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**RESTRUCTURING AND GROWTH IN ALBANIA:  
AN INSTITUTIONAL APPROACH**

**Abstract:** The aim of this paper is to explore the consequences of the first years of chaos and transition on the Albanian economic system, and more specifically the consequences of the international community (IC) program. To achieve this, an evolutionist approach has been chosen, with some contributions from North. The main finding is that these first years set the Albanian economy on a specific path: the informal economy is very large, and the formal economic framework not fully enforced, as illustrated by the competition institute case. Both these factors weakened the political power, along with state distrust inherited from the past periods, especially the socialist one, which reinforce the already widespread personal relationships usually find in economic exchange. Thus, informal institutions do not support the formal ones created since the beginning of the nineties at the IC instigation. Indeed, the lacks of transports and communication infrastructures and the weak political power favour corruption and the informal economy perpetuation.

In this context, growth is mainly financed by the migrants' remittances and the adjustments of the less developed sectors such as the services or the building sectors. But demographic factors imply that the remittances will not last more than fifteen years at best. In between, it seems difficult for the domestic savings and foreign direct investments (FDI) to be at a sufficient level to finance the much needing investments, as the formal institutions lack proper enforcement to set the right economic incentives.

**Keywords:** Albania – Institutions – Restructuring – Growth – International Organisations

**Research Area:** I Structural and institutional change in Eastern Europe

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## **RESTRUCTURING AND GROWTH IN ALBANIA: AN INSTITUTIONAL APPROACH**

During communism, Albania was under the most severe dictatorship, and locked up from the rest of the world. Dissidence was almost impossible, and self sufficiency was advocated during the eighties. Hence, post socialist transformations in this country have a deeper meaning than anywhere else: the transformation was almost total, from an extremely centrally planned economy, to close to nothing during 1991 and 1992, and since then to a kind of market economy.

Institutions to make that market economy efficient had been built almost from nothing. International organisations had been and still are deeply involved in that restructuring as stated recently by the International Monetary Fund (IMF) (Oestreicher 2006). In the first years and after the pyramids' crisis in 1997, the Albanian government followed quite thoroughly the program established by the IMF and the other international organisations, such as the World Bank and the European Union. According to them, Albanian growth in the past fifteen years has been quite impressive. Still, some improvements could be made on fighting bureaucratic corruption and on the law and order side. They are stressing as well the need for both infrastructures and an efficient regulatory framework. So far, growth is said to be not yet sustainable, as shown by low foreign direct investments and exports.

That is why institutions are needed to channel the wealth growth into economic activities that will generate a dynamic making the growth long-lasting, that is to say able to reproduce itself and evolves. At the same time, the stabilisation process demands a low state budget and a strict control of public expenditure.

The aim of this paper is to get past this picture to determine the macroeconomic framework set up by the successive governments and how that framework is influencing the Albanian growth. To achieve this, social, historical and anthropological factors will be called up to clarify economic outcomes and analyse economic restructuring since 1990. The first part of the paper details the theoretical framework mobilized to take into account these factors. Then, in the second part, the different stages of the Albanian post socialist transformation is described, in order to work out the economic sources of growth. That will ensure, in the third part, the understanding of the economic system structure, dynamic and

evolution, and the lock in situation it is in. The conclusion takes stock of the previous findings.

## **1. Introduction**

Since the end of the nineties, the post-socialist countries paths vary, though the initial program of transformation was almost identical everywhere. This variety led to a reappraisal of the Washington consensus and of standard economic theory, which were the basis of these reforms (Andreff 2002).

This reappraisal led to a greater considering of institutions, now the focus of the international organisations for developing countries. The issue is now to define which institutions are to be considered, how they should be taken into account in the continuing post-socialist transformation, and, especially in developing countries such as Albania, what is the aim of their implementation in the post socialist countries. Usually, institutions are considered to be a frame of constraints on human relationships in order for the markets to function properly. That is to say, means to forbid disloyalty, to maintain fair competition, and ensure contracts and properties are respected. From that point of view, the best institutions are the one from the western countries, and the developing countries will be better off implementing them.

Another point of view is to see institutions as a frame to human relationships in a wider sense, but to observe them only in the economic sphere. Here institutions are taken as North defines them:

*“Institutions and the way they evolve shape economic performance. Institutions affect economic performance by determining the cost of transacting and producing. They are composed of formal rules, of informal constraints and of their enforcement characteristics [...]. Both are ultimately shaped by the subjective perception people possess to explain the world around them which in turn determine explicit choices of formal rules and evolving informal constraints. Institutions differ from organizations. The former are the rules of the games; the latter are groups of individuals bound together by a common objective function” (North 1997, pg 1).*

These definitions have to be adapted to the Albanian realities, as there are not organizations strictly speaking; 92% of enterprises are composed of less than 5 persons, so there individual will be the player of the games. Formal institutions are the consequences of the beliefs of the decision making actors. Here, it is mainly the political, as the economic sphere is not organised well enough to put some pressure on them. The main influence and constraints active on the political, is the international community, that is to say the IMF, the WB and the EU. Their aims are different, as Albania is bound to integrate EU which gives some weight to the Stabilization and Association process, but overall the recommendations are similar. Thus, there we will talk indifferently of the international community, talking specifically of one of these organisations when their policies will differ from the other two.

As for the informal constraints, issued from the dominants beliefs, according to North there are the beliefs of entrepreneurs in the position of making policies (North 2005), or at least to influence them. In Albania, the informal constraints, that is to say, the dominants beliefs which have an impact on the economic outcome are much more issued from the population as a whole, with some variation according to the local situation. Indeed, as developed later on in this paper, personal relationships are still common in Albania, which decentralized the informal constraints and multiply its sources. Still, there are some common characteristics which could be found in a majority of economic exchanges.

Formal and informal institutions act as incertitude reducing agents. They enable the actors to elaborate some routines to act upon, and thus not to have to spend too much energy on each economic action. Both institutions evolve in a frame constraint by passed choices, as these choices narrowed the possible choices for the next period. This structure of formal and informal constraints, along with the beliefs underlying them is called the artifactual structure by North. It enables the incertitude reducing, and thus is the precondition to understand economic problems and sort out different situations. According to North, it is not possible to understand problems far from our culture.

As in Albania personal relationships predominate, informal norms are the ones to be taken into account to understand the economic system dynamic. The development toward impersonal exchange can come from exogenous factors, such as new formal institutions, or from endogenous consequences of the economic dynamic, such as the demographic evolution, or the competition evolution: new leaders can put pressure on the polities because of some new economic incentives, such as returning migrants with a new economic culture. Thus institutional change is the structural change humans impose on human interactions with the intention of producing certain outcomes. The outcomes can be unforeseen, or they can be

quite close to the incentives where the institutional framework is complemented by an elaborate artifactual structure, and where the institutional alterations are build on proper knowledge of their properties. That is why it is important to take into account some anthropologic, historic and geographic factors to understand the outcomes of the last alterations of the institutional framework.

The aim of these alterations is the economic development of Albania. It is quite difficult to measure this development, even with Human Development Indicator (HDI) like indicators. Most of the time, development is measured by the GDP and its annual growth, along with the GDP per capita. It is true that most of the time a high GDP enable people to live better off. Still, some particularities should be taken into account in measuring poverty or wealth in the developing countries. So, development here is taken as an economic change in the material and physical wellbeing of humans. It includes not only national and personal income data, but aspects of human wellbeing embodied in non-market economy, such as growth in the stock of knowledge or richness of the artifactual structure, which implies impersonal exchanges.

Indeed in Albania most of the IC societal studies are made with western concepts. Albanian realities have to fit into these concepts, for international actors to be able to work on them and to modify these realities. The movement is going from this conceptual world to the Albanian realities and not the other way round: it may be possible that as such some particularities of the Albanian economic realities may not be taken into account because they do not fit in these concepts. Here, we will try to start from the Albanian realities, thanks to the anthropologic, historic and geographic factors, to understand the economic realities from within, and thus its possible evolution in the near future.

## **2. The restructuring dynamic in Albania since 1990**

The path of economic development in Albania is a mix between traditional values, the formal norms imposed by the international organisations and the resulting opportunistic behaviour resulting from that melange. Thus, it is important to take into account the historical past, here the socialist legacy, the different stages in the early post socialist transformations, and the IC interventions.

### ***The starting point: a disintegrating socialist system.***

Because of the Albanian socialist system particularities, the starting point for the post socialist transformations in Albania was quite different from the other countries. Indeed, when

others European socialist countries were beginning to reform their economic system, Albania was still much centralised, with an economic structure particular to the Stalinist countries and thus with big internal and external imbalances. All the economic decisions on production, pricing, wage settings, investment and domestic and external trade were centralised in the five year plan. The decision making hierarchy divides in four tiers: the council of Minister, then the Branch Ministries, the Executive committees and the state enterprises (Pashko 1991). The cooperatives had a small part of self-management, but the plan was as well compulsory (Sjöberg 1991a). The labour market was also centralised, as well as the inputs affectation.

In 1990, some attempts were made towards decentralisation, but it never really functioned on the field, and some even aggravated the financial situation, leading to an orientation of the enterprises profits towards importations because of the lack of price flexibility (Muço 1997a).

The structure of the economic system was inefficient because of the property structure dominated by state ownership, with tragic consequences in the rural areas. For example, the cattle nationalisation in the beginning of the 1980's led to a blood shell, the peasant favouring eating their cattle rather than giving them to the state, which led to a lack of meat in the whole country in the following years. Beside, after the successive political ruptures, in 1976, Hoxha decided Albania "was going to build socialism with [its] own forces" which means the economic system was adapted to the need of autarky. Thus, the production scope was very large to meet the entire country's need, even with poor technological performance and a short industrial experience (Pashko 1991).

The aim of autarky led as well toward the priority in heavy industry, as in other socialist countries, to restore economic independence. In fact, 75% of exportations were from enterprises realising only 26% of the whole industrial output. On the contrary, 75% of the gross industrial output realised only 13% of the exportations (Pashko 1996; Muço 1997a). The inefficiency of heavy sectors, such as metallurgy or chemistry, sucked up the hard currency coming from the exports in the mining and energy sectors. The priority on heavy industry and ideological orientation led to the undervaluation of construction, transport, tourism and more generally the other services. Consequently to the high degree of decision making centralisation and the production concentration some management problem and input affectation arose, creating a shortage economy (Kornai 2001). In agriculture, concentration reached quite high a degree as well, and the combination of a lack of investment and the aim of autarky and unmotivated workers led to a food shortage in the end of the eighties.

Thus, several imbalances weakened the economic system when the first strikes were organized. In 1988-1989 the rise in the enterprises subsidies, following the end of foreign aid since 1979, and the decline of output led to government deposits shrinkage. The monetary policies were passive as usual in a socialist country, but the increase in budgetary deficit have the effect of creating money: in the 1980-1988, broad money increase by an average of 5% a year, compared with an average annual growth of nominal GDP of 1,1 %. In 1989 and 1990 the monetary creation was even more important creating the condition for the consequent inflation (Muço 1997a). The income policy was as well much centralised and lacked any system of profit-sharing. At the end of the eighties, not only Albania was among the poorest countries in Eastern Europe, but the imbalances consequent to more than 10 years of total isolation and of Stalinist ideology set the ground for a complete institutional breakdown, which took place between 1990 and 1992.

***The different stages of the Albanian post socialist transformation.***

Theory and practices were dominated by the so called Consensus of Washington in the early years of post socialist transition. It consisted mainly in very strict fiscal and monetary policies. At first, liberalizing prices, privatising state owned enterprises and cooperatives and opening the trade to the international competition was believed to be enough to create an efficient market economy. At the same time, monetary shrinking and fiscal policies would be complementary requirements. Thus, the first reforms did not take into account culture, social capital or informal institutions such as traditions or way of trading and exchanging goods and services, and ignored a possible path dependency in the economic dynamic. The aim was to implement a comprehensive reform, and to reject gradualism, which could lead to possible reversible reforms (Roland 2001).

Thus, right from the beginning the aim was to settle a market economy close to the theoretical model, that is to say with as few as possible state interventions, all the more so as the socialist state was a kind of anti-model with the extreme decision making centralisation. Rapid privatisation was important to create rapidly the right economic incentives by supporting the private owners of enterprises. The focus was on creating the right laws, implying they will create the emergence of proper behaviour among the population, and settling the country toward growth as markets will develop spontaneously. Hence the need to weaken the state to depoliticize the economy and prevent political intervention in markets.

From that point of view, Albania was quite good a field to test the theory. Indeed, between 1990 and 1992 the state collapse, the country fell into chaos making the starting

point to restructuring quite neat. Since 1990, three stages can be determined in the Albanian post-socialist transformations. During 1990-1992, it was the chaos and uncertainty period, with all the socialist institutions crumbling, without any clear program for the future. Then between 1992 and 1997, it was the euphoria period: Albania was on the road to become a successful capitalist country, to eradicate poverty and to offer possibilities for everyone to become prosperous. And since 1997, it is the realistic period, capitalism not being as easy as it first seems.

The communist collapse in Albania took some time, but the result was a complete disorganisation of the state and civil society. The first demonstrations took place in December 1989 and January 1990, especially in the northern towns. Right from the beginning of the 1990's, Ramiz Alia, who succeeded Enver Hoxha to the presidency, started some radical reforms concerning religious freedom, travelling rights and an eventual reconciliation with Russia and the USA, reconciliation that will be effective the next year. In spite of these measures, the political discourse was still axed on socialist ideology. In July, thousands of Albanians fled from their country through the foreign embassies. In December, the students, more organised than the other social groups, demonstrated and obtained the instauration of a multiparty system, on December 11. The first multiparty election took place in March and April 1991. Because the communist benefited from their years in charge and from decision making networks, they won the election against the brand new Democratic Party, lacking experience, and means of diffusing their propaganda. Moreover, rural population, the majority of the Albanian population, didn't take part in the early demonstrations, which favoured status quo, mainly because of the lack of information. As soon as June 1991, following a three weeks general strike, the communist government resigned and a coalition government took charge. This new government tried to implement a comprehensive economic reform program, but just some main measures will be effectively realized, such as the liberalization of some prices, or the law on private property, free initiative and privatization, n°7512 dating from the 08.10.91 (Luarasi 1997). At the end of 1991, the opposition left the coalition government, paralyzing the political activities and inducing early election at the beginning of 1992. The 1991/1992 winter was quite hard on the Albanian population, almost entirely dependent on the international aid. Demonstrations, violence and destruction of everything that was linked to the state, such as school, enterprises, administrative buildings, endured and even increased. Calm would come back only with the PD's victory in the 1992 election and Berisha's accession to power.

It is during that period that the main characteristics of the Albanian post socialist transformation had be put in place, that is to say: a comprehensive transformation of the economic structure, the raise of profound imbalances and a very slow adoption of new regulation and their implementation, especially in the economic sector (Muço 1997b). These three characteristics are still in force today.

Albania became a member of the WB and the IMF on October 15, 1991. At that time, the law of land privatization was in the process of being implemented and some reforms were as well under way, such as the creation of a fiscal system of taxes and duties, the liberalisation of exports and imports, the initiation of the Banking System restructuring and the devaluation of the Lek.

But the cooperation with the WB and the IMF really started in March 1992, with the PD victory. The preparatory work was done by that time and the plan was ready to implement (WB 1994). A shock therapy, the STAND BY program, was first launch and implemented between mid 1992 and mid 1993 for the country to recover macroeconomic balances. The aim was to stabilize the economy, with fiscal and monetary controls along a comprehensive price and exchange system reforms.

In 1993, Albania achieved all the objectives set by the IMF, which was quite rare among the countries helped by this organisation.

*“Within the first year of economic reform, Albania met all conditions for standby arrangements with the IMF-a feat not matched by many other transitional countries in Central and Eastern Europe. In 1993 Albania achieved 11 percent growth of GDP following three consecutive years of drastic decline. This rate of growth was the fastest of any European economy. The budget was brought under control, while agricultural output and private sector activity increased. Foreign exchange reserves have risen, and the Lek has appreciated by about 30 percent since the institution of the freely floating exchange market. No one could have predicted that the poorest of all the post-Communist countries of Europe, the one with the most excessive Stalinist past and the most isolated from the outside world, would be able to generate such a dramatic turnaround so quickly.*

*These successes are attributable to early and decisive economic actions by the government. Starting in April 1992, drastic economic*

*stabilization measures were taken the budget deficit was reduced, strict monetary targets were enforced, automatic extension of bank credit to state enterprises was curtailed, legislation formalizing a two-tier banking system was adopted, trade was liberalized, and privatization in agriculture and housing was organized and completed. Most artificially controlled prices, with the exception of those for basic consumer goods, were freed. Although initially prices increased dramatically, they then stabilized. Albania stopped the high inflation that threatens so many countries in the region.” (Andrews and Ovaglioglu 1994, pg 87)*

The aim of achieving low inflation, privatising houses, encouraging private agriculture and stabilizing the economy was considered a success in 1994, supported by a social consensus on an economic orientation toward capitalism. Then, between 1993 and 1996, the Enhanced Structural Adjustment Program (ESAF) program was implemented, consisting in a strict monetary policy, along with compensation and aid, and supported by a tight fiscal policies. Indeed, in 1996, budget deficit and inflation were diminishing, as well as unemployment as the private sector expand at a good pace: from 5% of GDP in 1991, it was already 75% in 1994 (INSTAT 2002).

In 1996, restructuring and transformation was considered well advanced. GDP was growing at a quick rate, around 10% per year, and the industrial sector has been as well improving since 1995. The agricultural sector, albeit marking a pause in 1996, with only 3% of growth, has been growing since 1992. Inflation was higher in 1996, because of some more price liberalization and the introduction of VAT (at 12.5 %). Budget expenditure has been decreasing since 1990, and was around 8% in 1994, which was quite stable and low, allowing some public investments. Still, some alerts could be perceived: budget deficit was not controlled anymore, at 11.2 % of GDP in 1996, the investments were lower. States revenues were lower as well than in 1995, whichever came from taxes or non-taxes sources (Bank of Albania 1996). The private sector, because of its quick growth, has been rapidly out of control, fuelling the informal economy.

And yet, this indicators were not sufficient to really raise alarm among the international community, as stated in a consecutive rapport (Jarvis 2000). In early 1997, the financial pyramids set up as soon as 1992 collapsed, and consequently the whole economy fell into chaos once again. Once again infrastructures were destroyed, people were killed, the state was disorganized and humanitarian help was necessary to feed people and restore order.

The recovery efforts were coordinated by the WB. To avoid economic corruption and political collapse such as in 1997, some conditions were imposed. Indeed, Albania received more aid per capita during 1991-1996 than any other countries, and the crisis was the strongest (Elbirt 1997). A new emergency austerity plan was launched to diminish state deficit and inflation, and the Albanian government committed to national reconciliation and to restore law and order. The year after, the Kosovo crisis draw a new set back for the Albanian economy, albeit a minor one compared to the 1997's one. Since then, the focus is on strengthening the formal institutions, fighting corruption, fostering growth of private markets and developing infrastructures such as telecommunication and roads.

The institutional reforms set about until then were mostly still on paper, as showed by the law on bankruptcy voted in 1994, and implemented only once till 2005 (Easterly 2006). Indeed, at the end of the 1990's, there was a shift in the approach of development: in 2001, the developing countries were put "in the driver's seat" (World Bank 2006). Instead of standard program near identical for every countries, specific national poverty reduction strategies were adopted. Since 2001, a National Strategy for Social and Economic development (NSSED) was adopted, now aligned to the European Stabilisation and Association process (SAp). As stated by the WB, it was prepared through an "unprecedented participatory process" (World Bank 2006). Indeed, institutions reforms till now were placated from western countries, without taking into account societal particularities. Now people are talked to at a higher level, the NSSED program being discussed at the ministries levels. Still years of international influences somehow formatted the political minds and only minor evolutions are waited.

Control of corruption is the main and the most pressing challenge Albania faces and economic growth will be the main instrument to reduce poverty. And if institutional construction is now a priority, the institutions to build are still very much inspired by the western ones, the aim, especially in Albania because of the EU integration target, is still a market economy, with western-like institutions. Indeed there will be some variations from the European model, as there are variations between the market economy in France or Germany, but there will be coming from the implementation of these new institutions and not from some institutions creations in the country.

Thus these policies, and the way they were implemented, shaped the Albanian economic development.

### *The sources of economic growth in Albania since 1992*

During 1990-1992, uncertainty was at its climax. People didn't know whether they were going to get rid of communism or not (Mustafaj 1992). They relied on local solidarity, which were already the main survival strategy during socialism (Sjöberg 1991b; Saltmarshe 2001), stopping collective labour in industries and cooperatives, which implied a famine in the consecutive months (INSTAT 2004b). The low level of communication infrastructures isolated most of the population in the rural area from the towns, and they started to rely on their plots to survive, and to spontaneously privatizing some of the collective properties (Civici 1997c; Biba and Lerin 2001). Because of the small size of the farms<sup>1</sup>, and the uncertainty in the human environment, peasants do not specialized their production and carry on a self sufficiency production basis. Since then, the agricultural market is characterized by short circuit between producer and consumer, with few production organized at a more sophisticated level, such as the eggs or milk production. Only at the beginning of this decade, with the help of the remittances inflows, some greenhouses were set up in the coastal area near Fier, marking a starting point for a market gardening production.

In the urban area, the uncertainty and the early privatisation of dwellings and shops led to the creation of very small and small enterprises in retailing or services. Industries, because of the low level of technologies and maintenance, along with the destruction in 1990-1992 and in 1997, just stopped their activities. Indeed, the industrial output dropped dramatically: -40% in 1991, -10% in 1997.

The stabilization phase got some good results: inflation and budget deficit slowed down and growth is positive as soon as 1993. Actually, growth in the first years of transition in Albania was mainly due to the starting point of the post socialist transformation: the level of development was so low, with a GDP per capita around 220 US\$ in 1992, with such imbalances between the sectors, especially the services backwardness and the industrial obsolescence, that growth was almost a logic consequence of the dismantlement of the socialist system. In the first years, growth is pulled by the services sectors adjustments and the need for an agricultural production. And during this period, the methodology used to calculate GDP growth raised some questions. IMF calculated it on the basis of investment and income, leading to an overestimation. Some experts from INSTAT, the national statistic institute, mentioned as well the overestimation of the agricultural output by at least one third, especially after 1998, date of the most comprehensive agricultural studies in Albania. Indeed,

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<sup>1</sup> after the privatisation, the plots was around 1,4 ha per farms (Ministry of Food and Agriculture 2002; INSTAT 2003a, 2005)

most of these GDP figures were recalculated and lowered (Vaughan-Whitehead 1999; INSTAT 2003b). Thus, in 1999, the agricultural share of GDP dropped from 54.4% in 1998 to 37.2% in 1999 (IMF 2001).

Growth was as well pulled by the remittances. Migrants started to send money home, which were first used to raise the population's standards of living, by first buying some televisions, then having a real bathroom and only afterwards setting up a small business, like transports services or a bakery (Telo 1999; Axhemi and Sokoli 2000; Gedeshi 2002; Arrehag, Sjöberg and Sjöblom 2004; Carletto, Davis, Stampini, Trento and Zezza 2004; Germenji and Swinnen 2004; Nicholson 2004). Importations grew, making the trade balance negative. This exterior deficit was as well the result of the stabilisation program (Andreff 2002). Still, in 1997, this growth dynamic showed its limits, because it was based essentially on adjustment in standards of living through remittances and foreign aid. The informal economy makes the formal institutions and regulatory framework adopted since 1992 quite useless. Moreover, this false start makes the possible integration of this informal economy in the formal economy quite hard. The extent of the informal economy size, along with the tight credit policies favoured as well the creation of the pyramids.

Because institutions created so far were without any societal foundation, people still had to learn how a capitalist economy functions, and the state still had to learn how to inform the population of some economic risks such as the pyramids. Indeed, there were at first considered as classic capitalist enterprises, some of them investing in the real economy. The lack of warning by the political power, because of demagogic reasons in an electoral period, even if the head of the Bank of Albania raised alarm, encouraged people to participate. Actually, money laundering generating by illegal activities, favoured by the Yugoslav embargo, and the Albanian geographical position, helped them to survive much longer than usual: around five years instead of two years at most. It seems that the total sum the pyramids owed to their creditors was almost equivalent to the annual GDP, around 2 billions dollars. The real lost was around 60% of the GDP, thanks to some blocked accounts which stopped the money flight. The Berisha government was said to be linked to the schemes in various newspapers, or at least accused of negligence, if not forbearance (Vaughan-Whitehead 1999; Jarvis 2000). IMF was accused as well to have reacted way too late, indeed official warning came only in October 1996, to late to find any solution to the inevitable coming crisis.

When the pyramid schemes collapsed, the poorest Albanians were the last to invest, which they did with all their savings most of the time, some even selling their only cow to make money. The majority of poor was thus ruined, and became even poorer than before the

socialist collapse. This crisis was considered as the last straw, after the authoritarian renewal in 1994<sup>2</sup> and the obvious cheating in the 1996 elections. Once again there were riots and destructions, and this time the army did not resist the arsenal looting, setting free thousand of arms across the country, and led to three thousands dead. Calm came back only with the international intervention, but the political power were still unstable for one more year (Muço 1997b, a, 1998).

The destruction were localised to the regions where the pyramid were implanted, they were devastated while the others were quite spared. The destruction aimed for state building and infrastructures, such as schools or administrative buildings, but as well for foreign enterprises and joint ventures (Vaughan-Whitehead 1999). But if the macroeconomic indicators fell that year, as soon as 1998 they were positive again. Indeed, growth was, and still is, mainly dependant of the agricultural sector, which, with a low level of specialization and industrialization was quite spared by the destructions. The trend in importations accentuated that year and the following, and remittances grew with a new wave of migration. Inflation and budget deficit make a jump, reaching respectively 43% and 14% of GDP. A stabilization program close to the first one was launched, cutting public expenditure, and thus forbidding any state help for the poorest just ruined by the pyramids, which reinforced state mistrust.

### **3. A deficient economic system**

The economic growth sources since 1992 is therefore not induced by the creation of an economic market through the formal institutions created since 1992, but rather as a reaction to it. Lacking the reinforcement of informal institutions, the formal institutions are useless, not to say inept, and create a lock-in for the economic dynamic to evolve toward a functioning market economy at a national level.

#### ***The economic system dynamic***

The aim of the WB and of the other IC was to set up the necessary laws for a market economy to function as soon as possible, to make the most of the collapse of the former economic system, but because the priority was given to the formal institutions, such as laws, straight democratic elections, rapid privatization and liberalization, people behaviour did not adjust to this new setting, viewing it for what it was, a formal set up without societal ground,

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<sup>2</sup> In 1994, Berisha, then president, attempted to institute a new Constitution to give more power to the presidency. It was rejected by referendum that same year.

and thus not to be taken into account. The lack of the polities' legitimacy to implement these formal institutions, because of the period of chaos coming from the lack of organised dissidence<sup>3</sup>, was aggravated by the strict budgetary and fiscal policies, diminishing the state possibilities to improve people conditions and to implement the new laws.

Indeed, because the earlier plans did not take into account the trust media in Albania, the traditional enforcement of property rights and the behaviour adopted during the years of chaos, energy, intelligence and decision making were oriented and mobilised toward survival. The majority of the people organized the human interactions they need on a personal level, not trusting the state, not knowing how to handle the new formal institutions, and other part of the population, mostly urban, takes the opportunities given by the communist collapse to improve their individual or familial situations. The majority of the population have to rely on their own forces to survive, and did not trust the state or local administration to implement property rights and thus impeding fiscal development. Indeed, loans and the main means of financing is transfer between members of the same families or between friends. That impedes as well the evolution of the economic system toward impersonal exchange. The lack of routines, the hostility of the physical and human environment, and the high level of uncertainty let people to concentrate on their survival. It was subsequently difficult to get past this stage. Indeed, the routines collapse led to an impoverishment of the artifactual structures.

Personal relationships are thus the main vehicle of trust for economic activities, individuals favouring oral contracts and doing business with people they personally know, or family members. Indeed, the institutional macroeconomic framework is not efficient enough to provide good economic incentives, basic services such as insurances or loans, or even administrative documents that may help to get past personal relationships, entitling trust between two persons who do not know each other. These personal relationships impede the economic development of Albania by raising the transaction costs. Since 1992, the artifactual structure was constraint as well by a poor level in the educational system, and a lack of post analysis. Indeed, the socialist period was the context in which the national history was first set up, and it was not called into question since. Thus the archaic image of a nation rising against the ottoman oppressor, and more recently of an Albanian individual relying on familial solidarity, as was exploit during the socialist period, are still in force today (Fuga 1998).

This lack of history and anthropology rethinking impedes individuals to develop mental construction which would allow considering some positive consequences of a world in

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<sup>3</sup> The PD members are from the communist party as well, albeit from lower ranks than the PS members.

which impersonal relationships. The construction difficulties of a trusting relationship between the state and the citizens are impeding as well, which entails a slowing down in the artifactual structure development.

If at a micro level the economy market is functioning: goods and services exchange freely, and price are determined by offer and demand, it is not the case at meso and macro levels. Actually, laws are not fully implemented (Easterly 2006), the recession and the poverty of people draw them to opportunistic behaviours such as corruption or cheating, the disorganisation of the privatisation led them to uncertainty about property rights. For example, although privatization of agricultural plots started as soon as 1991, land registration and the properties title issuing were not finished at the end of 2006. Trust in state was very low and has been even lower since 1997. And that is another constraint of the impersonal exchange development. Indeed, it needs as well the adoptions of proper instruments to implement the formal institutions, and to enforce agreements resulting from impersonal exchange, which means a coercive state that will not use this coercion to exploit its citizens (North 2005). Albania is actually on of the most corrupt state in the region and the implementing of the civil judgements or decisions is at a very low level, around 10% (Broadman, Anderson, Claessens, Ryterman, Slavova, Vagliasindi and Vincelette 2004).

The economic dynamic set up during the first period of liberalisation and privatisation, do not permit a kind of connection and relationship between informal and formal institutions. Indeed, informal relationships are the economic basis, and there is not efficient in between organisations, such as professional clubs or efficient chambers of commerce, to spread economic information to reduce the transaction costs. The transaction costs consists mainly in the information costs, about quality of the products of services, delays and supplies details, on quality and reliability of suppliers, but also on enforcement of contracts. The administration costs and the lack of incentives to small and medium enterprises (SMEs) creation accentuate these transaction costs as well (Muent, Pissarides and Sanfey 2001; World Bank 2002; Mançellari and Xhepa 2003; Agolli and Xhepa 2004). The state spread formal information, through television and newspapers, and to a lesser extent, through local administration. At the micro level, people interact on informal basis; few trust the state representatives to tell them spontaneously and for free economic or legal information. Now economic activities are quite independent from any formal macroeconomic framework.

The economic system dynamic rely on remittances to finance its development, and on some localised initiatives, creating geographical imbalances between regions. Thus, the coastal area developed the tourism sector or the market gardening production, but the North,

already the poorest region, lack proper infrastructure to evolve. Because of the level of poverty and the hardship to live there, people left to reach the urban areas, or better leaving conditions abroad, leaving villages empty and entire zone deserted. The same happens in the South, where the proximity of Greece attracts people, often leaving plots of land lying fallow. These international emigrations continues to fuel the economic dynamic, but the imbalances accentuated, lessening possible incentives to invest in the infrastructures in the far reaching areas, thus raising the incentives to leave. Moreover, this low level of infrastructures<sup>4</sup> led to big differences between prices of goods only kilometres apart (Marku and Shuke 1997). The biggest problem is still the energetic one. Not yet privatised, the national company of electricity is not functioning efficiently, and shortages of electricity are daily.

Growth since 2000 is stilled pulled very much by the remittances, which will not last more than 10 or fifteen years at best. Indeed, the Albanian population was the youngest in Europe at the beginning of the nineties, with the higher fertility and fecundity rates during the socialist period, the aim being to be 4 millions in 2000. Since the levels have dropped because of the high emigration level among the youngest and a shift in mentality, the fecundity rate being around 1.8 children per women (Chalard 2007). The mortality rate is still low, thanks to the society youth, making the demographic growth still important, around 0.7%, but it would not last long. The last forecast predict a population of 3.5 millions inhabitants in 2025, only 500 000 more people than now (Chalard 2007). The main economic problem linked to that demographic evolution will be the ageing population, and the bringing together of families abroad, shrinking the level of remittances sent home.

This lack of proper infrastructures, combined with the state mistrust inherited from the past periods, the strict control of budgetary expenditures in the first years of transition, lead to an important informal economy, between 30% and 60% of GDP depending on sources (Gërxfhani 1999b, a; Telo 1999; Gedeshi and Uruçi 2003; IMF 2003; Muço, Sanfey, Luçi and Hashorva 2004). The international organisations pushed Albania to adopt some institutional frameworks, although relevant to western economies, which lead to a loose institutional framework, even sometimes not relevant or impeding economic activities because of contradictions within itself.

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<sup>4</sup> For example, it takes 4 to 5 hours to reach Korce, a southern town, from Tirana, only 150 km apart.

### *The possible evolution of the Albanian economic system*

Indeed, the formal institutions, far from setting a functioning market economy, are used as measuring tools by the IC to evaluate the differences between western economy or a normative economy and the Albanian one, like the European Bank for Reconstruction and Development (EBRD) indices, or the Millennium development goals. In Albania, informal institutions do not match the formal ones, and vice-versa. In this situation it is quite difficult to implement some new formal rules hoping they will be effective. Thus, the indicators measured only the extent of the inefficiency of these informal rules, and not the country level of development. The head of the state, whichever party he came from, favours this situation by double talking, on one hand having a discourse for the international community, like the clean hands program, while at the other hand trying to stop political adversaries with dubious means, like stopping civil engineering in the capital because the mayor is from the opposite party, or like some suspicious attempt to alter vote results in the last parliamentary election (Office for Democratic Institutions and Human Rights 2005).

The IC is looking at Albania through western eyes, thus not seeing it properly. For example, fight against corruption and weak governance is to be the main targets of the government. According to a public survey carried out by the IC, corruption is leading to a lack of jobs growth and state mistrust, especially against public services and political and legal sectors. Indeed, there is corruption in Albania<sup>5</sup>, especially harsh in the health sector, and indeed it impedes economic development, but to fight it, it is necessary to understand where it comes from. This corruption is the fruit of the Albanian history, first as a reaction against the state after the socialist period. Indeed, the first real experience of a national state was during the socialist period<sup>6</sup>, thus state notion and perception as the beginning of the post socialist transformation were very much mixed up with the socialist experience itself, in what Cabanes called the national-socialist experience (Cabanes and Cabanes 1999). Then, the first years of transition saw the impoverishment of large part of the population with the successive devaluations and the strict budgetary policy. The fell in the civil servant salaries (Vaughan-Whitehead 1999) favoured corruption, especially in the health sector. Then, the pyramid episode reinforced the impression of a powerless state, if not a corrupted one.

Thus the corruption is first the fruit of state distrust, of a lack of communication to spread the economic incentives created by the new institutions, the lack on enforcement of

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<sup>5</sup> Albania have a corruption perception index of 2,5 (Transparency International).

<sup>6</sup> Even if there was the royalist period during the inter war, just after the independence. But it not last long and the administration was not enough developed to be a real national centrifugal forces facing the local beys, as show the failure of land reforms (Civici 1997b, a; Biba and Lerin 2001; Distaso 2002).

these new rules. People had to rely on their own strategies with too little pensions and salaries ((Vaughan-Whitehead 1999; INSTAT 2004a), and thus adopting corruption strategies. Reducing budget expenditures favoured the blooming of this corruption. Moreover, corruption is sometimes not really a deliberate law bypass, a buying of favours, but it could be as well out of ignorance of the interest or incitation the law can carry. Here again is the problem of a good diffusion of economic information, and the problem of the lack of intermediaries to do it. As for the weak governance, actually governance in Albania is one that relies on personal relationship, and it therefore not possible to be changed by law or formal institutions. It needs a shift in mentality that is to say in informal rules, which could be induced by creating new intermediaries able to spread reliable information, thus bypassing personal relationships. These new intermediaries or less specifically a source of evolution can come from the returning migrants. Indeed, they improved their economic culture and are able to understand the positive aspects of impersonal exchange and the formal and informal institutions it needs to function properly. Several seasonal migrants stopped their running to and fro from their houses to the foreign countries or the town to set up a little business. Still most operate in the informal economy, believing their small size impedes them to have access to credit, which is not true: it is hard for all the enterprises to get bank loans (Muent, Pissarides et al. 2001). Indeed, before fighting corruption it could be more efficient to convince Albanians that an efficient judicial system can work properly to enforce their rights in Albania. For as now, the focus is on how corrupt they are, as show in several surveys<sup>7</sup>, enlightening the weak points and not the positive ones.

In addition, corruption is always put forward as the main obstacles to business development. Still the level of transport and communication infrastructure is linked to the level of corruption: even if in developed countries, with a dense network of communication and transports infrastructure, it could have corruption at some levels, but the countries with a low level of infrastructures development are mostly wear down by corruption. Indeed, it is easier to get on with corrupt practices in an environment lacking the proper information and the means to get it. However, level of infrastructure development is rarely put forward. Indeed, the manifestation of the problem, corruption, is much more focused on than the problem itself low level of infrastructure. The fact the IC is putting forward corruption just reinforce this focus, spreading the feeling in the population of a nation widely corrupt, and not helping people to focus on the real problem, which could be a constructive objective. People

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<sup>7</sup> In Albania - Country Fiduciary Assessment, august 2006, the worlds corruption or corrupt appear 51 times in 62 pages, covers included.

can help construct infrastructure such as communication network instead of fighting against corruption which would be the next consequences.

Indeed, adopting some ill-assorted institutions is most of the time counter productive, or at least useless. And in Albania, the adoptions of a kind of package of western institutions since the socialist collapse, from the Constitution to the civil or the penal codes, without the means to enforce them bring them into disrepute.

As North states it:

*“The creation of a stable consensual polity takes time and simply putting in place the formal rules is a recipe for disappointment, not to say disaster. [...] Obviously any deliberate effort to broaden the human capital of poorly performing economies must be built on an explicit understanding of the cultural heritage of that economy.” (North 2005, pg 161)*

Focusing on growth as a means to reduce poverty has as well the inconvenient of leaving aside rural areas. Indeed, growth, as in most post-socialist countries, is concentrated in the capital and around, and the poorest regions are the rural ones. This focus, showed by the localization around Tirana of the civil engineering financing, aggravates the geographical imbalances, and is a push factors for internal migrations.

To get out this economic dynamic is thus quite difficult, especially if the focus is still on growth and macroeconomic indicators. Problems will be even sharper when the end of a high level of remittances, in about fifteen years at most, arrived before the level of FDI and domestic savings are sufficient to finance the much needing investments.

### **3. Conclusion**

Albania, as stressed by the IMF, lacked communication infrastructures for the economic information and goods and persons to circulate, efficient institutions for the business climate to be transparent and a comprehensive economic restructuring for the informal economy to be kept at a minimum. Actually, growth is largely financed by remittances and a large share of the economy is in the informal sector, which reduces government revenues. Enterprises are consequently quite small, as usual in informal economy, and agriculture is still underdeveloped, lacking specialization. The absence of good and reliable infrastructures led to short distribution circuits and impedes information transmission.

The state mistrust, the importance of personal relationships, the formal institutions disrepute led to a lack of support from the informal institutions to the formal one. Growth dynamic is evolving in a loose institutional framework that has taken a specific path development, and there is at least hindrance or resistance, if not a lock in, for it to evolve towards an efficient institutional framework, entailing impersonal exchanges. This dynamic can not entail that transaction costs will be reduced. Institutions as advocated by the IMF and the others international organisations, not taking into account the country's social realities, are bound to have a very minor impact.

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