

# UNITED STATES AGENCY FOR INTERNATIONAL DEVELOPMENT



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## COMMERCIAL LEGAL REFORM ASSESSMENTS FOR EUROPE AND EURASIA

### **Synthesis Report**

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## I. Executive Summary

USAID has been providing economic reform assistance to emerging economies of the Europe/Eurasia region since 1990. Key areas of focus include banking and capital markets development, privatization, tax and fiscal reform, and commercial law and associated institutional reform activities ("C-LIR").

USAID's primary objective in supporting C-LIR efforts in the region has been to help accelerate the transition to a market economy by promoting the development of an appropriate legal and regulatory environment for commercial activity. As explained in the following section of this report, approaches and results in this area to date have been mixed. Overall, progress has been made in strengthening the commercial law environment throughout the region, yet in many cases these laws are being poorly implemented, and unevenly enforced. This phenomenon, which we refer to as the implementation/enforcement gap, remains a key development challenge throughout the region, with little consensus on what can be done to address it effectively.

USAID is seeking to better understand the dynamic forces that affect the content and pace of transition to the market, and to develop approaches that can help further strengthen and accelerate commercial law and associated institutional development in the region. To accomplish this, in 1998 USAID commissioned assessment studies in each of the key areas of activity mentioned above. This synthesis report presents the methodology, data, and interpretative results of four C-LIR diagnostic assessments that were performed between December 1998 and June 1999.

The four countries we studied in this assessment - Poland, Ukraine, Romania, and Kazakhstan - were selected to provide a diverse sample based on considerations of location, geography, size, relative wealth, economic structure, legal traditions, and relative progress in transition toward a market-oriented economy. In each country, we evaluated seven areas of commercial law - bankruptcy (insolvency), collateral (secured transactions), company, competition, contract, foreign direct investment, and international trade. In each substantive area of commercial law, we then assessed four "dimensions" of development - Framework Law, Implementing Institutions, Supporting Institutions, and the internally driven process of change that we refer to as the "Market" for reform.

One of USAID's desired principal outputs of this activity is the development of a set of common indicators that can be used for country-specific and cross-regional comparisons of C-LIR development. As explained in greater detail in the body of this report, these indicators were developed as a tool to help development professionals at various levels within USAID and other donor organizations make relatively quick, cost-effective, and accurate judgments concerning C-LIR development needs, priorities, and appropriate responses.

This Synthesis Report, four Country Diagnostic Reports, and the C-LIR indicator results upon which they are based, will be presented for discussion, comment and refinement at USAID's Regional Commercial Law Reform Workshop, Prague, the Czech Republic, December 6 - 9, 1999. Based on the results of this workshop, the C-LIR indicators and diagnostic methodology will be refined and made available for wider use within USAID and the larger donor community.

## II. GLOSSARY OF KEY TERMS & CONCEPTS

**Bankruptcy** - Mechanisms intended to facilitate orderly Market exit, liquidation of outstanding financial claims on assets and rehabilitation of insolvent debtors. Should be read to include "insolvency".

**Collateral** - Laws, procedures and institutions designed to facilitate commerce by promoting transparency, predictability and simplicity in creating, identifying and extinguishing security interests in assets. This term should be read to include "secured transactions".

**Companies** - Legal regime(s) for Market entry and operation that define norms for organization of formal commercial activities conducted by two or more individuals.

**Commercial Law** - Any one or more of seven areas of substantive law defined for the purposes of this study to include Bankruptcy, Collateral, companies, Competition, Contract, foreign direct investment, and International Trade laws, and associated institutions.

**Competition** - The legal and regulatory regime consisting of a body of rules, policies and Supporting Institutions intended to help promote and protect open, fair and economically efficient Competition in the Market, and for the Market.

**Contract** - The legal and institutional framework for the creation, interpretation and enforcement of commercial obligations between one or more parties.

**Foreign Direct Investment** - The laws, procedures and institutions that regulate the treatment of foreign direct investment.

**"Dimension"** - One or more of four elements that together make up the legal and institutional environment for modern commercial life. These include "Framework Laws", "Implementing Institutions", "Supporting Institutions" and, the "Market" for C-LIR.

**End Users** - Individuals and firms who use, or rely upon, the provision of goods (e.g., laws, regulations, licenses, certifications, etc.) or services (e.g., administration, adjudication, enforcement, etc.) provided by government (or its agents) that relate to commercial activity.

**Implementing Institution** - One of four Dimensions that together make up the legal and institutional environment for modern commercial life. The administrative body with primary responsibility for implementation and enforcement of framework and subsidiary laws, regulations, and policies governing one or more of the seven areas of commercial law assessed in this study. For example, Bankruptcy courts are the Implementing Institution for the Bankruptcy Framework Law.

**Indicator** - A point of reference or benchmark, whether quantitative or qualitative, against which a sample can be compared, measured, or evaluated.

**Indicator Result** - The value of an indicator's raw score divided by the reference value for that indicator. For example, a raw score of 54, divided by the indicator's reference value of 140, would yield an indicator result of 39%.

**International Trade** - The laws, procedures and institutions governing cross-border sale of goods and services.

**"Market" for C-LIR** - One of four Dimensions that together make up the legal and institutional environment for modern commercial life. The "Market" for C-LIR is a conceptual framework that helps characterize the dynamic of modern pluralistic society in which End Users "demand" and government "supplies" certain public goods and services that are necessary for modern commercial activity. For example, rent seeking by a local bread monopoly can give rise to demand by consumers (End Users) for specific remedial action by the government (i.e., enforcement of antimonopoly regulations) against offending firms.

**Raw Score** - The point value score of an indicator based on the data collected for that indicator.

**Supporting Institution** - Firms, individuals, or activities without which Framework Laws cannot be fully or efficiently implemented or enforced. Examples include notaries, bailiffs, trustees, banks, consumers groups, business support organizations, professional associations, and other similar ancillary service providers.

### III. Summary Indicator Results

The following table contains a summary of the indicator raw scores and results derived the four country diagnostic assessments. The scores reflect a "snapshot" of what our survey team found

**Development Indicators: Total Scores by Dimension**

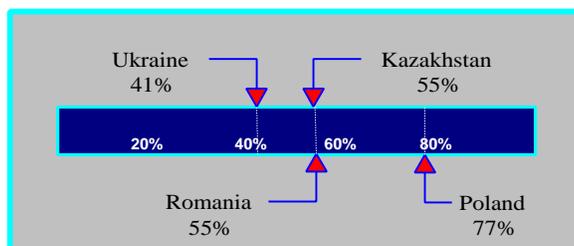
SUBSTANTIVE AREA		REF.	POL	ROM	UKR	KAZ
<b>A.</b>	<b>BANKRUPTCY</b>		<b>78%</b>	<b>54%</b>	<b>37%</b>	<b>50%</b>
1.	Legal Framework	280	224 80%	166 59%	114 41%	168 60%
2.	Implementing Institutions	170	136 80%	105 62%	76 45%	87 51%
3.	Supporting Institutions	200	151 76%	104 52%	66 33%	97 49%
4.	Market - Bankruptcy	290	225 78%	130 45%	81 28%	119 41%
<b>B.</b>	<b>COLLATERAL</b>		<b>77%</b>	<b>32%</b>	<b>48%</b>	<b>35%</b>
1.	Legal Framework	140	126 90%	62 44%	107 76%	79 56%
2.	Implementing Institutions	210	165 79%	27 13%	118 56%	49 23%
3.	Supporting Institutions	190	123 65%	66 35%	59 31%	58 31%
4.	Market - Collateral	310	234 75%	114 37%	92 30%	87 28%
<b>C.</b>	<b>COMPANY</b>		<b>79%</b>	<b>62%</b>	<b>44%</b>	<b>59%</b>
1.	Legal Framework	190	153 81%	119 63%	90 47%	118 62%
2.	Implementing Institutions	270	205 76%	198 73%	140 52%	182 67%
3.	Supporting Institutions	100	82 82%	70 70%	42 42%	58 58%
4.	Market - Company	270	211 78%	117 43%	89 33%	130 48%
<b>D.</b>	<b>COMPETITION</b>		<b>80%</b>	<b>60%</b>	<b>41%</b>	<b>62%</b>
1.	Legal Framework	210	172 82%	138 66%	115 55%	135 64%
2.	Implementing Institutions	220	178 81%	136 62%	92 42%	141 64%
3.	Supporting Institutions	160	122 76%	82 51%	59 37%	74 46%
4.	Market - Competition	290	226 78%	142 49%	80 28%	162 56%
<b>E.</b>	<b>CONTRACT</b>		<b>80%</b>	<b>63%</b>	<b>45%</b>	<b>64%</b>
1.	Legal Framework	90	75 83%	67 74%	45 50%	66 73%
2.	Implementing Institutions	180	150 83%	132 73%	89 49%	119 66%
3.	Supporting Institutions	70	55 79%	46 66%	35 50%	38 54%
4.	Market - Contract	310	234 75%	114 37%	92 30%	192 62%
<b>F.</b>	<b>FDI</b>		<b>77%</b>	<b>57%</b>	<b>41%</b>	<b>66%</b>
1.	Legal Framework	290	253 87%	278 96%	259 89%	240 83%
2.	Implementing Institutions	190	155 82%	110 58%	35 18%	129 68%
3.	Supporting Institutions	200	131 66%	76 38%	56 28%	100 50%
4.	Market - FDI	310	234 75%	114 37%	92 30%	201 65%
<b>G.</b>	<b>TRADE</b>		<b>68%</b>	<b>54%</b>	<b>33%</b>	<b>52%</b>
1.	Legal Framework	280	260 93%	252 90%	158 56%	221 79%
2.	Implementing Institutions	180	128 71%	96 53%	61 34%	109 61%
3.	Supporting Institutions	180	88 49%	72 40%	35 19%	58 32%
4.	Market - Trade	310	188 61%	107 35%	66 21%	111 36%
<b>AGGREGATE TOTALS</b>			<b>77%</b>	<b>55%</b>	<b>41%</b>	<b>55%</b>
1.	Legal Framework	1480	1263 85%	1082 70%	888 59%	1027 68%
2.	Implementing Institutions	1420	1117 79%	804 56%	611 42%	816 57%
3.	Supporting Institutions	1160	808 71%	570 52%	385 35%	553 48%
4.	Market for Reform	2090	1552 74%	838 40%	592 28%	1002 48%

at the time of their visit; these scores have not been updated and so do not reflect any recent changes. The seven subject matter areas analyzed appear in the left-most column of the table. Within each subject matter area (e.g., Bankruptcy), four Dimensions of C-LIR are considered. The total number of possible points that scored against an indicator appears in the adjacent column entitled "REF". The remaining columns of the table below are organized by country, in the order in which the in-country diagnostic assessments were conducted.

For each country analyzed, *raw scores* (the number of points assessed against the indicator) appear next to the associated indicator *result* (stated as a *percentage of the total possible raw score for that category*). For ease of reference, indicator results columns are shaded. "Tier I" indicator raw scores and associated indicator results appear in the rows highlighted in light blue in the table below. Similarly, "Tier II" scores and results appear in the four rows immediately beneath the highlighted Tier I rows of the table. The reader is urged to carefully read Section V, Indicator Design and Development, before attempting to draw any specific conclusions either from the raw scores, or the associated indicator results, that appear in the summary table below.

The following general observations can be made about the data summarized in the table above:

1. **Overall Rankings:** Overall country rankings, as a percentage of the total possible raw score, are:



At this general level, the overall rankings confirm what prevailing wisdom - that is, in relative terms, Poland's C-LIR environment is significantly more developed than Kazakhstan's; that Kazakhstan's and Romania's C-LIR environments, while quite different, are at the same aggregate level of development; and, that Ukraine is the least developed in terms of its overall C-LIR overall environment.

**2. Subject Matter Rankings:** Subject matter rankings track the overall scores stated above. They clearly show that Poland and Ukraine are the bookends in each category, except for collateral, where Ukraine ranked above Romania and Kazakhstan.

	1st	2nd	3rd	4th
<b>Bankruptcy</b>	P	R	K	U
<b>Collateral</b>	P	U	K	R
<b>Company</b>	P	R	K	U
<b>Competition</b>	P	K	R	U
<b>Contract</b>	P	K	R	U
<b>FDI</b>	P	K	R	U
<b>Trade</b>	P	R	K	U

The only anomaly we find in the general pattern of results (shaded cells) is in Collateral, where Ukraine is ranks higher than both Kazakhstan and Romania. Tier II results suggest that a strong Framework Law, combined with a comparatively stronger Implementing Institution explain this difference. Recent enactment of a Framework Law based on international best practices, combined with the establishment of a modern registry system, are the primary causes of this result. We believe that the assessment results reflect the positive impact that USAID's sustained support to Ukraine in developing these dimensions of its system for Collateral. The comparatively weak results for Dimension III, Supporting Institutions [31%], and Dimension IV, Market for Reform [30%], suggest that any possible future technical assistance interventions in this area should focus on bolstering results primarily in these Dimensions.

**3. High-Low Spread:** Another possible metric for cross-regional comparative purposes is high-low spread (or disparity between countries) within subject matter areas. As reflected in the table below, the greatest high-low spread was found in Collateral, where Poland scores 44 points higher than Romania. The closest high-low spread was found in FDI, with a 33-point differential. One possible interpretation of this result is that, again *in relative terms*, FDI is the most developed area of commercial law within the sample. This may be due in part to a political consensus in each country that FDI is important ( with policymakers thus generating to a greater "supply" of laws), to a relative lack of controversy over the shape of reform, to greater harmonization (or approximation) in international law and practice in this area, or to other factors. The importance of "exogenous" demand for FDI reform -- from foreign financial institutions and donors -- should also be considered as a possible factor driving change in this area.

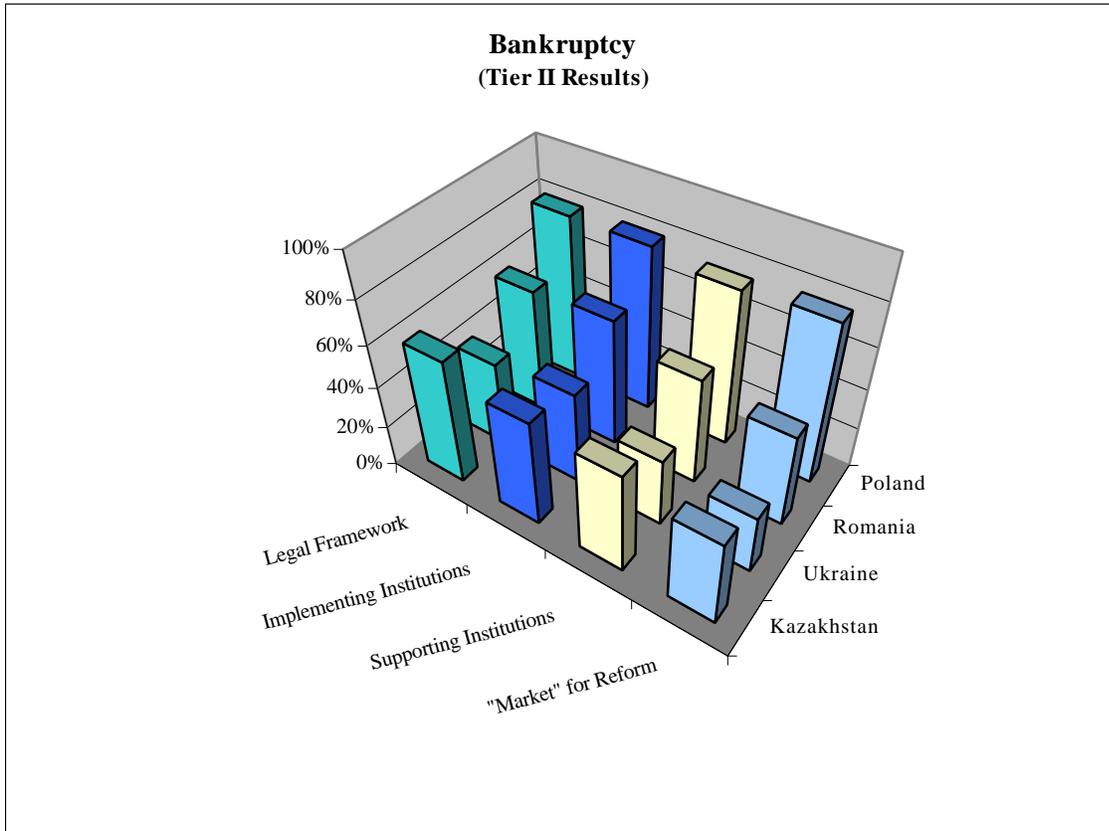
	High-Low Spread	Rank <sup>1</sup>	Total Average Score	Rank
<b>Bankruptcy</b>	37	3	55%	5
<b>Collateral</b>	45	1	48%	7
<b>Company</b>	35	5	61%	2
<b>Competition</b>	39	2	61%	3
<b>Contract</b>	35	5	63%	1
<b>FDI</b>	36	4	60%	4
<b>Trade</b>	35	5	52%	6

**4. Total Average Score by Subject Matter Area:** Total average score by subject matter area may be another useful metric for cross-regional comparative purposes. Based on the findings of the four country assessments, Contract ranked the highest with an average Tier I result of 63%. Collateral and International Trade, in contrast, had the lowest average Tier I results at 48% and 52% respectively. Based on this measure, Collateral and International Trade might be viewed by assistance partners as possible priority areas on a regional basis, relative to the other areas assessed.

**5. Rankings By "Dimension" :** The following tables summarizes the country rankings for each of the four "Dimensions" of C-LIR based on Tier II indicator results for each of the seven subject matter areas analyzed. Generally speaking, ranking patterns are consistent across subject matter areas. Pattern divergences are indicated by shaded cells in the tables. Column height in the accompanying charts represents the percent total possible raw score for each dimension within the subject matter area by country:

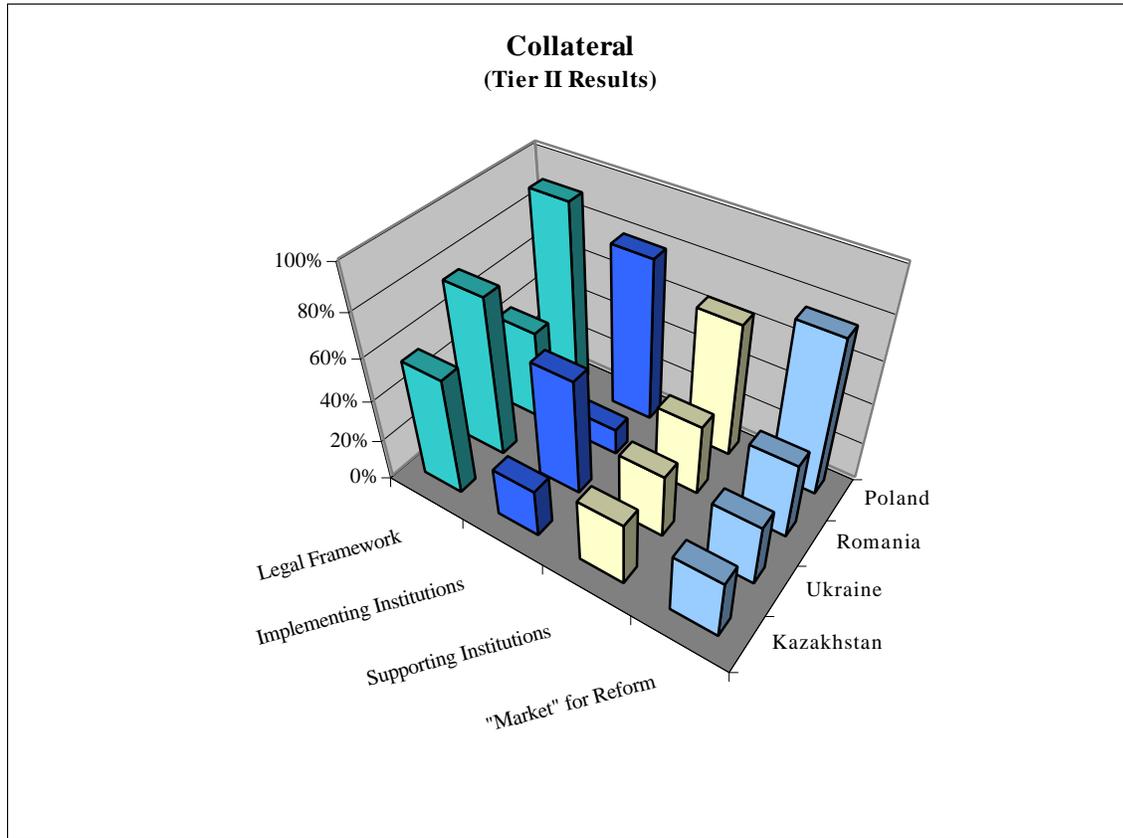
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<sup>1</sup> Rankings based on total spread between high and low Tier I rankings by subject matter area.



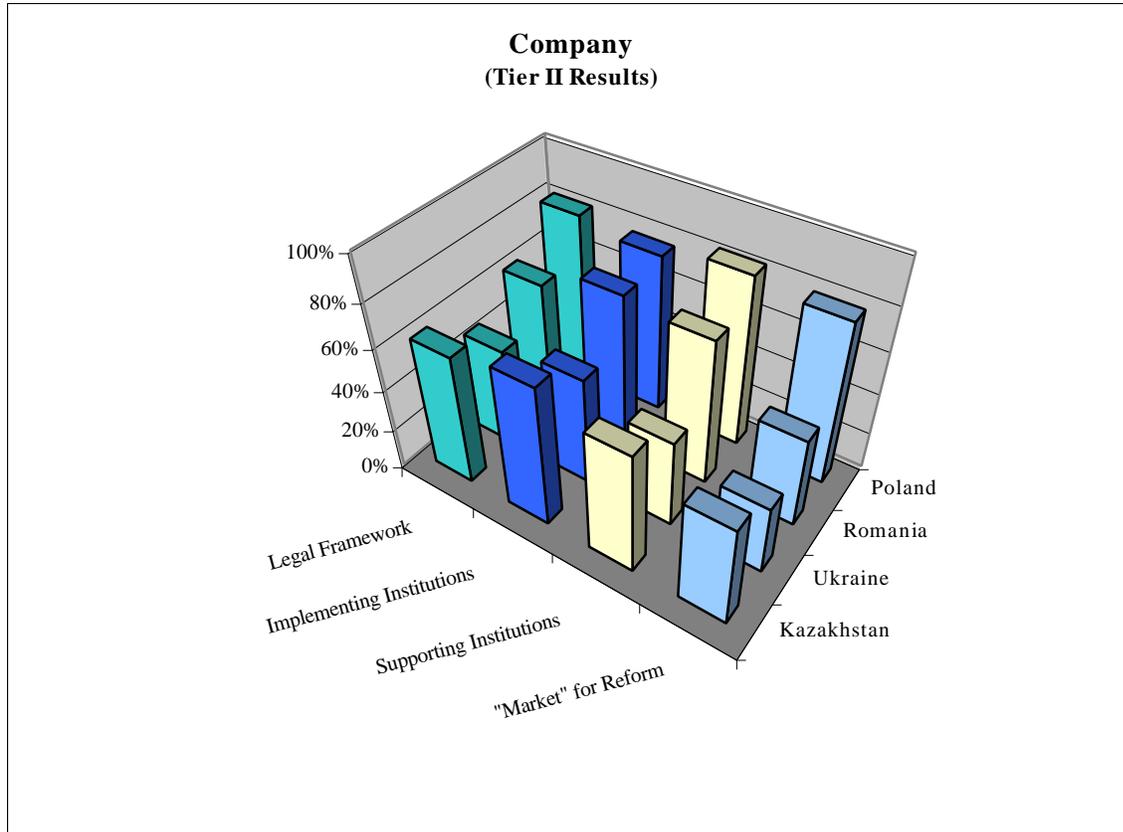
Bankruptcy	POL	ROM	UKR	KAZ
1. Legal Framework	80%	59%	41%	60%
2. Implementing Institutions	80%	62%	45%	51%
3. Supporting Institutions	76%	52%	33%	49%
4. Market for Effective Bankruptcy System	78%	45%	28%	41%

The chart above shows that Poland dominates the rankings in all four Dimensions and that, in comparative terms, the Market Dimension is the weakest of the four considered. Similarly, in all four Dimensions, Ukraine's scores were lowest among the group sampled. These basic patterns emerge with relative consistency in most of the charts that follow for the remaining six subject matter areas.



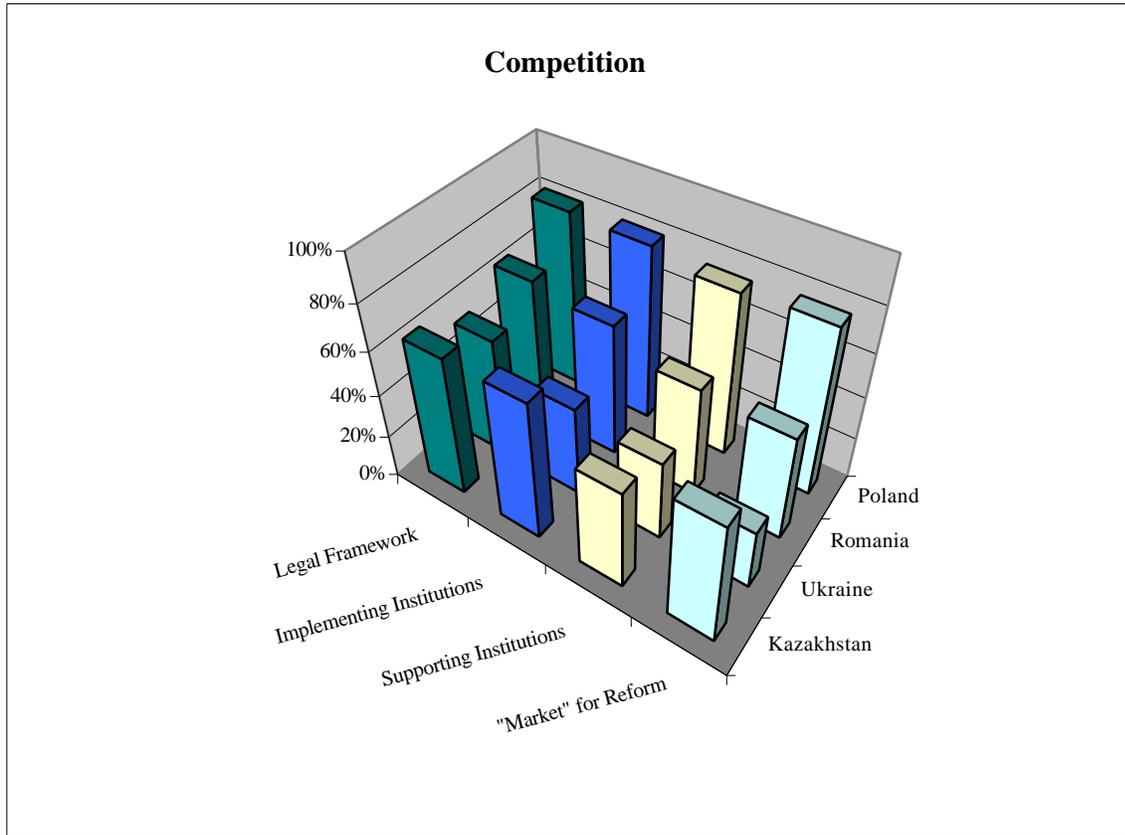
Collateral	POL	ROM	UKR	KAZ
1. Legal Framework	90%	44%	76%	56%
2. Implementing Institutions	79%	13%	56%	23%
3. Supporting Institutions	65%	35%	31%	31%
4. Market for Effective Collateral System	75%	37%	30%	28%

As in Bankruptcy, Poland's results in all four Dimensions outpace the rest of the sample group. In Dimensions I and II, Romania's Tier II results are clearly well below the other countries assessed, reflecting the absence of an appropriate Framework Law, and associated Implementing Institutions. Shortfalls in Dimension III indicator results for Kazakhstan, Romania, and Ukraine indicate a relatively less well developed supporting environment for commercial activity generally. Supporting Institutions, therefore, might be area where the experience of Poland, in comparative terms, might yield greater insights into this Dimension of C-LIR. Similarly, the weak Market Dimension results suggest an area of possible priority in future C-LIR interventions in Kazakhstan, Ukraine, and Romania.



Company	POL	ROM	UKR	KAZ
1. Legal Framework	81%	63%	47%	62%
2. Implementing Institutions	76%	73%	52%	67%
3. Supporting Institutions	82%	70%	42%	58%
4. Market for Effective Company Law	78%	43%	33%	48%

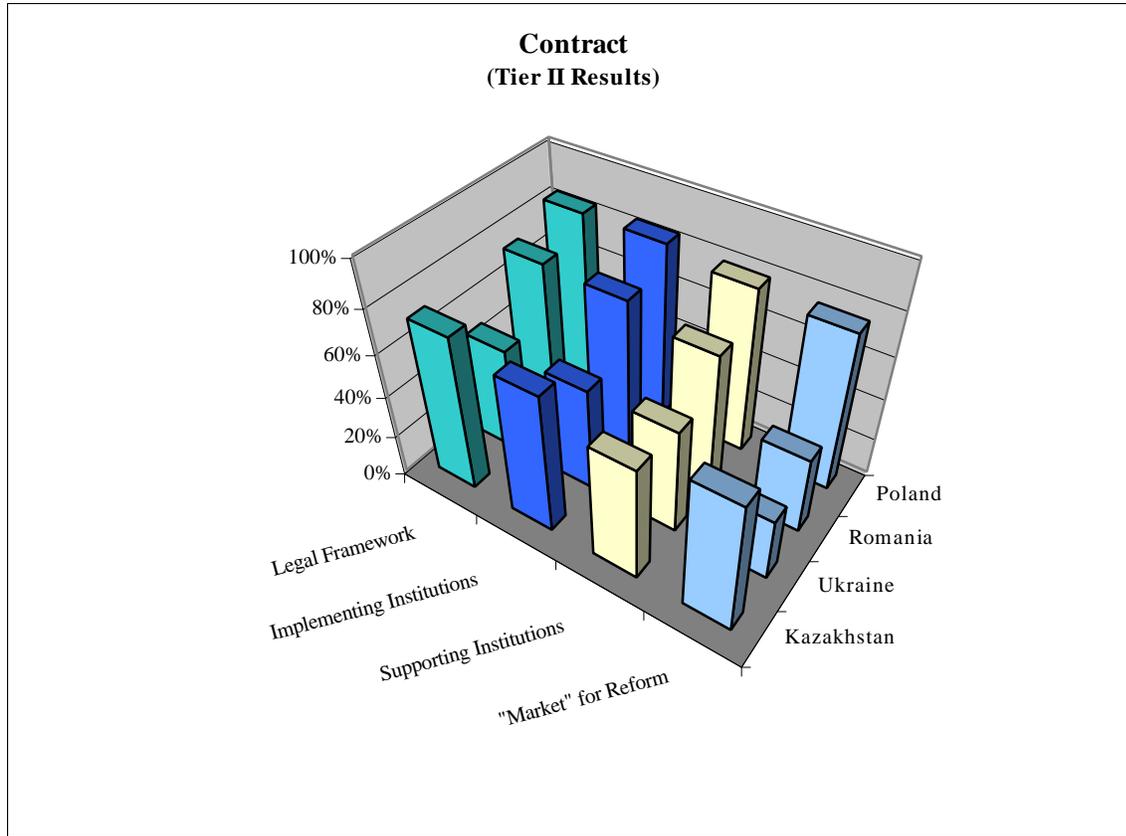
Tier II Company results show a greater degree of uniformity cross-regionally than Bankruptcy and Collateral. Overall, Ukraine's results are consistent with the overall results of the assessment, and reflect weakness in the Framework Law Dimension attributable to on-going debate and uncertainty concerning the enactment of a new Commercial Code. Implementing Institutions (e.g., commercial courts of general jurisdiction) were found to be performing below those of Kazakhstan and the other countries sampled. Particular areas of concern noted during the in-country diagnostic assessment were inefficient case management, corruption, and a weak culture of corporate governance underpinned by notions of fiduciary responsibility and shareholder rights.



Competition	POL	ROM	UKR	KAZ
1. Legal Framework	82%	66%	55%	64%
2. Implementing Institutions	81%	62%	42%	64%
3. Supporting Institutions	76%	51%	37%	46%
4. Market for Increased Competition	78%	49%	28%	56%

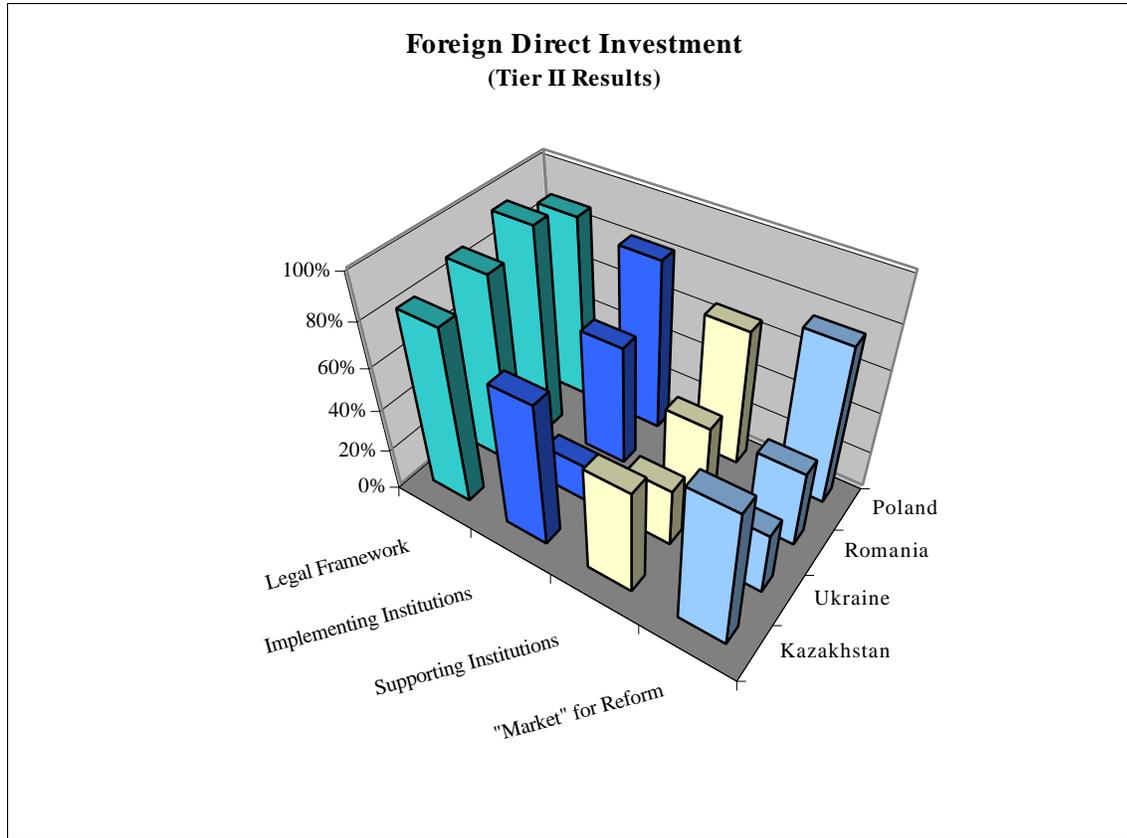
Poland's high scores in all four Dimensions of Competition suggest that this subject matter area is one of the most developed in the region. While these scores are comparatively strong, significant improvements will be required if Poland's competition policy regime is to meet EU standards for accession by 2002. This apparent contradiction between the diagnostic findings and EU perceptions of Competition in Poland is explained by the fact that EU standards are higher than those established as a benchmark for comparative purposes in this study.<sup>2</sup> Ukraine's Tier II results for Competition may reflect the high degree of concentration in Ukraine's economy, and also suggest that demand for an open, competitive market is quite low when compared to other countries in the sample group.

<sup>2</sup> For a more detailed explanation of the strategy employed in designing these indicators, please see Section V below.



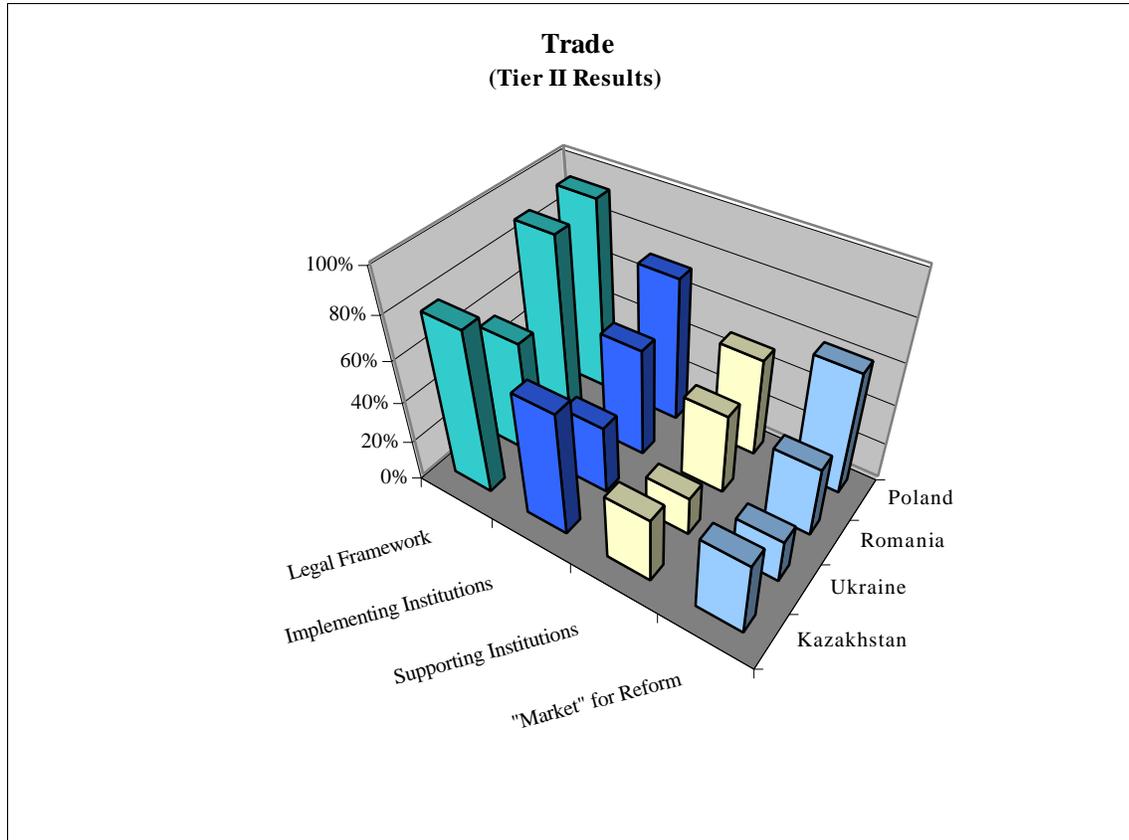
Contract	POL	ROM	UKR	KAZ
1. Legal Framework	83%	74%	50%	73%
2. Implementing Institutions	83%	73%	49%	66%
3. Supporting Institutions	79%	66%	50%	54%
4. Market for Reform	75%	37%	30%	62%

Ukraine's Tier I results in for Contract are only slightly better than for Company (45% and 44% respectively) and points up a fundamental weakness in the overall environment for commercial activity that is broadly attributable to a lack of broad political consensus on the direction and content of economic reform generally. Tier II Contract results show a degree of uniformity cross-regionally that is similar, but somewhat less pronounced, than that found in the Company subject matter area. Romania's relatively strong overall result is brought down by a weak result [37%] in Dimension IV. Implementing Institutions (e.g., commercial courts of general jurisdiction) were likewise found to be under-performing in Ukraine due to a significant degree to concerns relating to inefficient case management, corruption, and weak judicial enforcement of contractual agreements



FDI	POL	ROM	UKR	KAZ
1. Legal Framework	87%	96%	89%	83%
2. Implementing Institutions	82%	58%	18%	68%
3. Supporting Institutions	66%	38%	28%	50%
4. Market for Increased FDI	75%	37%	30%	65%

Tier II indicator results for FDI show a strong degree of uniformity in Dimension I, and great disparity in Dimension IV. In the former case, we believe that emerging standards for admission and treatment of FDI can partly explain this result. Interestingly, the disparity in Dimension IV results across the sample group may be attributable in part to a basic lack of consensus concerning the terms under which foreign investment should be made. Frequent changes to Romania's Law on Foreign Investment, for example, seems to support this hypothesis. In Ukraine, ambivalence concerning FDI is more pronounced, and the number of disputes involving foreign investors is an indicator of this attitude. Finally, for both Kazakhstan and Poland, who in per capita terms have received a great deal more FDI than Romania or Ukraine, the consensus concerning the desirability of attracting and retaining FDI appears to be much stronger, thus supporting the general result obtained here.



Trade	POL	ROM	UKR	KAZ
1. Legal Framework	93%	90%	56%	79%
2. Implementing Institutions	71%	53%	34%	61%
3. Supporting Institutions	49%	40%	19%	32%
4. Market for Open Trade Regime	61%	35%	21%	36%

Tier II results for International Trade are generally uneven, and particularly weak in Dimensions III and IV. Supporting Institutions, designated as the customs service and national standards agency for this subject matter area, is a Dimension where weakness was found across the sample group. The relatively weak Market results for Dimension IV, however, should not be interpreted as reflecting ambivalence or hostility to international trade in general, but perhaps could be ascribed to general lack of knowledge concerning the various commitments under which these countries are obligated in the sphere of international trade. This issue surely merits further discussion.

#### IV. Summary Findings & Narrative

The summary results presented above are offered as a general point of departure for discussion and further analysis of the country-specific findings contained in each of the four diagnostic reports that serve as the foundation for this Synthesis Report. In the following sections, a detailed look at the specific findings, analytical design, and diagnostic methodology are presented.

##### A. By "Dimension" of C-LIR

	POL	ROM	UKR	KAZ
<b>Tier I Results for All Subject Matter Areas</b>	<b>77%</b>	<b>55%</b>	<b>41%</b>	<b>55%</b>
1. Legal Framework	85%	70%	59%	68%
2. Implementing Institutions	79%	56%	42%	57%
3. Supporting Institutions	71%	52%	35%	48%
4. Market for Trade Liberalization	74%	40%	28%	48%

Poland serves as a logical benchmark for the sample group studied in this diagnostic effort given that it achieved the highest indicator results in all four Dimensions of the seven subject matter areas evaluated in this study. Poland's overall Tier I result is 77% of the total possible raw score.<sup>3</sup> Romania and Kazakhstan place behind Poland at 55% each. Ukraine's overall result was lowest, with 40% of the total possible raw score for all indicators. Broadly speaking, we believe the assessment results support what many already believe based on practical experience - Poland's legal and regulatory environment for commercial activity is relatively well advanced when compared to this sample group. Based on these results, one could say that Poland is approximately three-quarters of the way toward achieving a fully developed legal and institutional environment for modern commercial activity based on the benchmarks established by the C-LIR indicators.

Dimension I (Legal Framework) is the area where all four countries' rankings were closest. Poland's score was 85%, while Romania's [70%] and Kazakhstan's [68%] were essentially even, and Ukraine placed fourth [59%]. We feel that the distribution of results in this first dimension is instructive. Poland's scores were generally consistent (ranging only from 80% to 93%), while there were great fluctuations or "unevenness" in scores for the other three countries. Romania's indicator results ranged from a high of 96% for FDI to a low of 44% for Collateral. Ukraine's highest Dimension I result is in FDI [89%], while Bankruptcy and Company were 41% and 47%, respectively.

Overall, the assessment indicator results for Dimension I seem to suggest that opportunities for 1<sup>st</sup> Generation interventions in this sample group are limited. Except in the case of Romania's lack of a modern framework law for Collateral, and Ukraine's current lack of adoption of a proposed Civil Code, the basic legal norms for each of the seven subject matter areas are substantially in place. This seems to be particularly true for FDI, Contract, and Company. Neverthe-

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<sup>3</sup> For a more complete discussion of how these results were generated and interpreted, please see Section V, below.

less, Dimension I indicator results at the Tier III level do point up need for specific amendments or revisions to existing framework laws that constrain commercial activity. One case where this is true is Poland's Law on Bankruptcy, where the order of priority among secured creditors was identified as a major hindrance to the efficient operation of this vital mechanism for market exit.

In Dimension II (Implementing Institutions), Poland's results were again the highest among the sample group [79%]. Scores for the remainder of the sample group drop off significantly with Kazakhstan [57%], Romania [56%], and Ukraine [42%] results well below the level measured for Poland. This result highlights the general deficit in institutional capacity across the seven subject matter areas, and cross-regionally as well. In Collateral, the average Tier II result for Dimension II was only 43%, reflecting the lack of a formal Implementing Institution for this subject matter area. Another of relative softness across the sample is found in International Trade, where the average Tier II result for Implementing Institutions is 55%. We believe this result may be explained in part by the complex institutional and technical requirements of administering a trade regime. In this particular, Ukraine [34%] is far weaker as compared to the rest of the sample group whose averages result for this dimension is nearly double Ukraine's [62%].

For Dimension III (Supporting Institutions), all countries generally scored lower than the first two Dimensions (Legal Framework and Implementing Institutions) in most of the seven subject matter areas. Notable exceptions to this general trend are found in Collateral for Romania and Kazakhstan; Company for Poland; and FDI for Ukraine. We believe that the weakness observed in this Dimension across the sample group is a typical characteristic of economies in transition. Poland, which maintained a fairly significant level of private sector activity through the Communist period and started the transition to market earliest of the sample group, clearly had a head start in this development Dimension. It is interesting to note Romania's relative strength in this Dimension as compared to the results obtained for Ukraine and Kazakhstan. A question exists whether variables like the length of time under Communist rule, the geographic distance from Moscow, the degree of collectivization in agriculture, and the relative intensity of industrial concentration help determine the starting point and pace of development of the C-LIR environment in these countries. If this is the case, the Tier II results in this Dimension could be viewed as generally consistent with these possible variables of transition.

The greatest unevenness or divergence in results among the sample group, and between Poland and the other three countries, is found in Dimension IV (the Market for C-LIR).<sup>4</sup> Ukraine lags behind Poland by a whopping 46%, while Romania and Kazakhstan had similarly weak showings with results spreads of 34% and 26%, respectively. At the Tier II level, the only surprises were registered in Kazakhstan, where contract law and FDI went against the grain by scoring grades of 62% and 65%, respectively, in Dimension IV. The overall imbalance in the Market can be characterized by a relative "over-supply" of inadequate, incomplete, and often conflicting laws, regulations, and institutional arrangements for some legal areas and an "under-supply" in others, but in both cases is this in response to a weak and rather diffuse level of demand from the private sector.

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<sup>4</sup> For a more detailed discussion of the market concept, please see Section IV of this report.

## B. By Country

### 1) Poland

SUBSTANTIVE AREA	TOTAL	Legal Framework	Implementing Institutions	Supporting Institutions	Market
<b>POLAND</b>	<b>77%</b>	<b>85%</b>	<b>79%</b>	<b>71%</b>	<b>74%</b>
A. Bankruptcy	78%	80%	80%	76%	78%
B. Collateral	77%	90%	79%	65%	75%
C. Company	79%	81%	76%	82%	78%
D. Competition	80%	82%	81%	81%	78%
E. Contract	80%	83%	83%	79%	75%
F. FDI	77%	87%	82%	66%	75%
G. Trade	68%	93%	71%	49%	61%

Poland has far outpaced the other countries in this study in adopting and implementing legal and institutional reform, scoring at least 25% higher in most areas covered. Also, with higher absolute and per capita GDP, Poland has maintained strong economic growth since 1994 and attracts substantial foreign direct investment. Its neighbor to the east, Ukraine, lags far behind in the transition, despite close proximity, geographic similarities, and a high level of industrialization. These disparities raise numerous analytical questions, especially in trying to replicate successes in legal reform programs.

The average legal framework score for all subject areas was quite strong [85%], evidencing the positive legal reforms that have been underway this decade. The overall score for implementing institutions was only 6 points lower, at 79%, a relatively insignificant difference of only one-fourteenth. At the Tier II level, however, the difference between scores for law and implementation particularly stood out in two areas: collateral and trade law had implementation gaps of 11% and 22%, respectively.

For Dimension III, the assessment found supporting institutions generally strong. However, at the Tier II level, the supporting institutions for trade were quite weak, scoring only 49%, or 44 points lower than the legal framework for the same topic. FDI [66%] and collateral [65%] were also relatively weak, while supporting institutions for company law [82%] and competition policy [81%] boasted the highest scores for supporting institutions registered in the four-country study.

The market for commercial law reform in Poland is similarly strong in most areas. The only weak point was in trade [61%], which echoes the low scores for trade in Dimensions II and III.

In viewing Dimension IV, Poland's long and distinguished legal tradition of adaptation and survival is extremely relevant. When Poland regained its status as an independent nation following World War I, it was faced with the challenge of harmonizing a patchwork of various laws that were inherited from occupying powers including Russia, Prussia, Austria, and France. This *mélange* of traditions and influences apparently survives today. It is reported that judges

give different interpretations - French, Austrian, and German - to the Commercial Code of 1934 depending on the region within Poland where they receive their training. If the inter-war period can be viewed as one of adaptation and harmonization of law, the period of Poland's Nazi occupation and Communist rule can be viewed as one of a successful struggle for survival. Poland's communist rulers, instead of simply scrapping and replacing the prior legal system with socialist law, adapted the existing system to the state's needs. Other provisions of Poland's commercial law and traditions were allowed to survive, albeit in dormancy. Perhaps most significantly, the private sector continued to function throughout the Communist period, thus perpetuating "demand" for commercial law, even if this contradicted the prevailing ideology.

In considering Poland's speedy transition to a market economy, it seems credible that Poland's tradition of adaptation and survival played an important role. There is great pride, for example, in the Commercial Code of 1934, and a consensus that it remains generally serviceable, with some adjustment, for contemporary needs. The current process of "approximation" of Poland's legal regime in preparation for full membership in the EU seems to represent yet another period of adaptation and harmonization in Poland's legal tradition, and provides a strong gravitational influence on the drive and direction of Poland's overall commercial law reform effort.

## 2) Romania

SUBSTANTIVE AREA	TOTAL	Legal Framework	Implementing Institutions	Supporting Institutions	Market
<b>ROMANIA</b>	55%	70%	56%	52%	40%
<b>A. Bankruptcy</b>	54%	59%	62%	52%	45%
<b>B. Collateral</b>	32%	44%	13%	35%	37%
<b>C. Company</b>	62%	63%	73%	70%	43%
<b>D. Competition</b>	60%	66%	62%	62%	49%
<b>E. Contract</b>	63%	74%	73%	66%	37%
<b>F. FDI</b>	57%	96%	58%	38%	37%
<b>G. Trade</b>	54%	90%	53%	40%	35%

Our assessment detected a major disparity between Romania's laws and the institutions responsible for their implementation and enforcement. In Tier I, Romania scores 70% for Dimension I (Legal Framework), but then drops 14 points to 56% in Dimension II (Implementing Institutions), and from there continues to decline to 52% and 40% for Dimensions III and IV. While some of the specific laws are rated quite high, there is not a corresponding trend at the institutional level.

The weakest of all legal areas is Collateral, with an aggregate Tier I score of 32%. Romania lags behind other Central and Eastern European (CEE) countries and could benefit from a system of collateral legislation similar to those established in Bulgaria, Latvia, and Poland. Security interests in movable property would support the extension of commercial and consumer credit, both of which are essential for a market economy. Interestingly, while many CEE countries have developed a non-possessory pledge system, many have failed to carry this to the next logical step - creating a centralized registry to record secured interests. Romania has a sophisticated registry

system developed to handle company registration and more recently adapted to record bankruptcies. This registry system would be an ideal complement to a Romanian collateral system.

In Dimension II scores, Collateral is last [13%], followed by Trade [53%] and FDI [58%]. Unlike collateral law, however, the other two have very high Dimension I scores, in fact, some of the highest scores for all countries with FDI at 96% and Trade at 90%. Collateral is thus weak on all fronts, while FDI and Trade suggest that there is at least an effort to upgrade these areas, although this effort has not yet been translated into institutional development.

Breaking with the usual pattern, Romania's score for Company law implementing institutions clocks in at 10% *above* the score for Company law legal framework on the strength of recent improvements in the company registration process. The expense and delays of registration have been greatly reduced. With the exception of a single visit to the notary's office to certify the company's bylaws, all other contacts are with a single institution that has offices in Bucharest and each of the country's 40 counties.

In Dimension III, the assessment found a relatively wide range of development in the supporting institutions for the seven legal areas, from a low of 35% (Collateral) to 66% (Contract). Supporting institutions for trade scored only 40%, a 50-point difference from the legal framework score of 90%. FDI [38%] and Collateral [35%] were also weak. Supporting institutions can serve as effective focal points for capturing and voicing demand for reform, providing feedback and direction in the reform process. In Romania, however, the path of change has not been linear; reform has proceeded in spurts - advancing, stumbling, and then surging forward again.

The market for commercial law reform in Romania is imperfectly developed, scoring only 40% for the fourth Dimension. The *supply* of commercial laws has been volatile, often exceeding or failing to capture the *demand* for them. A frequent criticism of private sector companies and associations is that laws are changed too frequently, creating uncertainty for investors. Poorly conceived laws and regulations appear with no advance warning. This theme was echoed by Romanian business leaders, NGOs, lawyers, judges, government officials and ordinary citizens. Practically everyone agreed that it would be better for the government to concentrate on a lesser number of essential laws that are well prepared than to enact hastily-prepared drafts that only have to be corrected in the next legislative session. This would also allow the authorities more time to get the necessary implementing regulations into place. Currently an overly ambitious legislative program, combined with hastily-drafted and adopted Emergency Orders, leaves very little time to make the necessary implementation arrangements and to prepare the institutions involved in the implementation of the law for their new tasks, or to establish new institutions.

### 3) Ukraine

SUBSTANTIVE AREA	TOTAL	Legal Framework	Implementing Institutions	Supporting Institutions	Market
<b>UKRAINE</b>	<b>41%</b>	59%	42%	35%	28%
<b>A. Bankruptcy</b>	<b>37%</b>	41%	45%	33%	28%
<b>B. Collateral</b>	<b>48%</b>	76%	56%	31%	30%
<b>C. Company</b>	<b>44%</b>	47%	52%	42%	33%
<b>D. Competition</b>	<b>41%</b>	55%	42%	42%	28%
<b>E. Contract</b>	<b>45%</b>	50%	49%	50%	30%
<b>F. FDI</b>	<b>41%</b>	89%	18%	28%	30%
<b>G. Trade</b>	<b>33%</b>	56%	34%	19%	21%

A significant constraint to doing business in Ukraine remains the relative lack of transparency, stability, and predictability in the legal framework for private sector activity. Many of the problems encountered in Ukraine were found in the other countries surveyed, but with major differences in magnitude and nuance. The diagnostic team's findings support the widely held view that Ukraine's progress toward a market economy is not proceeding well. Despite the proliferation of McDonald's restaurants and upscale shops in Kiev, the environment for private commercial activity seems little changed since early 1994. In fact, the commercial environment in outlying *oblasts* and cities is reportedly eroding.

As reflected in the summary table of Tier I and Tier II indicators, Ukraine scored significantly below the three other countries across all four Dimensions. With a total aggregate score of only 41%, Ukraine's Tier I scores were 36 points below Poland and 13 below Romania and Kazakhstan. In Dimension I - the legal framework - bright spots for Ukraine were Collateral [76%] and FDI [89%]. Every other area under-performed the other survey countries.

For Dimension II, (Implementing Institutions), FDI [18%] and Trade [34%] ranked lowest, while Collateral was the highest [56%]. The first of its kind in the former Soviet Union, the new Ukrainian Pledge Registry is a state-of-the-art system designed to reduce the type of fraud resulting from the previous pledge law's ineffective provisions governing third-party notification of existing pledges or liens. Ukraine's registry has barely begun, but still, the past year's accomplishments are impressive for a country that in many reform areas has lagged behind its neighbors. Of course, it should be noted that this was the second attempt to introduce such a system.

Dimension III found supporting institutions weakest in the areas of Trade [19%] and FDI [28%], and strongest in Contract [50%]. Given the well-known difficulties of contract enforcement in Ukraine, this result may actually overstate the relevant importance of such supporting institutions as law firms, notaries, and bailiffs.

The market for commercial law reform in Ukraine is similarly weak across the seven subject matter areas. All seven areas fall within the range of 21% to 33%. The lowest is Trade. The limited progress Ukraine has made in meeting the requirements of WTO membership is just one indication of a lack of clear policy priority. The relative abundance of non-WTO compliant

regulatory measures, the weak institutional structures, and the general lack of transparency and consistency in applying internationally recognized standards all point to a significant mismatch between word and deed in this area. On the demand side, the strongest and most consistent advocates for reform are international donor institutions (such as IMF, World Bank and USAID), foreign trading partners (such as the United States and the European Union) and foreign businesses operating in Ukraine. General perceptions and attitudes remain surprisingly ambivalent to the potential benefits of foreign trade; a degree of xenophobia seems to be a part of this phenomenon. Unlike with its neighbor Poland, the "gravitational pull" of prospective WTO and EU membership is not as strong with Ukrainian lawmakers. It therefore seems unlikely that significant trade liberalization and associated institutional strengthening can be expected in the short term. Unfortunately for most Ukrainians, this will prove likely that the prospects of an improved living standard in the near term are also diminished.

#### 4) Kazakhstan

SUBSTANTIVE AREA	TOTAL	Legal Framework	Implementing Institutions	Supporting Institutions	Market
<b>KAZAKHSTAN</b>	55%	68%	57%	48%	48%
<b>A. Bankruptcy</b>	50%	60%	51%	49%	41%
<b>B. Collateral</b>	35%	56%	23%	31%	28%
<b>C. Company</b>	59%	62%	67%	58%	48%
<b>D. Competition</b>	62%	64%	64%	65%	56%
<b>E. Contract</b>	64%	73%	66%	54%	62%
<b>F. FDI</b>	66%	83%	68%	50%	65%
<b>G. Trade</b>	52%	79%	61%	32%	36%

Assessment results for Kazakhstan indicate clear disparities between law and implementation. In most areas, the Legal Framework scores higher than the Implementing and Supporting Institutions. The gap is smallest in the areas of Company, Competition and Contract.

The weakest scores are in the two areas that may have the most significant long-term impact on the availability of credit: Bankruptcy and Collateral. In theory, a well designed, well enforced bankruptcy regime permits lenders to assess and control their risks more effectively. Likewise, collateral law permits lower-risk, secured lending. Together, the two laws contribute to the growth and availability of lower cost credit for both business and consumers. That both areas have very low scores in the Kazakhstani Market -- including demand -- for reform suggests that there may be a serious gap in understanding the function of these laws, or the benefits they can support. On the other hand, they could reflect a resistance to change, despite sufficient understanding. In either case, Kazakhstan must surmount the deficiencies in these areas to move beyond self-financed investment and create an environment for broad-based development.

As with all of the countries, Kazakhstan earns a high score [83%] for the legal framework for FDI. Policy-makers want and need to attract substantial foreign capital for the rich mineral industry in this country that has been characterized as a glorified quarry. The law also targets manufacturing, however, in recognition that commodity development is not enough to support

economic development. The second highest score for Dimension I is in Trade [79%], followed by Contract [73%]. Improvements in these three areas are often driven demand from foreign investors. Tier I aggregate scores in those areas that are needed to actually make investment attractive - Collateral [35%], Company [59%], and Contract [ 64%] - are very low, so, low, in fact that even FDI is discouraged. The overall diagnostic can be interpreted to suggest that the state is, perhaps, courting foreign money by passing laws oriented toward the foreign investor, but leaving domestic investors out of the picture by failing to bring about an environment that supports investment per se. This is not only a questionable economic strategy; it is poor sociology that can fuel xenophobia in the hinterland.

The legal framework for Trade scores relatively high marks with 79%, well ahead of Ukraine [56%] but behind Poland [93%] and Romania [90%]. Kazakhstan also has one of the higher overall scores for Implementing Institutions, with 57%. Viewed together with the scores for FDI, a picture emerges of reforms intended to bring Kazakhstan increasingly into the global marketplace, both as a magnet for investment and a crossroads for international trade. Again, the relatively low scores on Market [48%] and Supporting Institutions [48%], indicate that the reforms flow from upper-level leadership, with much work yet to be done in order for the country as a whole to embrace these changes.

Considering Kazakhstan's history of command economy and state controls, the scores for Competition are encouraging. The Legal Framework received marks of 64%, roughly even with Romania [66%], ahead of Ukraine [55%] and, as always, behind Poland [82%]. Implementing and Supporting Institutions are at approximately the same level of development. Internalization of the reforms is likely to take time, but the path seems headed in the right direction.

While Kazakhstan's scores are not stellar, the picture they sketch should not be characterized as bleak. The past two years have brought much positive change, and there appears to be a strong political commitment to continue on this road to reform. Success, however, will certainly require a growth in demand for these reforms at the bottom, not just a supply from the top.

## V. Project Background & Context

Since the fall of communism, most of the countries of Central and Eastern Europe and the former Soviet Union have been making the difficult transition toward a market economy. Early on in this process, it became clear that commercial law reform was a critically important component in a broad range of reform initiatives needed to promote the efficient operation of a market economy. Intuitively, many realized that because commercial laws serve as the “rules of the game” for a market economy, it was critical to get them “right” if a free market was to flourish.

Recognizing this, reformist governments began to tackle legal reform generally, and commercial law reform specifically. As a partner in this process, USAID and its partner agencies in the U.S. government lent support by fielding an army of short- and long-term technical advisors to provide an array of technical advisory services. The success of these early efforts - referred to here as *1st generation* commercial legal and institutional reform (C-LIR) - were mixed. New laws were drafted (sometimes copied verbatim from advanced market economies) and enacted, but with little lasting change. Two important lessons were learned during this early phase of C-LIR. First, getting the legal framework “right” is an essential, but not sufficient, precondition for sustainable, market-driven economic growth. Second, without a supporting institutional framework, and associated capacity, commercial laws cannot be fully implemented or enforced.

These lessons served as the basis for the *2nd generation* in C-LIR as a distinct area of economic development theory and practice. During this second phase, practitioners’ attention turned to rationalizing and strengthening the institutional framework for implementation and enforcement of commercial and other laws. This led to important advances in institutional and operational analysis, regulatory design, and capacity building. The international donor community to address institutional deficiencies marshaled policy advisors, technical training, and limited equipment procurements. The record of success for these 2nd generation interventions has been somewhat better - but still not what was hoped for. While significant gains were achieved in certain substantive areas (e.g., GATT/WTO accession, customs administration, collateral registries, and capital markets), there was little progress in others - notably in the enforcement of bankruptcy, antitrust, and intellectual property laws. This practical experience in the field brought to light the complexity and subtlety of the institutional dimension of C-LIR.

This project represents a tangible and significant commitment of resources by USAID to advance a “3rd generation” of C-LIR. Despite some success in the field, there is a growing recognition that the legal and institutional elements of C-LIR are perhaps two parts of a larger and more complex whole. The evidence to support this conclusion lies in the “implementation/enforcement gap” that has been observed even after technically competent 1st and 2nd generation C-LIR initiatives have been carried out. The 3rd generation of C-LIR will be distinguished by its focus on achieving sustainability in implementation and enforcement of legal and institutional reforms.

The challenge of the 3rd generation of C-LIR is to develop a cost-effective, results-oriented approach (or approaches) that will help close the implementation/enforcement gap described above. This project was developed with five principal objectives in mind:

1. Develop a more comprehensive understanding of the evolution and outcome of C-LIR in European and Eurasian countries;
2. Build USAID's internal capacity to define, measure, and evaluate C-LIR results by designing and testing appropriate quantitative and qualitative performance indicators;
3. Facilitate a discussion within USAID, and between USAID and host-country counterparts, on the impact of European and Eurasian C-LIR initiatives and implications for possible future interventions;
4. Develop and test new strategies for closing the "implementation/enforcement gap" through pilot and rapid-response C-LIR technical assistance interventions; and,
5. Design and construct a USAID C-LIR resource base containing the cumulative results of this initiative for use in the development, implementation and assessment of future LIR interventions in Europe, Eurasia and other regions in which USAID operates.

This report is intended to serve as the foundation for accomplishing Objective 3 stated above. The forum for evaluating and strengthening the results of this prototype is USAID's Regional Commercial Law Development Conference, scheduled for December 6 - 9, 1999 near Prague, the Czech Republic.

## VI. Indicator Design & Development

### A. Challenges of Indicator Design

Indicators are, by definition, comparative. The utility of indicators, particularly quantitative indicators, is that they permit ready comparisons between varying samples and over time. They are a useful shortcut - a means of *estimating* - without actually measuring every detail of a larger, complex whole. Indicators' usefulness, therefore, derives more from convenience than comprehensiveness. Viewed from this perspective, an "ideal" indicator is one that permits meaningful, reliable, and cost-effective comparisons between dissimilar examples.

Developing common indicators for commercial law development in the region implies the ability to compare "*apples with apples*". From an historical and practical standpoint, however, this approach is overly general. While the region as a whole falls within the Continental legal system that arose out of the Roman legal tradition, individual countries' commercial laws derive from different historical antecedents. Romania's commercial law follows the French tradition based on the *Code Napoleon*. Poland's commercial laws, in contrast, are based on the scientific rationalism of 19<sup>th</sup> Century Germany. Another layer of complexity is added in the form of Socialist legal theory and practice. While based on the German Rationalist tradition, "Socialist Law" has its own unique traditions and values that are distinct from the Continental legal system. The differences that each of these historical variations have on the development of modern commercial law and practice are subtle, yet real. It is therefore particularly important to develop indicators that focus on *outcomes*, rather than the relative advantages of one legal system over another.

"Development" implies growth and maturity -- a comparison to an ideal standard. Typically, such comparisons are stated in terms of "more" and "less" developed. On an intuitive level, this kind of comparative assessment is made every day when economies are classed as "more", "less" and "least" developed based on certain economic and social criteria. The key challenge of this work, therefore, is to determine whether it is possible to develop a common set of indicators that will allow temporal (e.g., "before" and "after") as well as spatial (e.g., "north" vs. "south") comparisons that meet the ideal of yielding results that are meaningful, reliable, and cost-effective.

One approach to this challenge is to measure "development" against roughly comparable countries and/or roughly comparable stages of economic development. This approach - *benchmarking* - is useful for general comparative purposes, yet assumes a degree of similarity that may or may not exist in practice. For example, can Poland's commercial laws and institutions be usefully compared against Germany's, given that they share a common border and considerable commonality in their commercial and legal traditions? Could Kazakhstan's be compared directly with that of France? Aside from the technical problems associated with such direct comparisons, the fundamental weakness of this basic approach is the normative content upon which they rely. Hence, if cross-regional comparisons are to be possible, the specific indicators of development have to be common to all, and abstracted sufficiently to eliminate bias arising from the peculiarities of the sample.

Another approach to designing indicators for commercial law development is to focus less on the "how" and more on the "what" by measuring specific steps or obstacles in a *process-driven* environment that can be roughly correlated with efficiency and hence "progress". For example, the number of administrative steps, length of time in process, total cost, number of companies registered are all possible measures of the development of company law in a given country. Constraints analyses focusing on barriers to foreign direct investment (FDI), and competitiveness analyses focusing on opportunities for increased exports, are two other examples of process-oriented analysis. While this approach lends itself to quantification, it is severely limited by the availability, completeness, and reliability of data upon such comparisons are made. Of the four countries examined, only Poland had data readily available that could serve as a basis for a process-oriented analytical approach. In the remaining sample countries, relevant data were unavailable, inconsistent, or suspect, making process-oriented indicators an impractical design option in most cases.

Another particularly difficult aspect of this challenge lies in addressing the temporal dimension of development. This difficulty derives from the dynamic nature of commerce itself. The laws are, to a greater or lesser extent, reflective of contemporary commercial practice. The *Convention on International Sales of Goods* (CISG), for example, explicitly recognizes the importance of custom and usage in international commercial law.<sup>5</sup> As a body of norms based on behavior, the CISG is organic and therefore subject to change as commercial norms and practices change. The rapid increase in the use of the Internet as a medium of commerce, for example, is creating an entirely new set of commercial practices, and associated legal questions of first impression. Similarly, genetic engineering is giving rise to new areas of legal inquiry in the area of intellectual property, trade, investment and other key areas of commercial law. Viewed in this light, the design of commercial law indicators should be thought as something approximating skeet shooting, where it is not the target, but its trajectory, that matters most.

## **B. Deciding What to Measure**

Based on the above, it is possible to conclude that designing a common set of indicators for commercial law development is very much a process of approximation and compromise. Our design effort proceeded on the assumption that it is possible to broadly identify what "better" and what is "worse" based on generally accepted international best practices, and overall economic performance. For example, it is assumed that some causal relationship exists between Poland's advanced legal traditions prior to World War II, its geo-strategic position in Europe, its aggressive approach to market reform, and its strong economic performance during the past decade. The same can be said of other countries in the region whose profiles in these areas are less favorable than Poland's.

The common indicators presented are intended to:

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<sup>5</sup> Art. 9.2, *United Nations Convention on International Sales of Goods* (1980).

- (1) Provide a common gauge by which commercial law frameworks can be compared against a standard based upon generally accepted international "best practice";
- (2) Collect information about both *institutional capacity* of primary implementation bodies and *individual capacity* (e.g., regulatory and enforcement personnel) to the extent that cross-comparative data are available;
- (3) Obtain information about the development of *supporting institutions* necessary for the efficient implementation and enforcement of framework laws by implementing institutions (e.g., notaries, registries, lawyers' associations, academic institutions, etc.).
- (4) Capture data on the level of *demand* for reform within the specific areas of commercial law development defined in this study; and,
- (5) Characterize a government's ability to *supply* products (e.g., framework laws, implementing regulations, courts) and services (e.g., judicial rulings, enforcement of judgments by executive agents, training, outreach) appropriate for the development of commercial activity.

"Commercial law" encompasses a great number of specific legal disciplines. For the purpose of this study, commercial law has been more narrowly defined to include the following specific substantive areas of law and their associated institutions:

1. **Bankruptcy** - Mechanisms intended to facilitate orderly market exit, liquidation of outstanding financial claims on assets and rehabilitation of insolvent debtors.
2. **Collateral** - Laws, procedures and institutions designed to facilitate commerce by promoting transparency, predictability and simplicity in creating, identifying and extinguishing security interests in assets.
3. **Companies** - Legal regime(s) for market entry and operation that define norms for organization of formal commercial activities conducted by two or more individuals.
4. **Competition** - Rules, policies and supporting institutions intended to help promote and protect open, fair and economically efficient competition in the market, and for the market.
5. **Contract** - The legal regime and institutional framework for the creation, interpretation and enforcement of commercial obligations between one or more parties.
6. **Foreign Direct Investment** - The laws, procedures and institutions that regulate the treatment of foreign direct investment.
7. **Trade** - The laws, procedures and institutions governing cross-border sale of goods and services

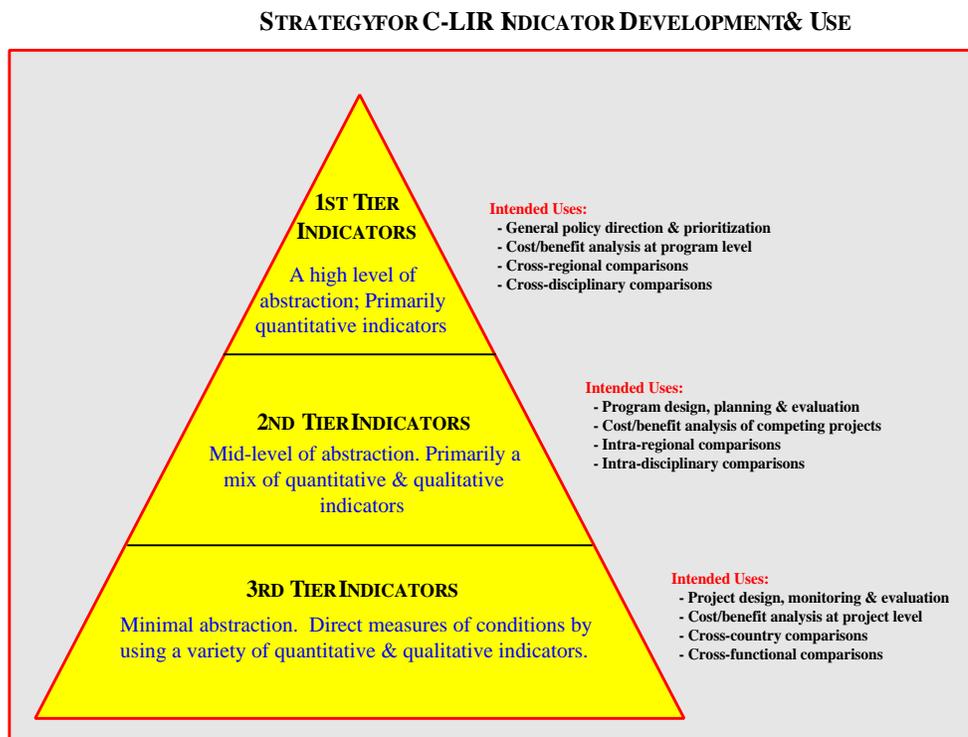
Within each of these substantive areas, four "Dimensions" of C-LIR are proposed as a conceptual framework for comparison. These include:

1. **Framework Laws** - Basic legal documents that define and regulate the substantive rights, duties, and obligations of affected parties and provide the organizational mandate for implementing institutions (e.g., Law on Bankruptcy, Law on Pledge of Movable Property);

2. **Implementing Institutions** - Governmental, quasi-governmental or private institutions in which primary legal mandate to implement, administer, interpret, or enforce framework law(s) is vested (e.g., bankruptcy court, collateral registry);
3. **Supporting Institutions** - Governmental, quasi-governmental or private institutions that either support or facilitate the implementation, administration, interpretation, or enforcement of framework law(s) (e.g., bankruptcy trustees, notaries); and,
4. **Market For C-LIR** - The interplay of stakeholder interests within a given society, jurisdiction, or group that, in aggregate, exert an influence over the substance, pace, or direction of commercial law reform.

### C. Organization and Structure of the C-LIR Indicators

The graphic below provides a conceptual overview of how the development indicators are organized.

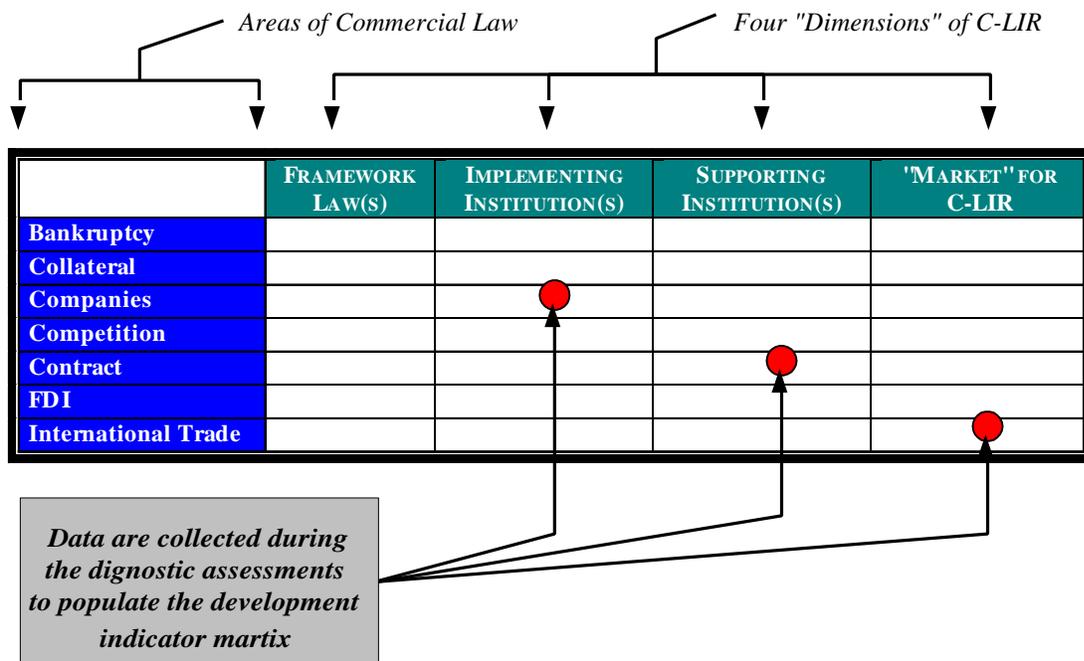


Each of the three sections or "tiers" of the pyramid in the diagram represent a different level of detail or "abstraction" generated by the indicators. The primary objective in creating three tiers of indicators is to provide varying levels of detail, depending on the needs of the user. Generally speaking, 1<sup>st</sup> Tier indicators are intended to be useful to high level policymakers who are responsible for establishing general policy direction and prioritization. 2<sup>nd</sup> Tier indicators are intended to be most useful to senior program- and country-level officials responsible for pro-

gram design, planning, and evaluation. Finally, 3<sup>rd</sup> Tier indicators are designed to be most useful to those who need to make detailed analysis of specific areas of the commercial law environment in a given country, or between specific countries. In this case, those responsible for project design, monitoring and evaluation are most likely to find the level of detail at the Tier III level useful.

The organization of the data into tables that can be easily read and interpreted is also a challenge given the amount and complexity of the data required. As illustrated in the diagram below, basic indicator groups for a given country are organized into blocks of twenty-eight "cells". The four Dimensions of commercial law development appear across the top of the table, and the seven subject matter areas defined for this study appear in the far left column.

**Conceptual Overview of C-LIR Development Indicators**



Given that four countries have been selected for assessment under this project, a total of 112 indicator groups (containing subject-matter specific indicators) have been developed and populated. For this reason, it is important for the user to have a firm grasp of the organization and logic of the indicator tables before attempting to interpret specific indicator scores or results.

**D. How To Read the C-LIR Indicator Tables**

The diagram below represents how Tier I and Tier II results are organized in the C-LIR indicator tables. The subject matter area ("Collateral") appears in the upper left portion of the table. Below it, the four Dimensions of commercial law are listed in their order of treatment. The column immediately to the right ("Ref.") contains a "reference value" (i.e., benchmark) against which the sample countries (i.e., "A" through "D") are compared. To illustrate, the total raw

scores for Country A and Country B are 228 and 235, respectively, as compared against the reference value of 638. These are referred to as Tier I *raw scores*. To obtain a Tier I *result*, the raw score is divided by the benchmark reference value (REF) to obtain Tier I results of 31% and 33% respectively. This example suggests that Country A's Collateral law system is comparable in relative terms to Country B's *when viewed at the highest level of abstraction*.

**BASIC INDICATOR TABLE ORGANIZATION**

SUBSTANTIVE AREA	REF.	A		B		C		D	
<b>COLLATERAL LAW</b>	<b>638</b>	<b>228</b>	<b>31%</b>	<b>235</b>	<b>42%</b>				
Legal Framework	120	85	71%	90	75%				
Implementing Institution	226	72	32%	25	11%				
Supporting Institution	154	34	22%	67	44%				
"Market" for C-LIR	138	37	27%	53	38%				

4 "Dimensions" of C-LIR

Tier II Reference Value

Tier I Indicator Results =  
the Average of Tier II Results

The same exercise can be performed at the Tier II level. If, for example the "Market for Collateral law reform in Country A is compared to that of Country B, a result of 27% and 38% respectively is obtained. From this it may be possible to infer that the Market Dimension for this subject matter area (Collateral) is *relatively* stronger in Country B than in Country A in aggregate terms, but relatively weak in comparative terms. It must be emphasized that a more detailed analysis of the underlying Tier III indicator raw scores and results would be required to draw more specific conclusions (e.g., a relative quality of policies "supplied" in Country A).

The Tier I and Tier II indicators in the example above are derived from the raw data collected in the course of the diagnostic assessments. This raw data is collected and scored against Tier III indicators. As a result, Tier III indicators provide the foundation for this analysis. In the illustration below, Tier III indicator results for the "Legal Framework" for Collateral are averaged to yield associated Tier II results. Individual Tier III indicator results provide the highest level of detail in the analysis. In this example, the result for Indicator B.1.3 ("Law recognizes bank guaranty.") is 43%, which can be interpreted to mean that this particular aspect of the Legal Framework for Collateral was found to fall well short of the benchmark Reference Value of 35. Where pertinent, a more detailed discussion of the basis on which this particular Tier III scoring was made would appear in the narrative portion of the diagnostic report.

Tier III Indicator Table

Reference value for "Legal Framework"		Raw Score		Tier II Result
<b>B.1</b>	<b>LEGAL FRAMEWORK- COLLATERAL</b>	<b>140</b>	<b>75</b>	<b>49%</b>
.1	Law recognizes personal guaranty	35	20	57%
.2	Law recognizes 3 <sup>rd</sup> party personal guaranty	35	10	29%
.3	Law recognizes bank guaranty	35	15	43%
.4	Law recognizes security interests in real property (mortgage)	35	30	86%

Tier III Indicator s                      Tier III Indicator results

These examples are intended to help show how indicator results "roll up" from one level to the next in terms of abstraction. This design is intended to dilute the impact that any single indicator *raw score* may have on the overall indicator *result*. It is our intention that the impact of a small discrepancy (or bias) in scoring at the Tier III level from one country to the next would be minimized provided the assessment methodology is applied consistently in each case.

## VII. Organization of the Diagnostic Assessments

In order to facilitate in-country data collection, preliminary research on background information was completed prior to the diagnostic. Generally, background information obtained included translations of relevant laws and legislation, statistical economic and trade information, earlier assessments of general and specific legal reform progress, and identification of relevant institutions and people to interview during the diagnostic. Information was gathered via the Internet, international financial institutions and donor organizations, academic and legal sources, embassies, and discussions with business organizations and lawyers knowledgeable about the particular countries. Both general and specific meetings and interviews were arranged in advance so as to “hit the ground running” upon arrival in country, and gaps could be filled and indicator-specific questions answered as the diagnostic progressed.

In order to provide an accurate diagnostic, taking into account regional traditions and historical influences, the diagnostic teams were comprised of both expatriate and local professionals. Expatriate members included senior lawyers from the United States and CEE who had practiced both in the region and the U.S., and cooperating country national (CCN) lawyers and experts. The advantage of using CEE lawyers was the unique comparisons they could draw between the region, in general, and the specific countries in particular to U.S. and western European legal systems. CCN lawyers practicing in the respective countries not only provided key background information and input on the indicators, but also attended meetings and provided the local view on legal traditions and reforms, as well as useful feedback on the team’s findings. In addition, when necessary the team used local junior lawyers to complete additional research and translations.

The subject areas of commercial law were divided so that the team could split up and cover the most ground possible during the two-week diagnostic. The diagnostic teams attempted, where possible, to focus on an area of familiarity and reported on the findings of the laws they covered. As many of the indicators cut across several areas of law, often a visit to a given Ministry or government office or public/private organization yielded information on more than one area of law. In order to ensure that the relevant areas were covered, the team conferred frequently to compare notes, assess progress, and make mid-course adjustments.

In-country data collection was conducted on a “360 degree” basis. That is to say that for each data point sought, an effort was made to obtain information from as many relevant perspectives as possible, given limitations of time and resources. To take bankruptcy law as an example, small and large debtors and creditors, lawyers, judges, scholars, government officials, and business and legal advocacy groups were consulted in an effort to gain as complete a picture as possible of the development and adequacy of the framework law and relevant implementing and supporting institutions.

The diagnostic assessments were conducted during the period October 1998 and June 1999. The purpose of the assessments was to field test and refine a diagnostic methodology for measuring commercial law development in transition economies.



The dates of the assessments were:

Poland	October 5-23, 1998
Romania	December 4-18, 1999
Ukraine	March 3-17, 1999
Kazakhstan	June 3-19, 1999

## VIII. Next Steps

The assessment methodology and the development indicators will be the subject of a regional workshop to be held in Prague during December 6-9, 1999. In attendance will be highly qualified local experts in commercial law, associated institutions (e.g. courts, registries, bar associations) or other relevant subjects (e.g. foreign trade, banking, SMEs) who could make substantial contributions to the discussion. Representatives of USAID, the World Bank, the EBRD, the European Union, and other international organizations concerned with commercial law reform will also be invited.

During the workshop, the participants will explore country-specific, subject matter specific, and cross-regional findings as a springboard for discussion and debate on the root causes of the implementation/enforcement gap and its implications for USAID and other donors. The objectives of the workshop are to:

1. Validate the conceptual approach (four dimensions, seven areas);
2. Consider refinements in the methodology and the development indicators;
3. Test the conclusions reached in the four country reports and the synthesis report based on participant experience and subject matter-specific knowledge;
4. Explore the implications of these diagnostic findings for USAID, other donors, and host-country counterparts throughout the region; and,
5. Develop possible approaches to test, refine, and improve strategies for closing the "implementation/enforcement gap"

The workshop is intended to promote a frank and constructive exchange of views that will help the contractor refine the concepts in these draft reports. Insights from experience throughout the region may be distilled into practical lessons learned that can be used in the design, implementation and evaluation of future C-LIR interventions.