STRUCTURAL REFORM

In light of the challenges that countries currently face in trying to achieve sustainable growth, the EBRD has reviewed its transition concept. Under the updated interpretation of transition, a sustainable market economy should be competitive, well governed, green, inclusive, resilient and integrated. Looking at reform efforts across the region over the past year, it is noticeable that many relate to competitiveness and resilience. Improving the competitiveness of businesses and sectors and strengthening financial systems seems to be a concern for many countries in the region. In addition, some have implemented reforms in order to improve aspects of governance – an area where the EBRD's new transition scores suggest that numerous countries have room for improvement.

A SUSTAINABLE MARKET ECONOMY IS CHARACTERISED BY

6

QUALITIES

COMPETITIVENESS AND GOOD GOVERNANCE ARE THE

2

AREAS IN WHICH THE LARGEST GAPS EXIST BETWEEN THE EBRD REGION AND ADVANCED ECONOMIES

INCREASING NUMBERS OF COUNTRIES IN THE EBRD REGION ARE SETTING THEMSELVES THE TARGET OF GENERATING

20%

OF ELECTRICITY FROM RENEWABLE SOURCES

Introduction

Last year the EBRD conducted a review of its transition concept. That review built on the findings of the *Transition Report 2013 ("Stuck in Transition?")*, which analysed structural reforms in the EBRD's countries of operations and was a catalyst for reflections on the modern-day relevance of the transition framework adopted in the 1990s. That review took account of all the economic developments that had been observed over the previous 25 years, as well as the EBRD's wealth of experience in supporting countries' transition from planned to market economies.

This has resulted in an updated interpretation of transition, under which a sustainable market economy is characterised by six key qualities; the economy should be competitive, well governed, green, inclusive, resilient and integrated. With the agreement of its shareholders, the EBRD now looks at transition countries' development and the impact of its operations through the prism of those six qualities.

This section takes a closer look at what those qualities mean and how they can be translated into new measures of progress that also contribute to shaping the global narrative on development. An outline of the EBRD's new assessment methodology is followed by a summary of key results.

This section also provides an overview of structural reforms in the region over the past year. This year, those developments are described using a new set of scores that cannot be directly compared with earlier sectoral scores. As of next year, progress in the area of structural reform will be assessed on the basis of upward or downward changes to these new scores.

The six qualities of a sustainable market economy

In the early 1990s, transition countries faced a common set of challenges, ranging from reforming economic systems and introducing market-based prices to creating appropriate institutional frameworks for growth and economic stability. Policy-makers encountered many major economic and social problems: industrial output, real wages and salaries fell, while inflation and unemployment both rose rapidly; and trade declined with the collapse of the main reference market (COMECON), while penetrating new markets on the basis of existing technology proved difficult. Since then, transition economies have experienced significant changes in terms of their institutions and markets, and those changes have varied considerably in terms of their pace and magnitude. Initially, with the market economy a distant goal, the direction of change was broadly uniform. However, as countries have progressed along the transition path, they have faced different conditions and drivers of development. As a result, the economies of the EBRD region are now far more diverse in terms of their institutional development and market orientation.

Views on the roles of the state and the private sector have also evolved since the start of the transition process. Following the fall of the Berlin Wall, the prevailing economic thinking was that the economic role of the state should be limited to dealing with certain issues (such as natural monopolies, public goods, some elements of income redistribution and the conduct of macroeconomic policy), with most other things being left to the private sector. In line with this approach, transition countries emerging from the command economy focused largely on the privatisation of state assets. More recently, however, it has increasingly been recognised – particularly after the 2008-09 financial crisis – that unfettered markets and poor regulation can lead to suboptimal outcomes such as rising inequality, variable productivity (owing to the effects of market failures – especially on innovation and growth) and poor environmental sustainability. The slow growth that has been observed in the aftermath of the financial crisis – especially the high unemployment rates and the weak growth in real incomes – has contributed, in some countries, to public disillusionment with markets and a decline in public support for market reforms.

It is now understood that the roles of the state and the private sector are closely intertwined. For a healthy private sector to exist, the state has to provide sound legal and regulatory frameworks that uphold the rule of law, correct market failures, prevent abuses by vested interests, ensure a level playing field and allow all sections of society to have equal access to economic opportunities.

This conceptual shift is reflected in the updated transition concept. While the previous methodology emphasised the promotion of structural aspects of markets, such as private ownership and competition, the revised approach focuses on outcomes, looking at the qualities of a sustainable market economy. In particular, as described below, successful economies are competitive and well governed, resilient enough to withstand shocks and economically integrated (both internally and with neighbouring markets and the global economy). Moreover, in order to be fully sustainable, they are also inclusive and green. These six qualities can be regarded as a natural extension of the original transition concept and represent a useful instrument facilitating the EBRD's continued focus on markets and the private sector as a tool for development and growth.

Transition indicators

Since the mid-1990s, the EBRD has sought to quantify countries' progress towards market economies with the aid of a set of transition indicators. This year, that assessment methodology has been updated in order to reflect the revised transition concept. The new methodology is based on the six qualities of a sustainable market economy, rather than structural or sectoral indicators (see Box S.1 for an overview of past approaches to the measurement of transition).

In the interests of consistency and continuity, the new assessment follows the principles used for sectoral transition

TABLE S.1. Components used to measure the six qualities of a sustainable market economy

Quality	Components
Competitive	Market structures for competition and business standards
	Capacity to add value and innovate
Well-governed	National-level governance
	Corporate-level governance
Green	Mitigation of climate change
	Adaptation to climate change
	Other environmental areas
Inclusive	Gender equality
	Regional disparities
	Opportunities for young people
Resilient	Financial stability
	Resilient energy sector
Integrated	Openness to foreign trade, investment and finance
	Domestic and cross-border infrastructure

Source: EBRD.

scores in previous years. This remains a data-driven comparative exercise, with a number of indicators being used to produce scores quantifying progress. At the same time, however, the updated approach further reduces the scope for discretion in the calculation of scores. Instead, country and sector-specific knowledge derived from the EBRD's activities on the ground plays a greater role in the strategies devised by the Bank in response to the challenges identified allowing for a more nuanced discussion regarding scores and what they mean for a specific country or sector.

The new assessment methodology also makes more extensive use of output indicators, thereby capturing not only processes and institutional set-ups, but also actual performance. This results in certain changes in terms of the overall picture of structural reforms. Lastly, structuring the assessment on the basis of the six qualities of a sustainable market economy allows country specificity to be taken into account when assessing the development of an economic system. Indeed, we can see from looking at advanced economies that there is no such thing as a "standard" market economy and no single way of getting there.

The results are also presented differently. Progress is now measured on a continuous scale from 1 to 10 for each quality, whereby 10 is the best possible score and denotes the frontier in terms of a sustainable market economy. (Earlier assessments used a scale of 1 to 4+, with discrete notches.) The primary purpose of the new scores is to provide a consistent high-level snapshot across countries for each quality. The composite indicators at quality level aggregate a wide range of sub-indicators.

New transition indicators: coverage and methodology

The first stage of this assessment process involves the identification of relevant key components for each quality (see Table S.1).

The assessment of competitiveness looks at market structures that support competition and incentives for sound decision-making (including measures of openness, business skills and the business environment). It also takes account of firms' capacity to add value and innovate (including measures of access to appropriate infrastructure and resources).

The assessment of the extent to which an economy is well governed builds on the EBRD's existing analysis of corporate governance for private enterprises, which is complemented by a measure of integrity. In addition, that analysis also incorporates measures of the quality of public governance, the control of corruption and the rule of law, which are based on available external sources.

The analysis of challenges in the green economy looks at the mitigation of and adaptation to climate change, as well as environmental outcomes such as air pollution, the generation of waste, and biodiversity. This builds on some of the indicators that were used in the assessment of sustainable resources in the *Transition Report 2015-16*, such as carbon intensity or the role played by renewables in the energy mix.

The assessment of economic inclusion is closely aligned with the previous methodology for quantifying transition gaps in the areas of inclusion and equality of opportunity, with a particular focus on gender gaps, regional disparities and opportunities for young people (see the *Transition Report 2013* for details). While that methodology has been refined somewhat in recent years, the key principles have remained unchanged.

The analysis of challenges in building stability and economic resilience looks at two different components of stability. In the area of financial stability, it draws on existing assessments of transition challenges in financial sectors. Given the importance of the banking sector relative to other sources of finance, most indicators relate to the health and adequate regulation of the banking sector. However, other aspects, such as the existence and performance of stock markets, are also taken into account. The second component relates to the resilience of the energy sector and looks mainly at domestic and cross-border connectivity (but also takes account of legal and regulatory considerations in electricity and gas markets). Even though fiscal stability is also an important aspect of resilience, it is not currently included in the EBRD measurements.

The assessment of economic integration looks at both cross-border and domestic connectivity, using measures of openness to trade and investment, as well as balance of payment considerations. It also maps the quality of cross-border and domestic infrastructure, incorporating cost considerations and the provision of services. Measures of the quality of energy and ICT infrastructure are also included as important aspects of integration in a modern market economy.

The next step is to identify relevant indicators and data sources (see Chart S.1). The majority of the indicators are quantitative, with some qualitative indicators being used where necessary. Indicators have been constructed using a wide range of sources, including national and industry statistics, data from other international organisations (such as the World Bank, the IMF and the UN) and surveys such as the Business Environment and Enterprise Performance Survey (BEEPS) and the Life in Transition Survey (LiTS), as well as expert qualitative assessments (see also the methodological notes in the online version of this report, at tr-ebrd.com).

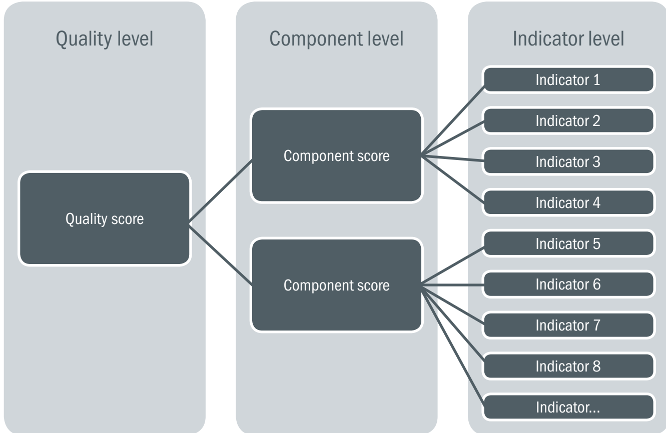
To some extent, the selection of indicators is limited by the fact that the data need to cover all of the countries in the EBRD region, as well as advanced comparator economies outside the region. Data limitations also mean that proxies and imputation have to be used for some observations. Furthermore, data on outcomes are, by definition, a reflection of past decisions. This means that more recent reforms which will take time to show in the data may not be reflected in current transition scores.

Lastly, a scoring mechanism needs to be developed for each quality (see Box S.2). That score measures the situation in each economy relative to a frontier representing the best possible features of a sustainable market economy, which acts as a common benchmark. At indicator level, this frontier represents the situation in the best-performing country in the sample (which comprises the countries of the EBRD region and selected OECD countries as comparators).[1] At component or quality level, the frontier can be regarded as a synthetic country made up of the best performers for each indicator, meaning that no single country in the world is at the overall frontier.

That frontier establishes a useful common benchmark, allowing all countries to be assessed in a consistent manner. However, the frontier is not intended to serve as a finish line. Even though all of the comparator economies included in the analysis can be characterised as well-functioning and sustainable market economies, they score differently across the six qualities. They stand out as being consistently high performers, but their degree of success varies. Thus, the inclusion of comparator countries in the analysis provides a more realistic indication of where countries could be expected to end up with respect to a given frontier.

THE EBRD HAS BEEN MEASURING COUNTRIES' PROGRESS WITH TRANSITION SINCE
1994

CHART S.1. Schematic representation of the assessment methodology



Source: EBRD.

New transition indicators: results

The scores and rankings of individual countries vary across qualities. For example, Slovenia is ranked fifth to seventh in terms of being well governed, resilient and integrated, but second or third in terms of being competitive, green and inclusive. These results may reflect variation in countries' priorities.

Regional aggregates (see Chart S.2) show that countries in the EBRD region tend, on average, to be furthest away from the frontier in the areas of competitiveness and good governance. At the same time, the EBRD region appears to be relatively well integrated, with much of that being driven by external integration.

Taking account of both the distance to the frontier and countries' rankings at quality level, regional results indicate that the best-performing countries are in central Europe and the Baltic states (CEB). Indeed, Estonia, Latvia and Slovenia are consistently among the top scorers in the EBRD region. Other CEB countries are usually in the top third, but perform worse than countries in other regions in at least one quality.

In south-eastern Europe (SEE), the picture is more mixed. In terms of the distance to the frontier, the largest gaps can be seen in the areas of competitiveness, good governance, the green economy and inclusion. A closer look at countries' performance relative to other EBRD countries shows that the four EU member states in this region (Bulgaria, Cyprus, Greece and Romania) perform well overall, but are weak when it comes to good governance and inclusion, as are the countries of the

[1] In some instances, benchmarks represent a theoretical ideal, rather than the performance of an actual country. For example, the frontier for the loan-to-deposit ratio indicator in the assessment of the stability of the financial sector represents a balanced middle ground, as going to the extreme in either direction is undesirable (with very high ratios implying insufficient buffers to deal with potential shocks and very low ratios implying that banks are failing to lend to capacity).

TABLE S.2. Transition scores for six qualities of a sustainable market economy

	Competitive	Well-governed	Green	Inclusive	Resilient	Integrated
Central Europe and the Baltic states						
Croatia	5.75	5.14	6.03	6.03	6.61	6.85
Estonia	7.58	7.58	6.44	7.30	8.19	7.77
Hungary	6.42	5.31	6.37	6.27	6.65	7.89
Latvia	6.53	6.09	6.37	6.82	7.66	7.73
Lithuania	6.06	6.10	6.06	7.05	7.23	7.78
Poland	6.38	6.15	6.56	6.29	7.64	6.79
Slovak Rep.	6.82	4.98	7.05	5.73	7.64	7.85
Slovenia	6.93	5.74	6.67	7.02	7.44	7.61
South-eastern Europe						
Albania	4.41	4.31	4.85	5.11	4.86	5.76
Bosnia and Herz.	4.74	3.66	4.85	4.83	5.35	5.47
Bulgaria	5.96	4.69	5.82	5.33	6.54	6.86
Cyprus	7.21	6.15	5.76	6.20	5.19	6.52
FYR Macedonia	5.39	5.20	4.91	4.72	5.31	6.04
Greece	6.31	4.34	6.27	5.63	6.67	6.38
Kosovo	3.37	3.73	3.80	4.70	5.09	4.89
Montenegro	4.89	5.12	5.15	5.62	5.93	5.59
Romania	6.28	4.97	5.86	5.08	6.98	6.88
Serbia	4.94	4.39	5.77	5.16	5.55	6.39
Turkey	4.89	5.30	5.12	4.21	7.08	5.90
Eastern Europe and the Caucasus						
Armenia	4.47	4.79	5.41	5.72	5.04	5.94
Azerbaijan	3.64	4.61	5.23	4.71	4.46	5.84
Belarus	4.99	4.32	6.16	5.72	4.17	5.38
Georgia	4.54	5.98	4.58	5.14	5.71	6.54
Moldova	4.87	3.94	4.14	5.19	5.27	5.64
Ukraine	4.68	3.58	5.54	5.88	4.60	5.04
Russia	5.20	4.55	4.92	5.94	5.95	5.17
Central Asia						
Kazakhstan	4.30	5.05	4.42	5.37	5.66	5.00
Kyrgyz Rep.	3.45	3.33	4.36	4.46	4.98	4.94
Mongolia	4.25	4.50	5.28	5.64	4.57	5.68
Tajikistan	2.66	3.69	5.58	4.58	3.76	4.23
Turkmenistan	1.46	3.83	4.13	4.86	3.12	4.64
Uzbekistan	2.72	4.32	3.20	5.34	3.98	4.20
Southern and eastern Mediterranean						
Egypt	2.87	3.90	4.41	4.24	5.41	4.27
Jordan	3.92	5.26	5.65	4.88	5.66	6.12
Lebanon	4.92	TBD	TBD	TBD	TBD	5.82
Morocco	3.98	4.35	5.47	4.16	6.06	5.45
Tunisia	3.94	4.33	4.78	4.72	4.75	4.70

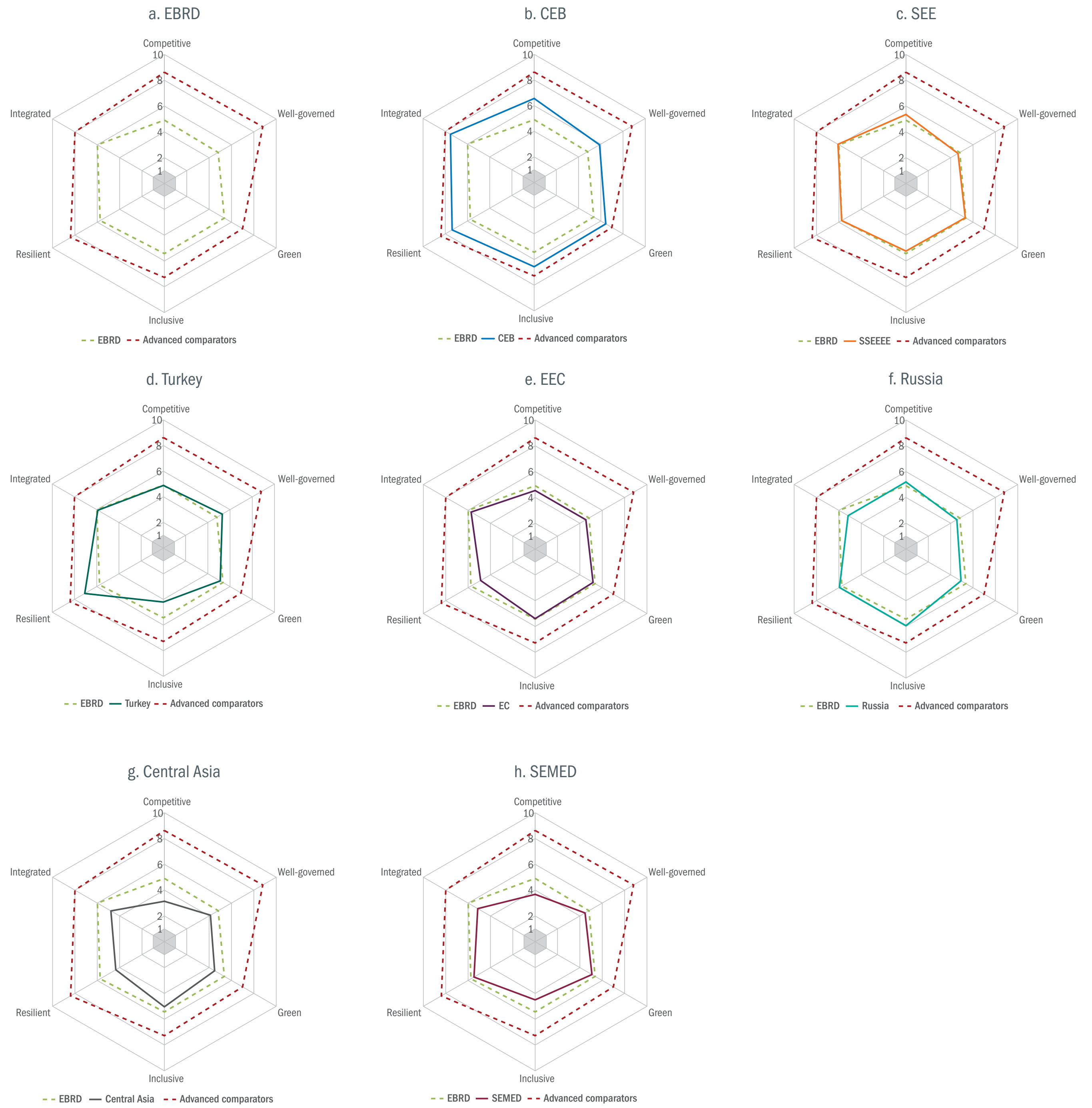
Source: EBRD.
Note: Scores range from 1 to 10, where 10 denotes the synthetic frontier for each quality. The inclusion score for Uzbekistan covers gender equality and regional disparities only. The inclusion score for Turkmenistan covers gender equality only. "TBD" indicates scores that are not yet available.

Western Balkans. In addition, Albania, Bosnia and Herzegovina, FYR Macedonia and Kosovo are all ranked in the bottom third in terms of how green their economies are. Lastly, Cyprus and Greece both appear to be less resilient than a number of their EU peers.

In eastern Europe and the Caucasus (EEC), countries' performance is similarly mixed. This region is weak when it comes to resilience, but two or three countries stand out on account of their performance in other areas. For instance, Georgia performs well in terms of good governance and integration relative to other countries. Meanwhile, Armenia, Belarus and Ukraine all stand out in the area of inclusion, but Ukraine faces considerable challenges in the area of good governance.

However, the biggest challenges in terms of transition to a sustainable market economy can be found in Central Asia and the southern and eastern Mediterranean (SEMED) region. All of the countries in these two regions need to improve in the areas of competitiveness, inclusion and, to varying degrees, internal and external integration.

CHART S.2. Average transition scores by region or country



Source: EBRD and authors' calculations.
Note: "Advanced comparators" denotes the average score for Germany, Sweden and the United States of America. The average for SEMED does not include Lebanon.

Overview of reforms over the past year

The new transition methodology outlined above provides a useful framework for thinking about reforms and evaluating reform efforts against the needs and gaps identified in the new scoring system. The past year has seen a range of reforms being implemented across the region, as well as a number of reversals, and these developments can be viewed through the prism of the new transition concept – despite the fact that, with the new system having only just been introduced, countries' transition scores are not directly comparable with data for previous years. The country pages of the online version of this report contain detailed evaluations of all the main structural reforms in each country over the last year, but the key developments are reported below.

Competitive

This quality covers a broad range of reforms aimed at making it easier for firms to do business and grow, improving the attractiveness of the economy for investors, and enhancing skills and innovation. Not surprisingly, a number of countries have made changes with the aim of improving the competitiveness of individual companies or entire sectors over the last year. Many such reforms have been seen in the CEB region, for instance, as well as Central Asia.

In some cases, governments have introduced comprehensive and far-reaching reform packages following long periods of inactivity. Uzbekistan is the most dramatic example in this regard. Uzbekistan has long been a laggard when it comes to market-oriented reforms, and it languishes near the bottom of the list in terms of overall transition scores (as it did under the previous methodology). However, in 2017 the Uzbek authorities initiated a number of reforms that could, if implemented, have far-reaching effects in terms of the country's competitiveness. Most notably, the country's exchange rate regime has been liberalised following a presidential decree on 5 September 2017 announcing the free convertibility of the Uzbek currency, the sum. This represents a major step forward, as convertibility has long been seen as a litmus test for reform efforts. Egypt has also liberalised its exchange rate regime and removed restrictions on cross-border currency transfers, thereby easing the concerns of foreign investors, who were previously unable to repatriate profits.

In recent years, the EBRD region has led the way in terms of reforms aimed at making it easier to do business, as measured by the World Bank's annual Doing Business rankings, and many countries have kept up this momentum in the past year. In Croatia, for example, the government has reduced the administrative fees that are charged for establishing a company, as well as implementing a number of other measures aimed at reducing the administrative burden on firms. These are long overdue, as Croatia has tended to perform poorly relative to its peers in the CEB region when it comes to measures of competitiveness and ease of doing business. In Turkey, meanwhile, the government adopted a reform package in June 2017 with a view to reducing operational and investment costs for manufacturing companies by easing access to and lowering the cost of land in organised industrial zones, as well as cutting fees and taxes on production and investments. Similarly, the Egyptian government has approved new laws on investment and industrial licensing, both of which should simplify the process of establishing companies and obtaining licences.

In FYR Macedonia, a two-year political crisis, which had led to stagnation and weakening growth, was resolved in mid-2017. The new government has introduced a comprehensive reform plan with an emphasis on support for local businesses and enhanced regional integration. Meanwhile, elsewhere in the Western Balkans, the EU approximation process remains the key anchor for market-oriented reforms. Montenegro continues to lead the way in this regard, with 28 of the 33 chapters of the country's accession negotiations now open, and three provisionally closed. Serbia has also made progress with its negotiations over the past year, while Bosnia and Herzegovina is in the process of completing the European Commission's pre-accession questionnaire, having applied for EU membership in 2016.

In addition, several countries have made important advances in the area of privatisation. In Greece, three important privatisation projects have been completed this year: concessions for Piraeus port and 14 regional airports, and the sale of the railway company TrainOSE. Slovenia has made progress with its plan to sell 20 companies in 2017, although the flagship sale of the country's biggest bank, NLB, is on hold. Progress has also been made with Kazakhstan's ambitious privatisation plan, with 53 small companies owned by state holding company Samruk Kazyna being sold between mid-2016 and mid-2017. However, Ukraine's privatisation programme has largely stalled. Indeed, the government was forced to nationalise Ukraine's largest commercial bank, Privatbank, at the end of 2016 in order to preserve financial stability. In Poland, where state control over the economy remains significant (particularly in the banking and energy sectors), the government has called a halt to the country's privatisation programme.

Well-governed

Improving governance is a difficult task and typically requires a sustained commitment to reforms over a period of time. Several SEMED countries have recently embarked on major reforms of their public administrations and civil services. In Tunisia, for example, the government adopted a new strategy earlier this year with the aim of reforming its civil service. That strategy aims to streamline the civil service by 2020 and substantially reduce its wage bill. Morocco has also made progress with reforms to its civil service, while the Jordanian government has carried out a comprehensive public investment management assessment with a view to enhancing the efficiency of public investment spending.

Reforms of public-sector governance have also featured prominently in the CEB region. In Poland, for example, a number of spending reviews have been carried out. In the Slovak Republic, meanwhile, a successful programme introduced in 2016 with the aim of ensuring value for money has been expanded to cover several new sectors. The Slovak government is also strengthening measures to ensure that the drawing of public funds (including EU funds) is carried out in accordance with best practices and that opportunities for corruption are minimised. Bulgaria and Romania both remain under the EU's Cooperation and Verification Mechanism, which was introduced when the two countries joined the EU in January 2007. Both countries have made further progress in this regard over the past year. Bulgaria has made progress with judicial reforms and drawn up new laws aimed at tackling high-level corruption and money-laundering. Romania has also taken important steps in these areas over the past year, including the adoption of a new anti-corruption strategy for 2016-20.

In view of the importance of the natural resources sector for many countries in the region, the EBRD continues to support the Extractive Industries Transparency Initiative (EITI). There are a number of EITI countries in the EBRD region, and developments in those countries have been mixed over the last year. Mongolia, for instance, has been certified as having made meaningful progress against the EITI's 2016 standards, while the Kyrgyz Republic and Tajikistan have both been suspended on account of inadequate progress. Most notably, Azerbaijan's membership of the EITI was suspended in March 2017 over concerns about the enabling environment for civil society. Following that suspension, Azerbaijan formally withdrew from the initiative, although the government has stated that it remains committed to the principles of good governance, revenue transparency and accountability. A presidential decree dated 5 April 2017 established a commission on additional measures to increase transparency and accountability in the extractive industries.

Governance is not just important at national level. Companies should also adhere to good standards of corporate governance. This can help to attract investment and provide a framework for identifying and managing risk, as well as helping to ensure better and more effective management that takes account of stakeholders' concerns. This is particularly important for state-owned companies, which can be subject to political demands. With the help of the EBRD, a number of countries are now implementing reforms aimed at improving the corporate governance of state-owned enterprises across a variety of different sectors (including transport, energy, finance and industry). In Belarus, for instance, a programme is being implemented in order to improve the governance of two state-owned banks in preparation for subsequent privatisation, while Albania's main utilities company, KESH, is in the process of improving its governance and operating practices.

Green

Major progress has been seen right across the region in the area of green transition, especially as regards the development of renewable energy.

The Egyptian government's Sustainable Energy Strategy, which was approved in 2016 and covers the period up to 2035, has formalised its commitment to renewable energy. That strategy seeks to establish a sustainable and diverse energy mix and reconfirms the ambitious target (previously set in 2008) of obtaining 20 per cent of electricity from renewable sources (particularly solar and wind) by 2022. Achieving this target will require massive investment, most of which is expected to come from the private sector.

In Mongolia, meanwhile, all of the financing for the Sainshand and Tsetsii wind farms has now been secured, and construction has begun. That progress followed more than six years of policy dialogue and project structuring in relation to the earlier Salkhit wind farm in order to help set up an appropriate framework. Those projects should help Mongolia to achieve its goal of renewable energy accounting for 20 per cent of all power by 2020 and 30 per cent by 2030.

In Serbia, where the use of renewable energy remains limited, the Kovačica and Dolovo wind farms have successfully raised all of the required financing following significant policy dialogue involving the EBRD and other international financial institutions with a view to ensuring the bankability of the associated power purchase agreements. Together, those projects will achieve carbon savings totalling more than 600 tonnes of CO_2 emissions per year, as well as helping to demonstrate the viability of the country's newly established renewable energy support scheme.

In Poland, however, new legislation on renewable energy which entered into force in August 2017 may discourage new investment and jeopardise the existence of current producers of renewable energy. That new law follows earlier legislation sharply restricting the deployment of inland wind farms. These developments make it less likely that the country will achieve its target of generating 15 per cent of its energy from renewable sources by 2020. On a more positive note, however, the government has also issued an important air quality directive restricting the production and use of polluting heating installations.

Substantial efforts have also been made across the region with a view to expanding the market for green financing, increasing fuel switching, reducing gas flaring and rolling out energy-efficiency measures. In the Baltic states, Lithuania's national energy company is issuing some of the EBRD region's first ever green bonds, while in the SEE region, Montenegro has embarked on the third phase of its modernisation and smart meter installation programme, which is expected to result in it becoming the first country in the EBRD region to meet the EU's target of having at least 80 per cent of the population covered by smart meters by 2020. In Turkey, meanwhile, gas companies have continued to expand their gas distribution network to new cities, resulting in significant switching away from higher-carbon alternatives.

Inclusive

The issue of inclusion poses major challenges across large parts of the EBRD region. The large skills gaps and high levels of youth inactivity in the SEMED region and the Western Balkans are hindering young people's access to skills and employment. Meanwhile, legal and regulatory barriers are continuing to prevent women from participating in labour markets to the same extent as men, particularly in the SEMED region, Turkey and Central Asia. In addition, variation in the quality of local institutions and access to services within individual countries is exacerbating regional inequality and limiting convergence in the SEE region and Central Asia. Moreover, for many countries, the ongoing refugee crisis and increased migration flows are posing substantial challenges. Nevertheless, efforts to promote inclusive growth are under way across the region.

Gender equality has been at the top of the policy agenda in the SEMED region and Central Asia in the last year, with Jordan becoming the third SEMED country (after Morocco and Lebanon) to preclude the use of marriage to avoid rape prosecutions. Tunisia, meanwhile, has adopted its first law preventing gender-based violence and providing support to survivors, as well as abolishing a law prohibiting Tunisian women from marrying non-Muslim men. In Kazakhstan, the Secretary of State has adopted a new Gender and Family Strategy 2030 to address legal barriers preventing women from working freely in all sectors. In this context, a commitment has been made to "optimise" the list of 299 jobs that women are currently prohibited from undertaking. Similar efforts are under way in the Kyrgyz Republic.

In many parts of the Western Balkans, reforms are under way with the aim of improving technical and vocational education and skills, albeit progress is often slow. In 2016, Kosovo and Montenegro launched strategic plans seeking to align their vocational education and training policies with labour market requirements. Albania has adopted new regulations aimed at improving its dual learning system, while the Montenegrin parliament has adopted a new social strategy with the aim of enhancing the skills and employment opportunities of its Roma and Egyptian minorities. At the same time, however, Bosnia and Herzegovina, FYR Macedonia and Serbia still have not adopted new national qualifications frameworks, despite this issue having been under discussion since early 2016.

In Kazakhstan, the authorities have launched an employment and entrepreneurship programme with a view to mitigating the impact that weak growth has had on the labour market. As part of those efforts, fees for basic vocational and technical training courses have been abolished. In Georgia, meanwhile, reform measures have been introduced with a view to strengthening work-based learning and facilitating the progression from vocational training to tertiary education. In Ukraine, pilot projects are under way in 200 local schools with the aim of testing new approaches to vocational education.

The Turkish government has adopted a new selective migration and refugee policy and is now allowing Syrians to apply to the Labour Ministry for work permits. Meanwhile, the Jordanian government has adopted the Jordan Response Plan 2017-19 (which includes initiatives aimed at strengthening resilience at local and national level), set up a new National Committee for Human Resource Development and developed a new strategy aimed at improving the development of human resources. In Egypt, meanwhile, resolutions seeking to protect the most vulnerable groups in society were announced by the President in June 2017. Those measures are aimed primarily at the poor and pensioners and provide vital cash support at a time of relatively high inflation.

200 SCHOOLS
ARE PARTICIPATING IN A MAJOR PILOT PROJECT IN UKRAINE TRIALLING NEW APPROACHES TO VOCATIONAL EDUCATION

Resilient

A number of countries have taken important steps to strengthen the resilience of their financial sectors in the last year. Indeed, there have been a large number of developments relating to this quality, suggesting that countries are still making major efforts to reform and strengthen their financial systems. In addition, some countries have taken steps towards putting their energy sectors on a more financially sustainable footing.

In many cases, this has involved dealing with the legacy of the pre-crisis credit boom and the high non-performing loan (NPL) ratios that persist across the region. This problem is especially severe in the SEE region – particularly in Cyprus and Greece, where NPLs still account for nearly half of all loans. Important legislative changes have been made in both of those countries in the last year with a view to helping to resolve this problem, and the countries' biggest banks have now started to tackle the issue of NPLs, with some limited success so far. Elsewhere in the SEE region, NPL ratios have fallen significantly in Albania, FYR Macedonia, Romania and Serbia. In order to support these efforts, an NPL project established as part of the Vienna Initiative has organised several workshops over the last year and launched a knowledge hub (npl.vienna-initiative.com) with a view to facilitating knowledge-sharing between stakeholders.

In Moldova, significant progress has been made with the mitigation of major vulnerabilities in the country's banking system. Two years ago, Moldova was shaken by a massive fraud in the country's three main banks, resulting in an outflow of funds totalling US$ 1 billion. At the time of writing, two of those three banks were still subject to special supervisory measures, while the third was under special administration by the central bank. Legal changes have been made to help prevent a similar crisis in the future.

In Azerbaijan, meanwhile, the authorities have made progress with the restructuring of the country's largest bank, IBA, in preparation for its eventual privatisation. And in Tunisia, the authorities have made important progress with the restructuring of public banks by concluding performance contracts – a major step in terms of strengthening the financial sector.

While subsidies remain a prominent feature of energy markets in a number of countries (notably in the SEMED region), the last year has seen some countries take advantage of low oil prices in order to reduce such market distortions. In Egypt, for instance, the government has carried out several rounds of reforms amending fuel and electricity subsidies, leading to higher prices for a range of energy products. The Tunisian government has also made progress with reforms to fuel and electricity subsidies, while the Jordanian authorities have introduced an electricity tariff adjustment mechanism to promote more efficient use of energy.

Integrated

Most of the countries in the EBRD region can be regarded as small, open economies, but barriers to cross-border integration persist. These barriers are gradually being broken down, with important advances being observed in the SEE region and Central Asia over the last year. Regional integration has been an important objective for SEE countries in recent years, but the poor quality of infrastructure has often been an obstacle to cross-border trade and investment. Albania, FYR Macedonia, Kosovo and Montenegro have all made major progress in the area of road building in the past year. However, important road projects in Bosnia and Herzegovina are being delayed by the authorities' failure to amend the law on fuel excise duties and allow an increase in the price of fuel.

Progress has also been made with a number of cross-border energy infrastructure projects supporting regional integration. Further progress has been made, for example, with elements of the Southern Gas Corridor (SGC), with major benefits expected to materialise across Albania, Azerbaijan, Greece and Turkey in the areas of employment, regulatory reform and energy security. In November 2016, Bulgaria and Romania completed the construction of a new gas interconnector, allowing gas to flow between the two countries and helping to ensure the eventual integration of SGC gas sources into central and western European markets.

In Central Asia, Kazakhstan is leading the way in terms of the promotion of international integration – notably in the financial sector, where the Astana International Financial Centre is almost ready to be launched. Meanwhile, the authorities in Uzbekistan are now reaching out to neighbours in order to open up new trade and investment opportunities. New road border crossings and a new rail link with Kazakhstan were opened in 2017, and commercial flights between Uzbekistan and Tajikistan resumed after a 25-year hiatus.

Box S.1. Measuring transition: an overview of past approaches

The EBRD has been assessing the progress made by countries of operations and attempting to quantify it since 1994. Transition scores are constructed on the basis of the EBRD's experience, surveys and available data, reflecting both the magnitude of countries' achievements and the scale of the remaining challenges. The first set of transition indicators was introduced in 1994 and covered various aspects of the transition process, focusing on what were considered to be the core elements of the market economy: enterprises and households, markets and financial institutions. The indicators that were selected on the basis of that conceptual framework ranged from privatisation and enterprise restructuring to price liberalisation and banking reform. That first generation of transition indicators was expanded over the years, being supplemented by measures relating to the development of the financial sector and infrastructure.

In 2010, those country-level indicators were complemented – and eventually replaced – by a broader range of sectoral indicators. While those original transition indicators had served an important purpose by providing an overview of progress over two decades where data on economic transition were relatively scarce, some of the limitations of those indicators were becoming increasingly apparent. One of the main criticisms was that the original indicators reflected a somewhat rudimentary approach to transition, with a focus on reducing the role of the state. Many countries had pursued reforms in these areas and achieved reasonable levels of private-sector participation in the economy. However, they continued to face challenges in terms of their economic development, which were not sufficiently captured by those fairly simplistic indicators. Many of the developments observed in the 1990s showed that having the state set the rules of the game and having an effective institutional environment was essential for the proper functioning of markets.

The new sectoral scores were based on a more nuanced approach, taking account of the market structures and institutions that are required to establish a well-functioning market economy. In addition, although they still incorporated an element of discretion on the basis of information that was not summarised in publicly available data, those sectoral scores relied more heavily on external data, thereby offering a more objective and justifiable account of countries' progress.

Box S.2. Scoring methodology

The raw data for each indicator are normalised to the same scale (0 to 1) using the values for the best and worst performers. If the highest value equates to the best performance, that transformation is carried out as follows:

$$x' = \frac{\mathrm{x} - \mathrm{x}_{worst}}{\mathrm{x}_{best} - \mathrm{x}_{worst}}$$

This ensures the comparability of scores across indicators. The next step is to aggregate those normalised data at component level using simple averaging. Lastly, components are averaged in order to obtain quality-level indicators using specific weights. Those weights are based primarily on the EBRD's judgement as to their relative importance (see the methodological notes in the online version for details). The resulting scores are then rescaled from 1 to 10, where 10 represents the frontier for each quality.