Is Transition Over?

Transition from a centrally planned to a market-based system in Central and Eastern Europe (CEE) started about a decade ago and - by its very name - was meant to end at some point in time. Has this date arrived yet? Or are we in the midst of the "transition from transition", is it "transformation", "post-transition", even "integration", or just plain "development"? Does anybody care anyway? They should, not least because the (alleged) transition countries still receive a very special kind of treatment, for example by being served by a development bank, the European Bank for Reconstruction and Development, designed for their transition-specific purposes. If transition were over, publicly financed credit provided by the Bank to these countries could unnecessarily crowd out the private sector, the activities of which should be encouraged as a matter of first priority.

The plethora of available terms reflects the confusion among economists about what the "end of transition" is exactly defined by. Witness for example the discussion in a recent book edited by Annette N. Brown ("When is Transition Over?"), which gathers several transition experts' opinions on the topic. Marie Lavigne considers the question right away as "unanswerable", while at the same time advancing the criterion of EU membership as the only sensible one. Alan Gelb's definition sounds more imaginative, albeit less operational, as he considers transition to be over "when the problems and policy issues confronted by today's transition countries resemble those faced by others at similar levels of development." In his view, "we are not there yet". Anders Aslund focuses on the reduction of rent-seeking, and therefore concludes that transition is over in all but a few countries. Jan Svejnar establishes two conditions for the end of transition: the abolition of central planning and the presence of an efficiently functioning market system. Despite the EU Commission's assessment that the latter is indeed the case at least in some of the more advanced candidate countries, Svejnar denies the end of transition. Janos Kornai argues that transition is over in Hungary and "probably in several other countries as well", given the fulfilment of his three criteria: the communist party is no longer in power, the dominant part of the means of production is privately owned, and the market is the dominant co-ordinator of economic activities.

So is it clear now? Perhaps not quite. We seem to be left alone with the conclusion that - if not for the transition researchers" very own survival interest - transition is but a very complex and multidimensional process. This, however, is something we already knew all along the way. But wasn't it economics that was supposed to put things sharply and unequivocally by coming up with some very concrete number or formula specifying the condition for, say, transition to be over? Hermeneutics was a branch of philosophy - which is beyond economists' means - wasn't it?

OK, there *are* numbers: it has become a very popular exercise to estimate the time the CEECs need to catch up with Western European development levels by using a standard growth regression framework, according to which GDP growth depends on factors that have proved to be significantly related to economic growth in a number of cross-country studies (e.g. school enrolment, investment to GDP ratios, initial GDP). Notably though, these studies base their results on the regularities observed amongst market economies. By imposing the same regression coefficients on the CEECs, they are implicitly assumed to be structurally identical to market economies, which is in fact just the question we would like to answer in the first place. Others assess the "distance" of the CEECs from Western market economies in terms of macroeconomic variables such as inflation and budget deficits. These indicators are, however, usually not the ones that unambiguously characterise a

market economy. Again others examine the difference between CEECs and EU member countries with regard to several more fundamental indicators such as infrastructure.

While all of these approaches are interesting in themselves, they do not help much in answering our question. Taking much richer Western European OECD countries as a reference model ignores the fact that many indicators by which the CEECs differ from OECD economies are in fact related to the development level, as proxied by per capita GDP. If a particular country, say Romania, has a less developed financial system than the EU average, this need not imply it is still in transition. Since richer countries are generally equipped with a better financial system, it may simply be a sign of its lower development level. This suggests a very simple approach, which allows us to translate the question "Is transition over?" into something which is more amenable to empirical quantification: "Has central planning under communist rule left a legacy that, even after ten years, distinguishes post-communist economies from other countries in the world with a comparable income per capita?" All we need to do in order to answer this is gather some set of "relevant" indicators for a country sample that is not only representative of wealthy Western Europe, but of the entire world distribution of income.

Talking about the legacy of communism, it is straightforward to start by drawing on those indicators that used to constitute the well-known characteristic traits of centrally planned economies and might have left a mark on economic structures because they could not be changed quickly: this is first of all the absence of a financial system that would serve to allocate savings to investments; second, the missing legal and institutional framework which commonly underpins a market economy; third, the marked preference of central planners for heavy industry and the neglect of services; and last, the excessive rates of investment, both in physical and human capital. Several quantitative indicators exist that attempt to capture any one of these dimensions. Regressing these in a world-wide sample of more than 100 countries on national per capita income and watching out as to how closely the CEECs are located in relation to the world "market" benchmark, provides a concrete way of checking whether the CEECs can still be perceived as being different from "ordinary" market economies.

As the results of this exercise suggest, the CEECs do still share some idiosyncratic features, even after controlling for per capita income. Today, after ten years, they continue to be characterised by a significantly higher share of employment in industry and a higher energy use than expected on the basis of their development level. They are also endowed with a much more extensive physical infrastructure and higher educational attainment. However, considering indicators that measure the extent to which the financial and institutional framework of a market economy has been put into place leads to more differentiated results. These features are clearly much weaker than one would expect for the former Soviet Republics (Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyzstan, Moldova, Russia, Tajikistan, Turkmenistan, Ukraine) and the Balkan countries (Albania, Bulgaria, Croatia, FYR Macedonia, Romania) whereas this is not the case for the advanced Central European countries (Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovak Republic, Slovenia). For some of the latter group there is even partial evidence that their framework is stronger than one would expect given their relatively low level of per capita income. Although some differences do prevail within this group, on average the Central European countries correspond sufficiently well to ordinary market economies at comparable levels of income as far as the "soft" factor "institutional and financial system" is concerned. For these countries, 10 years were enough to upgrade the economic "software", even if the "hardware" is still recognisably from a different era. Why then should they still be treated differently from other developing countries with a similar GDP per head, like Turkey or Brazil? The rest of the CEECs, i.e. the CIS and some of the Balkan countries are obviously in a different category. They still face problems with the transition towards credible market-based institutions and financial systems.

So much about a more quantitative approach to the issue raised above, which may have its own drawbacks, depending mainly on whether we believe in the data at hand. And if we don't, we can still go back to hermeneutics.

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