rate devaluation to ease fiscal and external imbalances. The initial privatisation drive during this period was continued in the second round of reform in the early 2000s, which has seen the retreat of government ownership from most economic sectors. Since its accession to the WTO in 2000, Jordan has entrenched its open economy status through unilateral tariff reductions and trade liberalisation. In addition, financial sector regulations have been upgraded and improvements made in the business environment.

The main reform challenges for Jordan are to improve governance and to enhance competitiveness and private sector development. This requires an investment-friendly legislative framework, including appropriate public-private partnership mechanisms to enable the large-scale infrastructure development that the economy needs. Reducing vulnerability to external shocks is another challenge, especially in light of a worsening fiscal position caused by increases in subsidies and budgetary pressures resulting from disruptions to gas supplies from Egypt. The energy sector also needs major reforms to reduce import dependence and promote renewable sources.

Morocco made substantial progress in fiscal and structural reform in the early 2000s and implemented a number of large-scale privatisations in service industries. The energy, telecommunications and transport sectors were liberalised, import tariffs were reduced and there was an overall increase in competitiveness. Reforms in public finance were also carried out, increasing the efficiency and return of the tax administration system, and the current and capital accounts were liberalised for non-residents. In addition, reforms in the financial sector improved bank supervision and reduced foreign currency exposure.

Nevertheless, challenges still confront Morocco. Earlier privatisations omitted utilities and natural resources, and reforms (including to tariffs) are still necessary in the energy and infrastructure sectors. A key element of fiscal consolidation is subsidy reduction, which the government has sought to address by increasing fuel prices from June 2012. In addition, there is scope for improving the business environment and the competitiveness of various sectors by reducing burdensome regulation, improving corporate governance and strengthening institutional capacity. For example, the government's Plan Maroc Vert aims to address these issues in the agricultural sector (see below).

Tunisia undertook a series of stabilisation and structural reforms from 1986-2004 to diversify its economy after a fall in world oil prices led to unsustainable fiscal and external imbalances in the mid-1980s. These reforms also helped create a better institutional framework and business environment, enabling accession to the WTO in 1995. Reforms were also implemented to advance the financial sector, liberalise trade and exchange rates and privatise non-strategic industries. However, subsequent measures had the effect of boosting the competitiveness of an "offshore" sector of the economy (through generous benefits) at the expense of less developed "onshore" activities. Also, despite some efforts in 2005-10 to promote the privatisation agenda, the government still retains significant control in a number of sectors, especially finance.

Challenges still facing the Tunisian economy include addressing excessive labour market regulation to tackle the significant skills mismatch at the core of the country's high structural unemployment, and improving the business environment across sectors through more effective institutional frameworks and operation. Weaknesses in the financial sector, which have repercussions for many areas of the economy, also need to be overcome, by strengthening the banks and facilitating more private-sector involvement in economic activity.

SECTOR TRANSITION INDICATORS

The sector scores in the SEMED region (see Table 1.1) suggest significant transition gaps across the four broad sector categories (corporate, energy, financial and infrastructure).

The main challenges facing the ***manufacturing and services*** sector relate to the general business environment. While reforms carried out over the past two decades have improved the ease of doing business in the SEMED countries, market structure and institution reforms still need to be accelerated to enhance competitiveness, efficiency and productivity. In Egypt the privatisation agenda remains unfinished and weak institutional capacity (such as lack of judicial and competition authority independence), together with continued state involvement in many sectors, have hampered private business growth. To a lesser extent, Jordan and Morocco also need to improve

competition policy and the business environment in key industrial sectors (and face similar challenges to those of FYR Macedonia and Georgia, for example). However, privatisation efforts have generally proceeded at a faster pace in Jordan and Morocco than in Egypt. Meanwhile, Tunisia's successful reform efforts – from price and trade liberalisation to privatisation and tax incentives – have created a thriving offshore sector, although the onshore sector's development is hampered by legal complexities such as weak contract enforcement and low investor protection.

In the ***agricultural sector***, the SEMED countries face comparable reform challenges, although Morocco (where the government's Plan Maroc Vert aims to reform the sector to increase production by improving the quality and efficiency of value chains and increasing crop diversity) and Tunisia score better than Egypt and Jordan. As net importers of food, all are vulnerable to the volatility of global prices for commodities such as grain, on which they are highly dependent. In addition, fuel and food subsidies have led to market distortions and inefficiencies along the whole food value-chain. In Jordan, Morocco and Tunisia particularly, efficient use of scarce water resources is crucial to improving agricultural productivity, while all four countries are disadvantaged by underdeveloped processing, logistic and distribution capacity and (as in Russia and Serbia) fragmented land holdings. The state remains heavily involved in the agricultural sector across the SEMED region, whether through its presence in rural financing provision or through price controls and guarantees for core commodities (as in Turkey). Untargeted subsidies for consumers and producers are also in place in all four countries.

The SEMED countries have significant challenges in the ***energy sector***, most comparable to those in Central Asia and eastern Europe. Heavy state involvement and the prevalence of vertically integrated utility companies are defining characteristics of the sector across the region (and indicate a stage of development similar to that in Serbia and Ukraine). Privatisation has not progressed substantially, and the different subsectors have not been fully unbundled. Together with continued fuel and electricity subsidies, this has led to poor energy efficiency and distorted markets. In all four SEMED countries electricity tariffs are not cost reflective, placing additional fiscal burdens on governments. At the institutional level, there is a gap between reform intentions and actual implementation. The regulatory agencies that exist in Egypt and Jordan have no tariff-setting authority and political interference in their activities and in price control is considerable. In Morocco and Tunisia, with no independent energy regulators, tariffs and prices are set directly by government. Jordan and Morocco, however, face slightly narrower transition gaps as efforts have been made to reduce Jordan's dependence on imported fuels and to achieve energy sustainability in Morocco.

According to the transition scores, the SEMED region's level of ***infrastructure*** development is most comparable to that of the countries of eastern Europe and the Caucasus. Significant challenges still loom. This is partly due to the weak municipal infrastructure across the region, which reflects low private-sector participation, poor regulatory frameworks and limited financing options outside of central government. In all four SEMED countries, the water and wastewater sector is characterised by heavy state involvement and/or centralisation, low tariffs below cost- and investment-recovery levels and extensive subsidisation across sectors and of consumers (as in Belarus and Georgia). In Jordan a National Water Advisory Council was created at the end of 2011 to oversee and coordinate institutional efforts towards a harmonised water policy. Across the SEMED urban transport sector commercialisation and cost recovery are low. Jordan and Morocco, however, fare slightly better, due mainly to greater private-sector participation and decentralisation. This is similarly the case in Georgia and Moldova, although municipal transport services continue to suffer from weak regulatory capacity and service quality.

A more varied picture emerges in the SEMED region's ***financial sector***, the level of development of which (apart from Tunisia) is most comparable to that of south-eastern Europe on the institutional side, but closer to central Europe in terms of market structure. In Egypt the greatest challenges are improving access to finance for MSMEs and deepening insurance and other financial services (as is the case in Moldova). Jordan, on the other hand, has a stronger banking sector (and is comparable to Croatia in respect of financial market development), but needs to strengthen the effectiveness and enforcement of bankruptcy procedure. A private credit bureau should be established in 2012, helping to broaden bank lending capacity. Morocco's financial sector is also relatively well developed, but struggles to secure long-term funding to ease maturity mismatch risk. Tunisia's financial sector, however, is hampered by balance sheet weakness, high non-performing loans and state involvement in the leading banks (similar to Slovenia), as well as poor governance and capital market development. There remains much scope for improvement in capital markets and the provision of insurance and other non-banking financial services across all the SEMED countries.

COUNTRY TRANSITION INDICATORS

The SEMED countries score reasonably well on the country transition indicators, having benefited from the earlier opening up of their economies, along with substantial price and tariff liberalisation, through the reforms starting in the 1980s. In respect of "first-phase" transition reforms – small-scale privatisation, price liberalisation and trade and foreign exchange system – the four countries scored 4- or better with the exception of a 3+ rating for Egypt relating to price liberalisation (see Table 1.2). However, the scores for the remaining indicators – large-scale privatisation, governance and enterprise restructuring, and competition policy – were significantly lower.

All four SEMED countries are members of the WTO and most have full current account convertibility and flexible exchange

rates (except for Jordan, which maintains a fixed, but stable, exchange rate). Also, with economies heavily reliant on trade, they have removed almost all export and import restrictions (with a few sector exceptions, such as agriculture). There has been large-scale privatisation since the reforms of the 1980s, which is almost complete in Morocco, but there is still significant state involvement in key economic sectors in Egypt, Jordan and Tunisia. However, most smaller enterprises operate firmly within the private sector and there are no legislative barriers to ownership of land or capital.

Some of the greatest challenges concern competition policy and governance, where the four countries typically rank in the middle, or the lower half, of the transition spectrum. Competition policy implementation remains weak (except in Tunisia, where an independent competition authority is in line with international standards), and is hampered by weak enforcement, the continued presence of state monopolies and low institutional capacity. Although steps have been taken to create or improve competition agencies in Jordan, Egypt and Morocco, these still lack enforcement capability and/or independence. In general, there remains a significant shortfall between *de jure* institutional frameworks and their operation and effectiveness. All four countries score between 2 and 2+ on governance and enterprise restructuring, largely due to the continued subsidisation of key industries and poor governance at most state-owned enterprises. In particular, energy subsidies have created market distortions and state involvement has deterred private-sector participation.

CONCLUSION

This chapter has summarised the main structural reform developments over the past year and provided a perspective on the remaining transition challenges facing the EBRD's traditional countries of operations and those in the SEMED region where the Bank is extending its activities. On the positive side, it remains the case as in all previous years that there has been more progress in reform than reversal, and any wholesale backsliding seems unlikely. However, further major advances are still necessary to underpin and ensure future sustainable growth. Although major, irreversible backsliding in reforms has not happened and is unlikely to happen in the future, the big risk is still that stalled or feeble reforms will keep the region's growth well below potential for the foreseeable future.

Table A.1.1.1
Sector transition indicators 2012: market structure

	Corporate sectors				Energy			Infrastructure				Financial sectors				
	Agribusiness	General industry	Real estate	Telecommunications	Natural resources	Sustainable energy	Electric power	Water and wastewater	Urban transport	Roads	Railways	Banking	Insurance and other financial services	MSME finance	Private equity	Capital markets
Central Europe and the Baltic states																
Croatia	Small	Small	Medium	Small	Small	Medium	Large	Medium	Medium	Small	Medium	Small	Small	Medium	Medium	Medium
Estonia	Small	Negligible	Negligible	Small	Small	Medium	Small	Negligible	Small	Medium	Small	Small	Small	Medium	Medium	Medium
Hungary	Small	Small	Small	Small	Small	Medium	Medium	Small	Medium	Small	Small	Small	Small	Medium	Medium	Small
Latvia	Small	Negligible	Small	Small	Medium	Medium	Medium	Small	Small	Medium	Small	Small	Small	Medium	Medium	Medium
Lithuania	Small	Small	Small	Small	Medium	Medium	Medium	Medium	Small	Medium	Medium	Small	Small	Medium	Medium	Medium
Poland	Small	Small	Small	Small	Medium	Medium	Medium	Small	Small	Small	Small	Small	Small	Medium	Small	Small
Slovak Republic	Small	Negligible	Small	Small	Small	Medium	Small	Medium	Medium	Medium	Small	Small	Small	Medium	Large	Medium
Slovenia	Small	Small	Negligible	Small	Small	Small	Medium	Small	Small	Medium	Medium	Medium	Small	Medium	Medium	Medium
South-eastern Europe																
Albania		Medium	Large	Medium	Medium	Small	Medium	Large	Medium	Medium	Large	Medium	Large	Medium	Large	Large
Bosnia and Herzegovina	Medium	Large	Large	Medium	Large	Large	Large	Large	Medium	Medium	Medium	Medium	Medium	Medium	Large	Large
Bulgaria	Small	Small	Medium	Small	Small	Large	Medium	Medium	Small	Medium	Small	Small	Small	Medium	Medium	Medium
FYR Macedonia	Medium	Medium	Large	Medium	Medium	Large	Medium	Large	Medium	Medium	Medium	Medium	Medium	Medium	Large	Large
Montenegro	Medium	Medium	Medium	Small	Small	Large	Large	Large	Small	Medium	Medium	Medium	Medium	Medium	Large	Large
Romania	Small	Small	Medium	Small	Small	Medium	Medium	Medium	Small	Small	Small	Small	Small	Medium	Medium	Medium
Serbia	Medium	Medium	Large	Medium	Medium	Large	Large	Large	Medium	Medium	Medium	Medium	Medium	Medium	Large	Large
Turkey	Medium	Small	Small	Medium	Medium	Medium	Medium	Medium	Medium	Medium	Medium	Medium	Medium	Medium	Medium	Small
Eastern Europe and Caucasus																
Armenia	Medium	Medium	Large	Medium	Medium	Medium	Medium	Medium	Large	Medium	Medium	Large	Large	Medium	Large	Large
Azerbaijan	Medium	Large	Large	Large	Large	Large	Large	Large	Large	Medium	Medium	Large	Large	Large	Large	Large
Belarus	Large	Large	Large	Medium	Large	Large	Large	Large	Large	Large	Large	Large	Large	Large	Large	Large
Georgia	Medium	Medium	Large	Medium	Large	Medium	Small	Large	Large	Large	Medium	Medium	Large	Medium	Large	Large
Moldova	Medium	Medium	Large	Medium	Medium	Large	Medium	Large	Medium	Medium	Large	Large	Large	Large	Large	Large
Ukraine	Medium	Medium	Large	Medium	Large	Large	Large	Large	Medium	Medium	Medium	Medium	Medium	Medium	Medium	Large
Russia	Medium	Medium	Medium	Medium	Large	Large	Medium	Medium	Small	Medium	Small	Medium	Medium	Large	Medium	Small
Central Asia																
Kazakhstan	Medium	Large	Medium	Medium	Medium	Large	Large	Large	Medium	Medium	Medium	Medium	Medium	Large	Large	Medium
Kyrgyz Republic	Medium	Large	Large	Large	Large	Large	Medium	Large	Medium	Large	Large	Large	Large	Large	Large	Large
Mongolia	Medium	Large	Large	Large	Medium	Large	Large	Large	Large	Large	Medium	Large	Large	Large	Large	Large
Tajikistan	Medium	Large	Large	Large	Large	Large	Large	Large	Large	Large	Large	Large	Large	Large	Large	Large
Turkmenistan	Large	Large	Large	Large	Large	Large	Large	Large	Large	Large	Large	Large	Large	Large	Large	Large
Uzbekistan	Large	Large	Large	Large	Large	Large	Large	Large	Large	Large	Medium	Large	Large	Large	Large	Large
Southern and eastern Mediterranean																
Egypt	Large	Large	Medium	Medium	Large	Large	Large	Large	Large	Large	Large	Medium	Large	Large	Medium	Medium
Jordan	Medium	Medium	Medium	Small	Large	Large	Medium	Large	Medium	Medium	Large	Small	Medium	Medium	Medium	Medium
Morocco	Medium	Medium	Medium	Small	Large	Medium	Large	Medium	Medium	Medium	Large	Medium	Medium	Medium	Medium	Medium
Tunisia	Medium	Medium	Medium	Medium	Large	Large	Large	Large	Large	Medium	Large	Medium	Medium	Large	Medium	Medium

Source: EBRD
Note: Large equals a major transition gap. Negligible equals standards and performance typical of advanced industrial economies.

Table A.1.1.2

Sector transition indicators 2012: market-supporting institutions

	Corporate sectors				Energy			Infrastructure				Financial sectors				
	Agribusiness	General industry	Real estate	Telecommunications	Natural resources	Sustainable energy	Electric power	Water and wastewater	Urban transport	Roads	Railways	Banking	Insurance and other financial services	MSME finance	Private equity	Capital markets
Central Europe and the Baltic states																
Croatia	Medium	Small	Small	Small	Small	Medium	Medium	Small	Small	Medium	Medium	Small	Small	Medium	Medium	Small
Estonia	Medium	Negligible	Negligible	Negligible	Negligible	Medium	Negligible	Small	Small	Medium	Negligible	Small	Small	Small	Medium	Small
Hungary	Small	Small	Negligible	Negligible	Small	Small	Small	Small	Small	Negligible	Small	Medium	Small	Small	Small	Small
Latvia	Medium	Small	Negligible	Negligible	Negligible	Small	Negligible	Small	Small	Medium	Negligible	Small	Small	Small	Medium	Small
Lithuania	Medium	Small	Negligible	Negligible	Negligible	Small	Small	Small	Small	Medium	Small	Small	Small	Small	Medium	Small
Poland	Small	Small	Small	Negligible	Medium	Small	Negligible	Small	Small	Small	Negligible	Small	Small	Small	Small	Negligible
Slovak Republic	Medium	Negligible	Negligible	Small	Small	Small	Small	Small	Small	Medium	Medium	Small	Small	Negligible	Small	Small
Slovenia	Medium	Small	Negligible	Negligible	Small	Small	Small	Small	Small	Medium	Small	Small	Small	Small	Medium	Small
South-eastern Europe																
Albania	Medium	Medium	Medium	Medium	Medium	Medium	Medium	Large	Large	Medium	Large	Medium	Medium	Medium	Large	Large
Bosnia and Herzegovina	Medium	Medium	Large	Medium	Large	Large	Large	Large	Large	Medium	Small	Medium	Medium	Medium	Large	Large
Bulgaria	Medium	Small	Small	Small	Medium	Small	Medium	Small	Small	Medium	Medium	Medium	Small	Medium	Small	Small
FYR Macedonia	Medium	Medium	Medium	Small	Medium	Medium	Medium	Large	Large	Medium	Medium	Medium	Medium	Medium	Large	Large
Montenegro	Medium	Medium	Large	Medium	Medium	Medium	Medium	Large	Large	Large	Medium	Medium	Medium	Medium	Large	Medium
Romania	Medium	Small	Small	Small	Small	Small	Medium	Small	Small	Medium	Small	Medium	Small	Medium	Small	Small
Serbia	Medium	Medium	Medium	Medium	Large	Medium	Large	Large	Large	Medium	Small	Medium	Small	Medium	Medium	Medium
Turkey	Small	Medium	Medium	Small	Small	Medium	Medium	Meidum	Small	Medium	Medium	Small	Small	Medium	Small	Small
Eastern Europe and Caucasus																
Armenia	Medium	Small	Medium	Medium	Medium	Medium	Medium	Medium	Medium	Medium	Large	Medium	Large	Medium	Large	Large
Azerbaijan	Medium	Large	Large	Large	Medium	Large	Large	Large	Large	Medium	Large	Large	Medium	Large	Large	Large
Belarus	Medium	Large	Large	Large	Large	Medium	Large	Large	Large	Large	Large	Large	Large	Large	Large	Large
Georgia	Medium	Medium	Small	Small	Large	Large	Medium	Large	Large	Medium	Medium	Medium	Medium	Medium	Large	Large
Moldova	Medium	Large	Medium	Medium	Medium	Small	Large	Large	Large	Medium	Large	Medium	Medium	Medium	Medium	Medium
Ukraine	Medium	Large	Medium	Medium	Large	Small	Large	Large	Large	Medium	Large	Medium	Medium	Large	Large	Medium
Russia	Medium	Medium	Medium	Medium	Large	Medium	Medium	Medium	Medium	Medium	Small	Medium	Medium	Large	Medium	Medium
Central Asia																
Kazakhstan	Medium	Large	Small	Medium	Large	Large	Medium	Large	Large	Medium	Medium	Medium	Medium	Large	Medium	Medium
Kyrgyz Republic	Medium	Medium	Medium	Medium	Medium	Large	Large	Large	Large	Large	Large	Large	Large	Large	Large	Large
Mongolia	Medium	Medium	Large	Medium	Large	Medium	Large	Large	Large	Large	Medium	Medium	Large	Large	Medium	Medium
Tajikistan	Large	Large	Large	Large	Large	Large	Large	Large	Large	Large	Large	Large	Large	Large	Large	Large
Turkmenistan	Large	Large	Large	Large	Large	Large	Large	Large	Large	Large	Large	Large	Large	Large	Large	Large
Uzbekistan	Large	Large	Large	Large	Large	Large	Large	Large	Large	Large	Medium	Large	Large	Large	Large	Large
Southern and eastern Mediterranean																
Egypt	Large	Medium	Large	Medium	Large	Medium	Large	Large	Large	Medium	Large	Medium	Medium	Large	Medium	Medium
Jordan	Large	Large	Medium	Medium	Medium	Medium	Medium	Large	Large	Medium	Large	Medium	Medium	Large	Medium	Medium
Morocco	Medium	Medium	Medium	Medium	Large	Medium	Large	Large	Large	Medium	Medium	Medium	Medium	Large	Medium	Medium
Tunisia	Medium	Negligible	Medium	Medium	Large	Medium	Large	Large	Large	Large	Medium	Medium	Medium	Large	Large	Large

Source: EBRD

Note: Large equals a major transition gap. Negligible equals standards and performance typical of advanced industrial economies.

COMMERCIAL COURTS IN TRANSITION

Previous studies have linked the effectiveness of the judiciary with the pace of economic growth and the cost of credit in liberalised economies.[1] However, many transition countries are yet to reap the economic benefits that an effective judiciary can generate. Over the 20 years of legal transition, commercial laws in the EBRD region of operations have improved substantially. Despite this, their implementation and enforcement in the courts have often been fraught with problems, deterring business from engaging in these markets for fear that their legal rights cannot be protected. While foreign investors can sometimes bypass the courts through international arbitration, local investors, particularly small and medium-sized enterprises (SMEs) need the means to resolve commercial disputes locally.

This annex reports on an analysis undertaken by the EBRD between 2010 and 2012 of judicial decisions made in the Commonwealth of Independent States (CIS),[2] Georgia and Mongolia. The objectives were twofold: to provide investors in these countries, including the EBRD, with an insight into key problems confronting commercial courts and the risks involved in litigation; and to produce data which could be used to encourage and assist reform.

METHODOLOGY

Local legal experts evaluated selected judicial decisions in respect of seven dimensions, or indicators, of judicial capacity (see Box A.1.2.1) and scored them on a scale of 0 to 5, with 5 representing the highest standard of fairness and efficiency.

All the dimensions are underpinned by international standards and are also reflected in the EBRD's Core Principles for Effective Judicial Capacity. In each of the countries under review, the local experts selected at least 20 decisions considered typical and representative of the broader case law for analysis in a purposive, rather than a random sampling, exercise.

The decisions were drawn from three broadly defined commercial law areas: (i) protection and enforcement of creditors' rights, focusing mainly on enforcement of collateral and recovery of unsecured debt; (ii) disputes over proprietary (such as land title) and shareholder rights; and (iii) disputes with regulatory authorities over business licences, taxation and privatisation issues. These areas were considered important from the perspective of identifying systemic concerns about judicial capacity that transcend particular sectors. To ensure consistency in the evaluation process, all of the decisions, scores and comments of local experts were reviewed by an independent regional panel of three further experts.

Box A.1.2.1

Assessing the dimensions of judicial capacity

Predictability of decisions
Were decisions broadly predictable and jurisprudentially compatible with others in the same field?

Quality of decisions
Did decisions comply with procedural requirements, display understanding of the commercial issues, identify and correctly apply relevant law and reach well-reasoned conclusions?

Adequate legislative framework
Were there legislative and/or regulatory or procedural obstacles to the court's consideration of relevant issues?

Speed of justice
Did litigation proceed at a reasonable pace from the filing date to the final judgment and in compliance with statutory deadlines?

Cost of litigation
Were costs reasonable, considered as a percentage of the value of a claim?

Implementation/enforcement of judgments
Were court orders voluntarily implemented or compulsorily enforced (based on case file follow-ups and direct contact with litigants where possible)?

Perceived impartiality
Did decisions appear to afford procedural equality and give adequate weight to the parties' arguments, or were there discernible differences in the court's treatment of the parties?

RESULTS

The overall results of the assessment in 12 countries are set out in Chart A.1.2.1.[3] They identify different levels of judicial capacity in commercial law across the region. Nevertheless, some of the underlying challenges are similar and derive from the countries' common socio-economic history. This is borne out by an analysis of the seven dimensions, the various themes which pervade them and the relationships between them.

In Russia the general level of sophistication of judicial decisions was higher in most dimensions than in the other countries. This may reflect more developed markets (creating more complex disputes for the courts to deal with), better resources than the other countries and a more advanced stage of economic transition.

PREDICTABILITY OF DECISIONS

A measure of risk and uncertainty is in the nature of litigation. However, it should be possible for investors to obtain meaningful advice about the likely outcome of commercial disputes. Decisions should show consistency in the courts' treatment of disputes of a similar kind. The assessment concluded that

[1] See Laevan and Mojnoni (2003) and Sherwood (1994).
[2] Armenia, Azerbaijan, Belarus, Kazakhstan, the Kyrgyz Republic, Moldova, Russia, Tajikistan, Ukraine and Uzbekistan. Turkmenistan is an associate member.
[3] In Turkmenistan decisions were not accessible and it was not possible to score the seven dimensions, although some information was gleaned from local counsel.

Chart A.1.2.1
EBRD Judicial Decisions Assessment: overall results by country

Source: EBRD Judicial Decisions Assessment.
Note: The diagrams depict the average scores given to the seven dimensions in the reviewed decisions, as assessed by local commercial law experts and a regional panel. The extremity of each axis represents an optimum score of 5, representing a high standard of fairness/efficiency. The larger the coloured area, the better the results.

decisions in the region indicated variable levels of predictability (see Chart A.1.2.2). For most countries local experts were able to discern patterns in the case law in each sector assessed, but with frequent divergences. Decisions were considered strongly predictable in Russia and Ukraine and least predictable in Mongolia and Tajikistan. In Turkmenistan, where case law is not available and the outcome of past decisions is not known, judicial proceedings are necessarily highly unpredictable.

Various factors affected the scores for predictability. Lack of predictability in a particular legal sector was often linked to uncertainties in the relevant legislation, reflecting the frequency of changes in the law and lack of consistency between primary legislation (statutes made by legislatures) and secondary legislation (rules and regulations made by executive authorities). However, the assessment found that the quality of legislation, although significant, was not an overwhelming factor driving predictability. Decisions in some sectors scored strongly for predictability despite more moderate scores for the adequacy of the legislative framework (see results for Russia and Ukraine in Charts A.1.2.2 and A.1.2.4); others were unpredictable within an adequate legislative environment. This suggests that lack of predictability often arises from underlying problems in judicial decision-making unrelated to legislative influences, a hypothesis supported by the correlation between the scores for the predictability and quality dimensions (compare Charts A.1.2.2 and A.1.2.3).

Another factor contributing to greater predictability was the presence of superior court mechanisms promoting the uniform application of commercial law, such as decrees, information letters and summaries on judicial practice and interpretative issues. Such instruments are present in all of the countries reviewed: in some they are binding on lower courts (Azerbaijan, Belarus, Russia and Turkmenistan), while in others only recommendatory (Moldova and Ukraine). In those sectors of law where such superior court guidance exists, predictable decisions were more prevalent. In Russia, which had the best scores for predictability, the instruments are well-developed; the Presidium of the Supreme Arbitrazh Court (the court of final instance in commercial disputes in Russia) has been very active issuing explanatory resolutions in many legal sectors, providing interpretative and procedural guidance for lower courts. In Tajikistan such mechanisms are also in place, although much less developed. The quality, frequency and comprehensiveness of superior court guidance, particularly dealing with topical and difficult areas where the possibility for confusion and divergent approaches is greatest, have a significant effect.

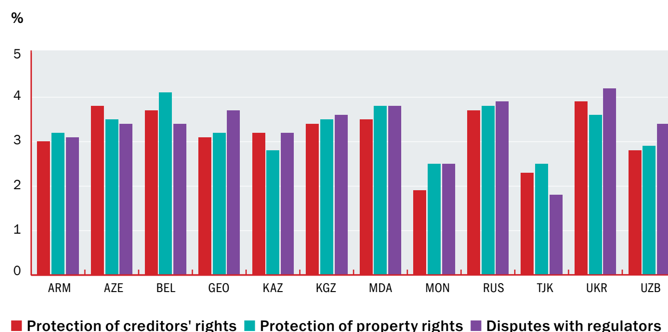
The accessibility of judicial decisions also had a strong correlation with predictability. By definition, predictability of decisions must be assessed within the known context of the broader case law. In countries where availability of decisions is limited, such as Tajikistan, predictability will be inherently lower, and trends in the case law, if they exist, will be less apparent. In contrast, commercial law decisions in Russia are widely available and searchable by subject matter on the web sites of the Arbitrazh Courts.

In addition, there was a moderate correlation between predictability and impartiality. Greater predictability in judicial decision-making can reduce the risk of improper influences on the court. The more coherent the case law, the more divergent approaches (including those resulting from corruption) tend to stand out, inviting scrutiny. However, predictability can have a negative manifestation where, on particular issues, court bias might be anticipated.

Chart A.1.2.2
Predictability of judicial decisions, by country and legal sector

Source: The EBRD Judicial Decisions Assessment.
Note: The chart depicts the average scores given to predictability in the decisions reviewed, as assessed by local commercial law experts and a regional panel. The maximum score is 5, which represents a high standard of predictability.

Chart A.1.2.3
Quality of judicial decisions, by country and legal sector



Source: The EBRD Judicial Decisions Assessment
Note: The chart depicts the average scores given to quality in the decisions reviewed, as assessed by local commercial law experts and a regional panel. The maximum score is 5, which represents a high standard of quality.

QUALITY OF DECISIONS

The highest quality of decisions was evident in Belarus, Russia and Ukraine, and the weakest in Mongolia and Tajikistan (see Chart A.1.2.3). Several thematic issues emerged.

In all of the countries assessed there were instances of courts wrongly applying *general* civil and procedure codes rather than the *specific* legal provisions of relevant commercial laws. For example, mortgage legislation in Moldova sets out exclusive grounds for the setting aside of orders to transfer pledged property; yet several of the reviewed decisions applied only the general civil and procedure code provisions, rather than invoking any of the relevant grounds stipulated in the mortgage law. Similarly, in Mongolia a challenge to the issue of a mining licence was resolved by reference to civil code provisions, without examining the relevant mandatory considerations. Decisions in several countries on the invalidation of privatisations also focused on general rather than specific provisions for example, in relation to time limitations.

Decisions often displayed rudimentary approaches to interpretation. Formalistic analysis was prevalent, while legislative intention and a law's commercial purpose were rarely considered. Decisions often lacked any detailed analysis of statutory or contractual provisions in circumstances where this was clearly required, and some displayed an overall paucity of reasoning. In cases that hinged on the meaning of contractual provisions, key clauses were often paraphrased rather than cited, making it difficult to follow the reasoning. Similarly, there was often scant reference to, or analysis of, the evidence.

In addition, the *operative* parts of courts' decisions frequently did not adequately reflect or address the parties' arguments. This was particularly the case in the Kyrgyz Republic, Mongolia, Tajikistan and Uzbekistan, where the parties' contentions were often identified in the introductory parts of decisions, but then not substantively dealt with. In one case a section in the judgment summarising the plaintiff's arguments reappeared *verbatim* in the dispositive part of the decision finding for the plaintiff, giving rise to a perception of partiality.

An underlying concern, particularly in early transition countries, is the low level of training provided to judges in commercial law, markets, economics and judicial decision-writing. Judges in many of the cases reviewed appeared to lack knowledge of specific commercial laws and concepts, although those in higher instance courts generally performed better. Improvement in judicial education is clearly a priority reform issue.

Chart A.1.2.4
Adequacy of legislation affecting judicial decisions, by country and legal sector

Source: The EBRD Judicial Decisions Assessment.
Note: The chart depicts the average scores given to the adequacy of the legislative framework from a litigation perspective in the decisions reviewed, as assessed by local commercial law experts and a regional panel. The maximum score is 5, which represents complete adequacy.

ADEQUACY OF LEGISLATIVE FRAMEWORK

There is no doubt that incomplete, ambiguous and poorly drafted legislation is detrimental to judicial decision-making. It is also conducive to corruption in the judiciary, as suspect or unlawful judgments are harder to identify.

Some legislative problems identified in the decisions reviewed related to the substantive law. In Russia and Ukraine local experts considered that existing legislation did not adequately proscribe sham bankruptcies, in which debtors siphon away assets and then have themselves declared insolvent. Courts' decisions in many such instances were considered of good quality, but could not compensate for shortcomings in the law.

However, in some cases it was legislation governing general civil litigation and its interaction with sector-specific laws that caused particular problems. For example, in Russia and Ukraine the law made it too easy for parties to re-open and undermine previously determined bankruptcy cases based on newly discovered circumstances. In such cases, the civil procedure legislation sometimes appeared ill-adapted to the relevant specific law, which might usefully have precluded or limited the reopening of litigation. In other cases, legislation had not kept pace with market developments, leaving gaps that courts struggle to fill through interpretation courts at a disadvantage. More positively, legislation in Russia governing disputes over the recovery of simple debts was identified by local experts as very straightforward and conducive to effective court proceedings.

Secondary legislation has also caused certain problems for courts. In one case, ambiguity over the land register rules in Mongolia led the parties to litigate a point where there was no apparent commercial dispute and to use the court to clarify the law in the abstract. Meanwhile in Ukraine, following extraordinary decrees of the National Bank issued during the financial crisis, it was not clear whether a temporary moratorium on creditor claims against banks covered retail depositor-holders. Ultimately the courts interpreted it broadly which, according to experts, was not how the decrees were supposed to work.

Legislation governing dealings between business and government agencies was often considered vague, in effect conferring substantial discretion on the regulators. This was especially so in Armenia and Azerbaijan, in respect to taxes and business licences, where the relevant law very broadly defines the

powers of the authorities to conduct inspections and to demand information and documents. In such cases, judicial decisions in favour of the authorities are the consequence of the legislation rather than judicial deference to authority; it can be difficult for courts to fault the actions of a regulator or authority conferred with such broad discretion.

SPEED OF JUSTICE

While large caseloads and backlogs delay judicial decisions and can affect the quality and delivery of court decisions, the speed of justice in most of the countries under review was not generally considered a significant problem, as Chart A.1.2.5 indicates. The best results were recorded in Belarus and Russia, which mirror the conclusions of the World Bank *Doing Business* reports in relation to enforcing contracts.

Causes of delays in the decisions reviewed included the late appointment of expert witnesses, motions for adjournments being too readily granted by courts, and the tendency of appeal courts to send cases back for further hearing rather than imposing their own decisions. In some instances it was suspected that judges delayed proceedings with a view to favouring a particular party (providing time, for example, to dilute assets or destroy evidence).

Courts generally dealt more swiftly with cases involving regulators than with creditor or property rights disputes. In seven of the countries reviewed, cases involving regulators were dealt with faster than others, while in all countries the speed of hearings in regulatory disputes exceeded the average speed for those in the other categories. This suggests that courts prioritised such cases, which is consistent with the perception of a pro-government judicial outlook (see also below).

Fast-track small claims procedures in some countries appear to have been very successful. Such procedures exist in Armenia, Moldova and Russia for relatively simple cases where there is no evidence in dispute and which can be resolved on the basis of available documentation.

COST OF LITIGATION

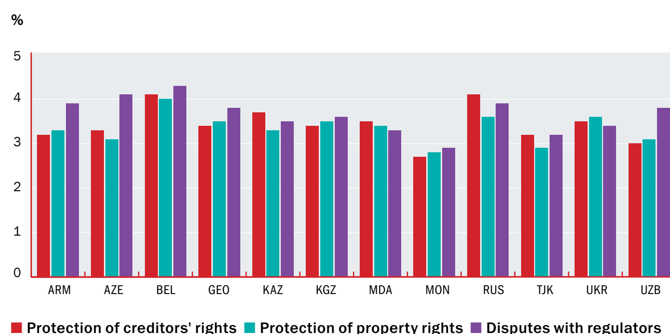
Cost was not viewed as a major concern in any of the countries assessed. In some instances legislation regulating court costs could have been clearer and the categorisation of different types of disputes, triggering different cost regimes, sometimes gave rise to contention. Payment of a state fee prior to filing a law suit is mandatory in all the jurisdictions and is one of the conditions for starting a proceeding in an economic case. The fee is normally expressed as an approximate percentage of the value of the claim and is therefore predictable. In all countries this was considered to be reasonable, although the potential maximum fees payable in Belarus and Turkmenistan were substantially higher than elsewhere.

IMPLEMENTATION/ENFORCEMENT OF JUDGMENTS

Enforcement of court orders remains a significant problem throughout the region. While implementation and enforcement were considered relatively good in Belarus and Georgia, none of the countries assessed scored highly. Some also have very large backlogs of unenforced decisions: in Ukraine, for example, the number is estimated at 2 million. Moldova, Russia and Ukraine have been respondents to a large number of cases brought by businesses in the European Court of Human Rights alleging a breach of the right to a fair trial because of a failure by the state parties to ensure implementation of court decisions.

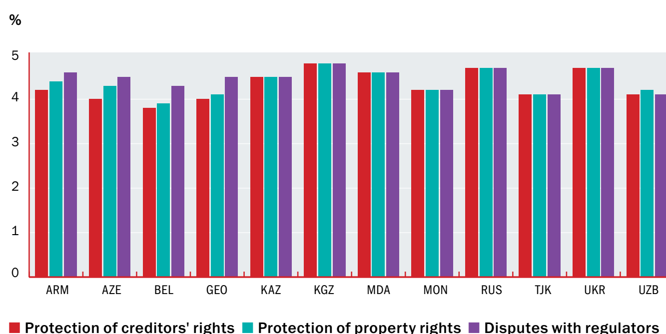
A particular problem identified in the cases reviewed related to legislative shortcomings in the enforcement process. For example, in Russia there remains a need for stronger provisions, such as freeze orders or security for costs, preventing

Chart A.1.2.5
Speed of justice, by country and legal sector



Source: The EBRD Judicial Decisions Assessment.
Note: The chart depicts the average scores given to speed of justice in the decisions reviewed, as assessed by local commercial law experts and a regional panel. The maximum score is 5, which represents a good pace of litigation.

Chart A.1.2.6
Reasonableness of court costs, by country and legal sector



Source: The EBRD Judicial Decisions Assessment.
Note: The chart depicts the average scores given to reasonableness of court costs in the decisions reviewed, as assessed by local commercial law experts and a regional panel. The maximum score is 5, which represents a very reasonable cost regime.

respondents to commercial cases diluting or hiding assets during litigation. Another issue was a lack of clarity in the text of the judicial decisions. In Tajikistan judgment orders in cases "undoing" privatisations did not envisage and deal with consequential and financial issues related to the invalidation (for example, a change in the value of the privatised property). Poorly crafted orders can simply be impossible to execute.

A major problem in many countries, and particularly Armenia and Azerbaijan, was the poor functioning of the government agency responsible for enforcement of court decisions. Thematic concerns arising in this context included: low salaries and high turnover of personnel; heavy workloads; bailiffs allegedly delaying enforcement while seeking bribes from judgment creditors; lack of personal liability of bailiffs for non-performance of their duties; poor professional training; and the need for court powers to punish recalcitrant judgment debtors (for example, through fines for contempt of court).

However, measures are being taken in several countries to address these issues. In Moldova the bailiff service has been further professionalised, with incentives provided for good performance. In Georgia and Kazakhstan a dual system of private and government bailiffs that aims to raise enforcement standards has been established. Armenia has introduced statutory time limits for the enforcement of court decisions and Azerbaijan has passed laws substantially increasing the penalties for failure to perform court judgments.

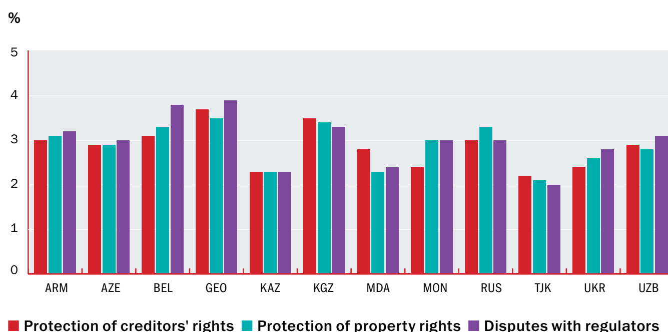
PERCEIVED IMPARTIALITY

In many of the countries reviewed a lack of judicial impartiality is seen as the major problem affecting the courts, whether in the form of corruption, lack of independence from the executive, or improper influences on judges from powerful individuals in business or government. Impartiality is a difficult dimension to measure in any categorical way, but reasonable inferences can be drawn from reviewing judicial decisions. The assessment results concluded that decisions reviewed displayed a moderate level of apparent impartiality, although scores varied considerably (see Chart A.1.2.8).

One of the main themes was an inference of court bias in favour of the state, either as a litigant in a commercial matter or as a regulator. In many decisions there appeared to be a discernible disposition towards arguments led by the state, particularly in cases involving challenges to the privatisation of state property. Courts did not always apply the same rigour and scrutiny to the arguments of state parties as they did to those of non-state litigants. For example, in a case in Moldova the court did not query the procurator's role in re-opening a privatisation transaction, when in fact the law required any challenge to be brought by the relevant state entity rather than the procurator, and there was no discussion of this issue in the judgment. Also, in Ukraine an appeal court heard and determined in the state's favour an apparently trivial matter within three weeks of the original decision, while other cases had been awaiting a hearing for many months. Such apparent special treatment, combined with the poor quality of the judgments concerned, gave rise to inferences of partiality.

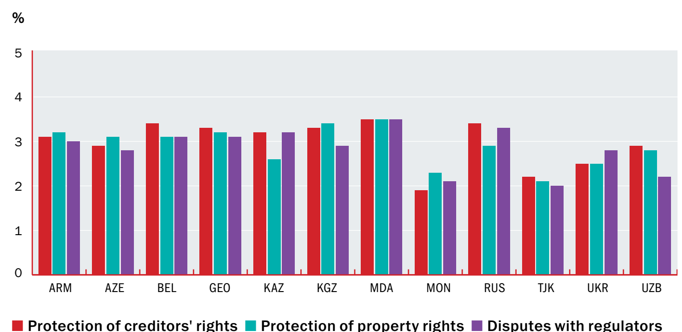
The extent of perceived bias in favour of the state varied. The state did not always win. Of 75 selected decisions in which the state or a public body was a litigant, the state was successful on 52 occasions. In cases involving regulators the perceived bias in favour of the state was generally not much worse than other forms of partiality inferred in the judgments reviewed. Only in the Kyrgyz Republic and Uzbekistan did decisions on disputes with regulators attract significantly worse scores for impartiality than other decisions. Nevertheless, in cases involving political and substantial economic interests, particularly privatisations or in

Chart A.1.2.7
Implementation/enforcement of judgments, by country and legal sector



Source: The EBRD Judicial Decisions Assessment.
Note: The chart depicts the average scores given to implementation and enforcement of the decisions reviewed, as assessed by local commercial law experts and a regional panel. The maximum score is 5, which represents reasonable ease of implementation and enforcement.

Chart A.1.2.8
Perceived impartiality, by country and legal sector



Source: The EBRD Judicial Decisions Assessment.
Note: The chart depicts the average scores given to perceived impartiality in the decisions reviewed, as assessed by local commercial law experts and a regional panel. The maximum score is 5, which represents a high standard of impartiality.

strategic sectors such as oil and gas, courts were considered to have a much more pronounced pro-state outlook.

The experts identified various factors contributing to judges' perceived bias in some of the cases reviewed. One was the practice whereby judges are appointed for an initial term of five years but are not guaranteed re-appointment, creating a perception that they will be wary of handing down too many decisions against government interests. Also, low judicial salaries, particularly in early transition countries, were considered to make judges vulnerable to improper influence. In some countries bribes were commonly believed to have been paid to obtain judicial postings, which appointees would then seek to recoup once on the bench.

Another factor was the absence in some countries of clear prohibitions on communications between an interested party (private or public) and a judge. In contrast, Georgian law expressly prohibits such communications prior to the court's judgment entering into force, and penalties for breach of these rules have been increased substantially. Many local lawyers believe that the bribing of judges has been all but eliminated in Georgia. This is consistent with broader public opinion gauged in the EBRD/World Bank 2010 Life in Transition Survey, which found that the level of perceived corruption in Georgia was as low as that in western European countries.

CONCLUSION AND POLICY IMPLICATIONS

In order to bolster business and investor confidence in the courts and to reap the full benefit of commercial law reform, the "law on the books" must be effectively applied and enforced in the courts. This assessment has found that commercial courts in the CIS, Georgia and Mongolia continue to face substantial challenges, particularly in ensuring the impartial treatment of litigants and the effective implementation of judgments. Overall, however, the quality and predictability of judicial decisions are better than many might have expected. Cost of, and, perhaps surprisingly, speed of justice do not pose major problems.

These results should be of interest to transition governments and invite further examination of the issues raised. For those involved in judicial reform, including the EBRD through its Legal Transition Programme, this assessment will help in formulating and targeting relevant technical assistance work. Priorities for reform include: better judicial training in commercial law, markets and decision writing; ensuring public access to all judicial decisions; improving the interaction of substantive and procedural law; better monitoring of training needs and the quality of judicial output; and greater judicial collaboration between court authorities and the business community on problems in the courts' handling of commercial matters and their possible solutions.

The EBRD has been providing technical assistance on projects to enhance judicial capacity in a number of countries covered in this assessment, including the Kyrgyz Republic, Moldova, Mongolia and Tajikistan. This work has included judicial training programmes in commercial law, institutional development of training and supervisory bodies, review and analysis of court structures and alternative dispute resolution. The Bank is also developing training products that focus on the interaction of law, markets, economics and accountancy for judges determining insolvency cases. These measures are designed to strengthen commercial courts and to enhance public, and in particular business, confidence in them.

References

Laevan and G. Mojnoni (2003)
"Does judicial efficiency lower the cost of credit?", World Bank Research Working Paper 3159.
R. Sherwood (1994)
"Judicial systems and economic performance", *Quarterly Review of Economics and Finance*, 34, Supplement 1, pp. 101-16.
EBRD (2011)
Life in Transition: After the Crisis, London.