Recensione del volume:

# *Transition and Beyond* ◊

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There are a number of ideal threads linking the papers collected in this remarkable book in honor of Domenico Mario Nuti. As usual the reviewer, who is simply a supposedly more careful and better informed reader, discovers and selects what are — according to his/her personal judgment — the most intriguing and relevant issues emerging from the text: but other readers will no doubt find other ones, maybe more crucial for them (and possibly for the authors themselves!).

First, this book provides guidelines for an economic account and interpretation of the "Short Century" that started with the burst of World War I and elapsed with the end of USSR in 1991. As it is well known, those definition and time span are due to Hobsbawm (1994) and — controversial as they are — have become popular as a description of an age of hard global war, both hot and cold. An age when ideology was a strong, though not unique, motivation moving governments and peoples to fight against each others. In this regard, the title of this book could have been "Transition (and Before) and Beyond", because it contains a toolbox for understanding what happened in the Short Economic

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Century, how it happened, and where did things go afterwards. And it is interesting to notice that one of Hobsbawm's reference author for the economic history of that age, Alec Nove, has also been Mario Nuti's co-author. After the Short Century has passed away, the economic controversies that have animated it for decades have soon been neglected by a large part of the economic profession — which in turn has been captured by subsequent historic trends (globalization, the rise and fall of worldwide democratization, global terrorism, climate change).[1] While it is reasonable, and even a sign of vitality of the profession, that economists became involved with other research agendas, some of the contributors to this book (above all, Ellman and Popov) remind us that some of the lessons of the Short Century are useful today as well. Other contributors focus on an individual country's transition experience and legacy (above all, Uvalic on Serbia and Desai on Russia), and help us understanding the specific pattern followed by some of the entities re-emerged from those peculiar confederations of states named Yugoslavia and USSR, where national identities have been concealed — but not eliminated — for decades.

A careful understanding of the legacy of Socialism is required also to get rid of some popular tales on post-1989 Central Eastern Europe, for example that their human capital endowment was very high and comparable to that of Western Europe. Commander's essay on "Skills and the Transition" argues that this is indeed a tale far from reality, as those apparently high educational attainments were of lower quality than usually retained, and decreased very rapidly as a consequence of both low investment rates in education, and a rapidly changing demand for skills after the transition. Human capital in Central Eastern Europe was often highly sector-specific, due to the requirements of the planning office, as I had the chance to discover in Latvia in 1994 where most of the Central Bank officers were physicists, due to the peculiar role of that country in the military-industrial *Combinat* of the USSR.

As pieces of an economic interpretation of the Short Century,

[1] For instance, a recent collection of outstanding essays of *New Comparative Economic History* (Hatton T.J. - O'Rourke K.H., 2007) does not contains a chapter on the Socialist experience.

the essays in this volume contribute also to the ongoing (and extremely trendy!) debate on the relationship and balance among market, rules and (political) power. This is, of course, a debate as old as Economics, but it has been revived recently in the aftermath of the "Short Globalization Golden Age" of 1991-2001, when the marriage of capitalism and democracy had appeared to many as an unavoidable destiny for mankind, the economic counterpart of the "End of History" evoked by a renowned historian. Other scholars, some of them contributing to this volume, argue instead that — far from ending — history is currently reproducing some patterns that emerged in the early Short Century (see for instance the close resemblance of some aspects of financial restructuring and exchange rate policy in Central Europe in the 1920's and today, as suggested by De Cecco). Or, as argued by Kolodko, that new economic arrangements and emerging conflicts (social, environmental, and so on) are currently exposing the world economy to new crises that push the End of History into an indefinite future.

What we are currently observing, instead, is a resurgence of economic nationalism after the Globalization Decade, which means that the world economy is far from becoming seamless not only for mere geographical or technological reasons, but for political ones above all. The Nation is back as a strong (the strongest?) economic concept, although difficult to define properly, as it was before War World II. On the contrary, the Nation had apparently faded away in the mythical age dominated by multinational corporations, multilateral organizations, international trade unions, and so forth (of course, those entities are alive and sometimes well).

Some lessons from the past balances (and unbalances) of markets, political power, bureaucracies and rules in the Short Century and after Transition, are extremely welcome today, because they help us understand the historical reality of concepts we are too often accustomed to use automatically.[2] In this respect,

[2] As done, in a different field, by the controversial book of CANFORA L. (2006) on the history of democracy.

Godoy's and Stiglitz's critique of the advantages of "shock therapies" (sudden liberalization and early, extended privatization) as a trigger of fast growth in transition economies, is worth especially because it can be included in a broader research effort on the sequencing of economic and political reform. On different grounds, for instance, Giavazzi and Tabellini (2005) have argued that early political liberalization can be counterproductive as it allows for the consolidation of lobbies that prevent subsequent economic liberalizations, but see Robinson (2005) for a broader overview of the complex relationship between democracy and development.

This is already much, but this book has even more to offer. Another strong message concerns the limits of economic, and economists', understanding of the real social process. In this regard, it is useful to read Ellman's essay on the rise and fall of socialist planning, in conjunction with Tanzi's chapter on complexity and systemic failure. Ellman provides a short but illuminating account of the historical path of socialist economies dung the XX century, stressing that three factors mainly accounted for their failure. These are: partial ignorance of the economic environment, especially due to the distorted incentives of those units whose data flow had to be incorporated into the plan; inadequate data processing of the growing amount of information generated by the system; and the increasing complexity of societies moving from agricultural and subsistence toward industrial economies. A relevant role in the failure of the planning experience is due, in Ellman's perspective, to the perverse action of bureaucracies, both at the high level of the Gosplan office and at the low level of the individual productive units.

Interestingly Tanzi, in his remarkable essay, not only broadly agrees with Ellman's view of the failure of socialist economies; he also adds an original interpretation of the consequences of complexity for market economies and economic policies. Technological and financial complexity is getting so high in current societies, that even skilled and informed analysts can find it difficult to trace the sequence of causes and consequences leading to specific events, above of all crises. Hence, the roots of both the Columbia

shuttle tragedy and the Enron bankrupt becomes obscure, and the steps needed to prevent subsequent failures become highly controversial. The current Western financial crisis, its background of bad monitoring and increasing complexity of investment markets, and its aftermath of very costly public intervention, make Tanzi's words extremely relevant. In his view, today's complexity exposes market economies to the risk of not fulfilling both the equity and the efficiency standards a politically viable economic system should in principle guarantee: the same standards socialist planning proved unable to fulfill during the Short Century. Economic policy in contemporaneous markets is limited in its action by a limited and incomplete knowledge of its targets and instruments, *ex ante*, and of its actual results, *ex post*. Complexity makes the exercise of unregulated private power (economic, political, and of the media) easier as it creates a deeper veil of ignorance about the conditions of agents and social bodies; and as it multiplies the opportunities for lobbing, corruption and opportunistic behaviors. Growing income inequality in Western societies would call for *more* economic policy, but the latter often proves ineffective: the lesson we should get, Tanzi argues, is that "transparency and simplicity should become driving principles for policy-makers in market economies". Nothing further away from what we are currently observing.

The current, disruptive financial crisis is raising doubts on some apparently well-grounded views on the working of capitalism and modern finance. In general, the interaction between surplus and deficit agents can be carried out either by markets, where firms obtain finance directly from savers, or by financial intermediaries, that absorb excess saving from one sector and channel it to another one with excess investment. The first case describes a market-oriented system, the second case describes a bank-oriented system. In the past, there has been wide consensus that, in the early stages of economic development, the saving allocation function is best carried out by banks. Such a view rests on the peculiarities of (traditional) banks.

When the economic system presents low levels of complexity, banks are especially fit to carry out the transformation of

maturities, by issuing liabilities with a degree of liquidity higher than that of the assets they hold: hence they satisfy both small investors' demand for short-term assets and firms' demand for long-term liabilities. Traditional banks used to perform this function efficiently, by managing large portfolios and therefore being able to face the insolvency risk of individual debtors and, at the same time, diversify maturities. In so doing, banks bear limited return and liquidity risks. Furthermore, to the extent that in the early phases of development markets are still partially developed, financial intermediation can be very effective in lowering transactions costs. In fact, in the early development stages (traditional) banking systems may result more convenient than direct finance as long as intermediaries can exploit both economies of scale in attracting firms' liabilities subscribers and economies of scope, by supplying a wide range of activities and services.

This point has been originally developed by Gerschenkron (1962), in discussing the relevant role played by banks in the industrial development of Germany and Italy at the end of the nineteenth century, when they carried out the key function of transferring funds from savers to investors (firms). Gerschenkron focused on the role of banks' very large investments in supporting German steel industry's development in the second half of the nineteenth century. He also noted that support was not limited to the supply of loans but it included banks' direct or indirect participation to firms venture capital (universal banks).

According to Gerschenkron, however, this latter role was temporary and justified by the backward conditions of the economy. Once the economy has reached a higher degree of complexity, investors can diversify their risk without necessarily resorting to banks. Transaction costs lower thanks to technological progress and the issue of the most appropriate financial system emerges. At least four alternative approaches to Gerschenkron's view were developed since the 1960's.

First, the so-called "new view approach" drawing on Gurley and Shaw (1960), that attributes to markets and non-bank agents a prominent role in the long-term. Second, the asymmetric

information approach (see Diamond, 1984) that instead considers banks as the most suitable engine of economic growth even in the long run.

Third, the historical-institutional approach, that criticizes the deterministic assumptions of the previous approaches by pointing out that the choice of the proper financial system depends on the existing historical and institutional framework. For instance, Allen (1993) argues that the superiority of either a market-oriented or a bank-oriented financial structure depends on how firms are managed. When the production possibility set is known and management decisions can be easily evaluated, bank-oriented financial systems prevail. Whenever, instead, uncertainty about the production function generates uncertainty on the evaluation of management decisions, market-oriented financial systems prevail. Therefore, the advantage of a system depends on the amount and the complexity of information to be taken into consideration in the decision making process.

Finally, according to the "law and finance" approach (see La Porta *et* al., 1996) the difference between financial systems depends on different corporate governance models, in turn determined by different legal systems. The most relevant distinctive element between the two main legal systems, the Common Law system, peculiar to Anglo-Saxon countries, and the Civil Law system, peculiar to continental Europe, is the different degree of protection provided to the shareholders vis-à-vis the State. This approach suggests that changes in the legal framework ultimately bear on the evolution of the financial system. It also highlights the fact that in systems with public companies and developed capital markets, the monitoring of management should be less costly and the allocation of resources should be more efficient. In short, market-oriented financial systems are in general preferable to bank-oriented ones.

These last two sentences highlights how much theory can be far away from reality, even when all sorts of caveats are taken into account. What the current financial crisis is showing is that banks and markets where so intertwined that one could not (and, above all, should not!) have applied the usual conceptual tools.

Banks were no longer "traditional" but they were deeply involved in the working of the markets, they were literally "making the markets". Even the distinction between developed and underdeveloped countries and intermediaries had been swept away by the wave of financial globalization started in the 1990's. Beyond the fog of technological and financial complexity, all sorts of conflicts of interests were flourishing. Monitoring and efficient allocation were often dismissed under the Common Law system, in favor of short-term performance and even robbery. Unregulated non-banking intermediaries are to blame, but often these are owned by banks or are simply financial vehicles that apparently regulated banks had put out of the scope of regulators. And how is it possible that sophisticated regulators did not see or understand what was going on?

If increasing social complexity and the changing environment make life hard for the policy maker, they make it even harder for the economist: some of the essays in this volume provides a much needed warning on the limit of economic understanding and economic forecast. What is probably the most effective in this respect, and the funniest as well, is in De Cecco's memories of a conference on socialist financial reform organized with Mario Nuti in 1987, when in his own words "we did not show much explicit foreboding of the sudden collapse that was soon to come about". No fellow economist should feel immune from such a risk.

Linked to this third message, this volume provides a last, but really not least, contribution: it is a real tribute to Domenico Mario Nuti, not a formal one. As shown by the brief but fascinating biography in the Introduction, Nuti has always been the kind of economist conceiving his profession as a mixture of research, teaching and policy advising, all interacting among them. And the essays in this collection, connecting economic ideas, history and living experiences, are the best tribute to his work: food for thought dedicated to an economic maverick.

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