Transition factors in former Communist countries' property markets

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Structured Abstract:

- *Purpose.* The article examines to what extent there are still transition factors influencing the property markets in the former Communist countries. When transition began over 20 years ago, there were clear differences from market economies as a direct consequence of their history in terms of institutions, property rights, approaches to markets, business organisation, laws, and physical forms of built environment. The article examines the extent of convergence with market economies and whether transition economies can still be regarded as a distinct group in terms of their property markets.
- *Design/methodology/approach*. The article takes a wide range of data, including that from the World Bank, World Economic Forum, Bertelsmann, Jones Lang LaSalle, European Mortgage Federation, and Transparency International, and compares transition economies with non-transition economies of similar level of development to see if there remain distinct "transition" differences.
- *Findings*. The initial findings indicate some areas of convergence with developed market economies in areas such as land governance and property registration under the influence of the EU and the Council of Europe and as a result of funding and technical assistance from the World Bank and bilateral donors, though differences remain in terms of the strength of property rights and land governance. Differences also exist from market economies with similar levels of income per capita in areas such as the business environment, financial services, and corporate governance. These indicate that a transition effect is still present.
- *Research limitations/implications*. There is a need for better quality data on transition countries' property markets.
- *Practical implications*. The differences suggest that transition economies continue to require specific policies for the development of their property markets.
- *Originality/value*. Whilst there have been studies of "transition" factors generally in economies, there have not been ones that look specifically at property markets.

Keywords: transition economies, property markets, market transparency, land governance, corruption, property rights.
Article Classification: research paper

Introduction

The opening of the Berlin Wall in 1989, followed by the ending of Communist rule in Central and Eastern Europe and the break-up of the Soviet Union, started a process of transition for these countries from being centrally planned to market economies. Subsequently the countries of the former Yugoslavia were drawn into the process after its break-up. The repercussions have been felt beyond Europe in Asia, with most of the Asian Communist countries also undergoing a transition process, and Cuba which under President Raul Castro has taken some tentative steps towards greater private enterprise in the economy. Marxist-Leninism and the ideology of central planning spread to the decolonised countries between the 1960s and 1980s. The USSR offered scholarships and training for cadres in its universities and those of its Eastern European satellites, as well as technical assistance. Many countries in Africa nationalised the land and, in some cases, attempted to create collective farming. The ending of Communist rule and the break-up of the USSR have also led to changes in many of these countries.

A defining feature of the Communist countries was the absence of significant private rights over real estate. The Second All-Russian Congress of Soviets in 1917 issued a decree on land which made all land in the Soviet Union the property of the State. The 1936 Federal Constitution of the USSR placed an absolute prohibition on civil transactions relating to land. Tenure rights permitted tillage of the land and the erection of buildings (Vondracek, 1975). State bodies had rights of operational management but private ownership of land, other than of small rural plots and some residential property, did not exist. This system was exported to the countries in Central and Eastern Europe that fell within the Soviet sphere. For example, the 1936 Soviet constitution was extended to Estonia, Latvia, Lithuania, and Eastern Poland after their annexation in 1940, the Hungarian constitution of 1949 was modelled on the 1936 Soviet one, and the Polish constitution of 22 July 1952 had 50 of the 91 articles translated from the basic law of the USSR (Wagner, 1953).

By contrast, in market economies the allocation of land is not primarily by government, though governments do use taxes and incentives to influence land use. Land allocation results from private interests bidding for the land they require. Land is allocated to the use that is able to pay the highest price, which, in principle, ought to be the most efficient use. The role of government tends to be limited to providing land for public goods and services and to prevent land from being used in ways that society deems unsuitable, for example by protecting heritage buildings and landscapes and by regulating externalities.

A feature of the transition process in most of the countries has been the creation of a land market in which private interests in land are traded. This has typically involved the privatisation of land and the restitution of property to those from whom it had been expropriated during Communism. The state no longer directs land use and which enterprises and households have access to land and buildings in the way in which it did in the centrally planned economy. The new constitutions adopted after the ending of Communist rule protect private interests in property. For example, the 1993 Constitution of the Russian Federation starts from the basis that private property should be protected, Article 17 of the 1991 Bulgarian Constitution guarantees the inviolability of private property, and Article 64 of the 1997 Polish Constitution guarantees everyone the right of ownership.

It takes time for the market institutions, infrastructure and regulatory framework required for an efficient property market to develop. Therefore it would not be surprising if differences between the transition economies and established market economies persisted for some time after the transition process commenced. Market infrastructure such as a valuation profession, public availability of market prices, land registration systems, and mortgages laws have had to be created. The transition economies inherited a land use pattern that was significantly different from that found in market economies. The economies were over-industrialised and under-provided with services leading to underinvestment in offices and retailing. In the absence of price signals, resources like space, energy and water were wasted. Development densities were often high at the edges of urban areas with high rise residential complexes in areas in which space was readily available. City centres often had large areas of prime land given over to low productivity industrial activities and their support functions (Bertaud & Renaud, 1997; Buckley & Mini, 2000). Such land use patterns take time to change. Factors such as the level of municipal ownership of land in urban areas, the need to resolve which level of government actually owns specific parcels of land, businesses not having long-term rights over the land they occupy or being incentivised to improve the productivity of their land, subsidies to housing and utilities, restitution policies, and the huge investment that has been necessary in land registration systems have slowed down change.

The process of transition started nearly 25 years ago. This raises the question of whether it is still valid to talk about transition economies or whether the process is now complete and, therefore, only of historic importance. There is unfortunately no universal agreement as to when the transition process can be considered to be over. For the EU, it is when countries have satisfied the requirements of the Copenhagen Council (1993) and have adopted the *acquis communitaire* (the body of EU statute and case law), and so can become member states. They must demonstrate stability of the institutions guaranteeing democracy, the rule of law, human rights, and respect for and protection of minorities (the *political* criterion), the existence of a functioning market economy and the ability to cope with competitive pressures within the EU (the *economic* criterion), and the ability to take on the obligations of membership, including political, economic, and monetary union (the criterion concerning adoption of the *acquis*). Countries cannot become members until they have adopted the *acquis communitaire* as only limited transitional arrangements are possible after accession (Grover, 2006). The decision to admit a new member state follows the recommendation of the Commission as to how well it has performed against the membership criteria. Since new members must have functioning market economies, EU membership should signal the end of the transition process.

The World Bank, by contrast, defines the transition process as ending at the point at which the differences between the old centrally planned parts of the economy and the new ones that have grown up under a market economy have been eroded away. In other words, one can no longer talk about enterprises being classified according to historically determined categories - old, restructured, and new.

> "At that point, the economic issues and problems policymakers must deal with are no longer specific to transition" (The World Bank 2002, p xix).

The implication of both approaches is that once the transition process is complete, it should not be possible to distinguish between countries based on knowledge of their recent histories alone. In a recent study of state land management, Grover (2012) compared the property markets in the transition countries with those non-transition countries in the European Economic Area. Property rights (measured using World Economic Forum data) were stronger in the non-transition European countries than in the transition countries, though property rights were stronger in the transition countries that had joined the European Union than those transition countries that were not members. Market transparency (as measured by the Jones Lang LaSalle Global Real Estate Transparency Index) was greater in the non-transition European countries than in transition countries. Within Europe, mortgage debt as a percentage of GDP was higher for non-transition countries than for transition ones. Although the risk premium on mortgage debt for transition countries had fallen relative to non-transition ones before the current financial crisis, it had not been eliminated. Corruption in land services (measured using data from Transparency International) was lower in the non-transition European countries than in transition countries. The data suggests that transition countries are still significantly different in terms of their property markets from developed market economies.

The weakness in this analysis is that the transition countries have attained a lower level of development than the non-transition ones. The transition countries with the highest incomes per capita within the EU have yet to overtake the incomes of poorest of the non-transition EU members. The differences in property markets may not reflect transition but the level of development attained by the transition countries. This paper therefore compares the property markets in transition countries with those of non-transition countries at a similar level of development in order to examine whether there are significant differences between the two groups.

Methodology

The research has focussed on 22 European transition countries, including those that have become members of the EU, the countries of the former Yugoslavia, and the European and Caucasus countries of the former Soviet Union[1]. Belarus was excluded because of data problems. Since incomes per capita in the Asian transition economies, with the exception of Kazakhstan, are significantly lower than the European transition ones, they have been excluded. There have been different patterns of transition and it was decided that to include the Asian transition economies would introduce a greater element of variability in the sample than would be desirable. The non-transition countries chosen for comparison were those listed by the World Economic Forum for which data was available and which had an income per capita between those of Moldova and the Czech Republic[2]. There were 39 countries in this group.

There is only limited data available about property markets, though information is available on the strength of property rights, and the efficiency of property registration and obtaining construction permits. The data on property rights is taken from the Bertelsmann Transformation Index (BTI)[3]. BTI produces data on emerging and developing countries using a ten-point expert scoring system. An alternative measure would be that produced by the World Economic Forum, which survey respondents (Schwab, 2012). This measure does not correlate very highly with those which are based on expert scoring. It is likely to be because respondents may lack the knowledge and experience to calibrate the performance of their country compared with others (Grover & Grover, 2012b). The data on property registration and construction permits come from the World Bank Doing Business survey (World Bank, 2013). They are based on standard scenarios (Grover & Grover, 2011). Transparency International has data specifically about corruption in land services. However, the number of countries for which this data exists is limited as it depends on there being an active chapter in the country. There are statistically significant correlations between its measures and the data on corruption from the World Economic Forum (Grover & Grover, 2011, pp 12-13), which is available for the sample of countries chosen.

There is very limited data about the property markets for the range of countries win the two samples so proxies have been used instead. Land governance is associated with a wide range of indicators of governance, corporate governance, business sophistication, and infrastructure

[1] Albania, Armenia, Azerbaijan, Bosnia and Herzegovina, Bulgaria, Croatia, Czech Republic, Estonia, Georgia, Hungary, Latvia, Lithuania, FYR Macedonia, Moldova, Montenegro, Poland, Romania, Russian Federation, Serbia, Slovak Republic, Slovenia, Ukraine.

[2] Algeria, Argentina, Bahrain, Bolivia, Botswana, Brazil, Chile, Columbia, Costa Rica, Dominican Republic, Ecuador, Egypt, El Salvadore, Guatemala, Honduras, Indonesia, Iran, Jamaica, Jordan, South Korea, Lebanon, Malaysia, Mauritius, Mexico, Morocco, Namibia, Oman, Panama, Paraguay, Perus, Philippines, Saudi Arabia, South Africa, Sri Lanka, Taiwan, Thailand, Turkey, Uruguay, Venezuala.

[3] http://www.bti-project.org/index/

(Grover & Grover, 2011; Grover & Grover, 2012a). In addition to data from BTI and WEF, one measure was used from the World Bank governance indicators, namely *Voice and Accountability* (Kaufmann et al, 2010). This is highly correlated with the Jones Lang LaSalle Global Real Estate Transparency Index (Grover & Grover, 2012a).

The groups of transition countries and non-transition countries have been compared using two main measures. The median scores for the two groups have been compared and the statistical significance of the differences examined using the Mann-Witney test. The use of non-parametric measures is because the underlying data is qualitative and because there is no reason to suppose that the distribution of the values is normal. Secondly, the research looked at the distribution of values within the two groups. This has been done visually using box whiskers diagrams and statistically using the Kolmogorov-Smirnov test. The detailed results are reported in the appendix.

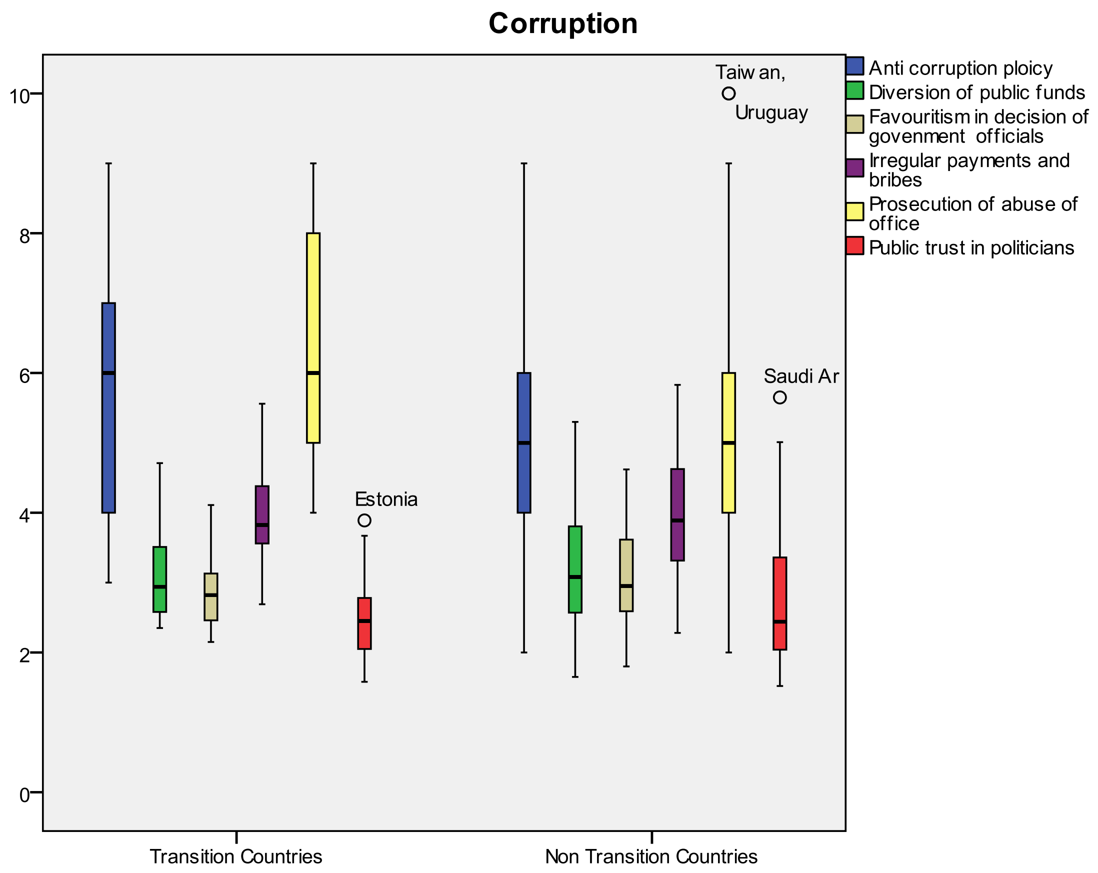
Comparisons between transition and non-transition countries

There is no statistically significant difference between the strength of property rights in transition and non-transition countries on either the Mann-Witney or Kolmogorov-Smirnov tests, though visually there is a longer tail for the distribution of scores for transition countries. This could suggest that security of property rights may be problematic in the outlying transition countries. The absence of significant differences in security of property rights between the two groups is likely, at least in part, to reflect some important changes in land governance during the transition period. All of the transition countries in the sample are members of the Council of Europe, which means that they are signatories to the European Convention on Human Rights and their citizens have recourse to the European Court of Human Rights. The Convention includes Article 1 of Protocol 1, which provides protection for private property, and Article 8, on the protection of private and family life and home, which has been used to achieve protection from forced eviction.

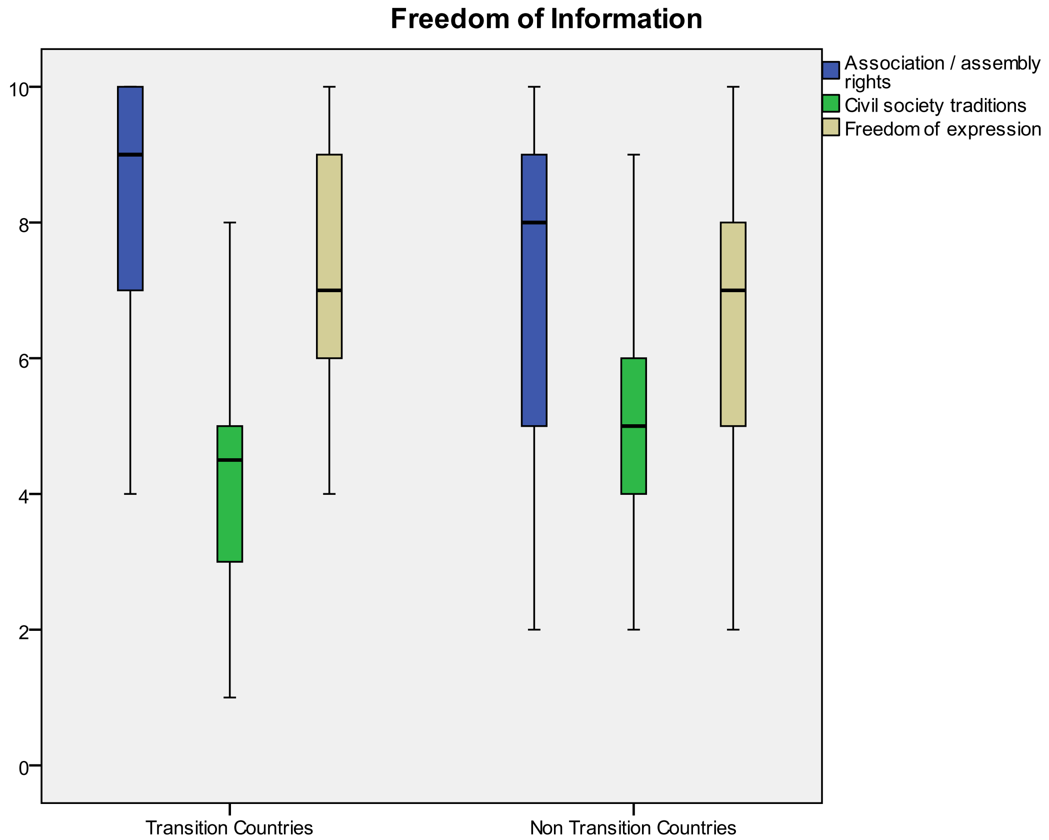
There are significant differences between the two groups of countries for the number of property registration procedures, their cost, and the distance the country lies from the frontier of best practice in this area. The transition countries tend to have fewer procedures to register changes in ownership, the cost of registration is lower, and they are closer to the frontier of best practice than the non-transition countries. The World Bank *Doing Business* survey uses data based on the transfer of a warehouse between two limited liability companies. It is open to criticism that the scenario does not reflect conditions for residential or rural properties, which affect the majority of the population. Its definition of costs includes taxes on transfers of title but not title insurance and the measures do not include ones of the quality of land registration. Nonetheless, the differences between the two groups of countries are entirely plausible. The World Bank and bilateral donors have spent many tens of millions of dollars on land registration and cadastre programmes in most of the transition countries. These systems did not exist during the Communist period as there was no need for efficient transfers of title in view of state ownership of land. Their creation has been viewed as an essential aspect of the creation of an efficient property market in which property can be traded and used as security for loans. The result of these projects has been generally to improve the quality of data about title and the reliability of information available to lenders on charges against properties. The World Bank loan agreements include quality targets, like customer satisfaction, as well as reductions in numbers of procedures and costs. The typical project creates a one-stop shop so that those wishing to register a change in title need go to just one office rather than collecting approvals from a number of different organisations. This reduces the cost of registration, the compliance cost to service users, and the opportunities for corruption. Typically also there has been a separation of the front and back office functions so that those processing title changes do not meet with the public. This division of labour increases efficiency and also reduces the scope for corruption. The improvements in this area have been so marked that the time taken and costs of registration in transition countries are generally below those of the non-transition European Economic Area countries (Grover, 2012, p 17). Some of the transition countries have state-of-the-art systems which are lacking in developed economies.

There are no significant differences between the two groups of countries on construction permits other than in distance from the best practice frontier, where the non-transitional countries are on average closer. A number of transition countries have significant problems with illegal construction, such as extensions and extra storeys on buildings for which consent has not been granted. This has not been an area that has attracted World Bank loans or bilateral donor support to the same extent that land registration has.

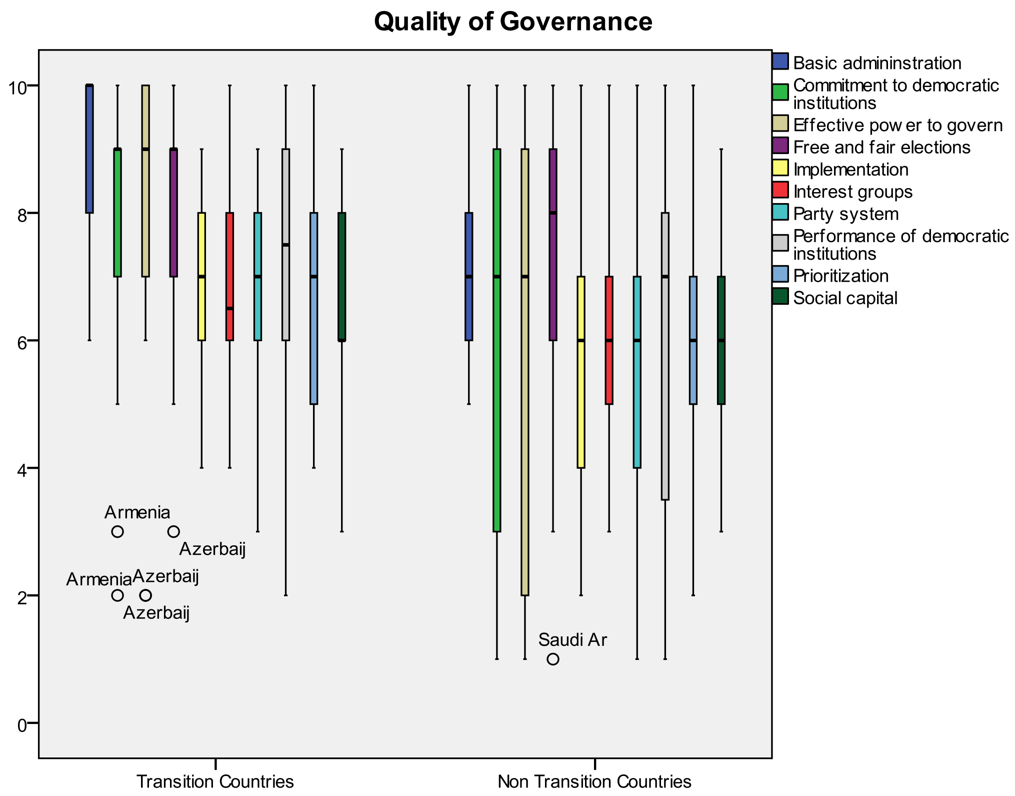
There were few significant differences between the transition and non-transition countries in terms of corruption. The only area with a statistically significant different was prosecution for abuse of office, where the transition countries achieved a higher score, indicating that officials have less opportunity to behave with impunity.

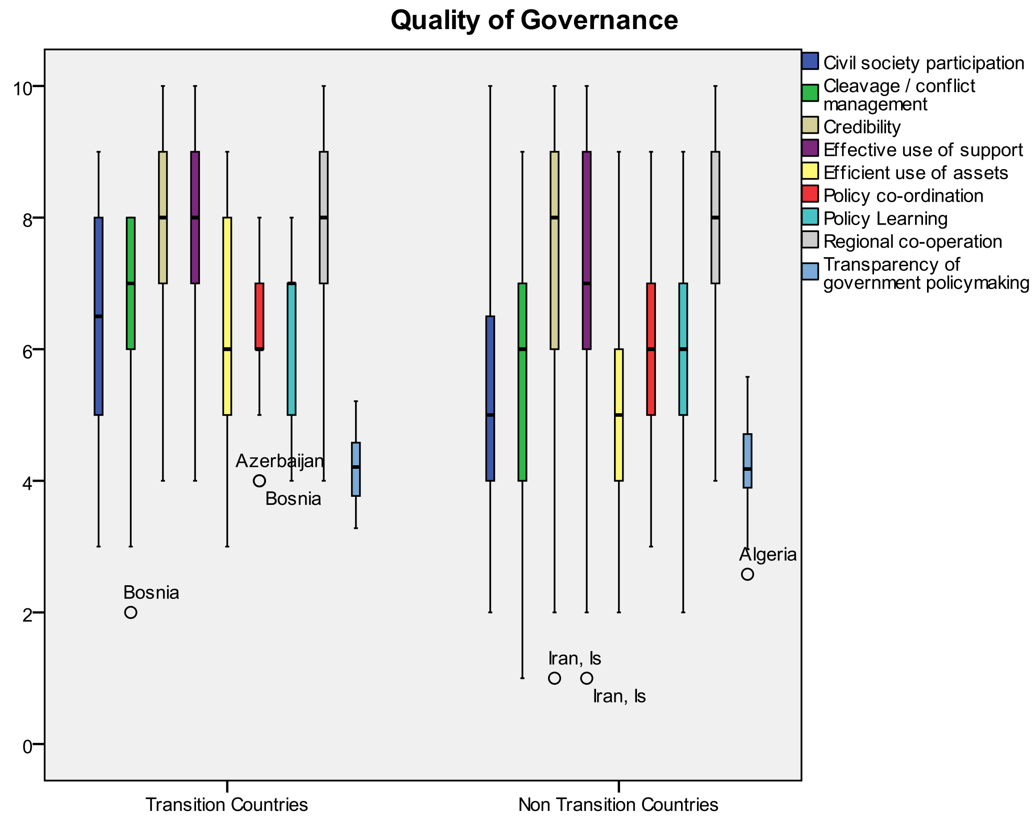


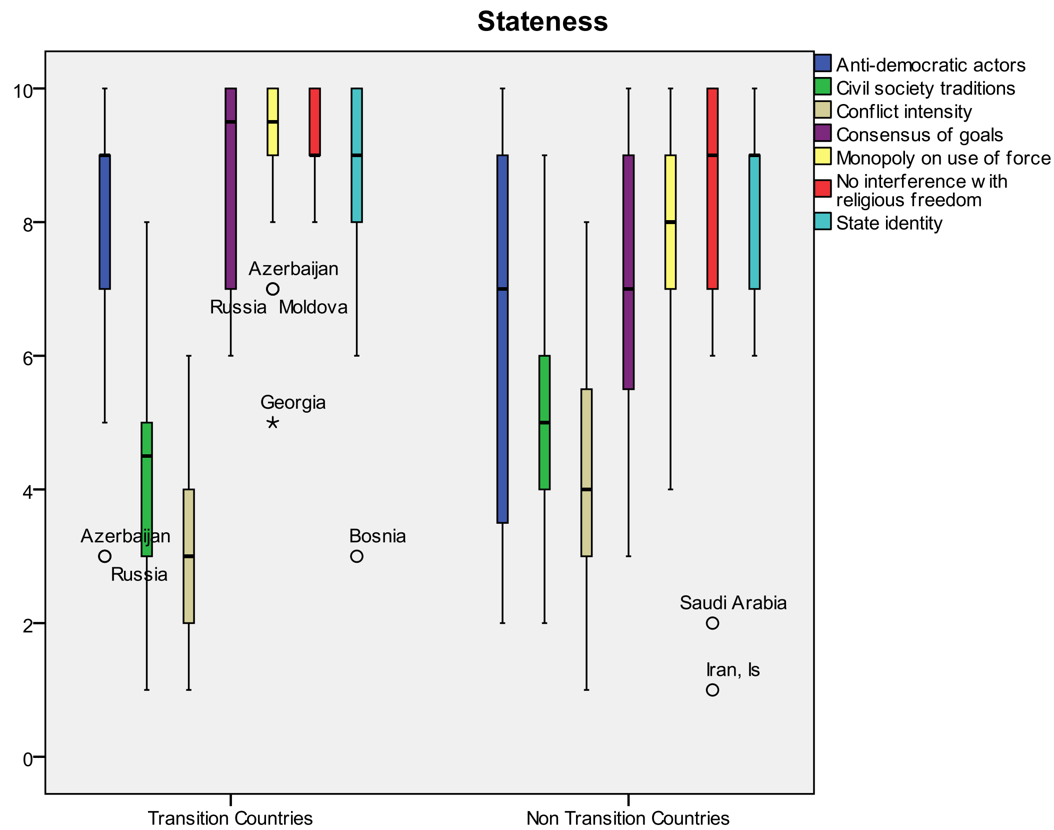
Efficient markets depend on information being freely available to participants. This implies that there is freedom of assembly and association so that market participants can meet up and of dissemination of information. These freedoms are encapsulated by the World Bank's *Voice and Accountability* governance indicator. The transition economies have a significantly higher median score on this than the non-transition ones and also on the BTI measure of association and assembly rights. This is not surprising given their membership of the Council of Europe and their adoption of the European Convention on Human Rights.

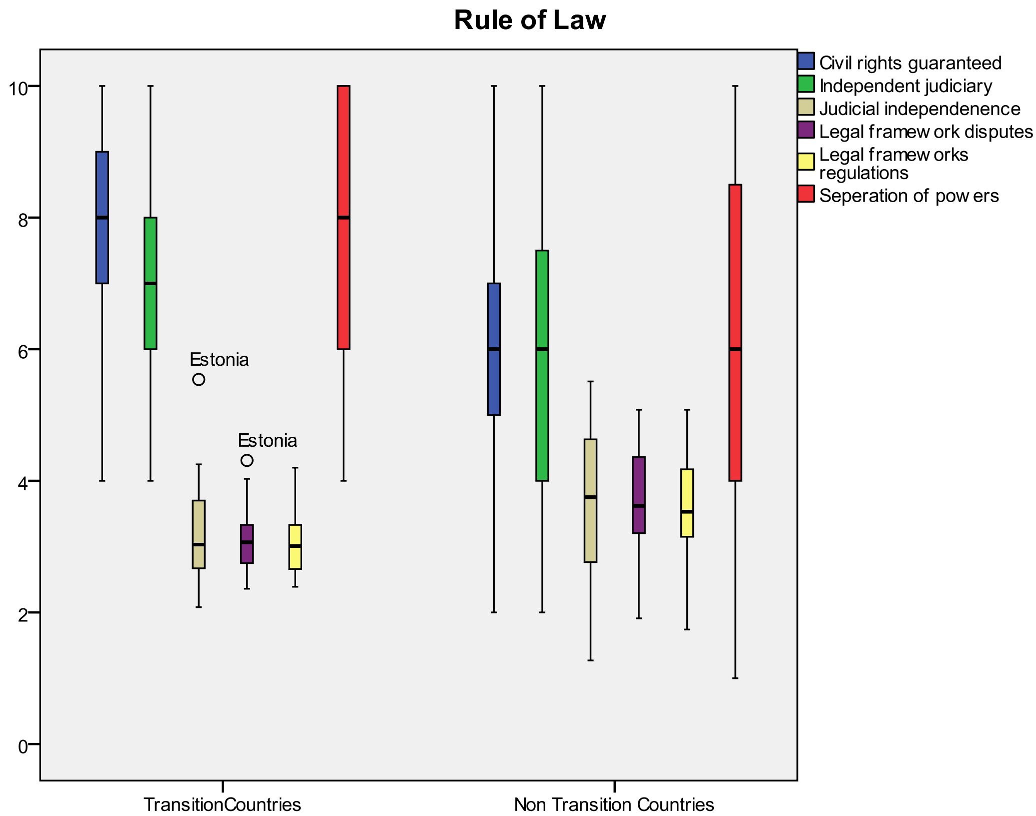


Freedom of assembly and association are likely to be associated with other aspects of the quality of governance. There are statistically significant differences between the transition and non-transition countries in terms of the quality of basic administration, effective power to govern, and the performance of and commitment to democratic institutions, with the median scores for the transition countries being higher. The other measures of governance, which come primarily from BTI, show no significant differences between the two groups. The strength of property rights is correlated with the quality of governance (Grover & Grover, 2012c). A challenge to the efficient functioning of property markets is where they cannot function effectively, for example, because of conflict, lack of consensus, or open challenges to the authority of the government. These can undermine the security of property rights. Statistically significant differences between transition and non-transition countries were found for government monopoly on the use of force, the absence of interference with religious dogmas, conflict intensity, and consensus on goals, where the transition countries had higher median scores, and the exclusion or co-option of anti-democratic actors, where the non-transition countries scored more highly. The membership by the transition countries of the Council of Europe and bilateral donor support given to projects for strengthening governance are likely to have resulted in improvements in these areas in the transition countries. Most of the transition countries have achieved EU accession or aspire to it and the political criterion for entry is focussed on the institutions guaranteeing democracy, the rule of law, human rights, and respect for and protection of minorities.




Quality of Governance
Civil society participation
Cleavage / conflict management
Credibility
Effective use of support
Efficient use of assets
Policy co-ordination
Policy Learning
Regional co-operation
Transparency of government policymaking
Azerbaijan
Bosnia
Bosnia
Algeria
Iran, Is
Iran, Is
Transition Countries
Non Transition Countries


Stateness
Anti-democratic actors
Civil society traditions
Conflict intensity
Consensus of goals
Monopoly on use of force
No interference w ith religious freedom
State identity
Azerbaijan
Russia
Moldova
Georgia
Azerbaijan
Russia
Bosnia
Saudi Arabia
Iran, Is
Transition Countries
Non Transition Countries

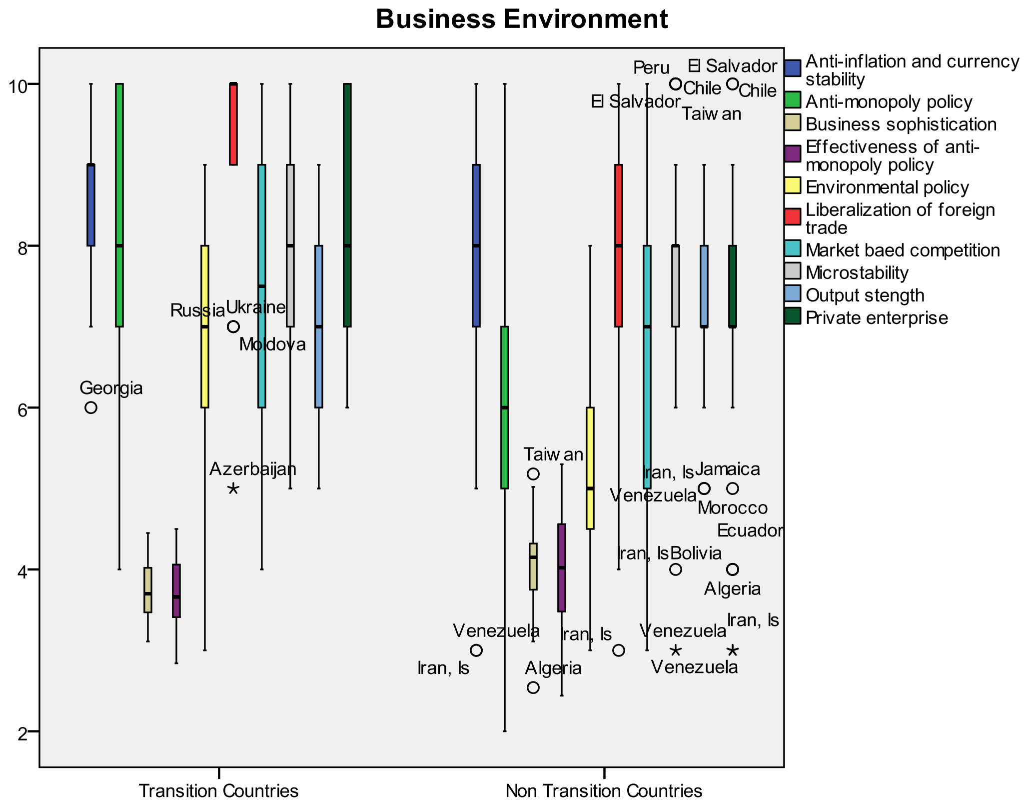


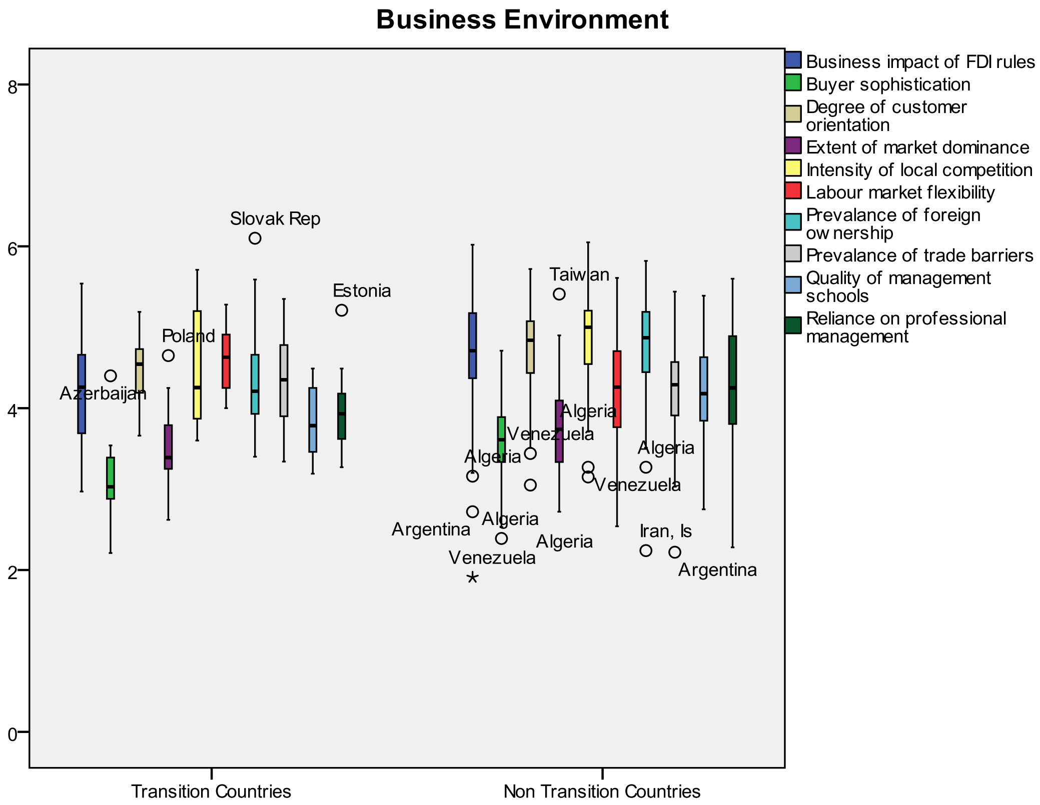
The security of property rights and the efficient functioning of property markets are affected by the rule of law. The property market is undermined if laws and regulations are unclear or subject to arbitrary interpretation. There were significant differences between the transition and non-transition countries on the separation of powers and guarantee of civil rights, where the transition countries had the higher median scores, and the efficiency of the legal framework in settling disputes and in challenging regulations, where the median scores for the non-transition group were higher.

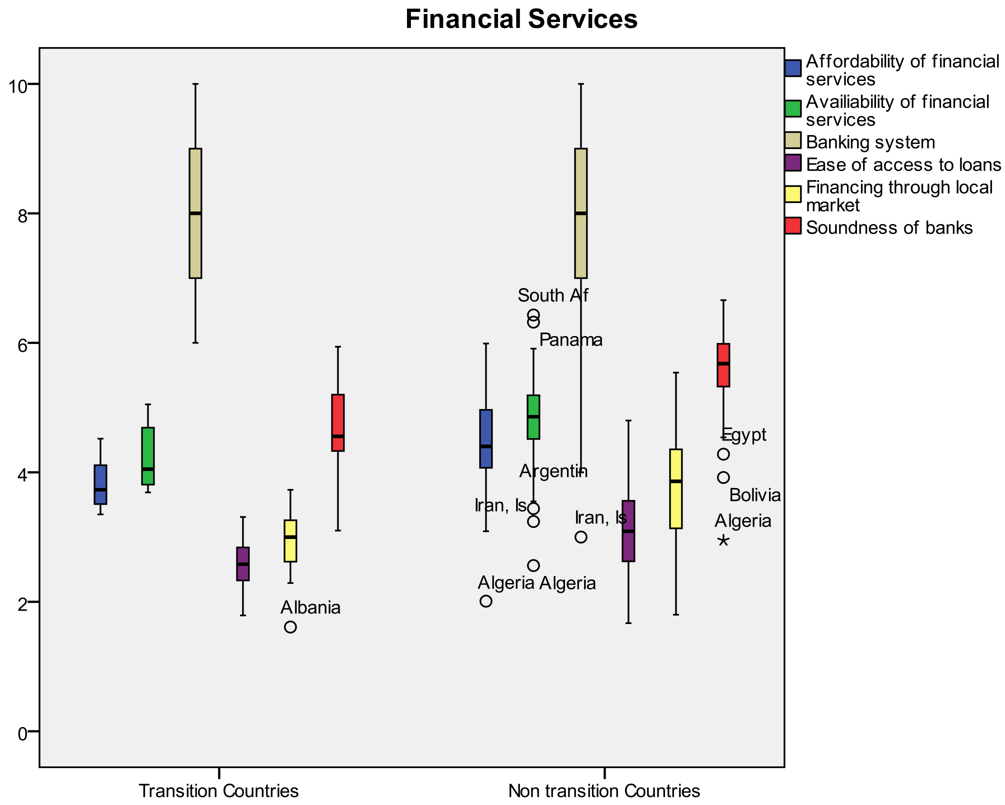
Different aspects of the business environment would appear to favour transition and non-transition countries respectively. Anti-monopoly policy is important for achieving contestability in markets and to ensure that the elite are unable to use their power to dominate the business world. On the BTI measure of anti-monopoly policy, the transition economies have a significantly higher median score than the non-transition ones but on the WEF measure, it is the reverse. An effective anti-monopoly policy is likely to be an important component of preventing state capture. The median scores for each group of countries on both measures indicate fairly effective anti-monopoly policies. The transition countries have significantly higher median scores for the liberalisation of foreign trade, the protection given to private enterprise, and environmental policy. On indicators like the prevalence of foreign ownership, the encouragement of foreign direct investment, buyer sophistication, business sophistication, the quality of management schools, reliance on professional management, and labour market flexibility, the non-transition countries achieve significantly higher median scores. These figures suggest that the transition economies have put in place policies to promote competition and private enterprise but the non-transition economies have the more effective business environment. In other words, there is still a legacy from the Communist era in terms of areas like labour markets, the professionalisation of market-orientated managers, openness to foreign enterprises, and buyer and business sophistication.

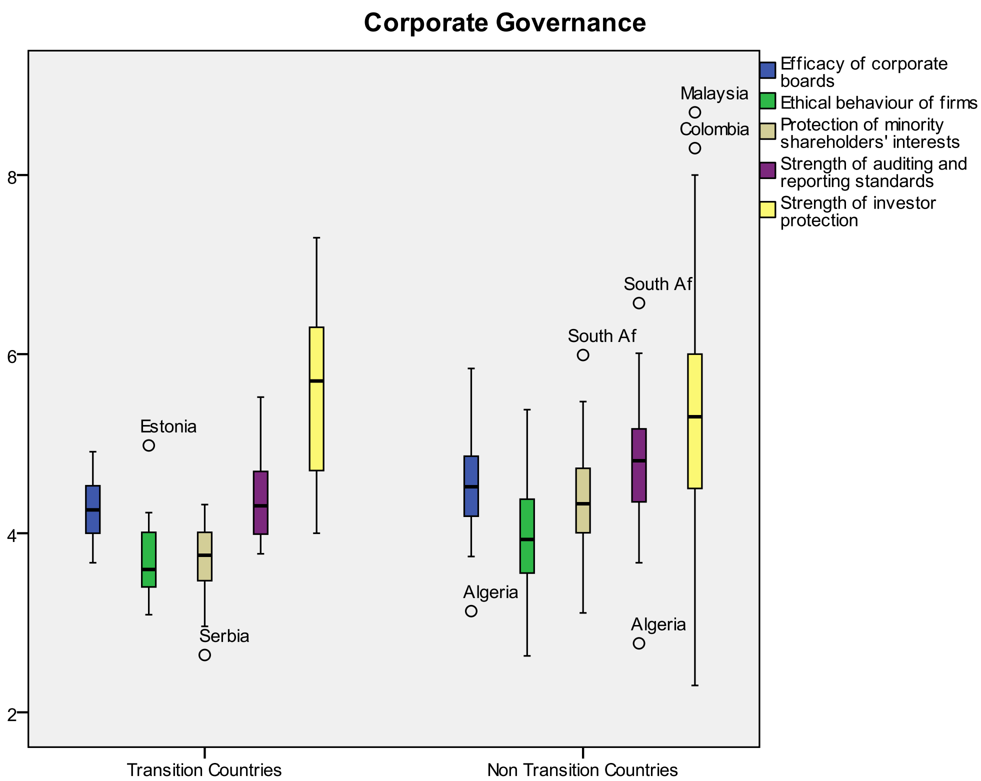
One specific area of the economy that transition countries have had to develop is the financial services sector. It has been necessary to develop banking systems with banks lending debt capital at risk rather than transferring state credits. During the early years of transition there were problems in a number of banks with failures and fraudulent practices. Particularly since the Russian financial crisis of 1998, the stability of banks has improved with a significant increase in foreign ownership of banks (EBRD, 2006, chapter 4). The data shows statistically significant differences between the transition and non-transition economies in terms of the availability and affordability of financial services, the ease of access to loans, the soundness of banks, and financing through local equity markets. The medians for transition countries were below those of the non-transition ones. These indicate that that there is still a transition factor with the transition economies lagging the non-transition ones.

There are significant differences on a number of the indicators of the quality of corporate governance between the two groups of countries. The median scores for the transition countries were significantly lower in the areas of auditing, the protection of minority shareholders, and the efficacy of corporate boards. Auditing is a profession that has changed as a result of transition from being a device through which government controlled enterprises to examining the quality of stewardship over shareholders' assets. This is not just an issue of the technical approach to auditing changing but also the attitudes of auditors. Auditors within a market economy are expected to follow codes of ethics and professional behaviour, for example, not engaging in fraudulent activities in their private lives and not investing in the companies that they audit. The creation of an audit profession involves cultural as well as technical changes.


Business Environment
Anti-inflation and currency stability
Anti-monopoly policy
Business sophistication
Effectiveness of anti-monopoly policy
Environmental policy
Liberalization of foreign trade
Market baed competition
Microstability
Output stength
Private enterprise
10
8
6
4
2
Transition Countries
Non Transition Countries
Georgia
Russia
Ukraine
Moldova
Azerbaijan
Peru
El Salvador
Chile
Taiw an
Venezuela
Iran, Is
Algeria
Jamaica
Morocco
Ecuador
Bolivia


Business Environment
Business impact of FDI rules
Buyer sophistication
Degree of customer orientation
Extent of market dominance
Intensity of local competition
Labour market flexibility
Prevalance of foreign ow nership
Prevalance of trade barriers
Quality of management schools
Reliance on professional management
8
6
4
2
0
Transition Countries
Non Transition Countries
Slovak Rep
Estonia
Poland
Azerbaijan
Taiw an
Algeria
Venezuela
Argentina
Iran, Is

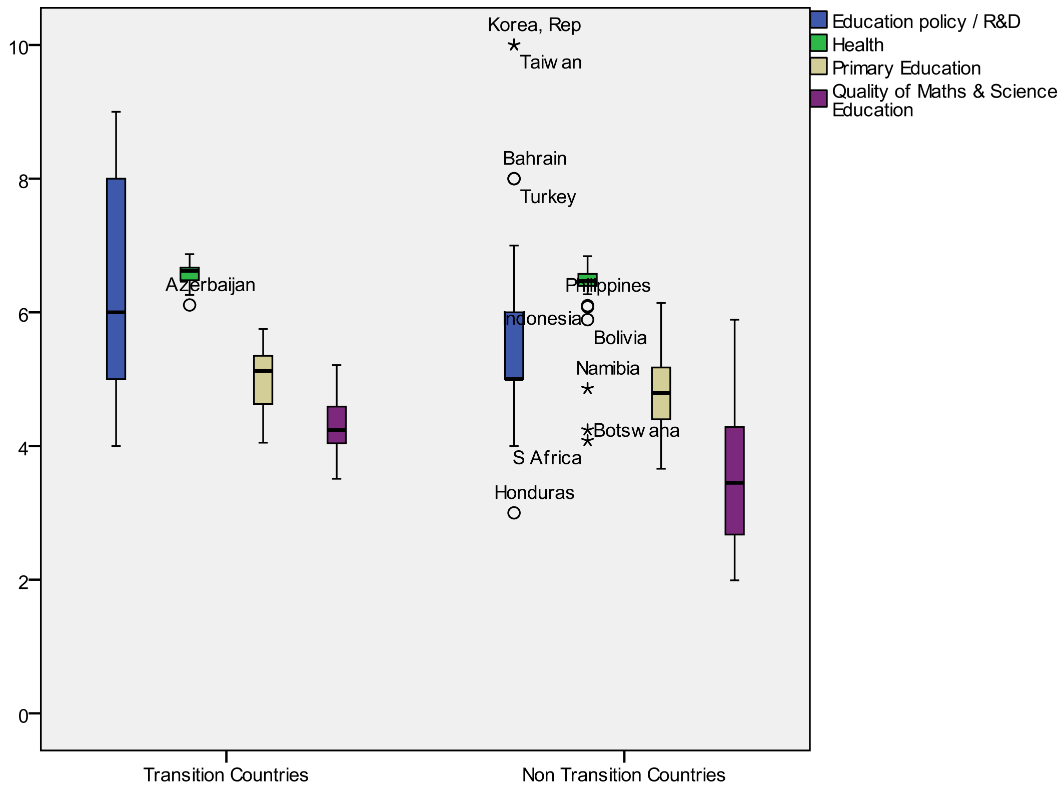


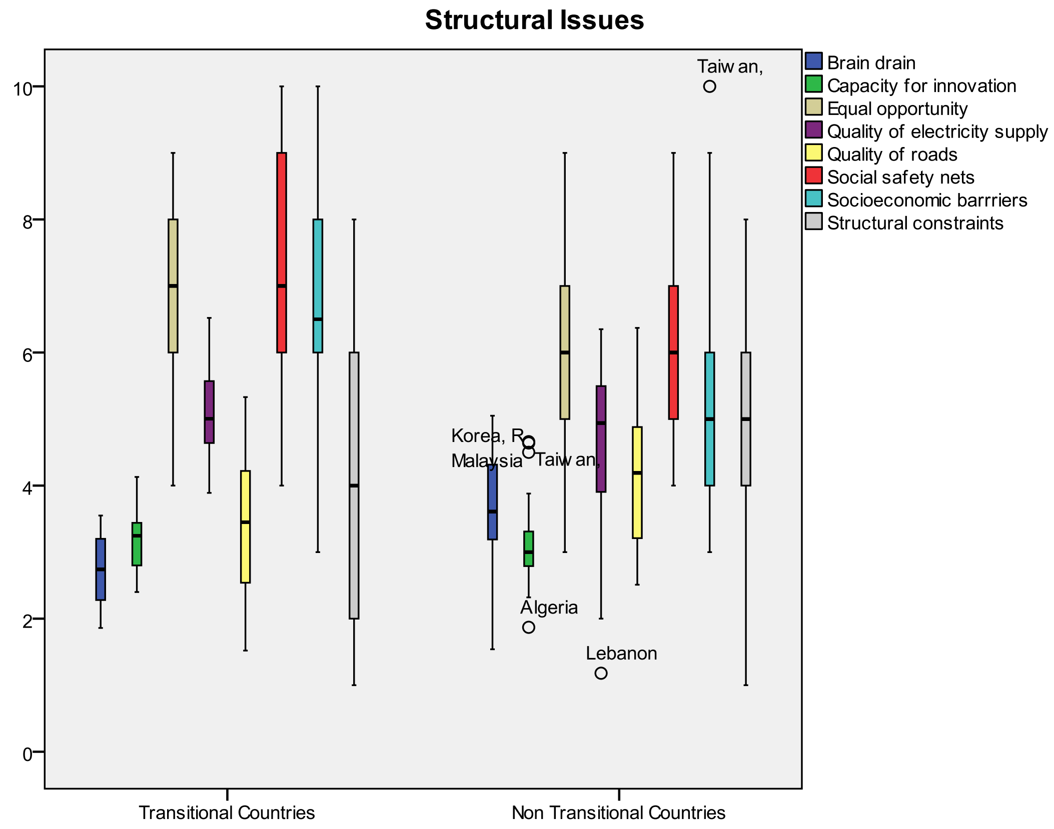


There are some significant differences between the transition and non-transition countries in terms of health and education. The transition economies inherited better systems of health care and education from the Communist era than the non-transition countries possess and the differences still remain in statistical terms for health, educational policy, secondary and tertiary enrolments, and the quality of maths and science education. These differences remain in spite of the budgetary problems transition economies have faced and the impact of these and inflation on public sector salaries.

These differences between transition and non-transition countries in terms of health and education are also reflected in certain structural issues. The non-transition economies are significantly more limited in capacity by structural constraints, such as extreme poverty, HIV/AIDs, and natural disasters, more of the population are fundamentally excluded by socio-economic barriers like poverty and inequality, and are more affected by a brain drain of talent. By contrast, the transition economies have better social safety nets and equality of opportunity. They also have some significantly better aspects of infrastructure including road systems and fixed telephone lines.

Education and Health Policies




Structural Issues
Brain drain
Capacity for innovation
Equal opportunity
Quality of electricity supply
Quality of roads
Social safety nets
Socioeconomic barrriers
Structural constraints
Taiw an,
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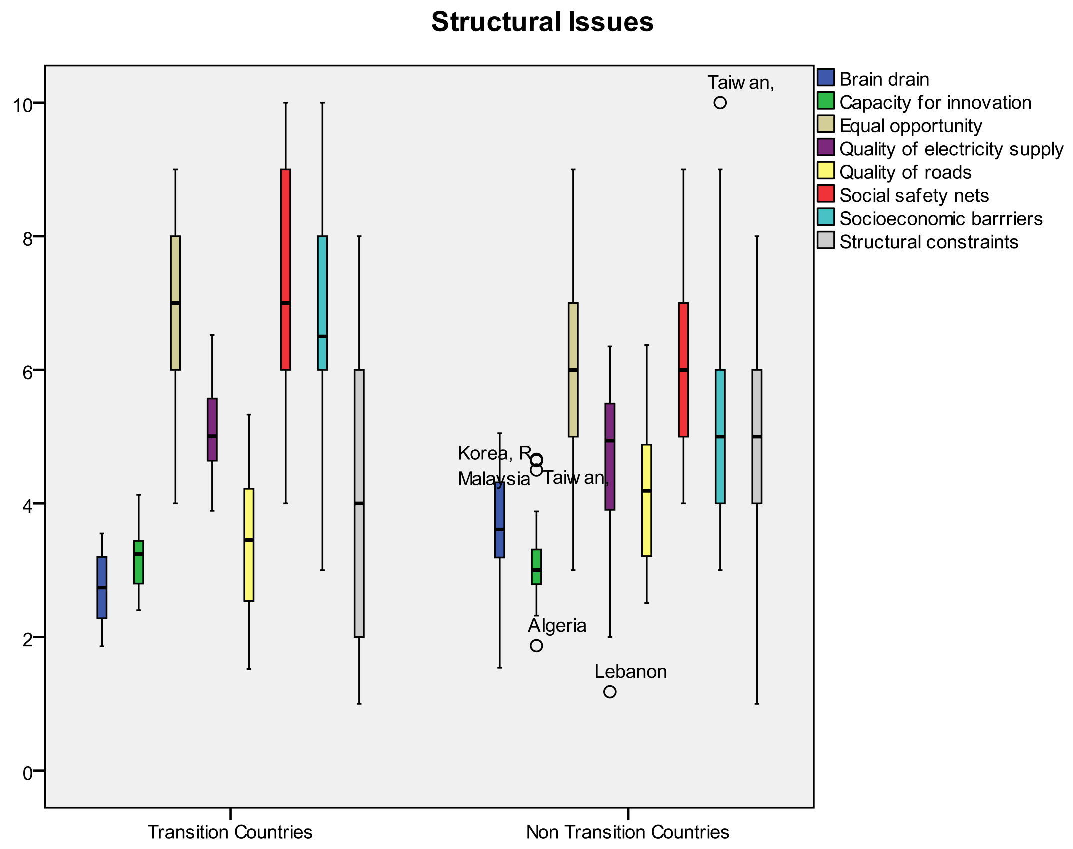
Transitional Countries
Non Transitional Countries


Structural Issues
Brain drain
Capacity for innovation
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Quality of electricity supply
Quality of roads
Social safety nets
Socioeconomic barrriers
Structural constraints
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Transition Countries
Non Transition Countries

Discussion

Ten years into the transition process a number of reports identified the key factors affecting the progress and the extent to which economic, political and social barriers were being overcome. At the start of the transition process, most countries experienced severe macro-economic instability with hyper-inflation in Georgia, Ukraine and Armenia. Former communist countries had a varied economic and political legacy. Weak government with ineffective rule of law, poor property rights along with corruption led to economic decline (Kauffman et al, 2001; Hellman et al, 2002). Although low levels of corruption were important for growth, it was found that the impact of structural reform was two or three fold greater (Abed et al, 2000). Progress in structural reform not only improved economic performance but reduced corruption (Nowak, 2001). Increased competition and economic freedom lowered the incentives for corruption (Norwak, 2001). In general, corruption reduced the level of FDI, however the abundance of rich natural resources in countries like Russia and Azerbaijan over-rode such concerns (Hellman et al, 2002; Abed et al, 2000).

The IMF reported a narrowing gap between advanced and slow reformers in 2000. Where political and economic reforms were limited or slowly adopted there was a greater level of state capture, where firms were able to influence and shape laws, policies and regulations through bribes to public officials. In 1999, nearly a decade after transition began, the level of this grand corruption was particularly high in Azerbaijan, Moldavia and the Ukraine and high in Bulgaria, Croatia, Georgia, Latvia, Romania and Slovakia. In a study of 3,619 firms working throughout 22 transition countries, a high or medium transition gap was recorded in state capture, in public procurement and levels of bribes. Azerbaijan, Ukraine and Romania experienced a high level in all areas and Albania, Armenia, Croatia, Slovakia, Georgia, Moldova and Russia in two areas. (Hellman et al, 2000; Hellman et al, 2002).

The success and speediness of the transition process reflects the strategies adopted in reaching the goals as well as the nature of the goal, for example entry to the EU. The two economic approaches adopted, which either focussed on macro stabilisation, price liberalisation and dismantling the communist institutions to improve economic performance or on the strengthening the legal and financial frameworks to ensure a market oriented economy, appear to have determined the rate of transition (Svejnar, 2002). The former was adopted by central Europe (with the exception of the Czech Republic) and the Baltic countries. The advantage of this approach was a greater control of inflation and with it high external debt and rising unemployment.

The countries' prime focus was often different: tax reform in Latvia, corruption and judiciary in Georgia and improvement in government effectiveness and accountability in Ukraine (Kauffman et al, 2000). Entrepreneurship is seen as a promoter of success; Poland and Slovakia were very attractive compared to Russia and the Ukraine (McMillan, 2002).

The transitional countries adopted different privatisation strategies with varying outcomes. Some countries used a range of methods depending on political, financial and technical constraints. Mass privatisation, favoured by CEE and FSU countries, was less successful without a strong legal system. Whereas the loans for share programmes used by Russia was open to corruption, the method adopted by Estonia, Hungary and also by Russia - transfer of ownership – reduced the chances of corruption when an implementing agency was used. Adopted by most countries, individual negotiated trade sales and international tenders gave inconsistent results. Management and employee buyout (MEBOs) were widely used in Croatia, Georgia, Hungary, Poland, Romania, Russia, Slovenia and the Ukraine MEBOs and led to poor corporate governance. Equal access voucher privatisation, adopted by the Czech Republic, Lithuania and Slovakia, failed to generate new investment. By far the most successful strategy was liquidation used in Estonia. Not only was it quick and efficient, it reduced the risk of corruption and established a new class of owners. (Kauffman & Siegelbaum, 2001).

The recession of the 1990s and the current affect of the euro crisis slowed down or stalled the economic growth of the transitional countries. After a slow period, Hungry, Poland, Lithuania and Latvia recovered rapidly but at different rates during 1992-1995; however after signs of recovery, Russia entered recession in 1998 (Rajagopal, 2008). Transition 2012 notes that some countries have not recovered from the 2008 crisis and the pace of reform has stalled. Large transition gaps were noted in the financial sector for all the Eastern European and Caucus (EEC) countries along with Bosnia and Herzegovina, and Macedonia. In addition Azerbaijan and Belarus had issues in Corporate sectors, energy and infrastructure. (EBRD, 2012). However, fiscal challenges, rise of public debt and rising employment are not unique to the eastern transition countries and they continue to be an issue with all countries linked to the euro zone.

The box plots for Bertelsmann and World Economic Forum measures highlight countries whose performance is extreme. Estonia scores very high for the rule of law and corporate governance and with Poland and Slovak Republic for the business environment. At the bottom end, Azerbaijan, Armenia, Georgia, Moldova, Russia, and Ukraine have shortcoming in many of the aspects measured (see box plots). Serbia and Slovenia score poorly in aspects of the business environment and Albania and Slovenia on aspects of finance. Clearly these countries are still in more early stages of transition.

Clustering of the transitional countries using a dendrogram has shown some clear patterns in some areas but different alignments in others. For rule of law indicators, the EU2004 countries, the former USSR and the former Yugoslavia form distinct clusters. For quality of governance, the countries that joined the EU in 2004, those that joined in 2007 and the EU candidate members, and the countries of the former Soviet Union along with Albania and Bosnia form clusters. For business environment, the countries that joined the EU in 2004 form a cluster whilst the other countries are chiefly aligned geographically. For corruption and financial services, the EU countries form one main cluster and the other Eastern European countries the other. Finally, the measures of corporate governance show no real pattern.

Conclusion

Earlier work comparing the property markets in transition economies with those in the developed market economies of Western Europe identified that there were significant differences in terms of the strength of property rights, market transparency, the cost of mortgage borrowing, and corruption in land services. However, since the Western European economies have higher incomes per capita than the transition ones, it is not clear whether these differences show that there is still a "transition" effect or whether they are explicable in terms of the differences in levels of development. Given that nine transition countries have satisfied the EU's conditions for accession, which include having a functioning market economy and achieving minimum standards of governance, whilst others in the Western Balkans are working towards accession, the idea that the differences may be due to the level of development rather than to any remaining transition legacy is clearly plausible.

In order to test whether a transition factor remains present, comparison was made between 22 European transition countries and 39 middle income countries not affected by the transition process. Whilst there is no significant difference between the two groups in terms of the strength of property rights, there are in property registration. The transition countries generally have fewer procedures, the costs of registration are lower, and they are closer to the best practice frontier. Property registration is an important aspect of creating an efficient property market in which transfers of rights can be undertaken reliably, speedily, and at modest cost, and that borrowing through mortgages and similar secured loans is possible. Property registration has been a major focus for World Bank loans and bilateral aid programmes since the transition process began, with the aim of securing the transfer for property rights from the public to the private sector. No similar difference between transition and non-transition countries exists for construction permits, which has not been the focus of World Bank loans until relatively recently, when the issue of illegal construction has been identified as a constraint on development in some transition countries.

Both groups of countries scored similarly on corruption, which was one of the areas of difference between the transition countries and the market economies of Western Europe. The transition countries score more highly on a number of governance indicators such as freedom of assembly, association and dissemination, basic administrative efficiency, commitment to democracy, and the absence or control over divisive forces. The transition countries are all members of the Council of Europe and signatories to the European Convention on Human Rights. The non-transition countries, though, score more highly on effective legal frameworks to settle disputes and to challenge regulations.

The transition countries have an inheritance of better education and health care compared with the non-transition countries and better infrastructure, such as roads and fixed telephone lines. Whilst the transition countries have adopted policies on the protection of private enterprise, the liberalisation of trade and environmental policies that score more highly than those of the non-transition countries, the actual business environment generally is less favourable. The non-transition countries score more highly in areas like foreign direct investment and ownership, buyer and business sophistication, management, and labour market flexibility. They also have better standards of corporate governance and more developed financial services.

The conclusion is that there are some important differences within transition countries and between them and non-transition countries. Some of these appear to have resulted from the transition process and the way in which the World Bank, EU and bilateral donors supported the transition process. This has resulted in better systems of property registration, higher standards of governance, and formal policies to support private enterprise, trade liberalisation, and the environment. There would appear also to be a legacy from the Communist era. Some of this is positive in the form of better education, health care, and infrastructure, and the absence of structural constraints. However, there would also appear to be a negative legacy in the form of less developed or market orientated business sector, weaker financial services, poorer standards of corporate governance, and legal structures less adapted to settling disputes or challenging regulations. The transition from centrally planned to market economies would therefore appear to be incomplete.

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Annex:

Transition and Non Transition Countries: Mann Whitney and Kolmogorov- Smirnov Tests for differences in median and distribution

Source	Measure	M-W Test	K-S Test
	Property and Construction		
BTI	Q9.1 | Property rights	0.088	0.374
DB	**Prop registration Procedures (number)**	**0.017**	0.096
DB	Prop registration Time (days)	0.444	0.516
DB	**Prop registration Cost (% of property value)**	**0.000**	**0.002**
DB	**Prop registration frontier DB 2013**	**0.005**	0.070
DB	Construction Permit Procedures (number)	0.285	0.602
DB	Construction Permit Time (days)	0.194	0.209
DB	Construction Permit Cost (% of income per capita)	0.718	0.293
DB	**Construction Permit Distance from frontier DB 2013**	**0.011**	0.066
	Corruption		
BTI	**Q3.3 | Prosecution of office abuse**	**0.014**	0.074
BTI	Q15.3 | Anti-corruption policy	0.087	0.059
WEF	1.03 Diversion of public funds	0.680	0.765
WEF	1.04 Public trust in politicians	0.380	0.242
WEF	1.05 Irregular payments and bribes	0.952	0.903
WEF	1.07 Favouritism in decisions of government officials	0.266	0.646
	Freedom of Information		
BTI	**Q2.3 | Association / assembly rights**	**0.013**	0.061
BTI	Q2.4 | Freedom of expression	0.280	0.803
WBGov	**Voice & accountability 2011**	**0.022**	0.151
	Quality of Governance		
BTI	**Q1.4 | Basic administration**	**0.000**	**0.005**
BTI	Q2.1 | Free and fair elections	0.085	0.537
BTI	**Q2.2 | Effective power to govern**	**0.008**	0.107
BTI	**Q4.1 | Performance of democratic institutions**	**0.036**	0.264
BTI	**Q4.2 | Commitment to democratic institutions**	**0.022**	0.137
BTI	Q5.1 | Party system	0.066	0.573
BTI	Q5.2 | Interest groups	0.146	0.903
BTI	Q5.4 | Social capital	0.092	0.221
BTI	Q14.1 | Prioritization	0.192	0.762
BTI	Q14.2 | Implementation	0.114	0.465
BTI	Q14.3 | Policy learning	0.133	0.404
BTI	Q15.1 | Efficient use of assets	0.082	0.482
BTI	Q15.2 | Policy coordination	0.466	0.975
BTI	Q16.3 | Cleavage / conflict management	0.182	0.423
BTI	Q16.4 | Civil society participation	0.087	0.374
BTI	Q17.1 | Effective use of support	0.231	0.797

BTI	Q17.2 | Credibility	0.620	0.903
BTI	Q17.3 | Regional cooperation	0.404	0.922
WEF	1.12 Transparency of government policymaking	0.669	0.898
	Stateness		
BTI	**Q1.1 | Monopoly on the use of force**	**0.005**	**0.005**
BTI	Q1.2 | State identity	0.443	0.646
BTI	Q1.3 | No interference of religious dogmas	0.199	**0.031**
BTI	Q13.2 | Civil society traditions	0.328	0.730
BTI	**Q13.3 | Conflict intensity**	**0.008**	**0.044**
BTI	**Q16.1 | Consensus on goals**	**0.001**	**0.013**
BTI	**Q16.2 | Anti-democratic actors**	**0.038**	0.298
	Business Environment		
BTI	Q7.1 | Market-based competition	0.094	0.293
BTI	**Q7.2 | Anti-monopoly policy**	**0.001**	**0.033**
BTI	**Q7.3 | Liberalization of foreign trade**	**0.001**	**0.005**
BTI	Q8.1 | Anti-inflation / forex policy	0.058	0.183
BTI	Q8.2 | Macrostability	0.755	0.996
BTI	**Q9.2 | Private enterprise**	**0.008**	0.157
BTI	Q11.1 | Output strength	0.204	0.872
BTI	**Q12.1 | Environmental policy**	**0.001**	**0.019**
WEF	**5.05 Quality of management schools**	**0.010**	**0.042**
WEF	**6.01 Intensity of local competition**	**0.045**	**0.006**
WEF	6.02 Extent of market dominance	0.080	0.221
WEF	6.03 Effectiveness of anti-monopoly policy	**0.025**	0.070
WEF	6.09 Prevalence of trade barriers	0.548	0.566
WEF	**6.11 Prevalence of foreign ownership**	**0.030**	**0.012**
WEF	**6.12 Business impact of rules on FDI**	**0.022**	**0.039**
WEF	6.15 Degree of customer orientation	0.102	0.092
WEF	**6.16 Buyer sophistication**	**0.000**	**0.000**
WEF	**7.A Labour Market Flexibility**	**0.017**	**0.031**
WEF	**7.06 Reliance on professional management**	**0.042**	0.070
WEF	**11th pillar: Business sophistication**	**0.003**	**0.015**
	Rule of Law		
BTI	**Q3.1 | Separation of powers**	**0.036**	0.404
BTI	Q3.2 | Independent judiciary	0.099	0.298
BTI	**Q3.4 | Civil rights**	**0.001**	**0.002**
WEF	1.06 Judicial Independence	0.095	0.070
WEF	**1.10 Efficiency of legal framework in settling disputes**	**0.001**	**0.010**
WEF	**1.11 Efficiency of legal framework in challenging regs**	**0.008**	**0.030**

	Financial Services		
BTI	Q7.4 | Banking system	0.655	0.970
WEF	**8.01 Availability of financial services**	**0.002**	**0.004**
WEF	**8.02 Affordability of financial services**	**0.000**	**0.001**
WEF	**8.03 Financing through local equity market**	**0.001**	**0.000**
WEF	**8.04 Ease of access to loans**	**0.004**	**0.007**
WEF	**8.06 Soundness of banks**	**0.000**	**0.001**
WEF	1.18 Ethical behaviour of firms	0.122	0.288
WEF	**1.19 Strength of auditing and reporting standards**	**0.013**	**0.039**
WEF	**1.20 Efficacy of corporate boards**	**0.039**	0.114
WEF	**1.21 Protection of minority shareholders' interests**	**0.000**	**0.000**
WEF	1.22 Strength of investor protection	0.428	0.720
	Structural Issues		
BTI	**Q6.1 | Socioeconomic barriers**	**0.006**	0.082
BTI	**Q10.1 | Social safety nets**	**0.007**	0.096
BTI	**Q10.2 | Equal opportunity**	**0.008**	0.142
BTI	**Q13.1 | Structural constraints**	**0.042**	0.090
WEF	**2.02 Quality of roads**	**0.027**	0.102
WEF	2.07 Quality of electricity supply	0.235	0.288
WEF	2.08 Mobile telephone subscriptions/100 pop.	0.196	0.114
WEF	**2.09 Fixed telephone lines/100 pop.**	**0.000**	**0.000**
WEF	**7.07 Brain drain**	**0.000**	**0.000**
WEF	12.01 Capacity for innovation	0.371	0.308
	Education & Health Policies		
BTI	**Q12.2 | Education policy / R&D**	**0.013**	0.167
WEF	**4.A Health**	**0.017**	**0.022**
WEF	4.B Primary education	0.097	0.126
WEF	**5.01 Secondary education enrollment, gross %**	**0.005**	**0.005**
WEF	**5.02 Tertiary education enrollment, gross %**	**0.002**	**0.002**
WEF	**5.04 Quality of math and science education**	**0.002**	**0.001**

Bold = significant at 5% level