

When is Transition Over? Theory versus Reality in Albanian Case

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Note

Doing a presentation with such a title is not an easy thing. The theme is very broad and actually has to do with every aspect of the reforms in Transition. As such it is impossible to cover those aspects in one presentation. Our aim with this presentation is to open a debate in this distinguished forum about the Question "When is Transition Over?". In this regard we will try to discuss some aspects of the reforms in transition, by adopting a somewhat defined framework.

Can the Question be answered?

One of the famous economist of our times Joe Stiglitz wrote that Transition from socialist regimes to market economies is one big experiment. Considering it such, means that something is being tested. Apparently in this experiment what is being tested are the methods and the ways to get to the result while the result is known – full-fledged market economy. So the debate is actually about the ways to get to the result. After more than a decade of changes and reforms in transition countries, an obvious question arises. **When is transition over?** Transition – as the name suggest is meant to end at some point in time. Is it any more transition or development?

Many researchers have asked the question of "end of Transition" and tried to give answers. Sometimes their answers just added to the confusion about what the end of transition is exactly defined by. What is the end of transition measured by? Many efforts have been directed to build indicators, which will define the status of the development in transition. Some of these indicators are qualitative and some others are quantitative. The use of these indicators is important on judging about the progress and problems but we should also state that sometimes these indicators just confirm what you can easily "see without the need of a guide"³. Sometimes anecdotal indicators can tell you much better where a country stands. Such an indicator that fits Albania is the time to pass the immigration counter at the airport⁴. If we translate this indicator for the purpose of this presentation we can say – the shorter the time the closer a country is to the end of transition. And we can say that there is quite a reduction of time to pass the immigration counter in Rinas Airport in the last years.

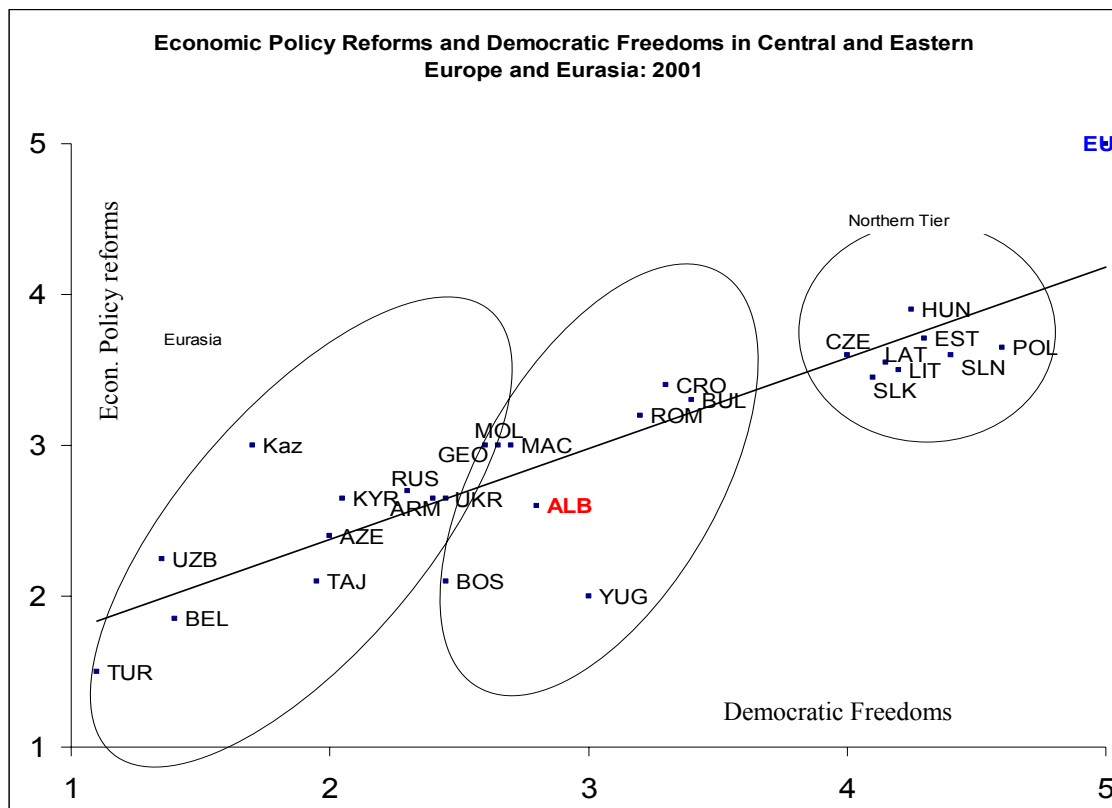
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³ The village that can be seen does not need a guide – Albanian proverb

⁴ Jak Jabes – On the (F)utility of Governance Indicators – ADB 2002

In order to measure transition progress EBRD has a rating scheme of transition indicators. Based on this scheme the economic reform indicators are grouped into stages. **The first stage reforms** consist of liberalization of prices, trade liberalization, small-scale privatisation and the establishment of key commercial laws. **In the second stage**⁵ the reforms are bit more complicated. Large scale privatisation, enterprise restructuring, competition policy, financial sector reforms (including banking and capital markets), infrastructure and the effectiveness of key commercial laws. The idea of these indicators is to measure the progress of reforms but also in way that can be compared with a **market economy benchmark**.



⁵ There is broad agreement that the second stage is more problematic because the institutional capacity required to implement those reforms is much higher than for the first stage. The second stage of reforms actually has to do with building the capacity of governments to govern. However apparently something that was not said quite often before is being now more loudly mentioned. And this is - **the way the reforms were implemented in the first phase (although the phase may be almost completed) had impact in the implementation of the reforms in the second stage. It either accelerated these reforms or delayed them.**

Explanatory notes for the graph

Taken from Monitoring Country Progress – USAID- E&E

Ratings of democratic freedoms are from Freedom House, Nations in Transit 2002 (2002), and cover events through December 31, 2001. Economic policy reform ratings are from EBRD, Transition Report 2001 (November 2001), and cover events through September 2001. Economic policy reforms include price liberalization, trade and foreign exchange, privatisation, legal, banking and capital markets, enterprise restructuring (credit and subsidy policy), and infrastructure reforms. Democratic freedoms include political rights (free and fair elections; governance and public administration) and civil liberties (free media and judiciary; freedom to develop NGOs and trade unions; equality of opportunity and freedom from corruption). Ratings are based on a 1 to 5 scale, with 5 representing most advanced.

Freedom House also has a rating scheme for three dimensions of economic reforms in transition countries (Privatisation, Macroeconomic reforms and Microeconomic reforms)

		Privatisation		Macro Ec. Ref.		Micro Ec. Ref.		Avg.*
		1998	2002	1998	2002	1998	2002	
1.	Poland	2.25	2.25	1.75	2.0	1.75	1.5	1.92
2.	Estonia	2.0	1.75	2.0	2.0	2.0	2.0	1.92
3.	Hungary	1.5	1.5	1.75	2.5	1.75	2.0	2.00
4.	Czech Rep.	2.0	1.75	2.0	2.25	2.0	2.25	2.08
5.	Slovenia	2.5	2.5	2.0	2.0	2.0	2.0	2.17
6.	Latvia	2.5	2.5	2.5	2.25	2.5	2.25	2.33
7.	Slovakia	3.25	2.0	3.75	2.5	3.75	2.5	2.33
8.	Lithuania	2.25	2.25	2.75	2.75	2.75	2.25	2.42
9.	Bulgaria	4.0	3.0	4.0	3.0	4.25	3.75	3.25
10.	Croatia	4.0	3.25	3.75	3.5	3.75	3.75	3.50
11.	Armenia	3.75	3.25	4.25	3.5	4.25	4.0	3.58
12.	Kyrgyzstan	4.25	4.25	3.5	3.5	3.5	3.5	3.75
13.	Albania	4.0	3.25	5.0	4.0	4.5	4.0	3.75
14.	Georgia	4.0	3.25	4.0	4.0	4.0	4.0	3.75
15.	Romania	4.5	3.75	4.5	3.75	4.5	4.25	3.92
16.	Russia	3.0	3.5	4.25	3.75	4.25	4.5	3.92
17.	Moldova	4.0	4.0	4.25	4.5	4.25	4.25	4.25
18.	Kazakhstan	4.25	4.0	4.5	4.25	4.75	4.5	4.25
19.	Ukraine	4.5	4.25	4.5	4.5	5.25	4.5	4.42
20.	Azerbaijan	5.0	4.25	5.0	4.5	5.0	4.5	4.42
21.	Macedonia	4.0	4.25	5.0	4.75	5.0	5.0	4.67
22.	Serbia/Mont.	4.5	4.75	5.0	5.25	5.0	5.0	5.0
23.	Tajikistan	6.25	5.5	6.0	5.5	5.75	5.25	5.08
24.	Bosnia Herz.	5.5	5.0	6.0	5.5	6.0	5.5	5.33
25.	Uzbekistan	6.25	6.0	6.25	6.0	6.25	6.0	6.0
26.	Belarus	6.0	6.0	6.25	6.25	6.5	6.5	6.25
27.	Turkmenistan	6.75	6.75	6.25	6.25	6.25	6.5	6.5

Source: Freedom House Ratings (2003). Ratings are based on the normal Freedom House system where essentially 1=maximum "progress" and 7=no progress

There are also popular models that try to estimate the time the countries of Central and Eastern Europe 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)⁶. However as rightly pointed out by several economists these models assume that developed market economies and transition economies have the same response to signals (meaning that markets are structurally the same). This is in fact the question related with the end of transition.

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

In order to answer the Question "Is transition over" perhaps we should answer the question "Has central planning under communist rule left a legacy that, even after more than a decade of changes, distinguishes post-communist economies (in this case Albania) from other countries in the world with a comparable income per capita?" (M.Suhrcke)

Eu Integration Process ... measuring the end

We will try to approach the "end of the transition" problem by adopting a certain framework. And in this case such a framework seems to be EU Integration process. The answer to the question "When is Transition over" would be – When Albania becomes a member of EU. It sounds easy but still without any detail of the process. We will elaborate further down what does this imply for Albania.

Before we get into the details of the process there is one issue to clarify. Does the entry of Albania to EU mark the end of transition? From theoretical point of view a country may be a market economy and still not a member of EU. So the end of transition may arrive earlier than the accession but the idea is that once you are a member of EU the question is not any more relevant. A country that is a member of EU can hardly still be a transition economy.

EU Accession Candidates must fulfill (referred to as "Copenhagen Criteria" include the following:

- **Political** – The achievement of Stability of institutions guarantying democracy, the rule of law, human rights and respect for the protection of minorities:
- **Economic** – The existence of a functioning market economy, and the capacity to cope with competitive pressure and market forces within EU

⁶ Marc Suhrcke. (intereconomics)

- **Administrative** – the ability to take on the obligations of membership, including adherence to the aims of political, economic and monetary union.

For the sake of this presentation we will group these criteria into two groups Economic, and Governance (Political and Administrative).

ECONOMIC CRITERIA

What does it mean to have a functioning market economy in place? According to these criteria as set in Agenda 2000 the existence of a functioning market economy requires that prices, as well as trade, are liberalized and that an enforceable legal system, including property right is in place. The performance of a market economy is enhanced by the consensus about economic policies and by the macroeconomic stability. A well-developed financial sector and the absence of any significant barriers to market entry and exit improve the efficiency of the economy.

- **Price liberalization** – Albania has achieved a high degree of liberalization. The only issues to be cover in this area are those related with number of infrastructure utilities products such as energy, water, telecommunication etc. Some of these prices are being decentralized (such as water) but full liberalization of prices of utilities need careful treating.

- **Trade Liberalization**

Albania is now a member of WTO which suggest that trade liberalization is a matter “passed exam”. However the Trade liberalization has as objective to provide a solid ground for more economic growth fuelled by export growth.

When trade liberalization is not followed by export supply this does not mean that TL is ineffective. Often it means that TL has only partly been implemented. (Export promotion actions are often absent or limited). The work on this area has already started.

Also trade liberalization forces the economy to concentrate on those sectors with competitive potential. From the point of view of the question posed in the beginning of the presentation we can also say that an economy where the organization of production has not yet reached long-term market equilibrium is still in transition. (*Annette N. Brown,1999*). It does not mean that the organization of production stops changing, but that the structure of production only slowly changes with the evolution of economy. ***The economy is still in transition when the industries are still significantly reshaping themselves.*** Signs of consolidation of the structure are seen during the last years but there is still some way to go.

- **Macroeconomic Stability**

Albania has reached a satisfactory stage of macroeconomic stability. Growth performance has been strong during the last years. (It should be said though that growth estimates are not very reliable since official national accounts do not exist yet, and the official growth estimates cover only inadequately private and informal sector). Remarkably inflation has been declining and reached a end-figure of 2,1 % in 2002. (Average inflation was 5,4%⁷) The question here how sustainable is this macroeconomic stability. There are several challenges in this regard. An energy problem has appeared to be lately another problematic issue that impedes sustainable growth. The first effects of the energy crises were seen in the lower growth rates for 2002. Apparently there are improvements in this area during this year but the problem has not yet been fully resolved. Low level of investments, the tendency for the decreasing of the remittances and foreign financial support are also challenging factors. On the other hand the level of GDP per capita remains one of the lowest in the region (reaching the level of 1521 USD per capita in 2002). All these are issue to be faced in the process of integration to EU.

- **Property rights**

Property rights in place are crucial elements of a functioning market economy. The enforcement of property rights in Albania remains still difficult. Although there is improvement in judicial reforms still the confidence of people to judiciary, as a guarantor of reliable enforcement is weak. Intellectual property rights unfortunately remain largely unknown in Albania. Problems are related with legislation but also as always with enforcement. Apparently the most clearly defined market seems to be the housing market although even here there are still problem with registration offices. However it seems that this market is working well. While land market is something that still needs intervention. This market is not working properly especially that related with agriculture land because the property rights are not yet clearly defined. The restitution or compensation process has not finished and until than this market will be stuck. Land registration system is not yet finalized. This is considered a serious impediment to increasing productivity in agriculture.

- **Privatisation**

Albania is considered a country that has finished small-scale privatisation. The challenge for the moment is continuation of the strategic privatisation process with AlbTelecom, INSIG and Savings Bank, Oil industry, energy sector, water sector etc. There is still a pending issue that relates with the Mass Privatisation program though, with the voucher scheme. This scheme can be considered a failure⁸ and this issue is still unresolved. (We can here

⁷ According to Central Bank of Albania Annual report 2002

⁸ This process was not successful even in other countries of CEE where parameters of the markets were more developed.

remember the slogan for the enterprise privatisation which came from IFIs– let the market decide the value” while THERE WAS NO MARKET in place).

- **Financial Sector Development**

Banking sector has made quite some progress during the last years. However the development has been mainly quantitative. It is easy to have sound banks, banks that do not loose money because of bad loans – Simply require them to invest in Treasury bills. The challenge is not to create sound banks but sound banks that provide credit for growth.

For the last year in Albania the credit to economy was only 7,2 percent of GDP as opposed to 40% average of East and Central Europe⁹.

In an interesting EBRD paper prepared by Steven Fries and Anita Taci it is calculated the ratio of Total Private Sector credit to GDP and the Market economy benchmark which means this ratio for a country with market economy and similar level of development measured by GNP per capita (on PPP basis)¹⁰

	1994			1999		
	Ratio of Total Private sector credit to GDP	Market Economy Benchmark	Distance from the Benchmark	Ratio of Total Private sector credit to GDP	Market Economy Benchmark	Distance from the Benchmark
Croatia	31.5	39.4	7.9	38.5	46.9	8.4
Czech Republic	76.6	58.1	-18.5	61.4	63.5	2.1
Estonia	15.4	39.5	24.1	35.8	48.7	12.9
Hungary	26.2	49.6	23.4	25.7	56.8	31.1
Latvia	18.4	35.6	17.2	16.5	42	25.5
Lithuania	20	36.7	16.7	13.9	43.8	29.9
Poland	18.6	44.9	26.3	28.8	54.2	25.4
Slovakia	43.3	49.4	6.1	56.5	58.1	1.6
Slovenia	23.3	61.1	37.8	37	69.1	32.1
Albania	5.7	25	19.3	3.9	30.7	26.8
Bulgaria	49.3	41.7	-7.6	17.9	42.1	24.2
FYR Macedonia	45.3	34.2	-11.1	22.7	36.2	13.5
Romania	19.1	38.9	19.8	10.7	40.4	29.7

Source: Paper "Banking Reform and Development in Transition Economies" by S. Fries and Anita Taci.

Competition policy

The benefits of private sector development are linked with the role of improving allocative and productive efficiency. Having this in mind, economic

⁹ According to Central Bank of Albania. Annual report 2002.

¹⁰ The authors have calculated the market economy benchmark based on a nonlinear regression of GNP per capita (\$PPP) on ratio of private sector of GDP for a pool of 122 developing and industrialized countries.

reforms such as trade and financial liberalization, privatisation etc. have been always considered as tools of stimulating competition and promoting greater economic efficiency.

The competition policy is much more than Competition legislation. Competition policy is a set of measures and instruments where privatisation, restructuring, deregulation, liberalisation, foreign direct investments, are included as well.

Although efforts have been undertaken recently on preparing the competition legislation, harmonised with the European legislation in the field (the new law "On the Protection of Competition" has been approved by the Albanian Parliament on 28 July 2003), the enforcement of competition policy in Albania still needs to be improved. The new law lays the foundation for establishment of an Independent Competition Authority. Now, the main objective is to make this structure fully functional and operational. (Coordination of this structure with other regulatory bodies is indispensable for introducing pro-competitive policies in the regulated sectors)

Market entry has improved significantly, but still there are issues, such as licensing procedures or other administrative barriers, which need to be addressed. While market exit is not functioning properly. There is only a negligible number of firms that have declared bankruptcy, even though a law according to international standards "On bankruptcy" has been approved last year. Insolvency procedures need to be improved and judicial system needs to seriously cover the issues in this area.

Another issue related with competition is Informal Economy. The issue is very complex and cannot be seen only from one angle but we are all aware that informality has negative impacts from the competition point of view with formal private sector development. Informality in the economy on the other side is a proxy measure of the efficiency of state structures. Although we lack the data for measuring informal economy (better said we still lack the consensus about an accepted methodology) the figures from different institutions show that informal economy is around 30% (INSTAT) to 60 percent (IFIs assessment). This is apparently a challenge to be faced in the coming years.

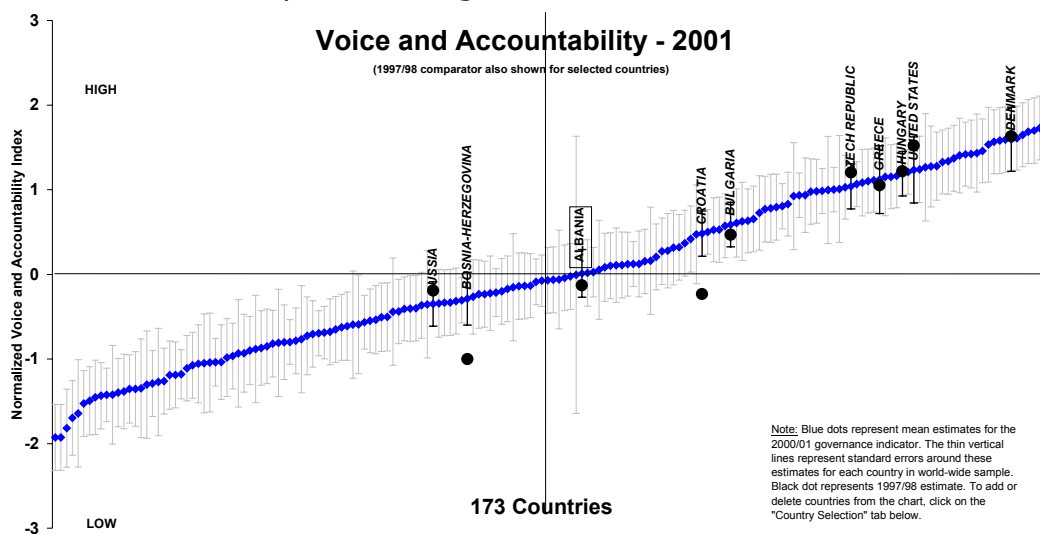
GOVERNANCE CRITERIA

Effective economic reforms are very closely linked with good Governance. Plenty of indicators have been built about the governance issues. However we can still say that the efficiency of state institutions is not easily measured.

To illustrate the issue of governance for Albania we would like to present here some governance indicators (Albania included) which were constructed in a research Project¹¹, of Daniel Kaufmann, Aart Kraay and Pablo Zoido-Lobaton. Their work consists in building aggregate indexes of governance for six broad concepts of governance¹² divided in three groups.

The first group of aggregated indicators aims at evaluating the process by which those in authority are selected and replaced. Two indicators comprise it:

1. **"Voice and Accountability"**¹³ – which includes a number of sub indicators measuring various aspects of political process, civil liberties and political rights. All these indicators measure the extent to which citizens of a country are able to participate in the selection of governments. In this category are also included indicators measuring the independence of media, which has an important role in monitoring those in authority and holding them accountable for their actions.



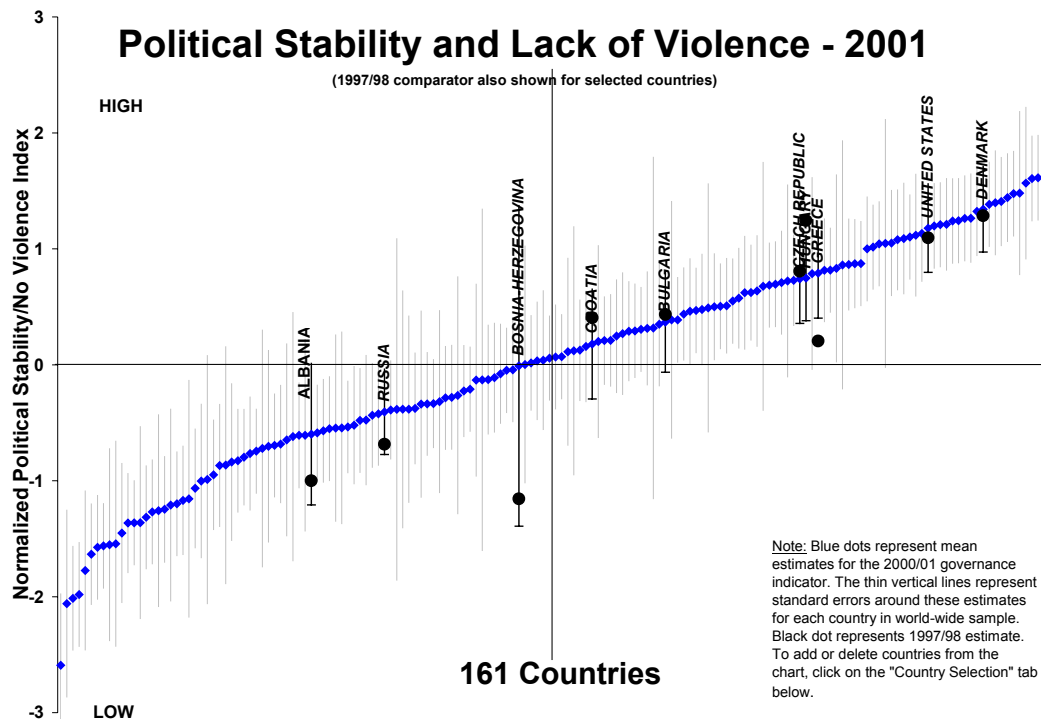
Source: "Governance Matters II: updated Indicators for 2000-01" by Daniel Kaufmann, Aart Kraay and Pablo Zoido-Lobaton, Jan 2002.

¹¹ "Governance Matters II: Updated Indicators for 2000/01"

¹² All six indexes are measured with units that vary from -2.5 to 2.5 where -2.5 is a very low level of the index and 2.5 is a very high level. However it should be said that the error margin of the indexes is relatively large and this is shown in the graphs by vertical lines. These indexes are still subject to further research and improvement but however they show a tendency that is valuable for assessing different policies and reforms in a certain country.

¹³ Graphs build by an interactive data interface (selected graphs to be presented)

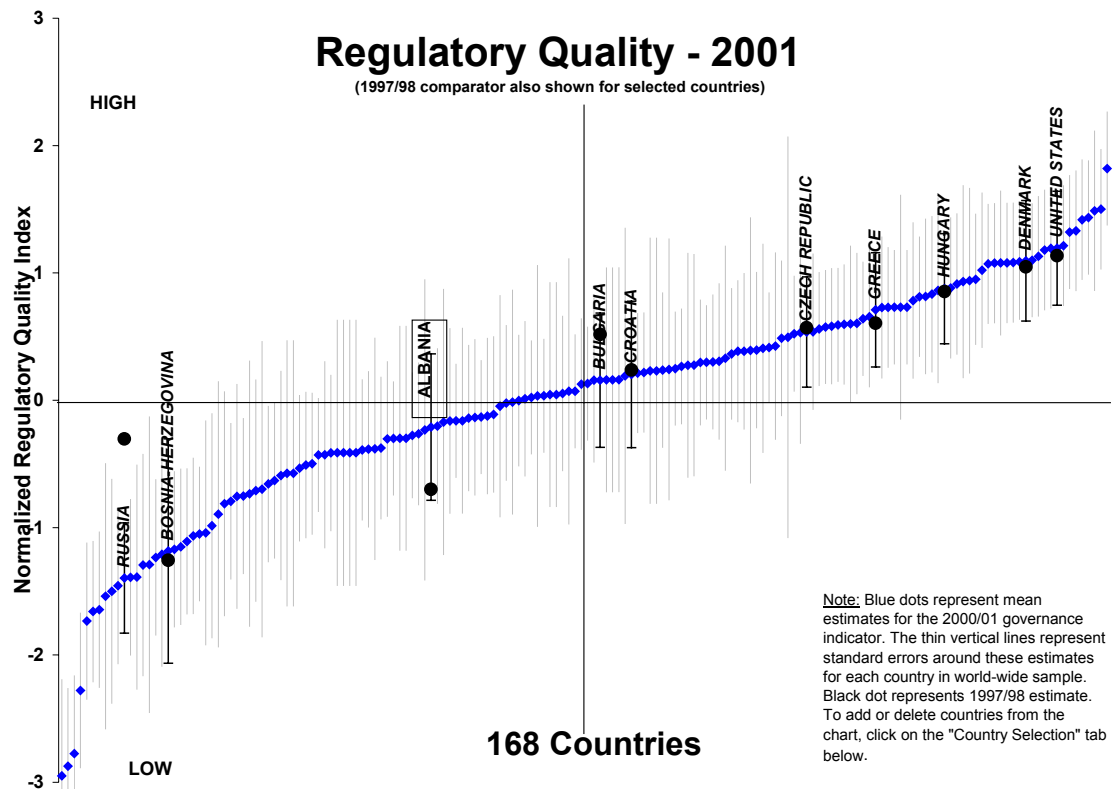
2. **"Political Stability".** In this index are combined different indicators, which measure perceptions of the likelihood that the government in power will be destabilized or overthrown by violent or unconstitutional means. This index captures the idea that the quality of governance in the country is compromised by the likelihood of violent changes in the government, which not only has a direct effect on the continuity of policies, but also a deeper level undermines the ability of all citizens to peacefully select and replace.



Source: "Governance Matters II: updated Indicators for 2000-01" by Daniel Kaufmann, Aart Kraay and Pablo Zoido-Lobaton, Jan 2002.

The second group of indexes is comprised by several indicators, which measure the ability of the government to formulate and implement sound and effective policies.

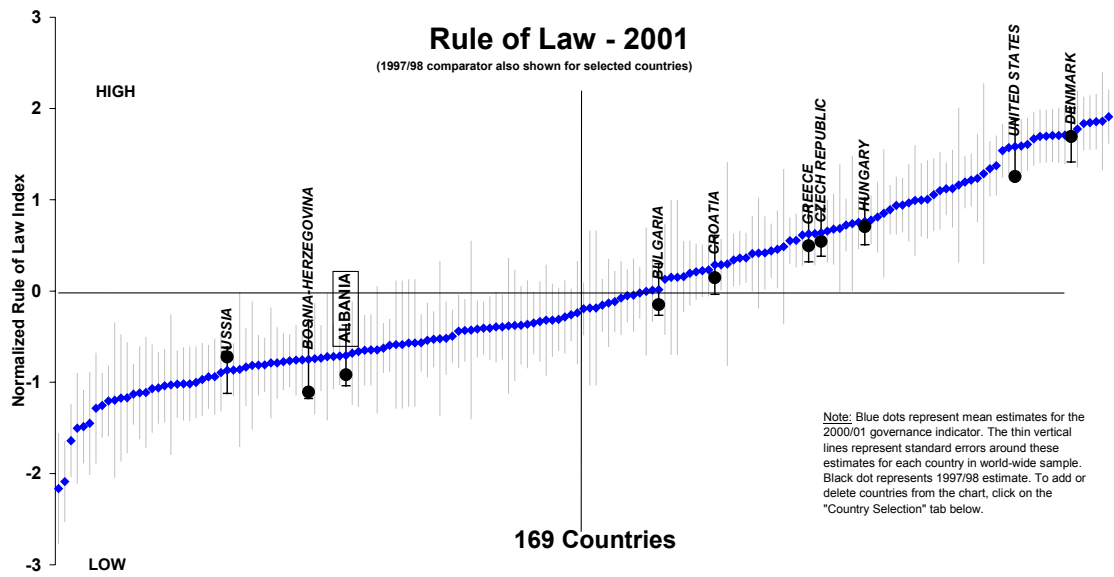
3. **"Government Effectiveness".** In this index are combined the perceptions of the quality of public service provision, the quality of the bureaucracy, the competence of civil servants, the independence of the civil service from political pressures, and the credibility of the government's commitment to policies into a single grouping.
4. **"Regulatory Quality"** is more focused on the policies themselves. It includes measures of the incidence of market-unfriendly policies such as price-controls or inadequate bank supervision as well as perceptions of the burdens imposed by excessive regulations in areas such as foreign trade and business development.



Source: "Governance Matters II: updated Indicators for 2000-01" by Daniel Kaufmann, Aart Kraay and Pablo Zoido-Lobaton, Jan 2002.

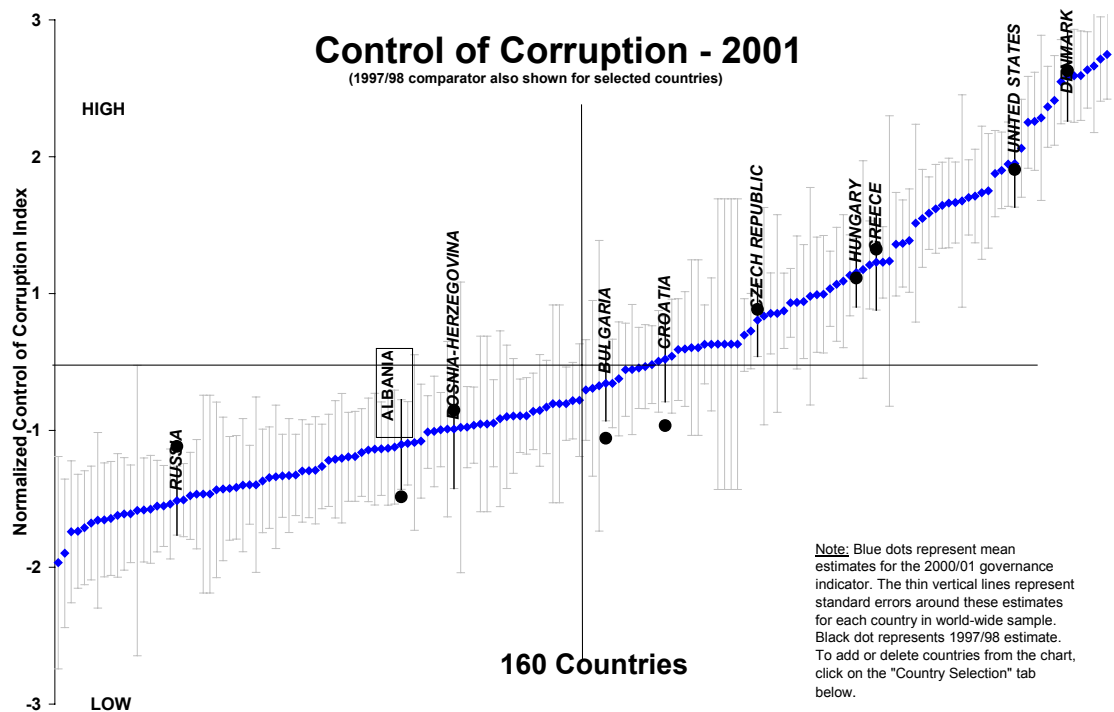
The last group summarizes in general terms the respect of citizens and the state for the institutions, which govern their interactions.

5. Rule of Law. In this index are included several indicators which measure the extent to which agents have confidence in and abide by the rules of the society. These include perceptions of the incidence of both violent and non-violent crime, the effectiveness and predictability of the judiciary, and the enforceability of contracts. In a single sentence this index reflects the success of a society in creating and environment in which the fair and predictable rules of the society form the basis on economic and social interaction.



Source: "Governance Matters II: updated Indicators for 2000-01 " by Daniel Kaufmann, Aart Kraay and Pablo Zoido-Lobaton, Jan 2002.

6. Control of Corruption. This index measures the perception on corruption, which conventionally it is defined as exercising public authority for private gains. Existence of Corruption manifests a lack of respect from both the corruptors and the corrupted towards laws and rules and hence represent a failure of governance.



Source: "Governance Matters II: updated Indicators for 2000-01 " by Daniel Kaufmann, Aart Kraay and Pablo Zoido-Lobaton, Jan 2002.

Perception versus reality.

In the issue of "end of transition" we cannot neglect the issue of perception. How are we perceived for the progress of reforms? Perception changes slower than the reality. The best example we would like to bring here is the Index of Economic Freedom from Heritage Foundation/Wall Street Journal indicators. The Index measures how well 161 countries score on a list of 50 independent variables divided into 10 broad factors of economic freedom. The higher the score on a factor, the greater the level of government interference in the economy and the less economic freedom a country enjoys. These 50 variables are grouped into the following categories:

- o Trade policy
- o Fiscal burden of government
- o Government intervention in the economy
- o Monetary policy
- o Capital flows and foreign investment
- o Banking and finance
- o Wages and prices
- o Property prices
- o Regulation
- o Black market (2003)

Each factor is scored according to a grading scale that is unique for that factor. The scales run from 1 to 5: A score of 1 signifies an institutional or consistent set of policies that are most conducive to economic freedom, while a score of 5 signifies a set of policies that are at least conducive. The four broad categories of economic freedom in the Index are:

- **Free** – countries with an average overall score of 1.95 or less
- **Mostly Free** – countries with an average overall score of 2.00 to 2.95;
- **Mostly Unfree** – countries with an average overall score of 3.00 to 3.95; and
- **Repressed** – countries with an average overall score of 4.00 or higher.

Individual factors	Score
Trade Policy	5
Fiscal Burden of Government	3.5
Government Intervention	3
Monetary Policy	2
Foreign Investment	2
Banking and Finance	3
Wages and Prices	2
Property Rights	4
Regulation	4
Black Market	5

Taking into account the fact that with the initiative of Bush Administration for the Millennium Challenge account this index will be one of the measures to decide how good a country is doing in implementing reforms, this is certainly an important index to look at. Most of the indicators here seem to accurate but we have our reserves for several of them. Especially for the indicators referring to the trade policy. Due to

the index Trade Policy in Albania is rated at scale 5 meaning – Very High Level of protectionism. The measurement is mainly based at average tariff rates and than adding the evaluation about Non-tariff rates. Based on this methodology the conclusion of this index is wrong. Albania is a member of WTO and as such is subject to tariff rules this organization imposes on its members. Also based on the methodology and the data the average tariff rates for 2000 and 2001 are respectively 10,4% and 7,87%¹⁴ . As a consequence Albania should get a score of 3 for 2000 (moderate level) and 2 for 2001 (low barriers. If we count NTB than maximum Albania would get is 3 for 2001.

This is just an example to show that sometimes indicators are not correct and they have impact on the perceptions for the progress of the country.

Conclusion

This presentation was not an exhaustive list of all actions that Albania needs to take in order to “end transition”. Rather it was picture of major reforms based on a framework that to our opinion fits best the aims of Albania for the future. The objective of this presentation was to present the EU integration process as a “measurement process ” of progress of the reforms that define the stage of a country in transition.

Coming back to the question of transition end we believe that this question should be answered – ONCE ALBANIA IS PART OF EU. The issue is not that it defines the end of transition but once a member of EU the issue of “end of transition” is no more relevant. A country may be a market economy and still not be a member of EU, but a member of EU is definitely a market economy.

The question about the end of transition should be linked with the question if the socialist past has left still any legacies that make Albania differ from other countries with comparable income per capita.

If we divide the factors into two groups (Economic and Governance) it is clear that there are still uncompleted reforms in both areas. Their completion is closely linked with the progress towards EU integration.

¹⁴ INSTAT – General Custom data

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