

RULE OF LAW AND ECONOMIC GROWTH - HOW STRONG IS THEIR INTERACTION?

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Ten years of development in the post-communist countries of Europe have provided an unprecedented challenge for scholars in analyzing the linkage between the rule of law and economic growth. Critical issues that stimulated debate for decades could now be explored in almost experiment-like conditions. Post-communist societies faced the enormously complex task of the simultaneous transformation of political, economic and social structures. As it is rightly pointed out, the mutual interaction and conflicts involved in such a triple transformation created a new situation in which necessary economic reforms had a potential to undermine newly established democracy - and vice-versa.

It is quite true that almost all transition countries made remarkable achievements in undertaking market liberalisation reforms, in establishing democratic institutions and with the creation of the necessary legislation. **These results are evident, but to the same extent it is also evident that these achievements have still to be sufficient and sustainable.**

It can also be noticed that countries that underwent a quicker and sounder development of the democratic system have also had the most advanced and successful economic transformation. Meanwhile, the countries trailing behind with reforms and with poor economic performances also have fragile and less effective democracies and an oscillating political stability.

While all post-communist countries implemented a relatively rapid and easy **adoption** of Western models of democratic institutions, their effective **adaptation** has been quite difficult, especially as regards the second group of countries. The strategies and models were basically similar across the various countries; disparities have resulted mainly from differences of their starting conditions and the legacies of the past.

Economic liberalisation, as an indispensable reforming process for all post-communist societies, carries in itself the causes of several negative phenomena produced during transition. When these liberal reforms were not synchronized with a parallel establishment and development of basic institutions, the result was the transformation of economic liberty into anarchy, of the market economy

into a bazaar economy or crony capitalism, and additional costs of transformation such as artificial consumption and the waste of capital and energy occurred.

The establishment of the institutions of democracy and a market economy in many countries in transition was only partially and nominally implemented, and thus featured many distortions and large asymmetries. The Western model of institutions is a complex network of interlinked institutions that communicate with each other in the form of “capillary tubes”. The underdevelopment of some of them, or the distorted development of other institutions, spreads and compromises the whole set of institutions.

In many transition countries, one can clearly observe a sort of “de-modernisation” or a step back to rather primitive forms of social and economic organization. This concept materializes in several ways:

- The prevalence of informal institutions (behavior, conventions, habits) against the newly created formal ones.
- Poor quality of informal institutions that slow the development of formal institutions.
- The spontaneous establishment of individual instruments against a poor and slow development of social instruments. For instance, the lack of institutional protection induces individuals to develop instruments and behaviors of self-protection or self-security.

The history of transition in **Albania** provides a somewhat specific but also typical example of the strong dependency between the level of democratic development and rule of law on one side, and the achieved level of market reforms and economic growth on the other.

In the first phase of transition in 1991-1994, enormous transformations took place: several pluralist elections were held; democratic institutions were established and started functioning; the civil administration was restructured; and a series of laws to support liberalisation reforms were produced. The economy was liberalised rapidly and market institutions were inaugurated. Market and price liberalisation, as well as privatisation of small enterprises in agriculture, were satisfactorily completed in the first three years. Albania witnessed a surprising economic growth (almost 9% annually), a significant reduction of the inflation rate (from 200% in 1992 to 10% in 1995) and the local currency was stable over these years. Huge foreign aid was flowing in and foreign and domestic investments started to thrive. The government’s role in implementing these reforms found from the beginning a wide consensus amongst the population.

However, the big political and social crisis of 1997 took even the most skeptical analysts of transition by surprise. The results achieved through hardship and at high cost evaporated almost instantly. But the complete and immediate paralysis of state institutions, the loss of public order, social anarchy and several acts of violence and destruction that seized Albania **were not an accidental product of circumstantial factors**. The causes of this crisis lay within the wide historical context of Albanian societal development where, of course, the

events that occurred during the transition period itself have had an impact of their own.

The weakness and fragility of state institutions and public distrust in political institutions were the most obvious indicators of the crisis, while the fall of pyramid schemes - into which over 50% of Albanians had placed their savings - was perceived as the direct cause. As a matter of fact, this crisis was not produced by economic factors alone. Neither the significant economic and social difficulties naturally generated by transition, nor the big loss of savings in pyramid schemes were in themselves sufficient cause to provoke the tragic social turmoil that occurred.

The 1997 crisis was mainly political and institutional, and was only the final act of reaction to negative political phenomena that built up gradually during the initial phase of transition. These phenomena that were either not understood or were ignored during their evolution had in fact undermined the *raison d'être* of the embryonic democratic institutions and the existence of the rule of law. These negative political phenomena were:

- Reformist demagoguery and populism, inspired by an unprincipled political opportunism, gradually replaced the ambitious reforming policies. Strategies of reforms were transformed into electoral propaganda rather than being a consistent program of policy actions.
- The freshly created Civil Administration was usurped by the governing party and became very much politicized. This significantly reduced its motivation, professionalism and efficiency. Drafting and implementation of reforms was not any more the domain of professionals and their pace was synchronized completely with the oscillations of the government party will.
- The new democratic institutions did not consolidate their regulatory role in social life. Political intervention of a dilettantist and pragmatic nature seriously harmed their identity and public mission. On the eve of the crisis, government institutions were just formal structures and the arbitrary authority of powerful individuals replaced their legal authority.
- Democratic norms that regulate political activity itself were systematically violated. Political life was characterised by conflict and aggression. This situation, combined with the immaturity of the political class, reflected to some extent the poor political culture of society itself, but it is hard to believe that it also represented the real interests of society. The Cold War that had ended in the international arena was alive and kicking within Albanian domestic politics.
- Respect for the basic constitutional principles of a liberal democracy was becoming more and more a mere formality. The declared separation of powers and the independence of the judiciary were either never fully accomplished or became seriously jeopardized. An authoritarian leadership born from anti-communist forces of the 1990s was turning into an anti-democratic factor. Political pluralism and the right to vote do not constitute a sufficient guarantee

when adopted by such hybrid, quasi-democratic regimes. On the contrary, they can serve as instruments of political manipulation at home and as a deceiving **facade** for international observers abroad.

The unfortunate rise of these phenomena in the period 1991-1996 clearly reveals the lack of credible political commitment to the rule of law. **When the rule of law is undermined, both the economy and the whole system grows sick.**

The worst deviations or distortions in the process of economic transformation that occurred during this period were:

- The high economic growth recorded during these years came mostly as a result of the immediate release of pent-up energy due to the introduction of free initiative and the rapid privatisation of small businesses. But this was not sustainable since market mechanisms remained embryonic, inadequate and incapable of imposing regulations. The goal of the reform was wrongly considered to be only the rapid expansion of the private sector rather than being also the qualitative development of market institutions.
- The private sector emerged and grew mostly as an informal sector. If we include illegal and criminal activities in the informal economy, then it counts for over 50% of the Albanian economy as a whole. Such a high figure is closely connected with the existence of some specific factors:
 - the under-developed economic culture and mentality of the population;
 - wild and disoriented migration of the rural population towards urban areas post 1990. Because of their low educational and professional level, these people could integrate easily only in the informal sector;
 - the opportunist and shortsighted politics that allowed this exploding bloom of informal and illegal activities to occur, considering them to be a solution to grave social problems like unemployment and poverty. The reality of pyramid schemes is a vivid example of this political irresponsibility.
- The disproportional development of economic sectors, especially the under-development of the banking system and the almost non-existent capital market. The Albanian economy remains even today a cash economy (approximately 60% of the money supply resides out of the banking system) with a rudimentary payments system.
- The incomplete development of some basic market institutions such as property rights and contract law. The slow process of defining and allocating property rights has contributed to the low level of investment and the unsustainability of economic growth. On the one hand, the unsynchronized and even contradictory implementation of the privatisation of agricultural land, restitution and the compensation of former owners, and the privatisation of state property, and on the other hand, a corrupted judiciary, have created a situation characterised by confusion and insecurity as regards property rights and their protection. Almost the same situation exists regarding contractual obligations. The fact

that it is impossible to resolve contractual rights through the courts obliges individuals to seek redress through the use of non-legal instruments.

In this analysis, I have focused upon the period 1991-1997, because developments and events in this period of Albanian transition illustrate clearly and tangibly the strong conditioning of economic reform by the (lack of) efficiency and sustainability of basic democratic and market institutions.

Unfortunately, even today, an understanding of the causes of the 1997 crisis has not provoked any serious and significant intervention aimed at radical improvement. Other political parties that took office after 1997 have tragically repeated the history of their predecessors, to the extent that existing institutions have deteriorated and become submerged.

However, one positive aspect is that donors - in their support programs - are prioritizing the need for radical reform and deeper institutional and administrative restructuring. Maybe the monitoring of such reform to assess its performance, as well as the extent to which aid is conditioned on such performance, should be reviewed and adopted in the light of lessons we have all learned during this decade of transition.