

THE ROLE OF INTERNATIONAL ORGANIZATION IN INTEGRATION PROCESS AND SECURITY IN ALBANIA AND NEWLY BALKAN STATES

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Executive summery

The research work is concerned with economic, political and institutional development in Albania and other Balkan states as well as with the role of international factor to such processes during the post communist transition. International dimension has an important role and it seems will continue to be a very major determinant factor of the democratization process in this region. The explosion of civil war in the former Yugoslavia as well as the continuation of political crisis in Albania is the ultimate instances of this kind of problem threatening the prospects of democratic transition.

Attempting to analyze the role of international factor the research work focuses on two major issues: first, it analyzes the question what might have been wrong in Albanian economic reform and the role of Bretton Woods institutions in this process, and second, it assess the problem of institutional development by attempting first to answer the question, do the institutions matter?

Hence the first part of research attempts to highlight some of the reasons why the government efforts in transition economies are mainly focused on achieving macroeconomic targets. Meanwhile, governments have not paid an adequate attention to institutional aspects of the reform and, as the result, there is less progress in transforming the old institutional infrastructure into a modern, competitive and efficient system, which will be capable to support various transition challenges including the accommodation of a newly emerging private sector. The emphasis is given in analyzing some particular aspects of the Albanian economic reform in the field of credit policy, interest rate fluctuations and the scale of capital

market development. The research concludes that a close and unconditional relationship between Albanian financial institutions and IMF has produced a rather biased government policy towards the orthodox monetary related policy. This in turn, has contributed directly or indirectly in increasing the informal activities within the financial market, causing market disruption and other negative phenomena.

In the second part the research attempts to give an answer to the question of why some countries in transition are still engaging in political turmoil and instability, while others are performing better, not only in achieving a sound macroeconomic stability, but also in creating well-canvassed democratic institutions? The research work neither follows a cross-country comparison nor a study of a particular country. It studies, through a positivist analysis, the institutional changes of some societies in order to find some practical indications of how the process of competitions between institutions affected their future path of development. The sums up of main conclusions of this part are:

1. A human society is a complex organism and must be studied in the same way.
2. Economic analysis of evolution process of a particular civil society might yield important conclusions if the analysis is not bordered under certain constitution framework.
3. The positivist analysis of historical development reflected the importance of how various institutions in society insure their coexistence. If institutions have been able to compete with each other the society has enjoyed a long lasting prosperity.
4. An over estimation in theory and practice of classical and neoclassical approach for transition economies does not help to distinct particular development in a specific country. Hence it is suggested to approach such development with more complex and unorthodox theoretical approaches.
5. The analysis of institutional development in Albania showed that there was less progress in establishing independent and formal institutions. Credit institutions and its system of guaranty are in its preliminary phase. Moreover there are fewer intentions on the Ideology as an important institution, which is hardly damaged during the communist regime.
6. Current international efforts to combine economic political and institutional strengthening are an appraisable development in the Balkan region. The implementation and enhancement of objectives laid down in the Stability Pact for South East European Countries is a movement in the right direction.

Research description

The problem of democratization and integration of Balkan countries is a complex and difficult task as it evolves problems of present combined with legacies of past. Likewise, the research on this topic is not an easy one to be answered in a short study. In this respect the role of international organization in the process of integration and democratization of Balkan countries is a difficult job too.

The research attempted to combine economic, political and institutional developments of these countries with particular focus on Albania. Going through various academic and other publication sources, several questions were raised such as:

In the process of answering the above-mentioned questions a book is written (in Albanian language). The book's title is "Albania: Democracy in Deficit – An Analysis of Economic, Political and Institutional Developments". The book will be published this year by "Center for Research and Developments" in Tirana and it contains about 300 pages. The book comprises three parts including the list of tables and figures as well as the bibliography.

Part one: A short analysis of economic development and the role of Breton Woods institutions

Introduction

The terms "informal", "parallel", "black", "underground" and in the Albania's case, "pyramid investment schemes", have been used in development economics to analyze the effects of various forms of economic activity. An informal activity is generally lying outside the officially regulated area and it is basically a response to the market imposed restriction or/and on the missing formal markets. As such, pyramid investment schemes are a specific appearance of financial informal market, in which a special private entity performs its activity by collecting a large amount of money in the promise to pay very high returns. The long life activity of this "business" depends on the new inflow of money into the pyramid entities, which use it to repay the previous creditors.

Development of pyramid investment schemes is becoming in the center of research studies of many Albanian researchers as well as other scholars (see for example Sadiraj, 1999

and Jarvis, 2000). In these works efforts are made to analyze this phenomenon in a wide range of socio-political factors (including the seemingly geo-political division of Albania between North and South). These factors may have a great influence on such development. Jarvis (2000) argues that pyramid investment is linked not only with past backward legacies on the financial market. It was also stimulated by the inactivity of the Albanian government by not informing in time the public for the risks that were facing by this kind of business.

In a recent interview, the current Minister of Finance, taken by the Albanian partisan newspaper “*Zeri i Popullit*” (dated 24.10.2000), indicates another factor that may explain why the informal financial market has grown so rapidly in late 1996. He links this development with the fiscal policy followed at that time by the Albanian government. The link between fiscal policy and the rise of the informal market has been not very much in the focus of research studies. Likewise, in the following section a short theoretical presentation will be given of the relationship between fiscal and monetary policy. Also an attempt will be made to explain if there are any causal link between fiscal policy and informal market indicators. Credit market and in particular the credit rationing phenomenon will be in the focus of the third section, while the fourth section analyzes the interest rate policy. The fifth section discusses the importance of a well functioning capital market. By numbering the main conclusions of this article, the sixth section gives some indications of what might have been wrong in Albanian economic reform before 1997. However, it is important to emphasize that the topic of this article is still relevant also for Albania. Today, the current fiscal and monetary policy is less different from the previous one and in many respects there is no any significant progress on the part of institutional aspects of the reform.

Fiscal indicators and macro-economic stability

From an historical perspective the economic role of state has been related with the proper development stages of the entire civilized society. At the same time economic thought has also changed through the same evolutionary process. Thus, Europe during the 16-17th century went through a process of diminishing the role of city-state and a gradual increase of larger economic and political entities. Accordingly, the role of state during this period (which was more attached to the mercantilist type of state organization) is to be (1) a regulator of legal system, economic activities and administration of money-printing; (2) a promoter for building the basic infrastructure such as highways (later railways too), water systems etc.; and (3) a

protector of entire economic actors by implementing a sophisticated customs system and other non tariffs barriers in order to protect internal producers.

In the eve of the capitalist era (end of 18th century and beginning of 19th century), economic thought was dominated by Adam Smith and David Ricardo. Both of them in essence promoted a liberal role of the state. Ricardo, for example, is known for his theory of comparative advantages, where he argued that both parties could benefit from international trade when they specialize in producing the products or services, for which they have a better comparative advantage. Meanwhile Smith, in his monumental work ‘*The Wealth of Nations*’ (1776...), by placing in the center of the system the role of economy, nearly ignored the role of state as it is better replaced in many cases by market domain.

In between the two World Wars of last century and especially after 1950’, many economists realized that government, as the main state institution, has important duties, which were far behind the imaginations of many other classical economists of 19th century¹. The economists at that time agreed among themselves that government has an irreplaceable role not only in the social and economic affairs but also in correcting market failures. Richard Musgrave² has summarized the government’s economic functions by pointing out that government performs the following main tasks in the field of economy:

1. *Allocation role and resource administrator.* This function is linked with the administration and allocation role of specific resources, which the market in itself fails to do in an efficient way, because there are resources that might be almost impossible to underline a clear ownership as such. In this group are largely included natural resources such as, water and mineral resources, eco-systems as well as radio frequencies and air traffic control system.
2. *Income distribution and redistribution.* This is a very important task of the government, which is performed through tax policy, as well as a well-defined subsidization system. In this case the government applies a twofold standard. It levies progressive taxes for high-income groups and at the same time uses various subsidization schemes for the low-income citizens.

¹ However, some other economists, mainly those who belong to German Historical School such as, Friedrich List (1789-1846), Adolph Wagner (1835-1917) and Gustav von Schmoller (1838-1917), were much more confident for the role of the state in promotion development, as well as an important actor in the society to replace some of the functions that other institutions such as family and economy fail to accomplish.

² Richard A. Musgarve and Peggy Musgrave, ‘*Public Finance in Theory and Practice*’, 5th edition McGraw-Hill Book Company, 1989.

3. *Regulation and coordination.* This is also an important economic function of government, because it is related with well performing market mechanisms and maintaining a well-balanced relationship between producers and consumers. The main task of government is to supervise the monopoly position of any company (or group of companies in an oligopoly situation), in order to check if they use price unfair discrimination and/or other discriminatory practices, which may harm other producers as well as the consumers.
4. *Stabilization.* In cases where the actors in the various markets could possibly fail to reach either proper coordination or enhance a desirable balance to a specific market, the later could fall easily in disequilibria. According to the neoclassical approach these anomalies arise by the market failures should be corrected by government intervention. Otherwise in case of price instability, for instance, the economy will show a variety of business disruptions. Hence it is one of the government's duties to avoid or alleviate such anomalies by designing a macro-economic stabilization program. In this instance government may use direct and indirect instruments in order to replace the market equilibrium. These instruments could be classified into two categories: the fiscal and monetary instruments. Milton Friedman has emphasized that the government could not create an immediate economic equilibrium as such. However if government changes fiscal policy (i.e. the expenditures budget program and tax regime) controls aggregates of money supply, accompanied by an active interest rate policy, could be possible to create a long term price stability.

The stabilization role of government can be better understood if we explain the content of the following equation:

$$Y = C + I + X - M$$

This equation derives by the national account system. It emphasizes that the gross domestic income (Y) must be equal with the sum of private and public consumption (C) plus the level of private and public investments (I) and trade balance (X-M).

After a simple transformation, the above-mentioned equation could be written in the following way:

$$Y - (C+I) = X - M$$

This equation indicates that the difference between foreign consumption (X-M) must be equal with the difference between total income and internal absorption (C+I). In contrary, if both sides are not equal, the economy is called not to be in an equilibrium position. In order to

replace and maintain a desirable equilibrium, the governments, in general, have in their disposal the following instruments:

1. The right side of the equation represents the foreign sector of economy. In this case government could take measures aiming to promote the exports or/and reduce the imports. From the mainstream development economics, it is known that such objectives generally could be achieved in the long run (especially for export promotion), as it requires further adjustment in the economy and additional investments. However, government could also use the foreign exchange reserve or/and may sell some of its assets in order to gain foreign exchange as much as it may close the external sector gap. Such measures could produce an immediate positive effect on the market, as they replace the desirable equilibrium at the same level. But the use of foreign exchange reserves or the sales of government assets are instruments, which cannot be used frequently. They depend on the availability of resources that government has in its disposal. Likewise both measures are not recommended and they are not likely to be used by governments as the efficient instruments to stabilize the unbalanced market.
2. The measures could be taken also on the left side of the equation. Such measures can be focused on policies that are likely to yield an expansion of gross domestic production (Y), or/and in reducing the internal absorption. But it is known also that the effects of various economic policies aiming to stimulate a sustainable growth pattern of the economy cannot be reached with the short-term policies. Hence, in order to find an immediate solution, government prefers to deal with the second component of the equation, i.e., by cutting absorption, mainly on the part of public consumption and investment.

Bretton Wood institutions (especially IMF) frequently advice client governments to use fiscal and monetary programs to cut public expenditure whenever it is necessary to reach the desired macro-economic stability. In addition, measures aiming to control money supply may produce a real and immediate shock to the economy, which in fact may bring the economy into equilibrium (generally, at a lower point). But the shock is likely to have in the same time (as we will see in other sections) negative effects for the rest of economy. Dornbusch has emphasized that 'price liberalization, without commensurate expansion of money and credit aggregates, leads to an exogenous real contraction. In segmented credit markets in which

firms cannot replenish their finance fully by borrowing, real credit contraction limits their ability to finance inputs and hence production. The more segmented and imperfect credit markets are, the more strongly their effect should come to the forefront' (1994, p. 295). As we will see in the following sections, the price liberalization program in Albania was accompanied by further restriction on money supply. Hence, the article continues with an overview of credit policy.

Credit policy

Another important macro-economic correlation which is also derived by the national accounting system, is expressed in the following expression:

$$I = S$$

It states that in a closed economy (without taking in consideration the effects of foreign sector), the level of private and public investment (I) must be equal to the level of aggregate saving (S). In an undesirable disequilibria momentum ($I > S$), the government is very keen to find ways to finance the investment gap by designing policies aiming to increase aggregate saving³.

This position is the core of monetarist theory, which institutionally is supported by IMF and World Bank. In general, it is suggested that 'higher real interest rates tend to raise the total volume of savings and increase the degree of financialisation, acting as a "conduit" for investment...' (Vincente 1989, p. 212). Roland McKinnon and Edward Shaw are the first economists that laid down the theoretical grounds for financial policies that developing countries should adopt. In 1973, they separately suggested that financial market in developing countries is underdeveloped and fragmented. Hence, they advised an orthodox monetarist approach by stating that in order to raise the level of aggregate saving, the interest rate must be increased administratively to the point that saving must balance the needs for investment (see, Mckinnon 1989 and 1991).

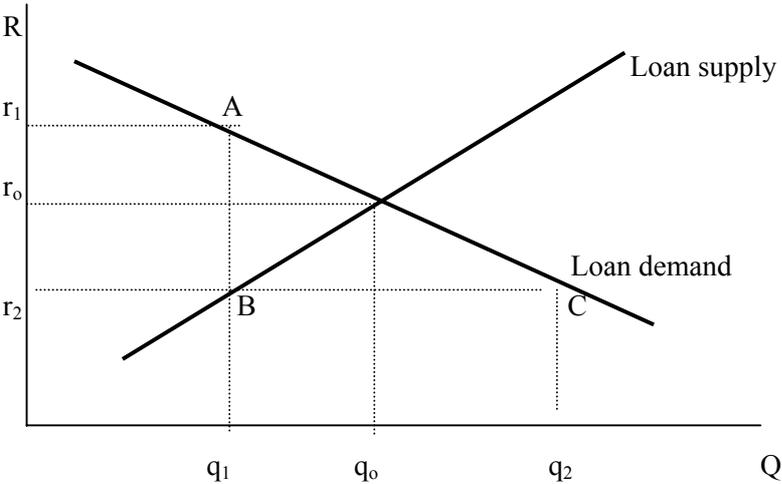
In addition to the saving-investment gap, government has to take measures to control inflation pressure. Hence, in the first phase of market liberalization, it is suggested that a necessary step for government is to take measures in order to create a desirable sound macro-

³ According to John Maynard Keynes (1883-1946), government, in order to overcome a recession phase of the economy, might raise the budget expenditure, especially those for financing investments. Such policy is likely to stimulate an increase on demand side of the economy. Likewise it will push up aggregate supply and will reduce in the same time the unemployment pull. Moreover, according to Keynesian theory, the economy will increase aggregate saving, which will lead to the increase of private investment.

economic stability. As is mentioned in the previous section, the main policies that government has in its disposal to control and keep the consumer price index under “reasonable” range of fluctuation are related with monitoring the parameters of money supply, as well as by raising the interest rate to the level, which yield a positive income in investing on domestic currency. The control of the aggregate money supply can be achieved by the use of direct instruments, which includes both the control of (1) the budget expenditure program and (2) the total amount of loans that commercial banks could lend to both public and private entities. The second option is known as the credit rationing.

In graduate textbooks, the credit-rationing phenomenon is defined as a situation when the demand for credit exceeds credit supply because the total credit available to the market is administratively decided below the market equilibrium level. In an effort to explain the consequences of credit rationing, Jaffé and Stiglitz have built a simple supply and demand model indicated in Figure 1.

Figure 1: Demand and supply for loan



Source: Jaffé and Stiglitz 1990, p. 870.

The vertical ax shows different levels of loan interest, while the horizontal ax represents the quantity of loan, available on the market. From Figure 1 can be easily understood that market equilibrium is at the cross-point between loan demands and supply curve. At this point the optimum interest rate is at the level r_0 and the quantity for credit is at the q_0 level. When the quantity of credit is administratively set at the level q_1 ($q_1 < q_0$), then we can distinguish two other interests rate points such as r_1 and r_2 . Point r_1 can be found if we go upwards from the level of the quantity q_1 to the point when it touches the demand for credit. This point

represents the highest level of interest rate that the customers (borrowers) are willing to pay to the credit institutions in order to fulfill their financial needs.

Another interesting point is the third interest rate r_2 , which can be found in the same way as r_1 by going upwards from the point q_1 to the point that it touches the loan supply curve. The level r_2 represent the lowest interest rate level at which the banks could lend. In the case when the interest rate is administratively placed at r_2 , the maximum amount that borrowers could require can be found at the level q_2 ($q_2 > q_0$). The difference between q_2 and q_1 can be considered as a shortage for credit in the market. When the interest rate is higher then r_2 we can speak of another important phenomenon such as credit seeking. Credit seeking represents the total amount of money that the companies are willing to pay in order to get a credit line. In Figure 1, the triangle ABC represents total expenditure that companies could possible further allocate in order (mainly in form of a tips to credit officers or/and bank managers) in order to “convince” bank’s officers that their business plan is the best. Any amount above the quantity expressed with ABC, makes credit more expensive; hence, the companies are theoretically not reluctant to pay such a price⁴.

Summarizing the conclusions drawn by the model described in Figure 1, it can be said that if credit policy is administratively set below the market equilibrium points then we artificially create: (a) a shortage for credit; (b) incentives for corruption among the employers of credit institutions; and (c) an extra-margin above the market price for loans, which in turn, will increase the cost of borrowing as well as it will raise the default loan rate (in other words it increases the level of non-performing loans in the bank’s portfolios).

Now, let’s see how the monetary authority (i.e. Bank of Albania) has handled the credit policy. Table 1, ‘*Credit allocation: 1991-97*’ is compiled in order to better understand credit development in Albania. It gives a general indication about the use of credit resources, the distribution of credit among the main actors in the Albanian economy, as well as the impact of the credit market to the rest of the economy. The credit sources are divided into three categories: credit to the government, credit to the public companies and third credit to the private entities.

⁴ The Herald Tribune, in a long analytical article dated 17 January 2001, emphasizes that half of the loans that commercial banks have allocated for the first five year of the reform in Check Republic, are lost because bank managers have provided them to their friends or politically affiliated companies. In this case our hypothesis cannot hold, because companies can take the loan at any cost because they know from the beginning that they will not repay it.

Table 1: Credit allocation: 1991-97

In millions of leks

	1991	1992	1993	1994	1995	1996	1997
Total credit, of which:	9447	18915	31773	80247	94524	85111	26061
Credit to government	-657	7662	20234	73342	84839	73672	111758
Credit to public companies	9909	10765	10164	2443	2485	3092	3413
Credit to private entities	195	488	1375	4462	7200	8347	10890
In percent of GDP							
Total credit, of which:	57,6	37,3	25,4	43,5	41,1	30,3	36,9
Credit to government	-4,0	15,1	16,1	39,8	36,9	26,2	32,7
Credit to public companies	60,4	21,2	8,1	1,3	1,1	1,1	1,0
Credit to private entities	1,2	1,0	1,1	2,4	3,1	3,0	3,2
In percent							
Total credit, of which:	100	100	100	100	100	100	100
Credit to government	-7	41	64	91	90	87	89
Credit to public companies	105	57	32	3	3	4	3
Credit to private entities	2	3	4	6	8	10	9

Source: *Annual Report 1998, Bank of Albania, f.19, and FMN, 1994*⁵.

In relation to GDP, aggregate credit in 1991 compared with 1993 has been sharply reduced from 57,6 to 25,4 percent. This development can be attributed to the severity of measures taken by the Bank of Albania in order to control different components of money supply. As previously mentioned, such measure has been taken in order to put pressure on the consumer price index, because in the early phase of price liberalization, Albania faced a hyperinflation phenomenon (in 1992 inflation picked 237 percent). After combined measures taken by the Bank of Albania and the Ministry of Finance, the consumer price index went down within the margins set up under IMF supervision.

Consequently, monetary policy after 1993 has been much more relaxed and overall aggregate credit has been increased above 40 percent of GDP in 1994 and 1995 and later on it is reduced again to 30 and 36 percent, respectively, in 1996 and 1997. The austerity of measures taken in 1996 and one year later in 1997 were replaced because the Albanian economy faced again some macro-economic imbalances. The frequent changes of credit policies confirm the fact that credit rationing has been used as a direct and active instrument to control money supply.

Another important conclusion that can be drawn by the third part of Table 1 is the distribution of aggregate credit through various users and how it changed during the period of study. After 1994 about 90 percent of overall credit sources have been allocated to

government sector in order to finance its budget deficit. Credit to private entities marks about 8-10 percent, but if we compare this figure in terms of GDP, the size of credit to the private sector is very marginal (initially it was about 1 percent). Such figure explains in large degree why the Albanian economy during the transition period 1991-97 largely depended on the functioning of the informal market. As such, the figures presented in Table 1 show that the formal credit institution has a minor effect on the real growth of the Albanian economy. Second, the need to finance the budget deficit has helped to crowd out private investment, instead of promoting this.

Despite the fact that Table 1 provides plenty of useful information about credit policy in Albania, it can be extended if we compare such figures with some other countries. Hence, Table 2, ‘Credit to non-government sector in some selected countries: 1993’ is compiled.

Table 2: Credit to non-government sector
in some selected countries: 1993
In percent of GDP

	1993		1993
Czechoslovakia	74	Hungary	28
Australia	98	Poland	21
Austria	88	Japan	202
Belgium	86	Netherlands	115
Canada	108	Sweden	143
France	90	Switzerland	179
Germany	125	United Kingdom	117
Italy	64	United States	114

Source: Borio 1996⁶

The first reaction is that credit has a significant weight in developed economies. In terms of GDP it varies from 64 percent in Italy to 202 percent in Japan. In transition economies the figure is particularly high in Czechoslovakia with 74 percent and much lower in Poland with 21 percent of GDP. In Albania credit to non-government sector has varied to 4-5 percent in terms of GDP, which shows that this country is still in an embryonic phase of creating formal money market institutions. Moreover the informal institutions replaced the lack of official

⁵ International Monetary Funds, 1994, Albania, IMF Economic Reviews 5, July 5. Washington, D.C.
⁶ Claudio Borio E.V, Credit Characteristics and the Monetary Policy Transmission Mechanism in Fourteen Industrial Countries: Facts, Conjectures and some Econometric Evidence. In: Alders K., Koedijk K., Kool C., and Winder C., (Eds.) Monetary Policy in Converging Europe. Kluwer Academic Publishers, 1996.

financial markets. But this substitution, created tremendous negative consequences, in a later phase of transition after the collapse of informal financial institutions, or as it is broadly known, the fall of the Albanian pyramid schemes.

Interests rate policy

The official date that marks price liberalization in Albania is 1 September 1991. Consequently during 1991-1993, it faced for the first time in almost 50 year the inflation phenomenon (in fact, it substituted the shortage of basic consumer goods, which was extremely high during the 80-s'). The consumer price index jumped respectively, 104 percent in 1991, 236 percent in 1992 and only 30 percent in 1993. Taking in consideration the fact that before the 90-s', the government authorities set administratively all kind of prices in Albania, we cannot say that inflation at this time is a monetary phenomenon as the monetarist school largely suggests. At the initial phase, the inflation was merely a structural problem, which was primarily related with different transition stages of the economy: from an economy ruled by the central planning to a liberal one. However, the Bank⁷ of Albania's monetary program designed under the direct influence of IMF team cured the inflation with wrong 'medicines'. By considering the inflation as a monetary problem, it has adopted a credit rationing policy, following an active interest rate policy. Hence, the primary interest rate, for most of the time, was set above the inflation rate.

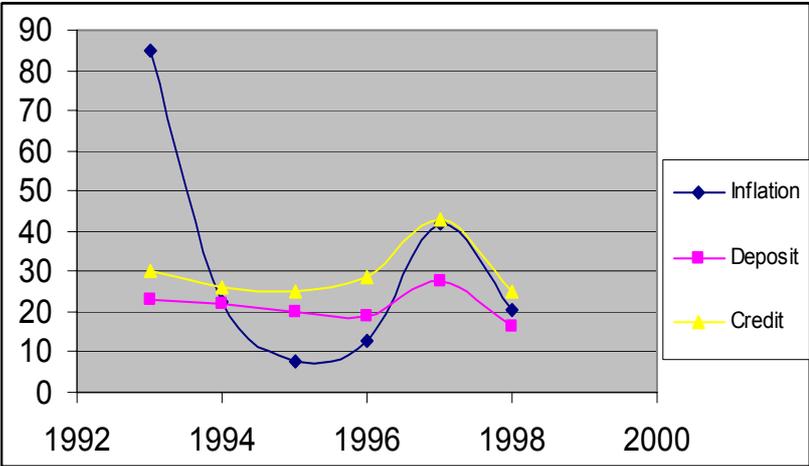
Figure 2, '*Interest rates and inflation: 1992-98*' is compiled to illustrate the interest rate policy. It shows three different rates: inflation, deposits and credits. As we can see, inflation has fallen sharply below 10 percent in 1995, but the deposit interest rate and especially the credit interest rate remained at high level. In 1996 and 1997 the consumer price index has been up again to around 40 percent, due to political instability following the collapse of pyramid investment funds at the end of 1996 and in the beginning of 1997.

The difference between the inflation rate and the credit interest rate is another problem. It picked 17 percent in 1995. A relatively high gap can be seen also between deposit and credit interest rates, which reached about 15 percent in early 1997 and about 9 percent in 1998. This development shows that the Bank of Albania has followed an inefficient interest rate policy, which, in turn, triggered further shocks to credit management. This is because the price for loans that private entities are asking is artificially increased. The Bank of Albania

⁷As an independent body, the Bank of Albania is established on June 1992.

reports⁸ that during 1996, the stock of non-performing loans increased to 60 percent of total loan portfolios of the commercial banks (from 10 percent in 1993).

Figure 2: Interests rate and inflation: 1992-98



Source: Bank of Albania, Annual Report, 1999.

Further investigation can be carried out on the direction of the use and management of treasury bills and the development of the capital market. But before we analyze this important aspect of the financial market, it is worth to mention that treasury bills were mainly sold to domestic financial institutions (the Bank of Albania itself is the largest buyers of treasury bills) at a higher price compared even with the interest rate, which is applied in the credit market. This difference is up to 3-4 percent, which, in turn, has increased the borrowing cost of government.

Consequently, the financial market in Albania and especially the banking institutions are transformed into a system of rent generation. The evidence provided by both the Ministry of Finance and the Bank of Albania show that the profit of Central Bank is increased three times from 1996 to 1999, while, in 2000 the largest commercial bank in Albania, the Savings Bank, is turn into a profitable institution because of investment on treasury bills.

Capital market

The scale of development of the capital market in a particular country and its integration with the most important international financial centers are important factors which contribute to the

⁸ See, Bank of Albania, Tirana, Annual Report 1997, 1998 and 1999.

quality of financial services as well as to the presence of informal financial institutions that substitute the formal ones.

Countries with a developed capital market, among others can pledge the following advantages:

- a. They create favorable conditions for big private investment programs.
- b. Small investors are much more protected, as they operate with large investment options.
- c. It strengthens the corporate governance of joint stock companies, because there are more institutions involved in supervising the companies' balance sheets. In addition to tax authorities, when a company is listed in stock market, it is under investigation of other institutions, which insure a better transparency for the companies. As a result not only the investors are much more protected, but it strengthens the performance of the economy as a whole.
- d. A developed capital market guarantees a better valuation of companies' assets.
- e. It increases the transparency during the privatization process of big public companies.
- f. Countries with a developed capital market could attract much more easily foreign investment.
- g. In the case of economic crisis, a developed capital market helps to overcome much more quickly the recession phase, as a particular country does not have a developed capital market. This is attributed to the fact that during the stagnation and recession phase of the crisis the credit institutions could be in a bad financial position. As a result they could not provide further financial sources to the economy. In this case the capital market serves as the best substitute institution of credit institutions.
- h. And the last, but the least for its significance is that a developed capital market prevents the development of parallel financial markets, which are mainly out of control by the state authorities. Parallel or informal markets, at first create the impression that they could better replace the formal institutions, as their operation generally does not add any private or public costs. But, what Albania has experienced in 1997 after the collapse of several pyramids investments schemas, is the best example to show that informal markets are not always the predecessors of formal one, as in many development studies are predicted.

Another important aspect of the analysis must also be the study of the degree of liberalization of the capital account. This is another important aspect of the capital market because of the following two arguments:

1. When a country adopts a full liberal approach for the flow of capital (so a free movement of capital in and out the country), the exchange rate is more “real” in the sense it will better reflect market forces. This is because full forces of demand and supply determine the exchange rate. Whereas the capital flow is prevented (especially, the capital outflow), the national currency will artificially be appreciated, because the monetary authority administratively controls the demand for foreign currency. An over-valuated currency (among other negative effects, it creates, for example, an artificial barrier for exports), damps much more “fuel into the fire”, when the economy is going into the recession, or when the country goes through a political crisis. The last situation forces many foreign investors to go out the country as soon as possible, which, in turn will create an immediate shock on the demand side for foreign currency. Consequently, national currency will immediately experience devaluation in the same degree as government has imposed restrictions on the flow of the capital market. Such quick devaluation of domestic currency will have further consequences for the rest of economy. Hence, it is likely that such devaluation has a kind of domino effect on the rest of the economy, because it will affect the banking assets as well as their availability to credit. The best example that supports this scenario is the Asian financial crisis of 1997, in which several countries such as Thailand, Malaysia, Indonesia, South Korea etc., were hit first by a currency crises which later precipitated in a full financial and economic crisis.
2. A free regime of capital flow creates a better environment for investment management. This may hold not only for large capital holders, but also for small ones, as it increases the possibilities for investment outside the country and consequently creates a better investment portfolio. This aspect is very important for countries with a high political risk, such as Albania, because it will create a counter-balance during a political and/or social disorder.

Actually, many Central and East European Countries have managed to create a sound capital market, which has started to be integrated with other financial centers in Europe and elsewhere. In the same time they have abandoned many obstacles on capital account

movements. But this is not the case in Albania, Macedonia and many other countries of the former Soviet Republic, which still have an under-performing capital market as well as a restricted capital account system. The economic idea behind such policy stands on three arguments. *First* governments still believe that a liberal capital market will drain their foreign exchange reserves, as many people will prefer to invest their savings in a foreign country. *Second* they consider that controlling the capital account will prevent illegal foreign exchange transactions, which in large degree serve for clearing the illegal money coming from criminal activities such as the drug trade, prostitution etc. The government argues that they do not retain proper mechanisms and institutions to control such activity. Consequently, these governments prefer to freeze the capital account flows. *Third* it comes from the past communist legacy, that an open capital market will increase dependence of the country from outside political institutions.

All three arguments could be discussed, as they may hold only for a reasonable period or specific conditions. But it is important to mention that the international press in many cases has provided plenty of evidence that governments themselves in developing countries possess and control the mechanisms for enhancing the money-laundering activities. Hence, the second argument, mentioned in the above paragraph, is only an excuse to keep their monopoly in this ‘profitable’ activity. Bretton Woods institutions also support the idea that in the early phase of transition countries must control and restrict capital account flows. In fact this attitude that BW institutions (especially the IMF in this particular case) have paid little concern about the institutional aspects of the reform. As a result countries like Albania, with little or no tradition as a capitalist democratic society (and seems that the early phase of transition looks like to be extended for a generation) are trapped within a vicious circle: macroeconomic stability – political instability – high country risk – low investment – poverty. Hence the investment in the creation of a sound capital market and in general of the establishments of market-oriented institutions, along with democratic political culture, are the best investment to overcome the initial phase of transition.

The first question, which have addressed in this research is the question of implication of fiscal and monetary policies on the stimulation of informal financial market. The analysis showed that monetary stabilization policies aiming at controlling money supply and controlling interest rates policies could create further “stress” on the rest of the economy, has it: (1) stops or/and control money from functioning as an institution and (2) control money supply in the time when private businesses is growing and they are looking for fresh capital. Dornbusch has emphasized that ‘price liberalization, without commensurate expansion of

money and credit aggregates, leads to an exogenous real contraction. In segmented credit markets in which firms cannot replenish their finance fully by borrowing, real credit contraction limits their ability to finance inputs and hence production. The more segmented and imperfect credit markets are, the more strongly their effect should come to the forefront' (1994: p. 295). Consequently, such situation stimulates other informal institutions to be in fact, which replace credit institutions.

The monetary and institutional aspect of credit rationing in Albania has been particularly, in the focus of this analysis. The evidence provided by Bank of Albania, shows that about 90 percent of the credit sources has been allocated to finance the budget deficit, while the credit to the non-government sector has been very insignificant (about 3 percent) when we compare it in terms of GDP. While the interest policy has proved to be successful has an instrument in cooling down the inflation pressures, but in the same it has very badly administrated by Central Bank, as it allowed large margins to be applied for credit compared with deposits interest rate, as well as high interests rate that Ministry of Finance is charged for its treasury bills. As a result, the non-performing loan portfolio in the commercial bank is increased and moreover, the most disturbing development is that the commercial banks (including the Central Bank) are turning into large rent institutions as their largely investing in almost zero-risk treasury bills. Hence, the credit market has an insignificant role in the real growth of Albanian economy.

The last aspect of this analysis is capital market development. Already, it is largely accepted that capital market is an important institution in the capitalist economies, but we have seen that few resources on institutional development aspects. As the result, the stock market in Albania is inexistent. No a single company is listed in the Tirana Stock Exchange, despite the fact that the law and some small preparatory work has been done since early 1996. Capital account out-flow is very much restricted. Albanians are forbidden to have private savings account outside the country. The seemingly macro-economic stability in Albania is due to the continuation of the orthodox monetary approach followed by Bank of Albania, which in many respects has stimulated the growth of informal financial market.

Conclusions

The first question that the article addresses is to find out the causal link between fiscal and monetary policies and their influence on the development of informal financial markets. The analysis showed that monetary stabilization policies aiming at controlling the money supply

and interest rate policies could create several “stresses” on the rest of the economy. They are likely to create a: (1) stop or/and control money from functioning as an institution; (2) control money supply in the time when private businesses is growing and they are looking for fresh capital; and consequently, (3) stimulation of other informal institutions to grow, because they substitute the formal credit institutions.

The analysis of the monetary and institutional aspect of credit rationing in Albania has been central in the third section of this article. The evidence provided by the Bank of Albania, shows that about 90 percent of the sources of credit has been allocated to the finance the budget deficit while credit to the non-government sector has been very insignificant (about 3 percent) when it is compared in terms of GDP. From a macroeconomic point of view, the interest policy in Albania has proved to be successful as an instrument in cooling down the inflation pressures. But in the same time the interest rate policy was very badly managed by the Central Bank. The Bank of Albania allowed large margins to be applied for loans, as well as for treasury bills that were sold by the Ministry of Finance. As a result, the non-performing loan portfolio in the commercial bank is increased and moreover the most disturbing development is that the commercial banks (including the Central Bank) are recently turned into formal rent institutions as they are largely investing in almost zero-risk and high interest rate charged for treasury bills. Finally, an important observation is that the credit market has an insignificant role in the real growth of the Albanian economy. Instead the informal financial market continues to play a crucial role in overall economic activity.

The last aspect of the analysis is the degree of capital market development. Despite the fact that the capital market is an important organism in a market-oriented economy, there is almost no progress in establishing it. Hence, the stock market in Albania continues to be inexistent. Not a single company is listed in the Tirana Stock Exchange or outside the country, despite the fact that the law and some small preparatory work have been in place since the early 1996. Capital account outflow is very much restricted. Albanians are forbidden to have private savings accounts outside the country.

The present Albanian Government is reluctant in maintaining the macro-economic stability by adopting an orthodox monetarist reform program. Government has also an ambitions program to privatize the last and the largest Albanian commercial bank, the Savings Bank. But another question arises: Is privatization *per se*, part of the solution? The experience of bank privatization in the Czech Republic showed that that privatization has turned to be part of the problem and not the solution in this country, despite the fact that the Czech economic reform is still regarded as a successful example among the transition economies.

Part two: Do Institutions Matter?

Introduction

No one can deny the gravity of the situation of the Jews. Wherever they live in perceptible numbers, they are more or less persecuted...Their equality before the law, granted by statute, has become practically a dead letter...Everything tends, in fact, to one and the same conclusion, which is clearly enunciated in that classic Berlin phrase: "*Juden Raus*" (Out with the Jews!) Shall now put the question in the briefest possible form: Are we to "get out" now and where to? Or, may we yet remain? And, how long?

Theodor Herzl, 1896

Everyone can understand that Herzl is a persecuted Jewish, who with a deep pain for the fate of his co-nationals, posted the above-mentioned questions. But, the Hungarian born citizen not only showed the Jewish prosecution, but he also went further in giving the solution to this dilemma. In his book, "*The Jewish State*" (1896), Herzl concluded that Jewish people will feel everywhere the same harassment and discrimination as long as they will be not in position to create their own state, and not only that but a strong independent entity. Looking into the Jewish question from an historical perspective, ***Herzl found a positive co-relationship between the virtues of state with the personality of its citizens*** (underlines by A.G.).

How is possible to relate two things that in appearance are different? It seems that the reality is different from a simple individual logic. However following Herzl's hypothesis, the article will transform this question to another one: Why Albanians, for almost one century, are not able to build a strong democratic state, which will give to his citizens proper security, prosperity, full protection of their individual rights and properties and further more to give them proper personality that everyone has the right to enjoy? In answering this long and sensitive question not only for Albanians, but also for many other citizens of third world countries, the analysis will keep a positive historical perspective.

The analysis of a particular society from an historical perspective is used by several social scientists. Depending from the problem and the branch of the social science, the use of historical facts can be in different forms and methods. In this context, combining the economic theory in explaining different historical events gives to an analyst a powerful

instrument, because it will be possible that different historical developments, which in essence are not compatible with each-other (as there are not repetition of historical events, in the sense that they are unique) could be placed in a same theoretical framework, which is provided by the economic science. The advantage of using an economic theory in analyzing the historical events derives from the fact that former one is developed through a competitive environment and during this time the theory is always tested with the reality.

Socio-political changes in context of economic theory

The old Greek model has important implication for the humankind because they created the first social model where the entire members of a community voluntarily had chosen to live under new regime, in which morality, self-control and the respect were norms that never known before the Greek civilization. The Greeks also shaped the first type of a civil institution named *polis*, which many social scientists believe that is first form of today's state institutions. In this context, the study of Greek polis and especially their classical philosophic inheritance is an important source of studies for all social sciences because:

1. The Greek polis is the first social model where people voluntarily agreed to leave under the same "roof", as we call now the state as a complex set of constitutionally established institutions. Consequently, it cannot be compared with other social systems. Instead, the evolutionary process of the birth, raise and the fall of various Greek states can be used as an historical frame to compare the proceedings civil societies.
2. During the Golden period (800-300 B.C.), the ancient Greeks experimented also various "seeds" of philosophic ideas and in a process competition between many authors and ideas they created the most important school, which for the first time explain "in the real term" the secrets of human life. As such, the Classical Greek Philosophy serves has a sticking point for other social models.
3. For more then fifteen centuries the social sciences have been illuminated by the Christian ideology, which largely adopted many aspects of the Classical Greek Philosophy. But the Christianity as a scholarly discipline turned many parts of Classical Greek Philosophy upside down, especially in explaining the evolutionary process of civil society. ...Hence, the last one is almost regarded as a stage development process, where the society goes to various stages according the economic

level of development. Such simplistic view can also be seen in today's economic thinking, which the progress of a particular society is regarded has a process that is largely depended form its backwardness of the economic level.

During the late medieval period, the only genuine economic school was the school, which was founded by the two French naturalists: Quesnay (1694-1774) and Mirabeau (1715-89). For the first time Physiocrats, in accepting the Greek' notion that private property as an everlasting social phenomenon, put together the political and the economic order. Moreover they situated the new order as a function of certain relationship depended mainly by the evolution of private property regime. According to this school (which is known as the 'Physiocracy'), the humankind started the transition from the tribe-based society to the civil ones at the time when the interested become the driving force. With the name of Physiocrates is linked also the *Enlightenment* ideology. The full individual freedom, economic prosperity and social harmonization are key prerogatives at the Enlightenment time. Elizabeth Fax-Genovese in her book '*The Origins of Physiocracy*' (1976) gives an accurate picture about the contribution of Physiocrates on the state and society progress.

It is a matter of fact that almost all social science disciplines have been concerns about the topic of social changes. In so doing they used different methods and approaches to investigate why and how some communities are much more advanced then others. Eric S. Reinert, for example, in his article '*Production-based Economic Theory and the Stages of Economic Development*' (2000), gives an overall picture of the various classification of social societies, which has been used by different philosophic proponents. Reinert emphasizes that most of the classical economists were biased in explaining social changes because they have an outright looking only to the economy⁹.

Karl Marx is one of the few economists that used his entire titanic work in order to create a new framework in explaining why and how a society is changing and how it may change from now on. Marx has a much more simplicity view then his predecessors or other classical economists. He rightfully argued that a society is progressing through a process of solutions and resolutions of internal contradictions. But at the same time he narrowed the range of contradicts of a society into the main contradict between the labor work and the capital, which represented by the working class (or proletariat) and the capitalist class. Hence

⁹ Eric S. Reinert, '*Karl Bücher and the geographical Dimensions of Techno-Economic Change*', in: 'Karl Bücher: Theory-History-Anthropology-Non Market Economics' Jürgen G. Backhaus, ed., Metropolis-Verlag, Marburg 2000, pgs. 177-222.

the main concern of Marxist followers is how to resolve this contradiction, when in a capitalist society the state is supposed to be an instrument of the capitalist class to protect his selfish interests. It is understandable that Marx almost ignored the role of other institutions in a society.

At the same scientific environment other German economists in the second half of 19th century took other stand in explaining social developments. They almost rejected the Marxist revolutionary theory by looking much more deeply into other aspects of a society. Using the outstanding legacy of the Cameralist as well as a substantial work at the German universities¹⁰ at that time. This group of economists, better known as German Historical School, looked also to other aspects of society. One of the best representatives of this school the socio-economist Max Weber (1864-1920) for example, as a good Calvinist related the fortune of high growth of Germany with its Calvinist religious. In this way, Weber by focusing on historical development understood the importance of other institutions of society such as the ideology.

Another German economist Karl Bücher (1847-1930) in his multidisciplinary work is very critical to the classical economic school because of its biased towards the economy in explaining the evolutions of social societies. Bücher included other dimensions in its socio-economical model by adding climate and geography as well as the family as an important institutions. However the German tradition of 19th century was not based on the classical legacy. Hence in 20th century other bunch of economists followed the steps of the classical economists by investigating how a society can better utilize its resources and insuring at the same time growth and prosperity.

Schumpeter in his book '*Capitalism, Socialism and Democracy*' (1942) followed another way to investigate different types of social order. He analyzed different political systems in separation and not related to each other. Hence when Schumpeter mentioned that the Capitalist social order is full with unresolved contradiction it looks like he was in favor a Socialist social order.

By the end of 1950, Walt Whitman Rostow published his book '*The Stages of economic Growth: A Non-Communist Manifesto*'. This is the time when the Cold War was on its pick. Hence Rostow was swift to argue that Marxist theory of how the society is not part of the reality as it serves only the Communist political ideology. He used some early work by

¹⁰ It is important to mention that social science at the German universities have been taught as a multidimensional discipline which included for example, fiscal policies, public administration, sociological studies etc.

Robert Solow¹¹ and Simon Kuznets (1901-1985) on the newly emerged economic growth theory to investigate the economic development path of various societies. Rostow concluded that a society could be in a different stage of development according to two parameters, the proportion of income saved and the output-investment ratio. Hence he distinguished five stages of development, which are known as Rostow's stages of development: [1] Traditional society. It is characterized as an agrarian society with low investment ratio; [2] Precondition for take off. Surplus in agriculture occurs. Institutional evolution begins, but investment increases as a fraction of GDP. [3] Take off. Investment reaches 10 percent of GDP. Some "Leading sectors" emerge. [4] Drive to maturity. Institutional evolution consolidates. Growth moves towards a self-sustained magnitude. [5] Age of high consumption. Investment continues with high levels. High ratio of income per capita. Despite the fact the Rostow mentions the emergency of institutions in the second stage of development, he didn't go further to this point to explain what kind of institutions and how they were organized. Moreover in other development studies we have clearly a biased position towards the investment ratio against the role of institutions in a society.

Combining growth theory with the evolution of a civil society has had important implication not only on development studies but also on the policies of international organization concerned with development issues. In addition to that, Keynesian legacy and especially his personal influence in framing the Bretton Woods institutions created the proper academic "humus" for IMF & WB to base their entire credit policy to developing countries. Based on the assumption that in a close economy investment and savings are equal (otherwise government must intervene to close the gap) the only form of increasing future investment is by increasing accumulation. Hence it is argued that developed countries in order to catch up developed economies they must insure that new investments must be higher than the level of the capital depreciation plus the level of investment need to ensure the amount of capital per worker constant. An abundance of academic work was undertaken to study the effects of foreign aid as well as foreign direct investments on the recipient countries. Most of these studies has shown different results but it is hardly explained why some countries did progress and some other not?

¹¹ For an extended view of economic growth theory see: Charles I. Jones, '*Introduction to Economic Growth*' W.W. Norton & Company, Inc. New York, 1998.

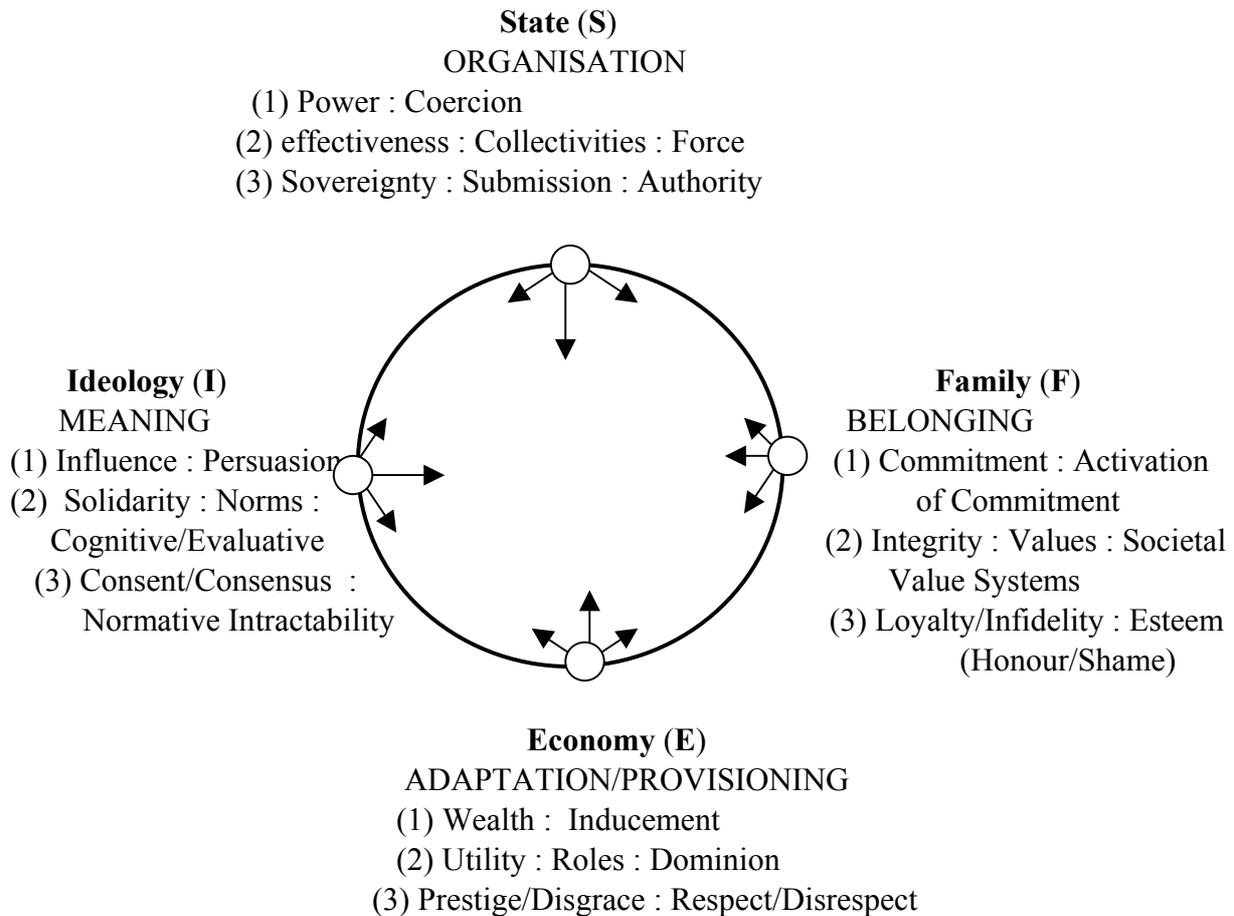
Institutional model

Various civil societies will be analyzed on a positivist way because it allows drawing normative policy recommendations for a specific society. This method is intensely used on the political economy especially by constitutional economics to analyze implications of different constitutional regimes on a specific society. The positivist methods is also important from the historical perspective because it allows to see how and why in certain period of time a nation has a different development path with another one, which similar resources. Looking into institutional legacies may help to answer the questions like, why industrial revolution was first United Kingdom in after half century later other countries followed it? Or, another question, why Spain and The Netherlands have a different development path in the late 16th and 17th centuries, when the first has three times gold reserves then The Netherlands? Georg Simel argues that the Netherlands have had tremendous advantage against Spain because the money was used unhampered and based upon the credit institutions, which are able to allocate the financial resources at the time and place where it is much needed (1907, p. 171).

The main institutions that will be under this analysis are state, family, economy and ideology. In Figure 3 Nitsch (1994) places these institutions in a circle, which in fact do not correspond at any particular society.

Every institution is in close relationship to each other, but in the same time everyone in itself represents different values. Hence many economists have paid much more attention in particular to the economy and state because they have considered as the most important of a human society. Other social scientist such as the German philosopher Hegel placed family in the centre of social model, whereas the state institution and the economy are distinctive part of family's moral values. Ideology is hardly studied in economic studies and mostly it is regarded with the religion institution. As it is mentioned Weber paid a lot of attention to the impact of Protestantism on the birth of capitalist society in Germany. In this article the Ideology will be looked as a complex institution that include also the economics of right and left political ideology. In particular James Steuart's *Inquire on the Political Economy* will be seen as the an example when we can investigate the economics grounding of right political ideology.

Figure 3: Basic Institutions of Human Society



Source: Thomas Nitsch¹², 1994 p. 105.

An historical interpretation of institutions

Sir James Steuart published his treatise ‘*An Inquiry into the principles of Political Economy*’ nine years before Adam Smith’s famous book ‘*An Inquiry into the Nature and Causes of the Wealth of Nations*’ (1776). Hence it can be presumed that these two massive works may have faced a certain degree of competition between each other. In fact, Smith’s Inquiry was a great success and consequently overshadows Steuart’s work. Concepts such as money, credit, debt etc., were analysed by both Steuart and Smith, but the latter almost sidelined Steuart’s interpretation on such issues. Furthermore, it was not only Smith that overshadowed Steuart’s

¹² Thomas Nitsch, ‘Church, State, and Market: Accent on the Social’ in: ‘Economic Thought and Political Theory’ editor David Reisman, Kluwer Academic Publishers, Boston/Dordrecht/London 1994, p. 103-127.

work. Staderman and Steiger (2000) emphasize that there were many economists of the last century who neglected or misinterpreted Steuart's ideas. Thus in this connection Staderman and Steiger mention Eli F. Heckschers the author of the voluminous book on the mercantilist period (end of 18th century) '*Der Merkantilismus*' (1931) in which Steuart is not even mentioned. Also in Guggenheim's book '*Preclassical Monetary Theories*' (1978), Steuart is neglected while in some other cases Steuart is misinterpreted as a predecessor of Keynesian demand theory.

However Steuart's work doesn't belong only to the history of economic ideas. As it will be argued in this short article, his work comprises many valuable parts, which still may be considered of relevance in the study of present day developments. Steuart spent a great part of his lifetime in the Continent. At that time the mercantilist system was almost in a process of dismantling, and the new capitalist system was simultaneously emerging. But Steuart was neither an advocate of new capitalist economic order nor a criticiser of old feudal system. Steuart was much more concerned with explaining how a human society progresses. In particular he argued how institutions of a society might stay in equilibrium without being placed under a "patronage" system, but rather by competing with each other. Steuart's ideas may be also usable in explaining much of development in transition economies as well as other economic phenomena, which seem difficult to explain by classical and neoclassical theories (for instance the emergence of new virtual money via Internet etc.).

Steuart divided his voluminous book (about 1300 pages) in five parts, population and agriculture, trade and industry, money and coin, credits and debts and the last part, taxes and the proper application of their amount. His scientific affiliations were mainly with Physiocrats (especially with Mirabeau), but there are other authors (see for example...) who refer to Steuart's legacy in relation with the German Cameralists tradition. For the first time in his book, the term political economy appears to have been used correctly, because as it will be argued, Steuart gave for the first time an indication of how a market oriented economy could stay in equilibrium based on its institutions. Nevertheless, before going into Steuart's political economy I would regard it useful to discuss the question: why his work has been rather neglected within the history of economic thoughts?

First, by the end of 18th century the British society and later on other Western Nations, especially in the Continental Europe, were seem to have been much more concerned with knowing about what might be the causes of wealth from Smith's point of view were then with the ideas that Steuart conveyed through his treatise. At that time the new capitalist order in the United Kingdom faced serious challenges and obstacles especially with regard to international

trade because of many trade barriers, which were imposed by several European countries in the Continent. Instruments that were used as trade barriers in the latter countries were an important financial source for treasuries of the European despots. Thus protectionism has been part of feudal political economy that Smith challenged.

Second, after *'The Wealth of Nation'* was published, the economic discipline was transforming into a separate branch within social sciences. This is because Smith analysed many important economic concepts, which tackled the heart of the problem of how a market functions. Hence other economists followed in Smith's footsteps because economic concepts that he analysed have had to be further elaborated and later tested in new market conditions.

By way of contrast, Steuart's Inquiry could be considered as "a finished job", because he was interested in the question of how institutions operate within a society. There are only few economists that, in line with Steuart, treated money as a social institution. The most important are for example Carl Menger of the Austrian School or the German socio-economist Georg Simmel, who in his book *'The Philosophy of Money'* (1907) shared the same view as Menger and Steuart that the main characteristic of money is its availability in serving as a social institution.

Third, Marshall's book, *'Principles of Economics'* (1890) has had a great impact in transforming economics in a more consolidated science. This work accompanied by the work of two leading economists of the Lousane School, Leon Walras and Vilfredo Pareto, made it possible for economics to become capable of offering generalizations. Thus it attracted contributions from scientists from other disciplines especially from mathematics and physics. Since then economics developed towards greater levels of formalization then towards levels of conceptualisation, because many economic phenomena were able to be captured in formal mathematical ways. Steuart's ideas are, by contrast, very difficult to be expressed in the form of mathematical expression.

Fourth, another explanation of why Steuart's work does not seem to have received a lot of welcome by Britons could be linked also with his ideological background (Steuart was a Jacobin), which at this time was seen as hostile towards the old aristocracy. Hence it seems that the context had a constraining effect on the impact of Steuart's work, in the sense that his ideological differences with the prevailing thinking of the period can explain his undervaluation. Steuart himself felt this constraint and he explains this situation from the beginning of his book:

‘When I compare it (the book) even with my own abilities, I still think favourably of it, for a better reason; because it contains a summary of the most valuable part of all my knowledge. But *when I consider the greatness of my subject, how small does the result of my application appear!*’

Later on, Steuart continues:

‘I nowhere, I think, have shown a desire to make my court to any particular minister, whose administration might have been hinted at. *I have freely followed the thread of my reasoning without a bias, either in favour of popular opinions, or of any of the numberless systems which have been formed by those who have written upon particular parts of my subject...* this work, therefore, will not, in general, correspond to the meridian of national opinions any where; and of this it is proper reader should be apprised, that he may not apply to the domestic circumstances of his own country what was intended to refer to those of other nations; nor impute to wilful prejudice, what was the irresistible effect of my experience and conviction (emphasis added, A.G.).

Fifth, Perelman (1983) gives another explanation why English scholars ignored Steuart. He emphasizes the fact that Steuart was an intellectual that belonged to the Scottish community. Consequently, as old Athenian intellectuals, the Scottish ones were victimised by the military superiority of their English neighbors (1983, p.77). Steuart himself felt this intellectual persecution and a deep disappointment wrote to his dog that when he will write about the its life (dog’s life), this will be a much voluminous work as my Political Economy and maybe it will be much more acceptable for the public (Pareman 1983, p.98).

Sixth, some early writers also misinterpret Steuart. In describing the core of Steuart’s doctrine, Pareman for example, refers to Karl Marx’s interpretation of Steuart’s doctrine who emphasizes that Steuart is the first theoretician to have described the early phase of primitive accumulation. Moreover, in reference to the social institutional model, Perelman emphasizes that Steuart’s ideal model owes to the Roman philosopher Lucretius (about 94 – 55 B.C.) who is a follower of the well-known Greek Philosopher Plato. On the other hand, Plato was a partisan of Spartan human society, which is known as the first society that adopted a common property regime. Joining these two facts, Pareman concludes that Steuarts’s ideal social model is one, which is based on a common property regime (i.e. also known as a communist

property regime). In fact this conclusion could not be further away from the facts of the matter, because Steuart always refers to a society in which institutional relationships were based on a private property regime. Moreover, Beatty and Johnson emphasize that Lucretius is a follower of Democritus who is well known for his atomistic theory, which explains the existence of various undivided units within a civil society as electrons form an undivided atomic system. (Beatty and Johnson 1995, f.182).

In fact, in Steuart's time, Newtonian discoveries in physics were quite fashionable for many social scientists. Hence, in Steuart's imagination a civil society is closely related to this system in which separate and autonomous institutions become part of an undivided human society.

Steuart can be better understood if his ideas are confronted with the work of other classics such as Smith and Marx. In that case it might obviate a full interpretation of Steuart ideas offered in his book and second, it will help to pick up some of the most important concepts that are more relevant to current social and economic developments.

Steuart describes the content of his book on the subtitle as, 'being an Essay on the Science of Domestic Policy in Free Nations; in which are particularly considered Population, Agriculture, Trade, Industry, Money, Coin, Interest, Circulation, Banks, Exchange, Public Credit, and Taxes'. It is unlikely that the book was accidentally organized in this way. According to Stadermann and Steiger the analysis of these concepts helped Steuart to show what was by then an obsolete feudal economic order created a state of freedom for the labor force, which stimulated in its turn a transformation of the economy from agriculture towards industry leading to wealth and credit, with debt and taxation as counterparts (2000, p.4).

Hence the very first problem for Sir James seems to have been the analysis of social relationships, because under the feudal system labor market was based on bandage of a slavery system. Consequently, working person was forced to work in a specific feud for the whole of his/her life. In Steuarts's view, the gradual process of acquisition of freedom gave also a big push to industrial development as well as creating the basic conditions for a revolution within the agriculture sector.

An important development is the birth of new bourgeois class, whose role was to serve as an intermediary amongst owners of land and labour sources. The need to maintain a long term relationship between these three actors in society brought the development of two important categories, rent and wages, The notions of rent and wage are not only important as economic concepts but also social one as on the basis of Steuart's approach it can be utilized in developing a social equation of apparent importance:

Private property regime on land resources (aristocracy or landlords)



Land administrator (bourgeoisie class)



Labour resource owner (labour class),

which represent a social relationship based on free will, equality, mutual respect and recognitions.

The constitution of above relationships is not based on the power struggle, as it could be in a Levian regime, but as a relationship of freedom and mutual recognition standing on a formal agreement. It seems at this point easier to move to the second important concept, namely the contract. The contract lays down [1] responsibilities of the parties involved in a relationship, [2] mutual obligations, [3] place and authority for resolving eventual disagreements, and [4] ways for any parties to go out. But the most important development in the pre capitalist era is the extension of civil obligations and rights to all people that now can take juridical responsibilities. Secondly, an important development is also related to the institutional aspects because the new relationships based on contracts require a highly regulated and developed legal system, including civil, administrative and penal courts etc.

Further development of agriculture and especially the increase of industrial production created new incentives for a fast development of trade, which still was carried out through a barter system. At that time agriculture was able to produce more food commodities, which were available on the market through the trade sector. A new labour force was released by rural areas and was available in urban areas. This event had other social implications. It created a new available working force and second it increased the demand for agriculture-related products. New branches of industry were developed in order to fulfil such demand. New labour force was hired in industry as it has a bigger productivity then in previous agriculture work, and consequently earned higher wages. Hence according to Steuarts, in the course of this continuous and uninterrupted process, the society as whole become much more wealthy and prosperous.

This explanation of causes of wealth is rather different from other classics especially from Karl Marx' doctrine of surplus value. In analysing the process of capital formation,

Marx concluded that profit of entrepreneurs is unpaid work of labour force, while the wage was simply the used value of the working force. As a result two classes, i.e. bourgeoisie and proletariat are always in antagonist relationship, which can be resolved according to Marxist doctrine, by revolution. Such different explanation of social relationship makes Marxist doctrine and Steuarts's political economy to be positioned on two different scale of political economy or as it is much better known resending left and right sight of ideology.

The institutional model based on Steuart's interpretation of money

However, there are differences between Steuart doctrine and classical economy. Staderman and Steiger emphasize that the main differences between these two important economic doctrines stands on explaining how a society passed the transition process from a barter economy to a money economy. According to the classical theory, money's birth is related to the increase of social cost of barter transactions. As a result a small group of commodities were specialised to play the role of money. This process continued as a competitive process between various money-commodities till the society found the most attractive gold and silver to play the role of universal money. Classical theory of money suggests that value of money in circulation is equal to the value of goods and services on the market. Accordingly there are four functions of money, measure of value, payment instrument, circulation and treasury. In more general way, Schumpeter in his important publication of history of economic analysis emphasizes that according to classical perspective 'money enters the picture only in the modest role of a technical device that has been adopted in order to facilitate transactions' (1954, p. 277).

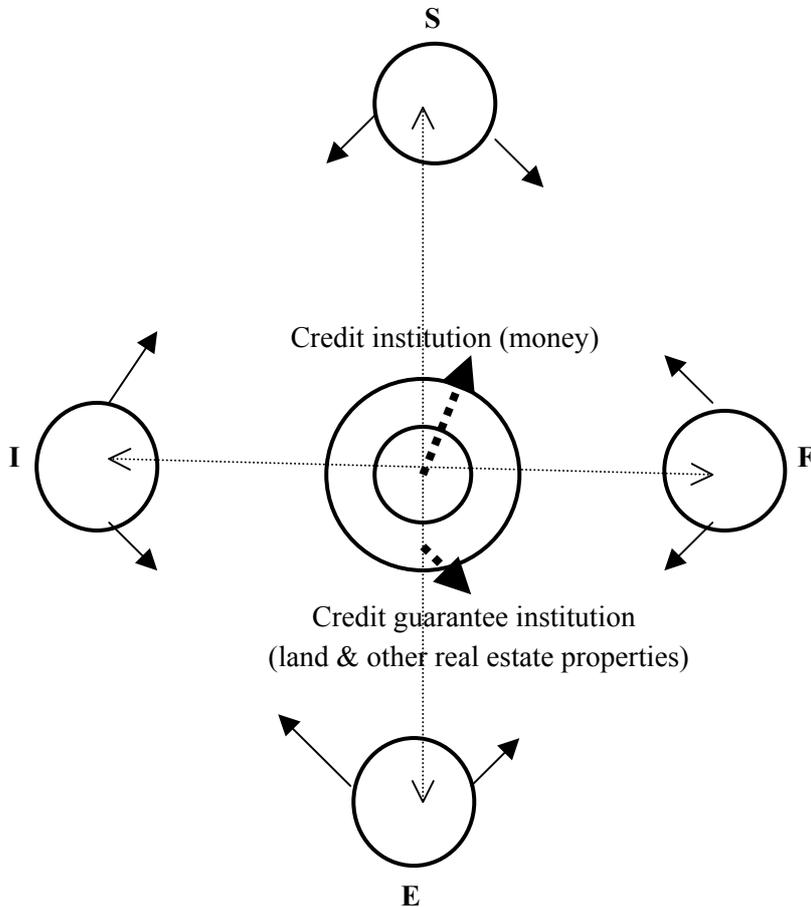
Steuart's perceptions about money, its functions, and causes of its birth are quite different from the classical one. Since Steuart wrote his *Inquire* before other classical main works, he didn't give any comment about classical view of money. But if we use his approach to comment on classical theory of money, the answer could be more or less in this way: As soon as the farmer find at any time a market for its products the system of barter will never collapse despite the fact how much is the cost of transaction and consequently how big is its super production available to the market. Hence the cost of transaction will not affect the barter system and consequently we have not to have the money as a new economic category. But, how Steuart explains metamorphose of money? A short answer to this important question could be: The appearance of money could only be explained with the need for credit. Credit development, from another side was stimulated from two other

factors. First, functions of the state as an institution were increased. Consequently, the King has to require more financial resources to fulfil new state operation especially at time of war. Hence King's treasury issued new debt titles, which served as financial means to guaranty the new system not to collapse (at least till the inflation didn't drain the currency value). Second, the cyclical process of trade business was followed with increased of financial resource to cover the growing market in the urban areas. Hence both merchants and farmers were eager to find extra financial sources to finance investments on agriculture related activities.

Following the same argument, Staderman and Steger emphasize the Smith's model about price determination by combining demand and supply for a specific commodity or service is different from the way that Steuart views how actors in the market operate. Steuart's analysis was based on the fact that producers (supply side of Smith's model) and consumers are two separated markets. Hence the exchange between these two sectors of the society is made through commercial sector. Hence merchants themselves who view various markets to extract a higher price for their commodities bought from real sector enhance price policy. Following the Steuart's arguments regarding the relationship between supply and demand side of the economy can be distinguished another difference. In Steuart model demand is not limited by supply side of economy (or production capacity) as in Smith's model. This means that producers and consumers are viewed as two-separated institution with a civil society.

Merchants were eager to increase their activity by fulfilling the growing needs of consumers; hence they sanded proper signals to the producers that they require more products in coming seasons. Moreover, the need to finance expansion in production increased demand for credit in market. But since credit was given for the future prospect of production an institution of guarantees was instantly developed. Guarantees institution as a complex institution because it does not only involve the private property (i.e. land as most liquid and stable real estate property) as a means to insure the credit, but other institution needs to formalize this system. Such institution includes the court system, land registration system, a developed civil code etc. Setting and in the same time the importance of such development created proper arguments to Stuart to distinguish that the basic characteristic of money is the institutional feature. Hence two other institutions are mentioned by Steuart credit and credit guarantees institutions. As wealth of society is increased, the guarantee institution increases it basis for credit, hence the society is progressing.

Figure 4: Institutions after Sir James Steuart reconsidered



As it can distinguished from Figure 4, both new institutions are considered as independent institution in civil society (along with family, ideology, state, and economy) as well as they are placed in the centre of previous institutional model. Two factors influenced in such choice:

First, after a quick reconsideration of Sir James Steuart's doctrine it was distinguished the importance of credit and credit guarantees institutions in post-feudal society. From this point of view, we may consider also that transition process from a feudal society (where institutions are placed above each other) to a capitalist one ca be fully completed where credit is predominance of economic activity of newly emerged capitalist system.

Second, credit, and credit guarantees institutions based on a standard interpretation can be said that they are part of economy. Bur the emergence of credit institutions replaced

institutions from a pyramid form of institutions to an atomic one, where two new institutions played an important role to keep all this system into equilibrium.

Karayiannis emphasizes that Smith by neglecting the role of state as an important institution in a society has also a critical view for the state's supervisors, i.e. politicians. In '*The Wealth of Nations*' Smith considers statesmen or politician as an 'insidious and crafty animal...whose councils are directed by the momentary fluctuations of affairs'. While in another source of publication, '*Lectures*', Karayiannis underlines that Smith was not so positive about politicians when he says that 'they whom we call politicians are not the most remarkable men in the world for probity and punctuality' (1994, p. 54-55).

Steuart has another idea about the role of statesmen. By breaking the mercantilist concept that a statesman must work to create a strong state in order consolidate and even raise the economical and political power of the kingship, he placed it in a real balanced position. In his Inquiry, Steuart says that the statesman, 'in order to cement his society, should know how to engage every one, as far as possible, to turn his attracting pole towards the particular center of common good' (Karayiannis 1994, p.40).

Another important conclusion from the above quotation is that Steuart immunized himself about the political system. Hence his constituency of institution is independent of the fact that a society has a political constituency in the form of kingdom or a republic one.

Summing up it might be said that in Sir James Steuart's work '*An Inquiry into the Principles of Political Economy*' can be found four important peculiarities of a capitalist civil society: [1] private property; [2] individual freedom; [3] collaboration and agreement based on a formal contract; and the last but not from the importance, [4] independent institutions, including credit and credit guarantees institutions.

These four notions formed also an important aspect of economic interpretation of right ideology, which part of ideology of a social institution. Hence we have to add to the functions of religions those of right ideology.

Implication of communist legacy on institutions

Before the Second World War was ended, the Communist Party in Albania resumes the power by declaring the King Zog power illegitimate because its power is against the will of Albania people. After the War, Albanian Communist Party through its illegal institutions organized in the condition of war controlled all economic, political and administrative life of Albania without any virtual need to organize any kind of referenda or elections to legitimize

such power. Hence the head of Communist Party, Enver Hoxha declared himself, prime minister, minister of foreign affairs, minister of public order and supreme chief commandant of army. These posts were held till 1952-53 by then Hoxha has managed to consolidate his power both internally and in international arena especially with east communist block. But what are the main institutional reforms taken by the Communist Party to consolidate and maintain their long lasting power.

A. Controlling the state institution

This was achieved through a power struggle between regular military forces commanded by Communist Party (the partisans) and other nationalist forces. This struggle in the eve of Second World War turned Albania in virtually in civil war. In 1946, the first and the last pluralist election were organized during the communist period. Such election didn't have any effect on the power of communist party. Instead they declared the members of parliamentary opposition as enemies of the state and most of them were arrested, killed or persecuted in various forms. One party system was accepted and the new constitutions adopted in 1946 and later one in 1976 accepted no other political activity.

Under direct supervision of dictator Hoxha a strong internal security force was created, which first has been able to crack down any minor resistance of communist power especially in Northern part of Albania. In early 1950, in order to consolidate its power a new institution of secret police was established. The main duties of such institutions are to prevent the creation of any kind of organization, which can endanger the communist political power. Moreover, it played also an important role in consolidating the power of Hoxha with the existing nomenclature. Hoxha controlled these important institutions, first by ruling them directly, and then he adopted a kind of circulation between the top institution leaders, by killing or jailed them for more than 20 years.

B. Controlling the economy

The first important reform in the economy is related with land ownership. After the Second World War, Albania was largely an agrarian country where agriculture was about 80 percent of gross domestic production. An important aspect is that in rural area lived the majority of population, but land ownership was based on the previous ottoman legacy. Initially land reform aimed to destroy the monopoly of landlords on land property rights. Hence land was to distribute to farmers with motto: "Who works the land is the owner of it". But this was not the ultimate aim of the Communist Party (which was renamed in Workers Party), but to create a

common property regime for all factors of productions, land, capital and common and centralized policy for labor resources distribution. Thus the first agriculture cooperatives were created in 1946 and the process was end after 15 years. In urban areas all merchants and handcrafts were organized in cooperatives too, till all private sector disappeared be the end of 60'.

In order to destroy the economic power of old bourgeois class, the state imposed an extraordinary tax to all wealthy individuals. This tax was obligatory and almost all inventories including private housed have been sequestrated by the communist regime. People who refused to “voluntarily” refused to pay such obligation were jailed for many years.

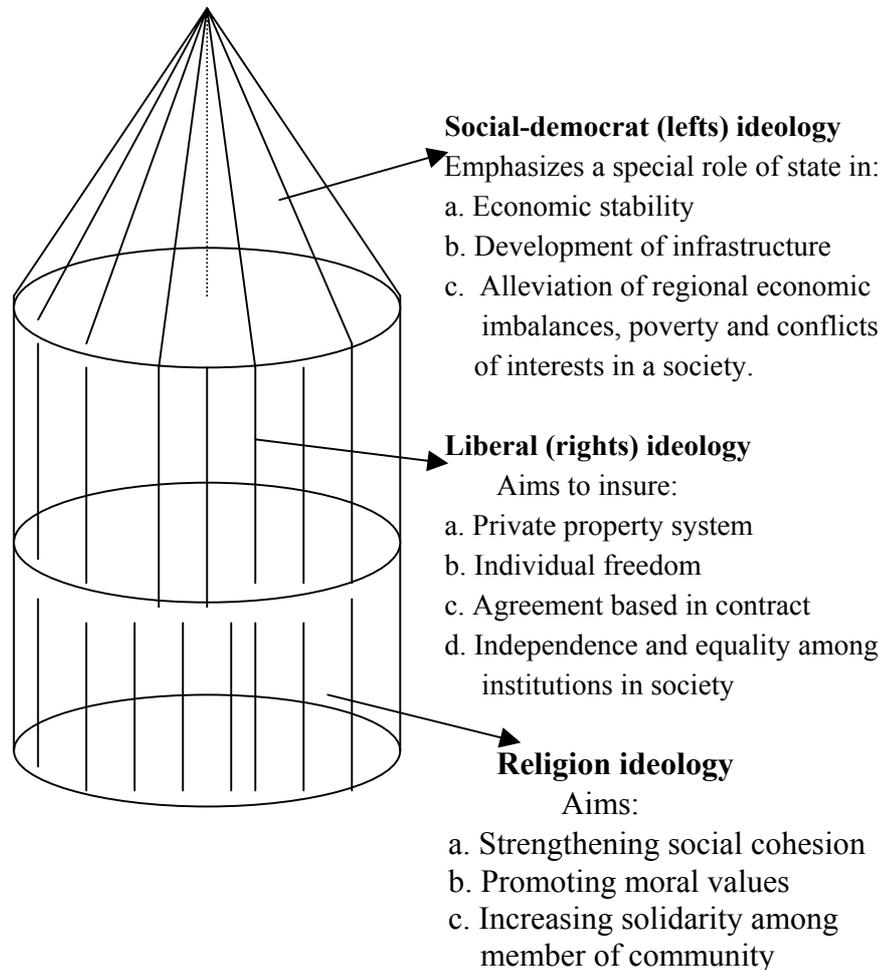
In 10-15 years all elements of market economy was destroyed and the economy was regulated under strict central planning rules. Money has lost its institution significance, and played the role only for accounting purposes. Prices and wages were strictly regulated too.

C. Institution of ideology

As you previously explained the ideology serves as an important institution for a human society. It comprises not only religion background and its institutions but also left and right wing political ideology. Figure 5 gives an overall picture of values that all three elements of institution of ideology affect a human society.

As we previously said communist regime destroyed the competition between the Marxist- Leninist ideology and other left and right ideology by not allowing other parties and other forms of political expressions in Albania. In early phase of the communist dictatorship regime only religious ideology has not been totally forbidden. Only in some special cases some catholic priests were been killed or jailed for alleged collaboration with nazi-occupation forces or in some other case they were accused for helping Anglo-American diversionist groups. By the end of 60' some youth organization marched to destroy all religious institutions. This initiative was immediately supported and inspired by the Work's Party, and it was tern to a second ideological revolution. In 6 months all churches and mosques were reins to the ground or they were transformed in cultural or sport houses. From this time on religion remained as a residual part of Albanian society. Instead Marxist-Leninist ideology has “fully” replaced all three component of institution of ideology. The impact of such action in Albania society was great, but it is not completely evaluated or analyses by scholars the scale of impact of such events.

Figure 5: Pyramid of Ideology



D. Family

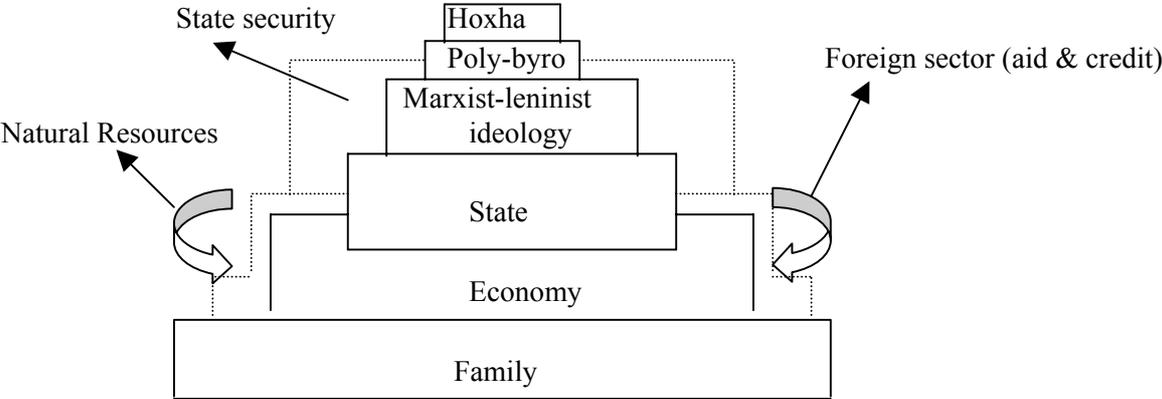
Family is the important fourth institution of our model. It is used to say that family constitutes the grounds of a human society. Its significance can be seen at that time when other institutions are not in comparable size as family is or they are in embryonic phase. In this case family and household economy is the primary source of institution stability of the entry community. This institution must provide wealth and protection to all members of family. Hence the significance of family is depended on the degree of development of other institutions within a particular human society. However the family is an important institution and it can be fully replaced by state or other institution.

During the communist period the family was “trained” to live always under the state of alert because of certain enemies surrounding the communist block and later on Albania. But first the regime was careful to destroy almost all the influence of *bajraks* in Northern part of Albania (this is a kind of big family clan, which have their own rules and normally do not

accept the rule of law and authority of state). This has been done through various forms including killing certain clan's heads or other form of persecution.

Figure 6 represents the pyramid tree of institutions under a communist dictatorship regime. The difference between Figure 5 and 6 is not only to the way the institutions are placed but also in Figure 6 two important institutions are missing; i.e. credit and credit guarantees institutions. As we explained this because money has no any significance in a command and planned economy and consequently it does not play the function as a social institution.

Figure 6: Institutions setting in a communist regime



In case of missing foreign sector (aid, credit and other foreign direct investment) and natural resource endowments are zero or insignificant for the economy, the “stability” of this type of institutional setting depends on the availability of the economy and households. If economy will face a long stagnation then its internal resources will be not able to keep institutions on check and a the reaction by public is expected to rise. In this case natural resources and later other resource from foreign sector are expected to be used by the regime in order to keep the system under control.

What happened in Albanian after China interruption of its economic aid is exactly what we said. The communist regime tried to increase investment on mineral and oil exploration in order to earn hard currency to finance the growing need for imported goods. Since such resources has a kind natural limitation for extraction the regime was under enormous pressure to keep in power. But the collapse of Berlin Wall in late 80' and the aggravation of economic situation made possible in early 1990-1991 that the most repressive communist regime in Albania to sign its bankruptcy.

Albanian society in transition

The post-communist transition process in Albania initiated since middle of 1991, with the support of IMF/WB, and has been aimed basically at liberalisation of economy, reducing the role of state and increasing market regulation, price stabilisation, as well as reducing budget deficit. The economic reform involved large institutional and legislative changes, including the reforms in the juridical system.

At its initial stages, this effort focused on re-establishing a degree of economic stability following the collapse of the communist system, while beginning the transition toward a market economy. According to IMF survey ‘Albania experienced the highest commutative output growth following the collapse of the real output among transition economies’ (1994, p.5).

Table 3: The breakthrough of gross domestic production according to the main sectors of the economy, 1990 – 96.

	1990	1991	1992	1993	1994	1995	1996
Real growth (%)							
GDP	-10.0	-28.0	-7.2	9.6	9.4	13.3	9.1
Industry	-14.2	-41.9	-51.2	-10.0	-2.0	6.0	13.6
Agriculture	-5.4	-17.4	18.5	10.4	10.3	13.2	3.0
Construction	-12.0	-30.0	7.0	30.0	15.0	21.2	18.5
Transport	-10.0	-30.0	-15.0	13.0	18.0	18.8	-1.0
Other	-8.0	-14.0	9.0	16.0	11.0	13.5	20.1
In percent of GDP							
GDP	100	100	100	100	100	100	100
Industry	40	32	17	14	12	12	13
Agriculture	37	42	54	55	55	56	53
Construction	7	7	8	9	10	10	11
Transport	3	3	3	3	3	3	3
Other	13	16	18	19	20	20	20
Growth contribution (%)							
Industry		-16.6	-16.4	-1.68	-0.28	0.25	
Agriculture		-6.44	7.86	5.64	5.63	5.51	
Construction		-2.04	0.46	2.29	1.36	1.05	
Transport		-1.01	-0.49	0.39	0.56	0.20	
Other		-1.82	1.40	2.93	2.13	1.57	

Source: Albert Gajo, Research paper, ISS The Hague 1998.

Real GDP grew more rapidly in Albania than in most other transition economies during 1993-1994, albeit from a very low base following the collapse of production in the state-owned agricultural and industrial sectors. Growth was estimated at 9.6 percent in 1993, 8.3 in 1994, 13.3 in 1995 and 9.1 percent 1996 (Table 3). Unemployment, which peaked at over 30 per cent of the labour force in 1991, fell to 19 percent in 1994, and it continued to decline to 13 percent in 1995 and 12.4 percent by end-1996. Inflation has also been relatively favourable.

The main contributor to the recovery in growth has been the agricultural sector. After the huge decline in agricultural output in 1990-1991, output began to recover in 1992 followed by three consecutive years of growth at around 10 percent. As a result, agriculture as a share of GDP rose from the pre-transition 37 percent in 1990 to nearly 56 percent in 1995 (Table 3). While in 1996 we could distinguish only 3 percent growth, which could be explained by the development of informal financial market in Albania.

Over the period 1991-1998, the total foreign aid committed to Albania is about \$2,494 million, of which grant is 64 per cent, soft loans 26 per cent and commercial loan to the government 10 per cent.

In first five years Albania received a substantial foreign aid that helped to overcome much more easily the first years of reform. Foreign aid was mainly allocated in humanitarian assistance, food aid, commodity aid, balance of payments support, project development aid and technical assistance. Food aid and humanitarian aid has been particularly high in the early phase of transition period 1991-1993, as well as 1997 reflecting the impact of political and economical crisis of this year.

EU/PHARE programme and World Bank/IDA are the biggest contributors, which provide about 45.5 per cent of all assistance. From donor countries, Italy has committed about 15.3 per cent, the United States of America 7.81 per cent, Germany 6.27 per cent, Greece 3.02, Switzerland 2.64 percent etc. During the same period, the cumulative level of resources disbursed has been in the level of 63 per cent including the disbursements of humanitarian and food aid. According to the data provided by Ministry of Economic Coordination, aid disbursements as a proportion of GDP were particularly high at 39 per cent in 1992, but as GDP rose in proceeding years the share of disbursements aid in GDP decreased to 7 – 9 percent over the period 1994 – 1998.

Despite the macroeconomic achievements and the flow of foreign aid the democratic transition in Albanian was interrupted in 1997. In the first part of research we discussed some of the reason that might have caused the lost of economic control and especially the reasons

why financial informal market has been developed. Now we have to be concentrated in our institutional approach.

From Figure 4 it can be understood that a society need to have stable and autonomous institutions such as state, economy, family, ideology including a developed system of credit and guarantees institutions. Furthermore a full property right regime must be insured as well as a juridical system to insure proper implementation of law and protection of property rights.

In fact one of the first reform carried out by Albanian Government was to reverse property right regime on land. But it largely used a populist reform to make the members of ex-cooperatives new landlords. Table 4 shows how land is distributed and the size of land distributed for one inhabitant in all districts of Albania.

Table 4: Second land reform, 1991-97

Nr.	Districts	Total arable land	Total land offered for distribution	Population in rural areas	Land dist. for one inhabitant
1	Berat	40999	33013	110068	0.37
2	Diber	27455	17115	133498	0.21
3	Durres	51610	46568	126068	0.41
4	Elbasan	47471	40773	147645	0.32
5	Fier	71166	64320	177320	0.40
6	Gramsh	10360	6350	36631	0.28
7	Gjirokaster	17693	14185	39933	0.44
8	Kolonje	11248	7800	17810	0.63
9	Korce	62916	49384	143110	0.44
10	Kruje	15020	13163	67505	0.22
11	Kukes	17905	10400	87354	0.20
12	Lezhe	29027	26553	50721	0.57
13	Librazhd	15519	9746	64970	0.24
14	Lushnje	51122	46340	106325	0.48
15	Mat	14027	9639	63154	0.22
16	Mirdite	6228	3817	43720	0.14
17	Permet	14482	9558	30701	0.47
18	Pogradec	17506	12421	53210	0.33
19	Puke	5165	2020	44209	0.12
20	Sarande	25537	23404	62376	0.41
21	Skrapar	12102	6950	30310	0.40
22	Shokeder	45470	36336	157233	0.29
23	Tepelene	13055	7208	36609	0.36
24	Tirane	31445	27397	121345	0.26
25	Tropoje	7390	4600	35903	0.21
26	Vlore	37810	31342	92161	0.41
	Suma	699729	560402	2079889	0.34

Source: Ministry of Agriculture and Food 1998

The average land size distributed for one inhabitant is 0.34 ha, which means that for an average family with 5 members the farm size is about 1,5 ha. This figures varies from one districts to another, however, the size of a farm is very small to be considered as a business unit. Hence the result is the Agriculture bank in Albania passed three times big restructuring, and finally it has been closed down largely because it was not able to insure its credit. But as the land was the main real estate asset all credit market in Albania is an initial faze. Finding of Table 1 confirms also such conclusion.

Conclusions

Main conclusions that we can draw from second part of research are:

1. *A human society is a complex organism and must be studied in the same way.* Hence, four important institutions have been selected to be under investigation: State, Economy, Ideology and Family. Credit and credit guarantees institutions have been added also to the model.
2. *Economic analysis of evolution process of a particular civil society might yield important conclusions if the analysis is not bordered under certain constitution framework.* This particularly important for transition economies when they make an enormous efforts to catch up more developed economies.
3. *The positivist analysis of historical development reflected the importance of how various institutions in society insure their coexistence. If institutions have been able to compete with each other the society has enjoyed a long lasting prosperity.* The institutions setting in a communist dictatorship regime is the best example of placing institution under each other. It lasted till other resources; including foreign aid has been fully exploited.
4. *An over estimation in theory and practice of classical and neoclassical approach for transition economies does not help to distinct particular development in a specific country. Hence it is suggested to approach such development with more complex and unorthodox theoretical approaches.* Thus, Sir James Steuart has been reconsidered in our research in order to see how institution affect future path of development in early phase of transition.
5. *The analysis of institutional development in Albania showed that there was less progress in establishing independent and formal institutions. Credit institutions and*

its system of guaranty are in its preliminary phase. Moreover there are fewer intentions on the Ideology as an important institution, which is hardly damaged during the communist regime. Since relatively few efforts are making from present government to establish independent and autonomous institutions the risks for instability are still high.

6. *Current international efforts to combine economic political and institutional strengthening are an appraisable development in the Balkan region. The implementation and enhancement of objectives laid down in the Stability Pact for South East European Countries is a movement in the right direction. Another important aspect of such reform must be on education of public opinion on the need to keep going on the way of democratic reforms as well as make all efforts not to discourage people from the political process in Albanian and other South East European Countries.*

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