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**ECONOMIC TRANSITION IN ALBANIA: POLITICAL
CONSTRAINTS AND MENTALITY BARRIERS**

by

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Introduction

Following the big changes in Central and Eastern Europe, economic literature is often dealing with different transformation and development models of the area countries. At the outset many standard reform packages were discussed extensively as it was widely accepted that their models are similar in many points. Time passes for this part of the world and each of the countries has already established its own path and pace of economic reform. Alongside with similarities country economists notice a lot of differences. Advancers and less advancers could be easily recognized. Meantime a growing amount of literature discussing the challenges of the unknown and specific paths of economic transition has been appearing. Most of it, in general or for specific cases, written by native economists or other professionals, contributes to the understanding and explanation of the situation.

Albania is obviously one of the most unique cases in Eastern Europe not only for its size and location but also for its legacy in the economic development and many other peculiarities as well. Without denying similarities with other ex-communist countries, Albania has pursued its way of economic transformation toward a market economy. Unfortunately very little has been published about Albania. Only some few articles of Albanian researchers (Pashko, Muço, etc.) and also few attempts by some European colleagues (Schnytzer, Kaser, Hutchings, Sjoberg etc.) are in circulation. Recent publications by IMF, World Bank and EBRD are filling up the virtual lack of data.

Located in the Balkan Peninsula, in southeastern Europe, Albania is one of the oldest nations in the region. It inherited many natural resources and an authentic culture and tradition. Historic and political events left this small country on the Adriatic coast for 500 years under the Ottoman Empire, which did not stimulate development and prosperity. After the Second World War it joined the European communist block, followed by 45 years of autocratic rule and extremely self-isolated policy. Albania entered the fight to create a democratic society and a market economy in the beginning of 1990s. After half decade of reform it might be too early to affirm that every thing was done in the right way to establish the new market economy. Although difficulties emerged from Albanian situation and there are still many unsolved issues, Albania is seriously involved in this historic transformation and has all the chances to join Europe, to which it belongs, and furthermore the worldwide economic community.

Taking in consideration many factors, internal and external, and comparing them with similar conditions in some Eastern European countries, it seems that the completing of the task might need still some time. Albania with its overall heritage and present condition can not make a jump in a very short time. One problem

to be discussed here is, choosing the lowest cost of transformation, how energetic, radical and fast this process could be.

This study seeks to present the Albanian economic reform analyzing the current situation and the strong influence from the past. The advantages and disadvantages of Albania, the similarities and specifics of its model, as well as **political, institutional and mentality constraints** are discussed, too.

The first chapter of the paper tents to analyze the socialist legacy and initial conditions inherited from the past, similar to those of the other ex-communist countries in Eastern Europe. The level of centralization, structural misorientations and macroeconomic imbalance are analyzed briefly.

The second chapter examines the first years of the Albanian economic reform, the difficulties and the early outcomes of this process. The earlier economic transformation followed by the stabilization program that has been implemented since 1992 show the real chance of this country to abandon its long isolation and to create a new democratic society and a new market economy. Possibilities for a sustainable growth after solving some post emergency issues are also discussed. Political and economic reasons that could be at the roots of recent 1996-1997 crisis have been analyzed.

The third chapter seeks to highlight some important aspects of the Albanian economic reality that makes its transformation different. Compared with other countries that suffered the same legacy, Albania had the most difficult initial conditions. Some political and mentality constraints are emphasized.

Chapter 1

THE SOCIALIST LEGACY-A REAL OBSTACLE TO ALBANIAN ECONOMIC TRANSFORMATION.

Until the beginning of 1991, for more than forty years, Albania was described throughout the literature as the poorest country in Europe, however very little has been published concerning the country, with a strange and extreme position of self-isolation. Although with a socialist, centralized economy, Albania for many years after 1960, did not see itself as a part of the Central and East European communist countries. The virtual lack of data and its unique political and economic strategy made it mysterious for foreign researchers and observers. The rigid communist model which prevailed during those 45 years in Albania was based strictly on Marxist ideology and Stalinist economic practice¹ (A.Schnytzer, 1982, 1992), with some differences chiefly oriented towards a more orthodox model adapted to the special circumstances of the size of the country, its political choices, some structural deviations and its level of economic development (Sjoberg, 1991a).

After the collapse of communism in the other Eastern European countries events pushed very quickly for Albania, leading to the train of transition, passing through a very difficult path. The difficulties have been of two kinds. **First**, the process involved economic, political and social problems more or less similar to those found in other former European communist countries. **Second**, its own specific problems set Albania apart from the rest since it still suffered diverse internal and external shocks. We will return to this second topic in other sections of the paper when we emphasize the differences with the other countries of the region.

In that kind of situation, where a blueprint for the task was not clear and relevant difficulties, both common and specific were to be faced, Albania, the smallest and perhaps the most original country in the community of the former command economies, after a widespread popular revolt against the old regime, entered enthusiastically in the process of transition. But from the very beginning, like other ex-socialist countries, it faced three kinds of problems:

¹ The Stalinist economic practice seems to be different from the "scientific socialism" that designed by Lenin and proceeded after the death of Stalin to other East European countries. After the break with CMEA countries in 1961, Albania criticized their "revisionist" way of socialism for many years, pretending to be guardians of clean and safe Marxist and Stalinist ideology, applying an extreme orthodox practice. Official behavior and professional publications were under severe control, suffering higher restrictions in order for this attitude to be reflected. For economic aspects of this practice see Schnytzer 1982, 1992 and for political aspects see Biberaj 1990.

First, after more than 40 years of a command economy there is a lack of institutions and the system of incentives appropriate to a typical market economy. Therefore starting from the productive and institutional structure, significant and deep changes on behalf of this aim are required. Obviously, higher stabilization and short-term adjustment costs occur during this transition.

Second, strongly connected with those costs, important political economy problems are emerging. The vibrations of the political system are affecting the overall reform and vice-versa; this tends to accelerate the political instability. In this environment, with reciprocal influence, the main danger remains the implementation of half-measures which cause rather uncertainty and delusion.

Third, there is not any given model or any precedent from which to derive full lessons. Certainly there are some partial similarities taken from the economic and political history of the world to benefit; hence an original way had to be found².

In order to explain the barriers of the transitions; let make a retrospective³ classifying main problems inherited by the old economic structure of the communist past:

1.1. The Level of Economic Centralization.

During the 45 years of communist rule Albania had become a very rigorously centralized economy. Central planing had virtually replaced all forms of market mechanisms. Within the context of five-year plans, all economic decisions on production, pricing, wage setting, investment and external trade were centralized, while changes between the plans were generally minimal. A four-tier, decision-making hierarchy was instituted starting with the Council of Ministers and followed by Branch Ministries, Executive Committees and state enterprises. All economic information was strictly reported vertically, and the decision making center was the central authorities. The agriculture cooperatives had a small degree of self-management in terms of the

² It is true that the standard stabilization package used by international institutions in other cases, as in Latin America, Africa, Korea, Turkey etc., to avoid hyperinflation and other macro imbalances, as well as privatization, is mostly the same. There are a lot of excellent studies which tend to analyze and take advantage from other worldwide experiences, as Corbo 1991, Kiguel and Liviatan 1991, Blanshard, Dornbusch, Krugman, Layard and Summer 1991, Edwards 1992 etc. Some of them, as Blanshard et al., 1991 and Krueger 1992, have argued that the initial conditions in Eastern Europe are not so different as to require a drastically different approach from other stabilization and restructuring experiences. Without any doubt the lessons of the past reforms are useful but the short history of transition shows also many peculiarities.

³ A fully statistical report on Albanian economy since 1992 is the work presented by IMF: Blejer at al. 1992, "Albania from isolation toward reform."

profit share transferred to the budget and wage policy, but the plan target was also compulsory.

The economic indicators of the state enterprises were imposed by the State Planning Commission and directed by Branch or sector Ministries, starting by physical quantities of each unit of production. Although a discussion of the targets, both physical and in value (quantity times wholesale price) took place, this process was made formally⁴. The rights of the enterprises on labor mobility were also completely restricted. The employment structure and the number of workers were well defined, and a centrally determined wage fund was used. Inputs were supplied in accordance with the central plan while investment and import decisions were made by the state, rigorously reflected in state budget.

Only during 1985-1990 were some weak attempts made to decentralize decision-making (Gjyzari 1989, Banja 1990). After long discussions and hesitations⁵, in response to a popular discontent in face of the failure of the overall system, the leadership of the country gave the green light for changes (Alia 1990, Carcani 1990). More evidently, in 1990, a "new economic mechanism" was adopted. Some modest microeconomic reforms were made, that were intended to decentralize and liberalize the management of the enterprises⁶. Under the conditions of a serious macro imbalance and a lack of price flexibility, rather than radical changes, these half-measures aggravated the financial situation, creating a big distortion on the supply response of the economy, leading to an orientation of the enterprises' profits toward imports as reducing the transfers to the budget.

1.2. Structural Misorientations.

The internal macro imbalance in the beginning of 1990s in Albania was deeply rooted in the inefficiencies of the past economic practice. The main sources for inefficient production consisted of the structural misorientations of the Albanian economic legacy.

i) **The property structure** of the Albanian economy for 45 years tended to be uniform, dominated by state ownership. Up to the middle of the 1960s all remaining

⁴ In 1965 in order to increase incentives among the workers a more democratic discussion of the broad plan targets was introduced. Holding the right to approve all enterprise propositions, the final decision-making power remained centralized until the new law on enterprises approved in May 1990.

⁵ E.Lhomel (1990) pointed out that until the end of '89 no visible change had yet taken place. However, among different levels of government, including the top ones, scholars and intellectuals the damage of the recent hyper centralization was widely accepted and emphasized, especially in agriculture (Banja, Hilmi, Koli 1988 and Konini 1989)

⁶ See: "Ligj per ndermarjet", Probleme Ekonomike, viti 37 (8), 3, pp20-25.

forms of private economic activities both in industry and in agriculture were reduced gradually to a minimum. This process culminated with the New Constitution of 1976⁷, which legalized the concept of a "socialist economy" based on the state ownership of all means of production, including agricultural land, prohibiting even minimal forms of private property or private activity. Only 200 square meter gardens and a law-defined number of livestock, as peasant property to cultivate their own consumption goods, were permitted. By 1982 this personal property⁸ was reduced again by the process of forced collectivization of the main livestock, decreasing drastically the meat supply on the market. After some unsuccessful experiments in 1985-1987 with "brigade plots" and "brigade herds"(see: Alia 1987), in July 1990, it was decided to allow peasants to raise their private plots and to transfer some of the cooperative livestock to their members. In a collapsed economy, together with other half-measures in economic policy, this showed the beginning of the rapid process of breakdown of the old property structure.

ii) The third principle of the Albanian economic "model", besides the above over centralization and rejection of private ownership, was the idealization of national self-reliance as a main orientation of economic policy. Albania, a country with 3.2 million residents, and 28,748 sq. km. area was supposed to produce almost everything in its self-isolated castle. The practice application of the slogan "we are going to build socialism with our own forces" not only made this model unique, but also an extreme economic autarchy was adopted. As a result a misorientation of the economic structure of the Albanian economy appeared. **The extreme diversification of production**, ignoring the international division of labor and all kinds of comparative advantages, applied to a very poor technological performance⁹ and to a weak traditional industrial development background, fed a complete inefficiency. This extensive growth strategy tended to achieve full employment of resources, (which was supposed to be one of the main tasks of the system) but through an inefficient use of them, without measuring and comparing the productivity, prices and costs. The above structural strategy was spread all over industrial manufacturing, as such as metallurgic, engineering, chemical, etc., and was quite unnecessary for such a small country as

⁷ See: "The New Constitution of PSR of Albania" Tirana 1977.

⁸ "Personal" is the usual terminology officially used by Albanian literature for peasant's plots. Theoretically this was not considered private property because the land was not owned by the peasants but only used by them. Its products were considered for personal needs and selling them in a free market was not permitted. Every resultant surplus production was to be managed by state channels.

⁹ At the end of World War II Albania was presented as agriculture oriented economy with practically no modern industrial production. After 1945 the industrial development took priority, but the technology given to Albania first by Soviet Union and then by China was the oldest and fully depreciated. Later on the financial imbalances, investment shortages and the extreme isolation made impossible any access to new foreign technology.

Albania. The aim was to meet the domestic demand for spare parts and input supply, while imports were restricted.

iii) As in other East European countries, the Albanian economic structure was strongly oriented towards industrialization. Beginning from a very low base the share of the industrial sector in 1990 accounted for approximately 45 percent of NMP and provided employment for about 23 percent of the working population. Industrial growth absorbed 42 percent of gross investment. In the 5 years plans, the strategy of industrial development emphasized **the priority of heavy industry**, keeping higher growth rates with the absurd pretense of restoring economic independence. Although up to the middle of '70s it was assisted by foreign capital inflows, the heavy industry (group A) was far from international standards, at higher costs and low quality.

Except for electricity and mineral production¹⁰, which had a significant contribution to exports, this policy was also rather inspired by economic autarchy and ideological reasons other than economic efficiency. But the structural distortions of the Albanian economy made a controversial picture. The main industrial enterprises, which were export oriented, provided 75 percent of the country's total f.o.b. exports at the end of the '80s, when their share in the gross industrial output was less than 26 percent. In 1990 manufacturing accounted for 75 percent of the gross industrial output, but it covered only 13 percent of country's total exports, or 23 percent of the f.o.b. export from the whole industrial sector¹¹. In order to keep such industries alive, the hard currency provided by mining and energy exports was swallowed up by the other inefficient sectors of heavy industry, as mechanical, metallurgic, chemical, etc., covering their needs for raw materials and technology. Hence less attention to food and light industries was paid. When the possibilities of the Albanian economy to support the heavy industrial burden decreased sharply after the breakdown with China in 1978, this sector together with the whole industrial production suffered a frequent decline.

iv) Besides this poor structural development of industry a huge **concentration and centralization of production** took place, and significant mismanagement problems occurred. The internal industrial market was ruled by the monopolistic behavior of large scale, overstaffed units as "combinats" or big plants. The same situation existed in agriculture.

¹⁰ Albania contains a wide range of natural resources particularly metals and minerals including chromium, copper, iron\nickel, coal\lignite, bauxite, etc. Due to geographical conditions Albania has also a good capacity for hydroelectric power.

¹¹ Source: Statistical Yearbook of Albania, 1991, pp. 296-297.

The prices were virtually fixed, and wages were well controlled; however any single sign of competition was denounced by the theory and practice, and was substituted with so-called cooperation and planning, eliminating the possibilities for incentive and motivation on quality and variety of products. Unfortunately very little data are available to prove this argument.

For a long time small, flexible and efficient enterprises were considered as an abandonment of socialist organization principles. Any attempt to change the situation was systematically criticized and labeled "revisionist." Only after 1985, together with other efforts on decentralizing the economy some signals of less concentration, especially in agriculture, occurred.

v) Construction, transport, tourism and other **services were relatively under evaluated** in terms of rate of growth. A mountain of problems that had accumulated in these sectors exploded in the early 1990s. Official estimates for 1989-1990 suggest a sharp fall of 14.7 percent in investment construction, primarily owing to a shortage of imported and domestic inputs. In addition to the declining of production and real wages, the excess demand on housing, the poor performance of roads, transport and telecommunication, and the serious lack in services significantly reduced the standard of living, creating a real obstacle for the economic reform after 1991. The serious neglect they suffered implies a lot of investments in order to facilitate the necessary recovery.

Despite large possibilities for Albania due to its geographical and climate position, the socialist economic strategy of development in tourism had never taken into consideration this sector as a major potential earner of hard currency. It was ignored simply for political reasons and the fear of the foreign ideology penetration.

vi) Agriculture has been for a long time the most important sector of Albanian economic development. Obviously the relative comparative advantage of Albania in agricultural production is due to its traditional heritage and the cheap labor force. This sector accounted roughly 33 percent of NMP (Net Material Product) and employed nearly 50 percent of the total working population¹². It used to be completely socialized, organized with cooperatives and state farms, both dependent on state budget investments, however in different degrees and well defined production targets.

Since 1950 **agriculture has received less support and attention** than industry. Nevertheless, considerable work on terracing, irrigation, drainage and desalination had been carried out in the 1970s and 1980s, increasing the arable land in the '90s to an equivalent of 39 percent of the total area. Since, however, the population

¹² Source: Statistical Yearbook of Albania, 1991, pp.78-79.

in 1950 was 1.22 million as compared to 3.22 million in 1990, arable land per capita has declined by over 10 percent. Agriculture output has chiefly depended on weather and on a scarce and outdated mechanization base. In the 1970s and 1980s the country used to be self-sufficient in wheat and claimed to be 85 percent self-sufficient in food altogether, with agriculture supplying up to a quarter of all exports.

Within agriculture, a misorientation in designed priorities among different productions occurred. Near two third of the Albanian territory is mountainous or hilly, covered with foresters and woodlands. The arable area is limited and is located, mostly in the western part, beside the Adriatic Sea. Livestock production, which might be advantageous because of the rugged terrain, was under evaluated and seriously damaged by a shortage of fodder that resulted, among others, from turning pasture areas in crop production areas. In the early 1980s livestock production, suffered a serious stroke as a result of the forced collectivization of the livestock inventory held on the private plots. So, crops constitute the main part of agriculture output, averaging 58 percent of total production during the 1980-90s, even with a poor performance of productivity.

As it is pointed out in some works (Hall 1987, Sjoberg 1991a, 1991b), the autarchy in food production, especially in higher cost crop production, was connected with the self-isolation and the restrictions which derives from it. It was a vicious circle where the above policy reduced the dependence on foreign trade for food, especially bread. At the other side, the policy on reducing the difference between rural and urban areas in their standard of living (a very well known slogan of Albanian social and agricultural development strategy) tended to affect the remainder of the population in rural areas. Meanwhile the low level of mechanization made possible the employment of that segment of the Albanian residents - more than 60 percent.

By the late of 1980s a combination of drought, inefficiency, years of higher population growth, acute shortages of domestic and imported raw materials had created big problems in feeding the population which appeared in a substantial excess demand in the food market: long exhausted lines and rationing, erupted in 1991. Since then Albania has relied heavily on foreign food aid.

1.3. The Internal and External Imbalance.

Up to the end of the 1970s the economic system in Albania generated stable growth and development. While real NMP had grown by nearly 44 percent in '65-'75, in 76-'80' it rose by about 20 percent and less than 1 percent a year in '80-'89 with no growth during '85-'90 and a sharp decline in 1990 (see Table 3). There are

some attempts to analyze the reasons of the successful path of the system in the first decades of its life (Pashko, 1991), as well as the slower growth in 80's (Kaser 1986 and Hutchings 1989). I shall emphasize briefly some of various reasons that I find more decisive.

After the Second World War Albania inherited a very weak economic development, based mostly on a feudal agricultural system. The lack of a genuine capitalist industrial production created a vacuum, easily filled by the imposed new socialist system. The method of economic centralization, in the context of an extensively oriented development, successfully mobilized the cheap work force from rural areas in the big industrial enterprises absorbing the post-war excess demand for labor. The rich natural resources, even inefficiently exploited, played an important role in getting started. The foreign assistance, in the beginning by the USSR and later by China, supported the main industrial projects. The initial post-war euphoria as well as psychological and political reasons still assisted the system.

The stagnation that followed in the early 1980s with slower growth and low productivity, and the complete failure of the system by the end of the last decade need some explanations:

First, the structural defects described above, combined with the over centralization led to the **inefficiency of the public sector production**, creating a circle that produced shortages. This well-known phenomenon occurred in other countries of East and Central Europe (Kornai, 1980), but seriously aggravated in the specific conditions of Albania. The prolonged strategy of import-substituting for the heavy industry (Group A) in the Albanian industrial structure followed as a consequence of a supply oriented policy that caused deformations and restrictions in aggregate demand. Yet, demand was determined by fixed plan targets rather than by market. As time passed a crisis on income side, as a result of outdated and ineffective revenue mobilization mechanism, the decrease of the profit transfers and the increase of the subsidies to the enterprises, became more evident and worsened the general imbalance. At the other side, the expenditure began raising faster than incomes while the central planning could no longer reach the personal consumption objective toward the fast population growth.

Second, besides some unfortunate years in weather that caused reduced **agricultural production**, the whole economic policy followed in this very important sector, for almost ten years since 1980, accumulated shortages actively contributing to the imbalance of the 1990s. The higher taxation applied during this decade ruined the peasant's interest in higher productivity and reduced substantially the cooperatives'

practical possibilities on investment. The share of agriculture in exports was considerable, about 30 percent, but the provided incomes were swallowed by imports destined to heavy industry with the main aim to secure the raw materials, spare parts, fuels and chemicals.

Third, as if the absence of capital inflows from USSR or China were not sufficient, the Constitution of 1976 (Art.28) established a **virtually closed economy**, banning all credits and loans from the rest of the world. Only in 1990 were this article abolished.

Fourth, optimism was weakened by time as the **credibility** of the successes of the socialist system fell considerably from the long lines for food and the decline in the standard of living.

Fifth, in front of increasingly difficulties in micro levels the **macroeconomic intervention** was slow and inappropriate. Its main task was to ensure the fulfillment of the centralized plan targets.

1. Fiscal policy was used to mobilize resources from state and cooperative sectors in order to maintain the planned level of investment, the planned wage bills, the social security system and the enterprise and price subsidies. The final aim of this redistribution through the authority of state budget was to achieve the quantitative plan. Since 1979 the foreign resources that financed the possible deficit of the budget ceased. The fiscal situation began to result in imbalance, and there was no way of adjusting it while the budgetary investments were still higher.

In 1986-1987 a tightened fiscal policy was followed through a small reducing in investments and a rise in social security contribution rates from 13 to 15 percent. But an uncontrolled and expansionary fiscal stance was replaced in 1988-89. The main factor was the rise in enterprise subsidies, reflecting their weak profitability, reaching a record of 16.1 percent of GDP in 1990. Government deposits in the Central Bank usually financed fiscal deficits. This reserve fund fell down from 21 percent of GDP in 1980 to 5 percent of GDP in 1990. The situation of budget deficit in 1990 was connected with the 13 percent decline of output, but at the same time it also reflected a lack in budgetary control and financial discipline.

2. Monetary policy was passive and was used merely for administering the monetary resources, mostly reallocating them in accordance with requirements confined by the plan. The interest rate policy played no important role, and the rates remained unchanged almost all the time. As a result of a slight openness of the economy, in order to stimulate the inflow of scarce hard currency, the only thing changed after 1986 was a slight rise in the rate on foreign currency deposits. The exchange rate

policy was limited to the confines of accounting purposes. There was not a financial market or any individual financial asset.

The State Bank of Albania was in charge of both central banking and commercial banking functions. Since 1970 a State Agriculture Bank has been created, covering the agriculture financial operations. Only in January 1991 did the Albanian Commercial Bank begin operating as a separate bank. In late 1991 the Savings Bank of Albania was also separated, including the entire existing savings bank network.

In the background of an extreme centralization, the role of the State Bank in monetary interventions has been paled for many years. The necessity of a macroeconomic maneuver in the monetary field became clearer after 1985 when the figures began showing an increase in budget deficits, a decline in the rate of growth of GDP, a deterioration of balance of payments and an increase of broad money. In 1980-88 broad money increased by an average of 5 percent a year compared with an average annual growth of nominal GDP of 1.1 percent. From 1989 money creation grew extensively, from 7.8 percent annual increase in 1988 to 14.8 percent in 1989 and reached 21 percent annual change in 1990, creating the conditions for the future exploded inflation and monetary overhang.

An easy borrowing process of the state-owned enterprises and soft budget constraints stimulated the monetary expansion. An unrealistic ceiling interest rate on bank credits of 2 percent yearly remained in power, while no sanctions to the unperformed enterprise debts emerged. In 1990 short term credits to the industrial enterprises rose 28.4 percent from the previous year¹³ going mostly to pay wage bills in overstuffed conditions or were used inefficiently. The dramatic situation in Net Foreign Assets of the State Bank of Albania 1990 was due to the recent deterioration of the balance of payments, the increase in foreign debt to the foreign Commercial Banks and bad transactions in foreign exchange markets.

3.The government income policy was based on the control of wages and planning of other social benefits on health, education and culture, while the system of wage determination was the main part. Other benefits as pensions, temporary sick pay or maternity allowance were completely wage related. The wage system was centralized, strictly controlled and rested unchanged for almost all the time. Some minor reforms were introduced in 1990. Wage policy was oriented from the principle of narrow differences between the physical and intellectual work as well as between sectors and workers with different qualifications. By law this gap was one to two. For the first time bonuses and penalties for the achievements of the plan targets were introduced in 1980. In 1990 for non-realized profit it was a penalty of 10 percent of both workers

¹³ Calculated from the Statistical Yearbook of Albania, 1991, pg. 337.

and managers and bonuses included the distribution of 50 percent of profit above the planned levels.

The policy of setting the minimum wage was theoretically based on a minimum cost of living computed for the first time in 1975. However, the average of the economy monthly earnings was for the whole decade 1980-1990, very close to the 450 lek estimated (but never published) minimum cost of living (IMF: Blejer at al., 1992), while the agriculture sector was substantially below this figure. In 1990 the monthly average earnings in the whole material sphere (industry, agriculture, construction and transportation) accounted to 442 lek and the cooperative sector was 292 lek¹⁴.

By the end of 1989 and in the beginning of the 1990s a growing wave of revolts and an overall discontent made the Government to review its wage policy. Instead of introducing radical reforms in privatization, restructuring and social safety net, the Government made a compromise, mostly for political reasons. The workers laid off by the enterprises forced out of business by the lack of production factors were being paid 80 percent of their former salary. This policy, however, was a poor one in economic terms, and contributed to aggravating the situation. Approximately one third of total industrial work force was given this unemployment compensation until May-June 1992 as production was completely paralyzed (Muco and Minxhozi, 1992). The burden of those payments placed on the state budget accounted for 7 percent of the total wage bill by the end of 1990 and the ratio doubled during 1991¹⁵. Furthermore, in 1991, under threat of general strike, the Government granted a 50 percent increase in all wages and salaries, without taking into consideration the inflation that would result.

Sixth, in the late 1980s the collapse of CMEA became one of **external shocks** that the weak Albanian finances suffered. A considerable part of Albanian exports was directed toward the CMEA countries. When the partners ceased the payments with clearing, shifting their relations to the West, the hard currency reserves of Albania were too small to face the import needs in raw materials and spare parts, necessary to keep open industrial enterprises. Step by step a debt problem to the foreign commercial banks occurred, blocking the ability to borrow from them. According to the estimates from the State Bank of Albania and other sources in 1990 the commercial banks arrears were approximately \$ 181 million. In a year and a half this debt reached about \$ 400 million, a big amount compared to the size of the Albanian economy. In 1991 it was about \$500 million or 30 percent of GDP.

¹⁴ Source: Statistical Yearbook of Albania, 1991, pp. 84-85.

¹⁵ Source: Pashko, 1993a, pg.909.

Although during the 1980-1990s trade has begun to be oriented toward industrialized countries, the competitiveness of Albanian products to enter in these markets was very low, except chromium, copper and electricity. The decline of production was reflected in foreign trade. In 1991 the ratio of the trade deficit to GDP reached 19.2, percent and debt service ratio to exports was 38 percent¹⁶. The balance of payment showed considerable deficit in trade and current accounts in hard currency, in the ruble and in other non-convertible currencies. This deficit increased sharply from \$95 million in 1990 to \$170 million in 1991¹⁷.

The picture of the Albanian economic situation that emerged in the early 1990s was dramatic. The main economic indicators showed generally sharp decline (see Table 1, first columns), and the standard of living might have been the poorest in Europe¹⁸. Implementing the reforms with the final objective of creating a market economy and a new democratic and civil society, since 1991, was and continues to be a real challenge for both a fragile democratic society, as Albania is, and for the international institutions providing assistance in the process.

Designing a stabilization program and furthermore a deep transformation of the Albanian economy requires taking important additional specific features into consideration. It is clear that some of them come from the socialist legacy. It is also clear that the path of the transition and the speed of transformation, sometimes the so-called sequencing of the measures, depend crucially on initial conditions (Fischer and Gelb, 1991). The search of this chapter for the roots of the pre-reform crises as well as current imbalances, and the understanding of the framework in which economic events have taken place, could contribute in formulating conclusions and proposals to the decision and policy-makers.

¹⁶ Source: State Bank of Albania, 1992.

¹⁷ See: The Economist Intelligence Unit, Country profile: Bulgaria, Albania.1993/94, pg.44.

¹⁸ GDP per capita in 1990 measured a level of \$ 623 at a commercial exchange rate of leks 8 = \$ 1. No purchasing power parity data was available for Albania.

Chapter 2

THE ONGOING ECONOMIC TRANSFORMATION IN ALBANIA

2.1. Initial Political and Macroeconomic Conditions

Albania was the latest ex-communist country that entered on the road of economic transformation. Results of the reform implementation till 1996, despite unsolved problems were optimistic. Albania's emergency to change was even greater, due to the severe economic crisis in the latest days of socialist system (see Table 1 and 2). Limited reforms at the end of 1980s, with the paradoxical name "New Economic Mechanism" borrowed by the very early Hungarian reform, only exacerbated the economic difficulties. Meanwhile, the situation reached the breaking point. These attempts were partial, mostly in the microeconomic field, and did not represent a coherent or radical program. Although the emergency was evident, no macroeconomic interventions or stabilization policies were undertaken. Limited progress and controversial results had already occurred in other reforms, called "market socialism", in Eastern Europe (Gelb and Gray 1991); however, these reforms continued to be applied in Albanian economy till mid-1991.

Coinciding with the political breakdown of the old regime, the economic crisis meant that the economic reform was a necessity. Apart from the ups-and-downs and the intensity of the political processes in Albania, which undoubtedly has its reflection in the trends of the economic reform, the first serious economic measures began after the first democratic elections, March 31, 1991. This might be considered as the first phase of the Albanian economic reform accompanied by a lot of controversies, confusion, half measures and, above all, a virtual political instability.

The first government created by ex-communists on May 10, 1991 presented a reform program to parliament but after less than five weeks in office they resigned because of the widespread opposition, mainly in the cities, and massive strikes. After long hours of discussions among the political parties, in June 1991, a coalition group, called Government of National Stability took office, while new elections decided to be held in spring of 1992. After the abrogation of the entire 1976 Constitution on April 1991, this government introduced and initiated a reform program, which was approved by parliament at the end of October 1991¹⁹. It included

¹⁹ For a detailed description of this program see for instance Pashko, 1993a, 1993b. Due to controversial political events of the period and the short time of the Coalition Government in the office (from June to December 1991), the implementation of the program reflects the overall confusion. Despite the inadequate publications of the period as well as uncoordinated measures and other mistakes this program might be considered as the first serious step toward a market-oriented economic transformation in Albania.

a series of laws about price liberalization, investment deregulation, macroeconomic intervention, as a tight monetary policy and budgetary austerity, land distribution and small-scale privatization.

The Coalition Government tried to make some macroeconomic interventions, although the figures showed a further balance deterioration. In fiscal and budget control terms the tight policy tried to prevent the fast spending increase. In order to create a source of revenues for the budget, a system of taxes and duties was introduced. Export and import licensing were relaxed with the exception of the foodstuffs because of the emergency food situation at that time. The currency was deeply devalued, vis-à-vis USD, first by 250 percent in September 1991 and other 100 percent by the end of the year. The restructuring of the banking system was initiated; however, a proper banking law was approved about one year later, in 1992.

The small-scale privatization of retail shops and other commercial services had progressed but the monitoring of the process remained disorganized and some signals of haste and dishonesty occurred. The most important achievement was in land privatization while the spontaneous breaking up of the cooperatives had already begun since the end of 1990. In the spring of 1992 about 70-75 percent of the arable land owned by cooperatives was freely distributed but the sale and transfer of the land still remained prohibited. The overall confusion and the uncertainty about the property rights, as well as the unclear attitude towards the restitution of the property to the former owners, meant that the land remained non-sewn and contributed to the further decline of the agricultural production. Food shortages became dramatic.

In order to decentralize the decision-making and increase the financial autonomy of the state enterprises, a number of reforms were introduced. The liberalization of the decisions, under the conditions of price restrictions and losses, still covered by the state budget subsidies, influenced negatively the financial flows from state enterprises to the budget. Under these circumstances the financial situation deteriorated sharply and the attempts to prevent this remained uncoordinated half measures.

Price controls remained in place until the end of October 1991, so that market incentives did not accompany the diminishing centralization of resource allocation. The breakdown of the institutional structure of management, without replacing it with an adequate one, in a situation where shortages in raw materials were larger than ever, caused a drastic collapse of production. At the other side, the work disincentives caused by the continuation of the payment of 80 percent of the wages to idle workers and the decision taken in 1991 under social and political pressure, made impossible any supply response of the economy and contributed to aggravating the

financial imbalances. In practice, most industrial enterprises had ceased their activity or were operating far below their capacity from the beginning of 1991.

At the end of 1991 the increasing dissent among political parties was finalized in a new government crisis after the withdrawal of the Democratic Party from the coalition. The government of technocrats, which replaced it, was the third in a period of seven months in 1991. It assumed office with the aim to prepare the new coming general elections in March 1992. The above mentioned political events had a negative impact on this phase of economic reform, leaving many things in the middle way and increasing the confusion. The preparation of the electoral campaign diverted the attention of the government and the parliament for the economic reform.

The results of that phase of the Albanian economic transformation leads to some conclusions. The first lesson was that political instability is definitely a strong determinant for the path of the economic transition. The facts from that period also argued that running fast without any clear strategy, in particular in Albania's case, might worsen the situation. On the other hand the theoretical rationales of the actions were not clear, since the coalition period bore ideological controversies and discords between political parties and inside them. Yet, part of this was obviously due to the lack of experience, or to the difficulties inherited from the past.

As a result the macroeconomic situation of the country was worsened. Output declined by more than 50 percent from the end of 1990 to mid-1992²⁰. The external debt became dangerously large at the level of 30 percent of GDP. Furthermore the foreign exchange reserves were completely exhausted. Budget deficit reached 44 percent of GDP by the end of 1991, and widened to more than 50 percent in the first half of 1992. The monetary was found to be an easy way of financing the resultant large budget deficit. Money supply in circulation doubled. In the beginning of 1992 broad money reached a record of 69 percent of GDP while the pressure for increase in wages became more insistent. In the end of 1991 inflation was in three digit numbers at 104.1 percent change from previous year. In the early 1992 a monthly inflation of 10-15 percent was observed.

After the general elections on March 22, 1992, finalized by the victory of the Democratic Party, a new government assumed office in April 1992. From the beginning this government tried to establish a civil order, completely absents during the previous political events, and launched ambitious economic reforms. The main aim was to halt further deterioration of the economy and to move towards a market economy.

²⁰ Data on macroeconomic situation from 1990 to 1992 is taken by "Albania", IMF Economic Review, 5, 1994, Washington D.C.

The program was performed in two phases. From mid-1992 to mid-1993, during a one-year program, the fiscal and monetary control combined with a comprehensive price and exchange system reforms, were introduced. The program was generously supported by various international financial and technical sources. One of them was a 12-month International Monetary Fund (IMF) stand-by arrangement of the amount of SDR 20 million (equivalent to about \$29 million)²¹. Financial aid was also provided by a World Bank critical imports target loan. European Community as well coordinated a balance of payment support and emergency assistance. Other supports, financial and in form of food aid, was also provided by individual countries as Italy, Turkey, Germany, USA, Greece, etc. An important element was the support and remittances sent by the Albanians working abroad.

After the good implementation of the almost one year emergency program, a medium term program was represented in the parliament in November 1993 for the period 1993-1996²². To sustain this program, Albania has been "graduated" to an IMF enhanced structural adjustment facility (ESAF) by July 1993 in a three year arrangement for the amount of SDR 42.4 (about \$60 million). Other aids continued to flow from humanitarian sources and G-24. European Union also had a very important role in helping Albanian economy.

2.2. Stabilization, Liberalization and the Openness of the Country

It is widely agreed in almost all the economic literature that macroeconomic stabilization is a prerequisite for later structural reforms and must be implemented quickly. Liberalization should shortly follow, or start concurrently in order to make the privatization process possible. All these three big steps should be accompanied and sustained by deep institutional transformations and legal reforms.

As the experience in Eastern Europe has shown, in order to achieve a better result, it is important to get started along many fronts. Though tightly interlined, the elements of the reform need different time periods to be implemented. Macroeconomics stabilization is certainly the earliest to be fulfilled quickly. This is true for the Albanian reform program, particularly after mid-1992. The first year's efforts, till mid-1993, were mostly dedicated to stabilizing the emergent situation of the Albanian macroeconomics imbalance. Still, most of the planned measures, or those

²¹ See for instance: IMF, 1994 Economic Reviews, 5, IMF, Washington D.C.

²² See: "Programi afatmesëm i Qeverisë për zhvillimin ekonomik të Shqipërisë në 1993-1996", represented in parliament in 24.11.1993 by the Prime minister Aleksandër Meksi, "Rilindja Demokratike", November 26-27, 1993, Tirana.

which are already realized in the medium-term 1993-1996 program, have a strongly stabilization nature. This was imposed, differently from Czechoslovakia or Hungary, because of the deep crisis due to Albanian's inherited imbalances. As in all observed and analyzed standard stabilization packages, although with different approaches (Lipton and Sachs 1990, Blanchard, Dornbusch et al.1991, Fisher and Gelb 1991, Kornai 1990, Bruno 1993, McKinnon 1993 and many others), inflation, money growth, current account situation and fiscal position were and continued to be the basic variables that need urgent stabilization measures.

It seems that the Albanian program had a strong monetarist flavor. Following the high inflation in 1991 up to mid-1992, which resulted to around 200 percent, the reduction of inflation to below 20 percent is determined in the program as a key objective. Monetary policy will be the principal nominal anchor of the program, supported by a fiscal policy that had as a central objective the elimination of monetary deficit financing by the end of the program period. In addition, income policy will remain an important second anchor as long as the public sector employs a major share of the labor force.

The first results of the used **strategy** emerge from the current situation of the macroeconomics variables. Output growth was showing a persistent improvement compared to other countries in similar conditions²³; budget deficit and inflation were diminishing. Although still very high, unemployment was moving down even slowly together with a fast development of the private sector. At the same time, according to official data, the rapid fall in the inflation in Albania, from 237 percent in the end 1992 to 31 percent in the end 1993, 16 percent in the end of 1994, and 6 percent at the end of 1995, is one of the best performances of the Albanian economic reform.

Monetary policy during the short and medium term stabilization program in Albania is based on direct instruments of monetary control. This was imposed by the situation of the banking system, the external debt situation and because of needs to finance the large deficit of budget. Along with the consolidation of the banking system in Albania the indirect instruments of monetary control, including the establishment of the required reserves, a refinancing window and a liquidity requirement, will become more powerful. Allowing new private banks in the market will also have a positive effect on using more actively the indirect instruments of monetary control and on increasing inter-bank competition. At the beginning of 1996 some licenses on private banking activity were issued to some foreign banks paving the way for a real market in that field.

²³ See for instance: Transition Report, EBRD, 1995.

Meantime, till 1996 financial market outside the bank was still absent and a **capital market** as well. Only on the May 1, 1996 for the first time in the history of Albania, started operate Tirana Stock Exchange. During 1995 a positive development on bond and Treasury bill market was appearing. Smoothing the negative impact that has the direct credit to government, the securities market would contribute to the targets of both public debt policy and monetary policy. However this is still embryonic and the development and improvement of capital market is a clear goal for the near future.

Interest rates are another important issue in Albanian monetary policy during the transition. There was not any legacy in this field since November 1991 when the interest rates were revised for the first time in the last decade. Only on the first quarter of 1993, when the inflation went down and exchange rates became more stable, the real interest rates became positive. Although the interest rate policy is becoming more flexible, it is still administered and seems to remain under central bank control until the banking system will consolidate and the monetary policy will move towards the use of indirect instruments. Along with strengthening of a developed capital and security market the interest rate policy would become more liberal establishing their positive levels, raising the flexibility and influencing on the medium and long-term investment policy.

At the other side a flexible **exchange rate policy** has affected the raise of foreign assets reserves. In 1992 Albanian economy passed from a fixed exchange rate practice to another one. The Albanian stabilization, as Bulgaria and Romania (Bruno 1993), is based on a freely floating exchange rate accompanied by a moderate control preventing large possible fluctuations. The main reason for implementing such a step was the lack of foreign exchange reserves. After substantial, though relatively gradual, devaluation in 1991-1992 the exchange rate remained relatively stable with an appreciation at the end 1993, mid-1994 and a slight change in the first months of 1995. By the end of 1995 and during the first months of 1996 a slight devaluation of domestic currency. One of the reasons could be the breaking down of the UN embargo sanctions to Yugoslavia and the strengthening of the custom duty services against the border contraband. Also starting political campaign for the new elections might have its impact on this market in the beginning of 1996. Central bank interventions had influenced significantly in developing of the exchange market increasing its presence especially in the parallel market. This operation stopped a further evaluation of the local currency at the end of 1994 keeping it relatively stable, and in the early 1996 for preventing a further devaluation.

One of the most important targets of the stabilization program in Albania is the reduction of the **fiscal deficit** and the gradual adjustment of the weight

of the revenues and expenditures in the budget. The dramatic worsening of the fiscal position in 1991, when the cash deficit reached 44 percent of the GDP (see Table 4), was result of the sharp decline in output, increases in wages and social protection, soft budget constraint on firms and the weakness of financial discipline. During the first half of 1992 this big deficit was financed totally by the domestic banking system. Only by the end of 1992, after the short-term program began applying a budget austerity, some signals of improvement appeared. Furthermore, in 1993 the deficit decreased again reaching around 16 percent of GDP while in 1994 it became 8 percent of GDP. A better situation seems to result in 1995, as the expectations of the deficit were 7 percent. This is partially result of the GDP growth. At the other side the strengthening of the new tax system, introduced gradually from 1991 to 1993, started to show its first results. The elimination of enterprise subsidies has also its positive impact on stabilization efforts.

The first **liberalization of prices** for goods was implemented in Albania in the last quarter of 1991 (following some irrelevant changes in 1990 for fruit and vegetable prices). A number of adjustments of the official wholesale prices were introduced as the share of price subsidies in the budget increased. The official monthly price index (CPI) for 1991 is an approximate estimation from the Institute of Statistics while a regular one was constructed in 1992 reflecting the price levels mostly in the black markets where the main prices for goods moved up very quickly. As a result CPI increased more than 100 percent during 1991 and 200 percent in the first half of 1992 (see Table 2). Food shortages became even more common, and made the market more dependent on food and humanitarian aid.

In August 1992, as a first step of the short-term emergency program, the government liberalized nearly 75 percent of prices simultaneously with establishing tight policies for domestic credit. The process of freeing prices in Albania was made relatively fast. Considering other government action during 1993, in a nearly two years period, most of the few prices that still remained under control and continued to be subsidized were moved quickly closer to cost recovery levels. This process still continues for a very small number of prices as bread and energy, as well as in services or the so-called non-tradable goods. Total price subsidies in 1993 dropped to 2.2 percent of GDP from 3.6 percent in 1992 and in 1995 represent an insignificant figure.

Obviously the price liberalization process together with other difficulties that characterized macroeconomics situation on the early days of reform program was accompanied by higher rates of inflation. By November 1992 inflation, due to the tight monetary policies in controlling monetary supply, began to show improvement and a relative stability in single digit monthly rates. In production sector agriculture, almost totally privatized, was the first to respond to the price signals, raising the availability of

food in the domestic market. The 1993-year finished with an inflation rate of 30.9 percent, lower than expected. Following by a 15.8 percent in end year of 1994-inflation level has overcome the forecast of 20 percent. The 1995 situation shows a further improvement reaching 6 percent at the end year (see Table 2). Later in the study we shall see that this result was reversed to 17.4 percent for 1996 and further more for the first quarter of 1997.

The process of liberalization extended also to the **external sector and foreign trade**, creating the possibilities for a plausible integration of Albanian economy to the worldwide one. The liberalization program that started at mid-1992 legalized a floating exchange rate with an active market outside the banks and continued to deeper trade reform. Import and export licenses were abolished with the exemption of the export of some food products. The traditional state monopoly on foreign trade was totally removed. No quantitative restrictions on imports existed while export licenses were eliminated together all kinds of export taxes since 1994.

Market access is one of the most important contributions that Western economies could give to the newly emerged economies of the ex-communist countries. The quality of the Albanian goods and services needs to upgrade to the Western standards but the availability of natural resources as chromium, iron/nickel, copper and hydroelectric power, could allow it to enter in these markets. To make possible the growth of the Albanian production a mutual policy of open doors must be applied.

The share of new private sector in foreign trade is becoming relevant covering 80 percent of imports and 50 percent of exports. The initial shock to foreign trade, caused by the collapse of the CMEA and other domestic endogenous factors imposed by the transition, is reflected in the large fall of the volume of exports by 50 percent in 1994. On the contrary, the volume of imports nearly doubled between 1989 and 1995. The structure of the geographical distribution of exports is reversed. According to different Albanian estimations the exports for CMEA countries fell drastically from 46.3 percent of the total exports in 1989 to less than one percent in the end of 1995 (see Table 8). The same reversed situation resulted for imports, which shifted from 44.8 percent to around 10 percent²⁴ for the same years.

While the increase of imports reflects the urgent overall needs of the country to reduce shortages, the decline in exports had its roots mainly in the domestic contraction of output. Moreover, after decades of extremely controlled trade system the rapid liberalization that took place from 1991 so far has created the need for Albanian products to confront with international standards. The ability of these products to compete in the world market is still low. The protection that Albanian goods practically have in the new liberalized system is weak. Traditional exports of

²⁴ Data are from Albanian Center for Foreign Investment Promotion.

products other than minerals and energy, such as manufactured goods or beverages and tobacco, decreased sharply. The inflows of these goods, especially from the countries in the region have strongly competed in the domestic market. A differential tariff system introduced might help to improve the situation.

On the other hand, the rapid trade liberalization might be another repressing factor, although temporary, for export collapse. Besides their low quality, poor package and lack of advertisement it seems that the fast way pursued, without stimulating first any kind of domestic competition, contributed strongly in raising the adjustment costs. Perhaps this might not be the best solution considering the extreme isolation of the country not so long ago. The McKinnon' s conclusion about similar conditions in other transitional economies that: “ A precipitate move to free trade could, therefore, provoke the widespread collapse of domestic manufacturing- no matter how the exchange rate is set, and no matter that some of this industry might eventually be viable at world market prices”(pg. 9), fits well the Albanian situation. The expansion of the private sector and the entrepreneurial spirit of Albanians are expected to improve the situation and to face the challenge that the newly emerging market is offering.

All facts show clearly that the Albanian openness and foreign trade policy are clearly in the favor of a closed cooperation toward integration to the EU countries. Also nothing denies larger possibilities for a further cooperation in the region despite a lot of political and economic difficulties and barriers. If we take a look at the data on Albanian economic development and on the variables that show the openness of the country the main investors in Albania are the European Union neighbor countries. It might be because of the vicinity and traditional pre-communist economic relationship. At the other side, the natural resources have been always complementary for each other and the similarities in culture and mentalities have encouraged the economic relations. All these advantages are reflected in the geographical distribution of foreign investment in Albania during transition. Italy and Greece together covered about 70 percent of the total number of the companies that had invested in Albania by the end of 1995. Italy is clearly the main economic investor in Albania during the transition.

The geographical distribution of trade is addressed mainly to the industrial countries, mostly to Italy and Greece (see Table 9) and also Germany and Turkey. From 1991-1995 trade with European Union countries grew rapidly²⁵. By 1995 they accounted for about 79 percent of the exports and 76 percent of imports. Italy ranked first in 1995 with 51 percent of exports and 37 percent of imports, compared to 9 and 10 percent respectively in 1990. Greece came in a distant second

²⁵ See “Albanian Human Development Report, 1996”, UNDP, Tirana.

with 10 percent of exports and 27 percent of imports, followed by Germany and Turkey: 6 percent exports and 4 percent imports. The beneficial results of this policy for the side of industrial countries are evident from the level of imports. Statistics shows that 82 percent of the total imports of Albania in 1995 came from EU and EFTA countries (see Table 8).

If we look closely at the map of trade distribution evidence show that as exports by the transition countries of region are insignificant, imports represented in 1995 a bigger number (see Table 9). Only Bulgaria covered around 9 percent of Albanian imports. FRY Macedonia and Bulgaria are the most important trade partners of Albania in the region. The vicinity determines this, but also show the willingness of these countries to cooperate.

Sustained growth in particular over the medium term will require substantial investment in infrastructure and human capital as well as the transfer of modern technology from abroad. Considering Albania's financial possibilities and its overall antiquated equipment the role of the foreigners is clearly very important. It must be ranged as one of the most important factors for the recovery and growth prospects of Albania. Furthermore the success of the economic reform in Albania, especially in the first years of transition, depended heavily on foreign capital inflows and foreign expertise.

2.3. Privatization, Employment and the Labor Market

Privatization is considered by a broad consensus as the main action in economic transition toward a market economy. It represents a key issue as the inefficiency of the State-owned Enterprises (SOE) has been clear not only in the East but in West Europe too. The privatization process for the countries of Eastern Europe, where the main part of the assets of the society were state property, has a broader meaning and involves a fundamental transformation of the economy. Under these circumstances the privatization, as Lipton and Sachs (1990) pointed out, represents "a complete redefinition of property rights". Obviously the performance of this action is complex and influences strongly all the other elements of economic reform.

As in all other countries in transition Albania is seriously involved in a privatization program, considering its fast implementation as a priority of the transition²⁶. Alongside the traditional arguments, such as the necessity for free

²⁶ See: Programi afatmesem i Qeverise..., "Rilindja Demokratike", November 26-27, 1993. Yet, the privatization process and especially mass-privatization is emphasized recently as the main economic tools to be solved during 1995-1996.

decisions in the economic field and the need for the economic efficiency, there are several reasons that give this high priority in the Albanian case. One of them is the financial rationale. Under the conditions of a deeply imbalance budget the simple way of applying a hard budget constraint is a fast privatization (Stiglitz 1992). Privatized companies could be no longer a burden to the budget, on the contrary this would generate state incomes by taxes. This is definitely more necessary for Albania where the deterioration of the revenues in the budget is a real threat. There are fewer chances for the weak Albanian finances to subsidize any further losses or arrears of the public sector. If not privatized quickly Albanian industry will need large investments to renew old inherited technologies since serious damages and vandalism on enterprise properties accompanied the deep and drastic political changes. Furthermore, more than in other Eastern European countries, the level of living standard might influence in fueling the corruption, bureaucracy, abuse of services and illegal activities. The postponement of privatization could create high cost in changing the above mentalities that needs much more efforts to adjust in the future. This does not mean that the speedy action could justify the quality errors and the lack of transparency.

Priorities for the privatization are always country-specific. Most governments began by giving priority to the small and medium- size enterprises. Almost the same scheme of selling these enterprises is following by all Eastern European governments. Generally such sales are quickly and simply performed, as they require no or little prior restructuring and small institutional capacity. The same strategy was chosen by Albanian medium-term program of 1993 where all forms of privatization are considered possible. This mixed model includes auction, tender, buy-out process, direct sale, mass privatization with voucher schemes and joint ventures with foreign capital. The speed is designed as the determinant factor of privatization. The speed is designed as the determinant factor of privatization. The speedy performance of the small-scale privatization is considered especially essential in Albania in order to put such assets to more productive use and create more room for efficiency on resource allocation in the market, to remove financial burden from the government and to eliminate the shortages.

Albania began the small-scale privatization process in middle 1991 with the Privatization Law²⁷. The National Agency of Privatization (NAP) was established

²⁷ There is a package of laws that accompany the process of privatization by 1991. Some of them are: - Law on Privatization, no.7512, 10.08.1992, "On Permission and Protection of Private Ownership and Private Activities", -Law on Land, no. 7501, July 1991, -Law on Commercial Companies, no. 7638, 19.12.1992, -Law on Foreign Investment, no. 7496, 8.04.1992, replaced by Law no. 7764, 2.11.1993, -Law on Restitution and Compensation of the Properties of some Ex-proprietors, no. 7698, 15.04.1993, -law on Bankruptcy, no. 7631, 29.10. 1992. Very important was the Decree of Council of Ministers, no. 248, 27.05.1993, "On some measures for accelerating small and medium-size enterprises privatization".

in order to organize and monitor the process. A rapid privatization of small-scale entities in transport, trade and services was implemented before the program of 1992 but many economic and social problems appeared. The political confusion and the lack of civil order that characterized this period made the process of privatization mostly spontaneous. After mid-1992 the small-scale privatization according to a strategy designed by the government²⁸ continued extensively till the beginning of 1994 when it is considered almost completed. Yet a lot of criticism and discussions accompany the process where the "winners" and "losers" claim their rights. This was more dramatic in agriculture because of restitution problems.

Agriculture had already begun to be privatized in mid-1991 when the cooperatives were spontaneously dispersed. Although discords and even violence appeared during the distribution process, by the end of 1993, according to official statistics, 93 percent of cooperative land was privatized²⁹. From this process around 380,000 small farms were created, starting to produce and answering properly to the market signals. According to the new legislation former owners were eligible for financial compensation, but not restitution. During 1995 a new law on land compensation in the seaside zone of the country was approved, smoothing discords and political discussions. However, a significant number of claims by former owners are still outstanding; some have still not been registered, whilst others have not agree the compensation offered.

Privatization of housing started in May 1993 and in the beginning of 1994 it was almost completed. Compared with other countries of Eastern Europe where the private housing sector was more developed, in Albanian urban areas all houses were state properties. In a short time and generally in a democratic way around 200,000 apartments were sold to the citizens. To stimulate the process of house privatization low prices were set. The old apartments built before 1970 were distributed free and the other prices were differentiated by the location, time of construction, store, and area, etc. The citizens on this process benefited a significant amount of incomes.

Apart from unsolved problems the Albanian small-scale privatization in trade, handicrafts, transportation and housing, as well as in agriculture, compared to Balkan ex-communist countries as Bulgaria and Romania³⁰, was implemented relatively fast. The process is continuing in small and medium-size enterprises. The definition of the size of these enterprises was set up in June 1993 in the Decree 248 of the

²⁸ See: Bashkim Kopliku, "Strategjia e Privatizimit", 1994. Tirane.

²⁹ Source for the data in land privatization is from ministry of Agriculture and Nutrition, 1993.

³⁰ For details see: Frydman, Rapaczynski, Earle at al., 1993.

Government where is reflected also the policy and the rules of this privatization³¹. The number of SOEs is accounted at around 1196. The end of 1994 already privatized some 305 enterprises. The auction was selected as the adequate form of privatizing and a transparent way of selling. The government gave the preference to the former owners, ex-political prisoners and ex-persecuted people as well as the present and the former employees. Foreign bidders are considered eligible to the auction.

The privatization of large-scale enterprises includes all enterprises with more than 300 employees and with a value over \$500,000. In the government program mass privatization was foreseen as the main form to be used in that phase. There are around 300 enterprises that are considered as large but some of them are shrinking in order to survive. Under the decree 248 they can treat as medium-size and sold as the others. In February 1995 was announced a presidential Decree about the mass-privatization of enterprises through a voucher distribution system. Foreign capital is invited to take part, as domestic resources are relatively limited. The process of mass-privatization started at the beginning of 1995. During this year was distributed the first wave of vouchers. A new legislation on the Investment Funds was introduced. The first 20 enterprises are privatized under this scheme by 4,100 first shareholders, and the other 50 of them have been finished the process in the same way. The process seemed to proceed successfully; however, a lot of questions and uncertainties are circulating. In the free market the value of vouchers is still too low and the creation of Investment Funds seems to be slow. Obviously, as Fischer (1992) and Stiglitz (1992) pointed out, in such conditions the development of a stock market became urgent in providing more efficiency in capital allocation. Now that we have one its development represent a priority for the economic reform

The structural reform and in particular privatization and restructuring is accompanied with "social costs" concerns **employment and the labor market**. The proper balance between stabilization measures and increase of the efficiency in allocation of labor, remains a challenge for most of the countries in Eastern Europe. Moreover Albania that inherited difficult initial conditions would have a more costly transition. Even with a clear signal of recovery in GDP growth, the new private sector, which according to EBRD account for around 60 percent of GDP, is still weak to absorb the whole excess supply in the labor market as its activities are mainly in services and trade. Expanding domestic and foreign investments is expected to increase the availability of new jobs in the private production sector

To measure the labor market development is very difficult in the absence of data on the private sector's activity. Total **employment** fell substantially

³¹ Under the Decree 248, June 1993, small and medium size enterprises was called every enterprise with fewer than 300 employees or a book value of less than \$500,000.

from 1990 to 1993³². The state sector employment decreased by 50 percent in these three years. Consistent with the output pattern, as in other similar cases (Bruno 1993), the main decline was in industry, while in education and health was almost unchanged. The process of restructuring and reforming the budgetary institutions made possible large reductions of the staff in order to cut further government spending. The privatization of agriculture made difficult the measurement of employment situation among the population in rural areas and the labor mobility between sectors. The private sector, excluding agriculture, employed 124,364 people in 1994 mainly in trade and service sectors³³, which represent 8 percent of the labor force. This figure, however, should be treated as a conservative one because many small firms do not report the real number of employees in order to reduce the tax and insurance payments.

Mainly as a result of the first waves of the economic reform the unemployment rate moved from 10 percent in 1991 to 25 percent at the end of 1992, with more than 400 thousand people unemployed. Official statistics reported the unemployment rate for 1993 at near 20 percent. Some estimation shows that the figure is smaller for 1994 at around 18 percent and even more so for 1995 at 13 percent. Although it seems as a success for the ongoing Albanian economic reform, this rate represents one of the highest levels of unemployment in all Eastern Europe³⁴ but still comparable to some European levels. The situation is more dramatic in the big cities of the country and in industrial regions of the northeast where the main industrial working force was located. Unemployment is mainly widespread among people over middle-aged and poorly educated and woman as well. Unemployment data does not include the labor force that currently is working abroad.

As privatization become more intense the employment fell down. But as private sector of economy expanded it could absorb better the supply of labor force and unemployment also would come down. Observations and statistics of transition period in Albania reveal another phenomena: the share of the long terms unemployed (more than one year) is growing. At the end of 1993 there were 193,000 of them (64% of the total) while at the end of 1994 the number increased to 210,821 (80,5 %). In 1995 it account for a slight decline as 73 %. The increasing of **the long-term unemployment** is an evident signal of the permanent versus temporary one. In that way "transition unemployment" risk to become rather persistent and to have all the characteristics of a stagnant pool. More over, as Boeri (1994) pointed out for other

³² Data on employment are from Institute of Statistics (INSTAT), *Conjuncture*, issues 1994, 1995, and ministry of Labor

³³ Source: INSTAT according to estimations from the Directory of Taxes and Tariffs, Ministry of Finance.

³⁴ See Transition Report, 1995, EBRD.

countries of Eastern Europe, the relative increase of the private sector unemployment in Albania - it account 124,000 people - does not necessarily involve large outflows from unemployment but direct job to job shifts and hiring of new entrance into the labor force.

Tax evasion tendency and informal activities make reporting difficult and private sector employment under evaluated. The tendency toward the long term unemployment and its persistent character might implies a reduction of effective labor supply, increasing flows from unemployment to out of the labor force. However reported labor force decreased in 1995 as people usually do not register as unemployed or work in the informal sector without being registered neither employed nor unemployed. International and domestic migration fuel also statistical errors. Decreasing labor supply may reduce the pressure on the labor market, which is a serious obstacle into the expected recovery after sharp output falls. Self-employment is also a spread phenomenon but unfortunately no data is available.

Active **labor market policies** are needed to reintegrate the long-term unemployed people into the market. Stimulating investment behavior in transition period and other more supply-side policies are clearly a necessity to face the problem. Those are the new post emergency stabilization measures, which recently start in Albania. Retraining long term unemployed people and preparing them for the new market environment is a practice that should continue extensively in the years to come. Another employment policy (Layard and Richter, 1995) could be the involvement of long term unemployed in public works projects. Moreover the establishing and improving the activities of Labor Offices and other new labor market institutions in regions and center could help the process. Considering the Albanian peculiarities of income standard, unemployment benefit system are likely to remain the most important labor market policies in the years to come. Unemployment compensation and the other forms of social assistance were introduced initially by the end of 1991 and revised during 1992 and 1993. The duration of unemployment benefit is one year in which earnings of first sixth months are 70 percent of previous wage followed by 60 percent in the second half. By the end of 1993 together with other benefits, compensations and social security payments it has reached 14.8 percent of GDP. During 1994 around 20 percent of unemployed people received unemployment benefit.

Albania's still low income per capita makes its population particularly vulnerable to the costs of transition. These costs could be extreme without an effective social safety net program. The consensus for the reforms and political sustainability easily could erode. The initial success of the program in maintaining price stability and improving financial situation might be threatened by the poor development of the labor market and poor supply response in particularly in industry. To stimulate an active

labor market and replace the temporary, but absolutely necessary, social protection policy with an adequate social safety net is an ambitious plan for Albanian reform, which might surpass the time of a medium term program and will continue in the years to come.

As mentioned above another factor that influences the reduction of labor force supply is **migration**. Migration in Albania has an ambiguous effect. It serves to reduce the high social tensions in the current large unemployment but also tends to reduce the labor force supply. It accounts for 350-450 thousand people or more than one third of the labor force, working mostly in Italy, Greece and other European countries³⁵. Initiated as a popular unrest against the very low standard of living at the end of 1980s, stimulated further by the ongoing privatization and its inevitable consequences, the migration is having a strong effect on income distribution, on labor market and stabilization. It is not an unknown experience, for Albania and other countries as well.

The difficult transition in Albania is strongly sustained by the large inflows of private remittances and transfers from immigrants working abroad. Estimations show a number of \$ 350-450 million per year, which account for 25 percent of GDP³⁶. They have contributed significantly in helping their families to survive and to promote small businesses. The immigrants cash transfers were also the main source in the parallel foreign exchange market.

2.4. Reform of Institutions and the Legal System.

One of the challenges that are facing Albanian transition is the creation of new market economy institutions. Most of them are initiated in Albania, however, but their activity is still at the beginning. A new legal framework is designed and has begun to operate but the process is carrying difficulties. Some times the laws are complicated and overloaded with difficult terminology and many exemptions. Some of them are copied from the Western models, which make them unrealistic and complicate their implementation in Albanian conditions. They can not reflect particular historical events or cultural attitudes. Rather than borrowing we should develop our own laws, appropriate for our conditions. Nevertheless a very good job is done by the Parliament in creating the proper package of laws, necessary to implement the difficult and

³⁵ This is estimation made by researchers. See for instance Misja, 1994.

³⁶ Source: Report on Human Development, Albania 1995, UNDP, Tirana 1995.

complex period of transition. Improving the legal framework remains a constant goal of Albanian transformation.

Another important issue is the creations of the institutional structures needed to apply these laws. For example there is no experience from the socialist past to solve commercial matters in courts in Albania. Few judges or lawyers are trained in these matters and the interpretation of the new law creates delay, inefficiency and sometimes-arbitrary decisions.

While the financial sector development is still slow in Albania, the need for creating institutions to support the market reform is indispensable. Such government institutions as National Agency for Privatization (NAP), Enterprise Support Unit (ESU), Enterprise Restructuring Agency (ERA), Albanian Center for Foreign Investment Promotion, etc., are playing a regulatory role in introducing market activities but still their contribution is quite pale. Obviously their role will decrease in time as the newly created market economy and the establishment of property rights will strengthened.

Two other important institutional changes are made in Albania in the banking system and tax system. Following a typical centrally planned model the structure of the banking system in Albania began to change substantially by April 1992 when the Central Bank Law and Commercial Banking Law were passed by parliament. A two- tier banking system was created. By 1992 the Bank of Albania (BoA) began fulfilling the functions of a central bank. The National Commercial Bank of Albania (NCBA) was established on January 1, 1993, to unite the functions of the former National Bank of Albania (NBA) and Albanian Commercial Bank (ACB). Also in October 1993 the Bank of Agriculture and Development was restructured and a new Rural Commercial Bank (RCB) began operating. The Savings Bank is already functioning since the end of 1991. Despite the progress made-with substantial technical assistance-a lack of experience in modern banking techniques is evident. Most transactions remain in cash, credit cards use is very limited, and bank services are poor. Cash foreign exchange transactions are more efficiently and competitively in the free market on the street or in some small private cash bureaus. There are not yet domestic private banks and only few foreign banks have entered as joint ventures-Arab Islamic Bank and Italian Albanian Bank. Also some license on private activity has been given to some foreign banks as a Greek bank and a Malaysian one. Progress is made recently establishing the new Tirana Stock Exchange as the first institution of the capital market in the history of Albania.

The tax system in Albania has been modified many times during the transition in order to build a new tax base while the state sector is shrinking. Custom duties were introduced in early 1991. One year later the turnover tax, profit tax and a

small business tax (income tax on individual proprietors) were enacted while social security legislation was modified in October 1993. These taxes have been amended a number of times since their introduction. A value-added tax finally decided to start operating at July 1, 1996 expecting a better implementation of tax collection.

A challenging point in Albanian economic reform is the creation of an adequate social safety net system with its proper institutions. The low level of incomes needs a properly targeted social program in order to reduce the pain caused by the economic reform. The social security system covering pensions, disability and unemployment benefits represented in 1993 a considerable part (around 30 percent) of the total budget expenditures. But given the resource constraints the reform of the social safety net will require a rigorous targeting of benefits and channeling the persons affected by the transition as quickly as possible to the newly emerging private job opportunities. A new Law for Social Insurance was introduced in May 1993 where the social security rate on the wage bills was increased to 33 percent. Despite the mentality barriers the social security payment is trying to be extended to the private sector too.

The state will continue to play an important role in Albania especially in improving the outdated infrastructure. The medium-term government program included a 3-year Public Investment Program (PIP) in close collaboration with the World Bank and other donors. On a preliminary basis, this program provides for an increase in government investment from 4 percent of GDP in 1992 to about 17 percent in 1996. Most of Albanian's public infrastructure is inadequate to support a modern economy. Urgent needs are appearing in electric distribution system, drinking water distribution, road repair, port equipment, telephone system, etc. Lots of development programs supported by different donors are initiated in these fields and are continuing extensively. Given the restricted capacity of the state investments privatizing a part of these sectors still remains the better solution.

2.5. Pattern of Growth during Transition and Factors that determine a Post-Emergency Growth Behavior in Albania

Five years old transition in Central and Eastern Europe accumulated enough experience as to be learned not only by other countries in similar conditions but to anyone that needs any institutional and economic reform. The five-year story of radical changes crossed the earlier academic and theoretical discussions on the speed of economic reform, as about big bang or gradualist approaches, ending to a more pragmatic and practical solutions that the experience itself told to the people and policy makers. This period also pointed out the divergence among countries already emphasized in particular by domestic economists. Now there are not only initial conditions that differ but also many macro and microeconomic issues concerning the further implementation of their economic transformation.

However, an initial macroeconomic shock has been experienced and faced by each country although in different scale. Sharing the opinion of Bruno and Easterly (1995) stabilization did not hurt the transition economies. After arriving at moderate rates of inflation many of them as other cases in the post-crises economic history of the world are having a rapid growth³⁷. Yet this is the case of Albania³⁸. But many lessons are deriving from the emergency stabilization of the first years of transition.

But let see the pattern of GDP growth in Albania during transition period? A sharp output decline has accompanied the early stage of transition in Albania (see Table 1). This is not a lonely experience. It did happen to almost all countries in Eastern and Central Europe. However not each of them had the same size of shrinking³⁹. Albania, from 1990 to the end of 1992, had a high cumulative drop in GDP measured around 50 percent. Recovery started in 1993 after a very difficult and extremely contracted short-term emergencies program. Following the extent of the private sector denied for forty years, GDP growth showed a very good performance. According to official data during the period 1993 to 1995, GDP grew by 31.8 percent in cumulative terms as in 1995 Albania results with the highest growth rate in Eastern Europe, accounting of 13.4 percent. A high number of private businesses are

³⁷ See "From plan to Market", World Development Report 1996, the World Bank, Oxford University Press.

³⁸ In a Figure produced by Bruno and Easterly (1995) about growth and inflation in a group of Transition economies for the period 1992-1993, Albania is located in the middle, certainly after better performed countries of Central Europe but still before Romania, Estonia, Croatia, Russia and other countries of former Soviet Union. The further progress during 1994-96 might have advanced the position of Albania in that Figure for the ongoing years but recent crisis of end 1996 and 1997 might have deteriorated the Albanian position.

³⁹ For a more detailed analyze and data on the subject see "From plan to Market", World Development Report 1996, the World Bank, Oxford University Press.

mushrooming, covering more than 60 percent of GDP and a growing number of employees. Most of them started their contribution in services and trade but recently their activity is extended in food processing, manufacturing, construction and other productive activities.

Despite the impressive recovery the level of GDP at the end of 1995 in constant 1990 prices is still lower than 1990 level. Considering the delayed entering of Albania in economic transformation compared to other Eastern countries the 1991 might be considered as the first year of this process. Only 1992 show the first year of a comprehensive reform program. As Table 1 shows GDP in 1995 reached a higher level relative to 1991. Even the steps seem to be successful GDP recovery is still fragile. Some other reasons might argue this possible statement. If we look more closely to the performance of different economic activities we could see that it had been grown differently. The first that answered to the rapid liberalization and to the market signals was agriculture. First of all, agriculture growth was result of the early, even spontaneous, privatizing process. Albania has a clear comparative advantage in agriculture development in spite of climate and geographical position and very low cost of labor. Moreover food shortages that resulted during first years of transition stimulated agriculture production responding shortly and properly to the highly excessive demand in the market.

Transportation, construction and services are also growing very fast. Starting from a very low base and usually under-evaluated by the planned economy those activities experienced in 1991 a sharp decline. The better performance has construction as the needs for construction materials are increasing rapidly. Services and in particular retail trade has been supportive to the short term growth and output rise, accumulating enough capital for investing in bigger projects. However, data on the growth rate of these sectors since there are almost private, are still estimations.

Industry and manufacturing are the most problematic branches of Albanian economy. Its relative recovery is insignificant showing some positive levels only in 1995 due to the development of the new emerging private sector in the field. There are some factors that influenced the shrinking of the old inherited industrial sector and growth deterioration in the industry so far.

- On the eve of economic transformation Albanian industry was the most outdated and inefficient sector of the economy that meant to large needs for investment which could not being faced by the weak Albanian finances.
- Industry in Albania was linked with the big sized enterprises with overcrowded employees and where the social costs of changing property or restructuring are the highest.

- Being very expensive the restructuring of industry was a delayed action in the Albanian transition. At the old conditions it could not survive in the new environment and while waiting to be privatized it was made possible of many damages and maltreatment of equipment, causing a practical cessation of many productions.
- The process of privatization in industry is based mainly in mass-privatization method, which started only in 1995. This led to a temporary blockade in industrial production because started later than other forms already finished.
- Industry, with some exceptions, does not represent any chief priority in the future's Albanian short and medium term development. According to the size, position and legacy of the country, Albanian industry, in particular big metallurgical, chemical and other mechanical plants have not been attractive to domestic interest and also to the foreign investors.

Recovery in industry is connected with the development of several private activities and reactivation of some mines and energetic sector. Also in manufacturing much progress is appearing especially in small traditional productions using domestic raw materials and the cheap labor force some times in cooperation with foreigners. In food processing as well private sector is booming even trying to enter in the international market. Unfortunately little data is available on the private sector activity.

The output growth is still a discussing question for the Albanian recovery. It is not expected that the capital would be allocated in the same sectors and activities. It seems clear that a reallocation process started during those years of transition toward the most profitable directions determined by the market forces. The ongoing success of the capital reallocation in order to generate a fast growth is depending first of all on the proceedings of macroeconomic stabilization, on the speed and sequencing of the privatization process and on the restructuring efforts of newly privatized Albanian enterprises.

Three blocks of problems concerning growth seems to face the today's Albania:

First, despite the reported official low rate of inflation up to mid 1996 strong and **continuing stabilization measures are still needed**. Notwithstanding a successful start, it is too early to say that stabilization program is over. This is more obvious if we consider the recent crisis of 1997 that could reversed the situation. As Fisher and Gelb (1991) pointed out, the initial success achieved in a short time does not assure the stabilization. Consistent policies over longer periods of time are required.

- Experience shows that the most difficult part is sustaining the low rate of inflation while improving the fiscal situation. But the fiscal situation results still very fragile as signs of increasing inflation are clear.
- The way of financing that deficit is not quite independent from the state banking system and money financing is found always as the easiest way. Easiest but the most threatened for a sustained stabilization.
- All this is connected with the development of financial markets in Albania that are embryonic and rather chaotic. Establishment of institutions in this field is an urgent need.
- Macroeconomic instability can still result from the inability of the new institutions to respond fast in the new market and social context of Albania.
- Although successful the hard budget constraint, credit ceilings and generally the use of direct instruments of monetary control have its influence on supply-side. Especially it might create obstacles for the dynamic part of the economy and above all for the new private sector (Muço 1996).
- To sustain a rapid growth high savings and investment rates are necessary. Data from countries of Eastern and Central Europe show that the size of both is not adequate to sustain a long run growth⁴⁰. In Albania also domestic investment fell rapidly during transition from 26 percent of GDP in 1989 to 4 percent in 1992⁴¹. In 1993 a Public Investment Program (PIP) for 1994-1996 started and investment reached around 10 percent of GDP in 1995. Proper policies to encourage private investment and foreign direct investment are needed in this post emergency time in order to assure sustained growth.

Second, the emergency phase was linked with a rapid liberalization and strong stabilization but without leaving apart the establishment of the property rights. Moving energetically to the privatization and restructuring of the firms and giving more incentives to the investments of private sector should follow quickly stabilization efforts. **Enlarging privatization and dealing more with restructuring and post privatization management of new private firms is the main challenge to be faced.**

- Speed is a very important element to implement mass- privatization program that practically is in the middle way for big and middle-sized enterprises of Albania. It has a significant relevance because of very limited possibilities of Government to

⁴⁰ It is considered that savings generally average at least 25 percent of GDP and investment at least 30 percent in fast-growth periods. In Central and Eastern Europe saving averaged 15 percent of GDP in 1994 and investment 17-18 percent. New Independent States (former Soviet Union) in the same year were close to 20 percent for both savings and investment. See "From Plan to Market", World Development Report 1996, pp. 41-42, The World Bank, Oxford University Press.

⁴¹ Source: Ministry of Finance and IMF Staff estimation.

proceed supporting non-efficient sectors and to prevent further damaging and stealing of assets. However, a speedy action without clear information and strategy and implementation of the privatization program in hurry might cause confusion fueling corruption and fraud.

- Transparency and honesty is still indispensable in accompanying privatization and the reallocation of property rights.
- Monitoring and improving corporate governance remain very important to the enterprises already privatized. The new owners should be enough motivated to use resources efficiently and to rise new one. The ongoing experience has shown clearly that the process is easier in the small firms where the owner is also the manager. In the other cases at the firms with many shareholders monitoring managers is quite a new and challenging experience for the new Albanian owners. These are causing fail or the difficulty to the fast restructuring.

Third, dealing with informal economy and fighting corruption is another area of problems quite evident for the new phase of post-emergency transition close related to economic growth and stability. The new legal framework has gone beyond the initial stage but strengthening and improving it needs still more efforts. **Creating and developing proper market institutions** could help in preventing unreported activities, legal or illegal could be.

- The establishment of informal economy in Albania and its development as a reaction toward the difficulties of transition and soft legal constraints represent a significant economic sector. The impact of this sector in Albanian economy is controversial⁴². It is obvious that it was a contribution to the economic growth during emergency. Initially, using illegal and unreported profits this market supported consumption and the level of aggregate demand, which come deformed from the past. Financing firstly the wholesale traders it started also to be a mechanism for a certain capital (cash) accumulation increasing the possibility to influence the growing supply. Despite the short run positive influence it had in the development of the private sector of the economy is accompanied by some negative consequences. Some of them are: deforming the effects of economic policies, in particular monetary and fiscal; imposing spontaneous and uncontrolled competition for the new entries; minimizing the role of formal sector; carrying a high degree of risk; causing tax evasion and further deterioration of budget deficit; increasing artificially aggregate

⁴² To have a detailed view see Muço and Salko 1996, a study and a survey about informal financial sector in Albania, financed by USAID on behalf of the Albanian Center for Economic Research as part of the project “Hidden barriers to economic growth in Balkan Peninsula”, The Balkan Network. Original data survey and the paper are at Dosje 1/4, “Balkan Network”, 1996, ACER, Tirana, Albania.

demand for consumption by not reflecting the real level of consumption based on the income policy; increasing inflation; etc. It seems that in the long-run informal activities could hurt growth and stability.

- Fighting corruption remains as a strong obligation for the Governments even during post emergency times. When corruption become present the social credibility fall substantially. Corruption appears when both public officials and private agents “have much to gain and little to lose”. Reversing that situation would minimize corruption. Limiting the power through clear rules and liberal regulation could prevent increasing it. An important factor is the income motive: increasing wages of the public servants would cut the attraction of corruption and bribe and fight the mentality of poverty. Making regulations and taxation more simple and clarifying property rights could help private sector and citizens to act without using fraud and corruption.

The pattern of output growth could not be easily monitored without a very good, professional and transparent national accounting system. Few macroeconomic variables, especially of the real sector, are regularly accounted. From the past it is inherited a different system based on the accounting of Net Material Product (NMP) which confuse the comparison and make difficult to set up a reliable time series on growth. IMF at the beginning of economic reform in 1991-1992 introduced the estimation and concept of GDP for the first time. Statistics are still one of the weak points of transition in Albania. Reliability of reported figures could have a negative impact not only to the researchers but also to the credibility and acceptability of the reform by the public. Independence of statistics remains an important issue. At the other side strengthening of statistics through increasing professional abilities of institutions and more investments in technique and human capital would help to improve the situation and to understand better the output pattern.

2.6. Crisis of 1996-1997: Complexity of Reasons versus Simple Financial Looses.

In principle the content of reform program remained the same during 1995. Mass privatization program through vouchers started for enterprises considered by the Decree 248 of Council of Ministers as large enterprises. The first wave of 20 enterprises was privatized followed by other 50 at the second half of 1995 and beginning of 1996 but the market value of vouchers was reported quite low. Despite the establishment of Tirana Stock Exchange these vouchers never entered and traded in this market. They continuously loose value and a lot of distrust by the public

accompanied the process of mass privatization. No any investment fund was created except a foreign license called Anglo-Adriatic that started to collect vouchers. Immigrant remittances and transfers remained a strong determinant in the small-scale investment giving contribution to the balance of payments also.

Nevertheless, a rapid development of private sector was occurred (see Table 5) and comparing to a year before the number of private entities was grown sharply. From the table it is worthwhile to notice that the biggest number of private enterprises operating in Albanian market in 1995 were in trade. It seems that a consuming illusion society started to emerge in the horizon. Despite an impressive economic growth reported officially (see Table 1) at the end 1995, IMF and other organizations cast doubt on the above data. Industry remained problematic and growth in agriculture started to show stability and a non-increasing growth rate tendency. However, inflation and budget deficit remained in acceptable levels better than all forecasts made in the beginning of the program. This was the main target of the short-term program designed by international organizations. Albania began treated as an example of a radical and successful economic reform.

All real transformation and success of Albania were not seriously accompanied by a deep institutional reform. Institutional changes, as the literature describes (Roland, 1994), imply a new constitution, political institutions of the country and the basic rules governing society. Institutional change also implies the setting up of a new tax system, central bank, market regulation, and so on. Lacking tradition of a market economy and a developed democracy, the case of Albanian transformation showed how important is to realize significant institutional changes right at the beginning of the transition process. As Roland (1994) argues this is true for all Eastern European countries in transition because these reforms are likely to bring the highest expected return and further more because institutional change is very risky. Institutional reform was the less developed in Albania in last five years. It might happen because this reform is the most complex, time consuming and costly action in a transition country.

Albania does not have yet its new constitution law and this is still a discussible question among political forces. It started to create political institutions and also a large number of laws regulating political and economic life have been passed in parliaments since 1992. A new tax system, as we tried to describe in the previous sections of this study, has been introduced together with other laws on banking system and market regulation. However the tragic and chaotic events of 1997 tells that the newly emerged institutions in Albania and the overall reform achievements in this field were fragile. Yet, crisis at the end of 1996 and first half of 1997 in Albania could be far more complex. What could be considered as the **main characteristics** of this crisis?

1. A significant **economic deterioration** (see Table 1) has accompanied this period. Budget deficit turned to be higher than in the previous year, 10.1 percent of GDP, as inflation reached 17.4 percent at the end of the year (see Table 2), while estimations for 1997 tells for around 55 percent. Growth of GDP was officially reported to be still high at 14 percent but this is a debatable data if one could see data on growth rates for different products in industry and agriculture. Earlier 1996 data on the current account and trade balance situation tell for a deeper deficit, although recent official data is absent. Domestic currency was further devaluated, around 100 percent in 6 months.

2. An **unprecedented financial crisis** linked with the disruption of the activities made by some pyramid-style investment firms which swallowed almost all domestic savings of the citizens was the main catalytic factor that fueled and speeded up an overall crisis. The main characteristic of the informal credit market before the crisis of 1997 is the high level of interest rates used in this market. Notwithstanding the interest rates for the deposits and credits, for the period 1991-1995 have suffered fluctuations compared to the interests rates that are applied in the informal credit, it have always been around 5 to 6 times lower. The evidence shows also the high risk of this market and the accompanying social problems that created in Albania especially in 1996-1997. In this period the interest rates of the main borrowing firms were competed by some so-called “charity foundations” that started borrowing with incredible high interest rates from the public practicing 30-100 percent monthly interest rates. Those foundations had the appearance of pyramidal schemes known in economic practice of other countries like Russia, Romania, Bulgaria, etc.

3. As main features of the crisis one can see a **combination of political, economic and social factors** that ended up in a political disaster, demise of state and institutions, chaos and violence spread throughout the country. An international military force was decided by UN and OSCE to come in Albania in order to secure international aid and after that to help Albanian police to restore order turning the country in his normal days. The Italians who are playing the most important role in it lead the operation ALBA.

Why the crisis exploded in this period of time when the general results of the reform, as some macroeconomic variables, seem to have reached good levels also appreciated by international organizations? The answer of this question might need some more deep and consistent analysis and also much more time to implement. I

would try to go through briefly leaving this duty to the future studies when more data would be available.

I. Political reasons. In the background of Albanian crisis are many political reasons linked with the lack of democracy in the Albanian past and present history. But the most visible one during 1996-1997 could be considered: **1.** Year 1996 coincided with two very expensive and debatable elections, which made increasing political instability. Political parties started accusing each other for abuse of funds and use of pyramidal schemes for electoral reasons. **2.** For the same electoral reasons political freedom decreased substantially as well as public discussions for economic policy issues trying to create illusions of a very successful economic life and for a society without economic problems. The political party in power, Democratic Party, treated what was considered as economic success, and what was a real one naively and unprofessionally. Still unsolved problems that the Albanian economy has to afford in the coming years, such as privatization, financial system reform and institutional reform, were not posed transparently. **3.** Popular unrest toward government inability to stop corruption, smuggling activities and pyramidal scheme investment with possible illegal activities behind them started to become present since the end of 1996. **4.** Substantial divergence between political parties caused confusion that led to a decrease in the public credibility to economic reform. Boycott of the opposition parties after elections of May 1996 practically blocked the political life in Albania slowing down all other economic measures. These divergences contributed to a large increase of political stability, which is proved to be an important element for a successful economic reform.

II. Economic reasons. First of all Albanian crisis has a very strong economic background that, coinciding with political instability, worsened the situation.

1. Deterioration of budget deficit due to a very weak tax collection showed an urgent need for a deeper institutional reform. **2.** Delayed and not clear privatization actions during 1996 created a non-confidential climate toward economic reform. Non transparent and non-well organized actions by the Ministry in charge of privatization combined with an embryonic and chaotic formal financial market made public indifferent to mass privatization. This was reflected at the market price for vouchers that during 1997 reached a ridiculous value of 1-2 percent. **3.** No substantial changes in the banking sector reform and in the financial reform in general. Banking sector reform started well with the restructuring of the central bank but it did not proceed successfully with the development of the second level commercial banks both by privatizing state banks or licensing new private ones. Informal credit was considered a normal and legal activity and never has been controlled or reported officially. **4.** Inflation increase sharply during 1996-1997 for different reasons: **systemic** as introduction of VAT, further liberalization of prices for bread and some energy prices

like fuels; **economic policy** as increase of money in circulation due to financing of budget deficit through BoA system, distributive activities of uncertain getting-quick-reach borrowing firms through very high interest rates; and **psychological** as political instability, etc.

Some **other economic problems**, however, could be at the *roots* of the dramatic situation in Albania. Its transformation might be one of the most painful transitions in the CEE countries due to the vulnerability of broad groups of population living for a long time in poverty. As we tried to analyze in the first chapter of this study Albania has the lowest economic base inherited from the past, a virtual outdated banking sector, an absent capital market and quite underdeveloped institutions. A very weak imposition of the fiscal reform and a weak tax administration has its roots both in institutional weaknesses and in the past. Albanian economic reform started well but a long-lasting very tight monetary, credit and income policies that stabilized macroeconomic variables was developed under the pressure of a very low standard of living that ended to “reform fatigue”. Most energetic social measures, supply side efforts combined with a more liberal income policy might become fruitful in Albanian case. High unemployment as a broad range of incomes was based on emigrant remittances and other foreign incomes was and continues to be a cornerstone for Albanian transition. A widespread corruption in the public services and the unclear legal framework and not well- defined government actions against corruption and illegal credit activities fueled dishonesty and a fraudulent economy. Flourishing of informal activities in particular in financial sector (forex market, voucher market, credit market) created big illusions by the public for an easy welfare economy.

The number of individuals that resulted at the beginning of 1997 giving their savings with interest into the informal sector was very high including almost all Albanian families and some times the emigrants. Even without measuring precisely the size of unofficial economy, and in the absence of proper data and serious information, from early surveys and studies⁴³ arise the conclusion that the impact of this sector in Albanian economy is connected with its length of time and its size. Initially, using illegal profits this market supported consumption and the level of aggregate demand, which come deformed from the past. As appeared long lasting and extremely widespread become dangerous and generated a profound financial crisis in Albania.

Differently from other countries that have experienced financial loses in the informal market, the **dispersing character** of this phenomenon in Albania is not

⁴³. See: Marta Muço and Drini Salko, “Some Issues on the Development of Informal Financial Sector in Albania”, Albanian Center for Economic Research, Project “Hidden Barriers to Economic Growth”, carried by Balkan Network and financed by USAID, 1996

linked only with a naive perception to the capitalist rules of the game. Neither could be consider as a national stupidity. In this financial disaster political factors as political legitimacy have their place. Approving the fact with silence or not reacting negatively was the attitude of political forces and the government for gaining political credit by the poor people who some times considered the interest earnings on their small savings as the only mean to survive in the new “market” environment.

As the result is quite depressing it is still to early and very difficult to analyze the activity of the money borrowing companies when there is still no concrete information on them. They did not report their sources of capital and did not publish their accounts. The firms were considered to conduct “normal business activity” while borrowing money to raise their capital and to implement their increasing investments. Their borrowing activity has its legal base at the rules of Albanian Civil Code that considered normal a mutual agreement between the borrower and the lender. Such a statement was repeated often as a point of reference to legitimate this activity. Officially they have been considered as the first Albanian capitalists and usually they had government moral support. They actively helped electoral campaign during 1996 sponsoring a lot of activities in particular those organized by the Democratic Party. At the other side they have been quite popular, as they have contributed for some years in smoothing transition pain coming mainly from unemployment and a very rigid income policy. Distributing high interest for savings they became very soon a good source for many Albanian families.

During 1992-1994 the use of informal credit was dominant mainly by the private subjects that operated in the wholesale trading of goods and in the service sector. Later in 1995-1996 some relatively big firms were using the major part of these savings concentrating the informal credit market in few hands. They have bought parts or whole enterprises, ex-state properties that needed reconstruction (such as VEFA, GJALLICA, KAMBERI, etc.). Foundations represent a different story since they have no any real economic activity except collecting and distributing money. Their activity is rather new compared to companies that have a certain activity.

Notwithstanding the virtual absence of data on companies’ and foundations’ activity it is believed that they have absorbed more than US\$ 1.2 billion⁴⁴. This is much bigger than the whole amount of foreign direct investment in Albania in those five years, or both trade deficit and budget deficit. The frozen deposits of two foundations (Xhaferi and Populli) on 21 January 1997 were reported to be US\$ 250 million without mentioned here Sude who got bankrupt in December.

⁴⁴. Albanian media has mentioned an amount of US\$ 2 billion but in the Annual Meeting of EBRD in London, April 1997, the Minister of Finances Malaj declared an approximate amount of US\$ 1.2 billion. Still this is debatable since a transparent verification of the whole firms or foundations that have used informal credit is just announced by a Law approved recently in Parliament.

It is still unknown the real amount of money that Sude has collected by the public. It supposed to be bigger than the two first since she started her “pyramidal game” three years earlier and her interest rates at the end of the story were from 15 to 100 percent monthly. The biggest firms as Vefa, Gjallica, Kamberi, Silva, are estimated to have been collected from US\$ 50 million to 400 million each. The smallest firms like Cenaj, Leka, Grunjasi, Blini, Bendo, Arkond are never reported, even when someone declared bankruptcy. However no one could say anything on the exactly inflow and outflow of money in those companies and the real level of their liquidity power.

If we take a look at the beginning of Albanian unprecedented crisis, in October 1996, after meeting with IMF experts, Minister of Finance called attention in media to the uncertainty and danger of the borrowing money firms and foundations. Meanwhile the government undertook no legal measure. During the last quarter of 1996, Xhaferri and Populli foundations increased their interest rates to 100 percent per month for three-month deposits while Sude offered 50 percent per month interest. Such an attractive interest rates in these foundations caused gathering of citizen's savings of several million of US dollars in a short time. In December 1996 Sude failed to pay her creditors and broke several times the deadline settled by her. In early January she announced her bankruptcy and, as a result of a large popular unrest, on 18 January she was arrested and placed in jail. Her creditors time after time protested against Sude, launching anti-government slogans. Nothing was said so far about her activity and where the money ended. Sude enigma still exists. Meantime, still in December one investment firms, Gjallica, with the headquarters in Vlora (SouthWest) showed the first financial difficulties and in February one of her coo-presidents announced bankruptcy. In January 1996 bank of Albania restricted the daily withdrawing of the foundations and companies up to a limit of US\$ 300,000. Companies complained for such a restriction. As the phenomenon started to become dangerously uncontrolled the parliament approved the law to establish a special commission to investigate the character of the money borrowing foundations and companies. This commission was to verify the source of their capital and if they operate as genuine “pyramid schemes” or not. As in middle of January government froze the current account deposits in the two state owned banks of the two foundations, Xhaferri and Populli, worth US\$ 250 million, a big wave of protests exploded asking government to resign. Their creditors reached 360,000 for both foundations.

The biggest borrowing company is Vefa. Only in 25 April 1997 was published a superficial report on her financial situation on her activity by the supervising commission approved by parliament in January. It resulted that this

company owes US\$ 400 million to 86,500 creditors⁴⁵. This company has started her activity in 1992 and owes, according to this report, around US\$ 500 million real estate and investment. At the time the balance sheet of 1996 for the company was not ready yet. Her liquidity crisis as well as other firm's crisis is quite evident. Recently in order to clarify all what happened in those firms and where the money are invested or spent the parliament approved a law asking for transparent investigation on firm's economic activity. The law will give to the public a possibility for highlighting circumstances of this national economic disaster that swallowed all their savings.

There are a lot of reasons that created a warm bed for **illegal activities, smuggling and illegal traffics** that are likely to be behind companies' funds. Geographic position and vicinity with Italian Mafia favored such activities. Albania is a small country but just in the crossroad between Islamic and Western worlds, Western Europe and Southeast. An easy passing through Albania could allow illegal traffics to the heart of Europe. Despite Albanian government commitment disturbed situation in the region, as war in ex-Yugoslavia and a prolonged embargo also favored different traffics, especially for fuel, passing from Greece or Turkey to ex-Yugoslavia. Taking advantage from this situation a lot of profits flow in Albania from 1993 to 1995. All this became possible by the weak legal system and also deep poverty especially in some border areas. At the other hand openness of the country found unprepared managers, lack of skills and experience in management of private activities and lack of knowledge about business risks in a capitalist economy.

⁴⁵ . See: "Daily News", 25.04.1997, Tirana or "Koha Jone", 24.04.1997 according to the report of the extra-parliamentary supervising commission has compiled and signed in 25.03 1997.

Chapter 3

POLITICAL CONSTRAINTS AND MENTALITY BARRIERS TO THE ALBANIAN ECONOMIC REFORM.

It is widely accepted by the literature and many researchers that despite their common heritage of party-state domination, the ex-communist countries of Eastern Europe confront different macroeconomic, structural, institutional and political problems. This results from their different heritage of economic policies and political developments. Furthermore this reflects their history and traditions in their economic and social life. The ongoing economic reform in the region can not be treated and discussed separately from institutional, political and social developments, which are mostly different. The differences give a certain degree of originality to the transition experiences in each of those countries, affecting the speed of reform and its level of radical changes towards the market economy.

In this context Albania should be treated as a unique case, despite similarities in micro and macroeconomic current shortages or in other fields discussed in the first section of this study. Yet, Albania's geographic position and history have set it apart to the rest of Eastern Europe. It has always been a battleground, located as it is between Europe and Asia, between Europeans and the Slavs, and between Christianity and Islam. Albania has endured long invasions but always fought for survival. These events have left their mark on the mentality and traditions of this nation and have influenced both politics and economics.

Peculiarities of the economic transition in Albania are strongly determined by political and social components. Although their close connection is also present in other economies of transition, in Albania these components are placed in a unique course with peculiarities that reflect the past and the present of the country. This study tries to highlight some political and social issues that interfering with economic transition makes it difficult and unique. To better understand the process and analyze political constraints and other barriers to Albanian economic reform let see first differences and similarities between Albania and other countries.

3.1. What Makes Albania Different and Similar to Other Central and Eastern European Countries.

To make a comparative evaluation of Albania and other Central and Eastern European countries⁴⁶ and discover their different patterns and their similarities in economic transformation requires specific criteria to use in making the comparison. The variables to look for are numerous and of large variety. Entering in details we can see a lot of other partial similarities or differences and every further classification needs other useful criteria. For this reason I shall try to emphasize only some **main economic, political and social aspects** of Albanian reality that set it apart from all the others and certainly affects its transition.

First, the delayed entering.

Albania was the last East European country after Berlin wall fell to undertake political and economic change. The conservative attitude opposing change was even more rigid than elsewhere. In many other former communist countries, reforms to adjust the old system had already begun during the eighties (without mentioned here Hungary which began in 1968). **In Albania only sporadic and isolated attempts at opposition, openness and reform were made⁴⁷.** Cultural, artistic and intellectual dissent was always present but never well organized and coherent. The weak democratic traditions and the scarce accompanied institutions were totally repressed by the totalitarian society adopted during the socialist era (Biberaj, 1990). The trade union movement and organization was part of the old ideological system and collapsed with it leaving an empty space, so a new experience is going to be established here. Further more, since 1967, it was the only country that proclaimed itself atheist and all kinds of religion practices were forbidden. All these make the Albanian political and institutional transition different and more complex. However, the delayed enter of Albania in the process of transformation gave a chance to learn from the experience of the other ex-socialist countries non-repeating their possible errors.

⁴⁶ In this part of the study we take in consideration for comparison countries of Central and Eastern Europe non enclosing New Independent States and countries derived from the former Yugoslavia because of some other specifics they show in their transformation path.

⁴⁷ In many cases the opposition raised against the old regime was merely a struggle for personal power rather than a struggle for democracy. However, the need for changes was more evident after the 1980, when the stagnation and shortages begun.

Second, the shock of a fast change.

The collapse of communism in Albania came about very rapidly⁴⁸ and without pre preparing processes neither in the political aspect nor in the economic one. Some limited reforms at the end of 1980s with their paradoxical name “New Economic Mechanism” borrowed by some early Hungarian reforms, accelerated economic crisis. In a year and a half-from December 1990 to March 1992 when the Democratic Party won the elections-Albanian society witnessed a change from rigid communism to a multi-party system, sanctioning private property, freedom of speech and of the press, freedom to move and live anywhere in the country, freedom to travel abroad, etc. **This pace of radical change and the lack of experience and adequate preparation for it have led to many errors.** A new populist mentality grew; social violence raged; the idea that in order to move ahead everything of the past must first be destroyed reigned; social uncertainty had increased while the legal system was still weak. As a result of the political chaos and the speed of changes the land was abandoned and production was paralyzed for at least two years; the illusion of the "golden spoon" was being perpetuated⁴⁹. All this, tended to bring to disrepute the original intentions of the Albanian economic transformation, and created room for delusion and less credibility. The tendency to switch on extreme reversal positions in political and economic decisions shows a degree of amateurism, making Albanian reform more unique and the economic stabilization and liberalization more difficult.

Third, adoption to the openness.

While timid steps were being taken towards openness in other Eastern countries, especially after the sixties, Albania adopted an even more rigidly isolationist and centralist line in political and economic policy. Foreign investment was cautiously encouraged in other former socialist countries, but law in Albania prohibited it from 1978 to 1990. These well-known facts are relevant in highlighting the differences that Albania shows towards other countries with similar initial political and economic conditions. **Nowadays the doors are opening flung but the consequences of isolation are still there.** It takes time for the economy and for the whole social life to adapt correctly and fully to the new conditions. Although the Albanian human possibilities to be adopted are higher enough, the production structure, the

⁴⁸ The process of change in Albania was sparked by student protests in November 1990. The outcome was the formation of the Democratic Party in December of the same year, and the proclamation of the multi-party system.

⁴⁹ After the Second World War and the victory of communism, Albania as several other countries shared the illusion that the communist system was the most just and efficient. This illusion of well being for all was symbolized by the promise that every one would eat with a "golden spoon". Now that the system is changing, a similar illusion, especially in the beginning, appeared: capitalism is considered a kind of "deus ex machina" that will miraculously solve all problems overnight.

macroeconomic situation, and above all the institutional restructuring will face obviously a more difficult time than in other ex-communist countries. In front of Albania, now more than ever, are unfolded a lot of choices to adopt the proper model, to determine its priorities, as well as timing and sequencing of economic reform. But this is a complex and non-easy task. Due to its long isolation Albania has not been a member of any international economic institutions. After the reform began, Albania overcame the isolation and restructured good relations with them but it still suffers the lack of experience. Foreign advisers and technical assistance are playing a very important role and usually are very competent but, considering also the low level of knowledge inherited, they know little about Albanian specifics. Albania has to prepare, as soon as possible, its own policy makers who know the concrete conditions and can make the right policy choices. This process has already begun but training such a class of managers and specialists for implementing the task still takes time and investment.

Fourth, lower level of economic development.

Even during the old regime Albania has the lowest level of economic development in Eastern Europe, non-implying here for just growth rates which up to 1970s were relatively high in similar levels to other ex-communist countries. Level of economic development meant also old economic structures in particular virtual outdated technological level. The reasons for all that backwardness are in Albanian distant past with complex historic and social factors but also in its socialist legacy with its inability to increase the economic level. Compared to what other reforms in Eastern Europe found the Albanian pre-reform economic base is less developed. Obviously this delays the economic recovery and makes the transition more difficult. Furthermore, the efficiency of Albanian industry and the level of its obsolete technology are even lower to any post-communist economy. Compared with Bulgaria the capital productivity of Albania during 1981-1989 was twice as low for the same period, and compared to Czechoslovakia, it had to invest, on average, almost 10 percent more of its NMP than Czechoslovakia each year, to compensate for lower productivity⁵⁰. The same picture emerged for Albanian agriculture productivity. As a result, Albania's competitiveness on the open market is also low. The new risks of the market should drive many firms to bankruptcy. The rapid openness to the world economy while the quality of products was very low ruined traditional Albanian products. There is some trade advantage in Albanian's location, as well as the rich natural resources owned. Albania's geographical position between Greece and Italy facilitates the inflow of capital from industrialized EC countries but the inflow of goods from the neighborhood competes virtually all Albanian products, which tend to be low quality. Because a large part of the newly

⁵⁰ See: IMF, Blejer at al., 1992, "Albania: from isolation toward reform". pp.25-26.

liberalized trade is developed between these countries, they influence considerably the Albanian exchange rates and its inflation.

Fifth, social peculiarities.

Albania faces enormous social problems. Two are more visible in comparison with other transitional countries: high levels of unemployment and in close connection with it the lowest level of the standard of living. There are some unique features that stimulate the situation.

1. The majority of the Albanian population-more than 60 percent-lives in villages⁵¹. After the political upheaval, land distribution began and is almost finished. But as the per capita quota of land is small, distribution set off mass migrations of farmers to the cities. Unfortunately no data to illustrate the phenomenon are available here but the new democratic law of freedom to chose stimulates explicitly large movements.
2. Furthermore, because of the lack of family planning, Albania had one of the highest rates of the population growth in Europe: in the last two decades, the rate has varied from 2 to 2.2 percent. For the first time, this figure dropped to 1.9 percent in 1989-90⁵², but the consequences of the former high growth rates will be felt in the future.
3. The process of privatization and restructuring of the economy, the break through of industrial production and a clear inefficiency of the public sector together with necessary reduction of expenses in the budget accelerated more than in any country the problem of unemployment. In 1993 official statistics account an unemployment rate of 23.5 percent which was the highest among Eastern European countries. In 1996 official data show a lower level of 12.4 percent⁵³ which is more or less on the European standard but still high if considering the emigrants that are not included. All these factors together make the problem of unemployment a sword of Damocles for Albanian economic transition. A spontaneous solution that tends to smooth the problem is the **massive migration**. Unpublished data and some researchers (Misja 1994) imply around one half million people or about one fourth of the working force migrating in search for a job. The massive migration, especially to the neighboring countries, tended to improve the situation but it is still not changing the core of the problem since the reform and the ongoing privatization should continue. This might ask the application of a more supply-oriented policy then in other

⁵¹ Source: Statistical Yearbook of Albania, 1991, p. 35. In 1990, 36.1 percent of the population lived in cities and 63.9 percent in villages.

⁵² Source: Statistical Yearbook of Albania, 1991, p. 41.

⁵³ Source: INSTAT, 1996.

countries of similar conditions, creating the possibility to absorb the excess of labor supply.

Along with other inherited elements this situation is reflected in the level of the standard of living as a deeper analyze of which could be subject of another study. Yet, it has to be mentioned that according to the international institution evaluations, although there are some improvements, Albania represents one of the poorest countries in Europe. In 1993 GDP per capita reached \$422⁵⁴. In 1995 and 1996 this data shows an increase around twice but still far from the European standards.

Taking in consideration the above specifics and looking more closely to the initial conditions and other variables and criteria, **Albanian case could be classified in different positions** toward other countries of Central and Eastern Europe:

- According to the level of economic development in general Albania **could be gathered with other Balkan states**, Romania, Bulgaria, etc, already used by other researchers, and **recently called as South Eastern Europe**. The logic of this classification, besides geostrategic elements as their location in the same peninsula, consists in their common history, with their undeniable legacy from the long Ottoman invasion. This is not a mere historical fact but, for one who knows something from the economic, political and social history of these countries, it is a strong determinant on the level of their economic performance, working attitude and mentality⁵⁵. Without over evaluating this factor while countries of Central Europe confronted their first economic stabilization during 1922-1927, and their growth performance was not different from that of the world⁵⁶, Albania was still fighting to win its first democratic revolution and the integrity of the country was still seriously threatened. Considering these facts, Albania can be compared with other countries of the Balkans even though its standard of living before the reform took place was lower.
- Albania can be classified as a country that **faced an urgent internal stabilization problem at the start of its reforms**. At this point it is similar with Poland,

⁵⁴ See: "Albania and the World Bank. Building the Future", Washington D.C., 1994.

⁵⁵ Albania became an independent in 1912 after five century of Ottoman rule. From that period Albania inherited the Muslim religion imposed on 70 percent of its population, and the overall feudal legacy of ownership and state organization, combined with a very low base of economic development. Bulgaria and Romania have suffered more or less the same.

⁵⁶ For a detailed explanation see: Blanchard at al., 1991, pg. 60.

Romania and Bulgaria (Balkerowicz and Gelb, 1994) which suffered the same problems. In all these countries the weakening of the old regime and following political changes showed a progressive loss of economic control and financial discipline, as we mentioned earlier for Albania. Sharp macroeconomic imbalance and deep disequilibrium because of deformed demand and narrowed supply were accompanied by growing consumption⁵⁷ toward substantially contracted production. Cumulative drop of production in 1992 resulted over 50 percent as inflation was of three digit number and budget deficit was 44 percent of GDP (cash basis)⁵⁸ The stabilization problem resulted less urgent in Czechoslovakia and Hungary⁵⁹.

- Different countries could be classified **according to time strategies of the reform** they have applied while the outcomes, the new established market economy and the proper institutions, are expected to be essentially the same. Sharing the opinion with Gomulka (1994), we can divide these strategies as: **A)**- shock therapy or big bang, **B)**- controlled shock, **C)**- semi gradual and **D)**- gradual. The position of Albania could be ranged between B and C. In this interval, with some differences, are most of the East European countries while A might be proper for East Germany and D for China. It seems that Albania was proceeding in a strategy nearly a "minimum bang"(Williamson J.1991, Clague 1992). Appearing mostly like the Polish case, however, it was not in B where Poland was and also was not in C where Hungary might be. Partial similarities on the strategy applied in specific elements of Albanian economic reform, for instance stabilization or privatization, could be found in Bulgarian, Romanian or even Czech experience. Nevertheless, according to the radical character of the transformation and its first results, Albania could be ranged between successful reformers. Yet situation has changed after the recent 1997 crisis.
- It is true that, compared with its size, Albania started its economic transformation with a considerable **external debt** of around \$500 million, which accelerates the macroeconomic instability. Situation of the foreign debt on the eve of economic reform at different countries of Central and Eastern Europe seems to be different. Share of Albanian debt to GDP looks more near Czechoslovakia than Poland, Bulgaria and Hungary. Still far from Romania that inherited almost nothing as foreign debt. Solving partially in fall 1995 the foreign debt, created mostly from

⁵⁷ This is according to Albanian estimations. See: Statistical Yearbook of Albania, 1991, pp. 133, 357.

⁵⁸ For detailed information see: "Albania", IMF Review, 5, 1994, Washington D.C.

⁵⁹ For instance see some of reports published in Portes, ed. 1993, "Economic Transformation in Central Europe: A Progress Report", CEPR and European Communities.

1989 to 1992, Albania could be in more favored position concerning foreign accounts. At the other side, in terms of **external economic relations**, the CMEA cessation was an external shock for the Albanian economy but obviously was not so serious as for Bulgaria and Czechoslovakia where entire branches of industry or agriculture were specialized to export in the region especially in the former USSR.

- As with Poland, Bulgaria and Romania, Albania suffered a considerable **political instability**, mostly in the first two years of reform, with many changes in government in a short time. Democratic practice still remained weak during transition time (Pashko 1996). Moreover the story had not finished for Albania. The recent crisis of 1997 shows the mutual impact that political instability, lack of democracy and economic problems could produce and block the economic development. On the other side Albanian economic transformation happened along with other intense political events in the region. War in Bosnia and the impositions of sanctions on Yugoslavia affected Albania as well as Hungary, Romania and Bulgaria. Meanwhile, as in other Balkan states, minority problems and nationalist feelings have a considerable impact on politics and raise tensions in the region complicating economic solutions for the plausible recovery.

Using more detailed criteria would discover many other similarities and differences non-described here. After all the above factors are plenty to reach the conclusion that Albanian transition toward market economy along with similarities has its unique character. As a conclusion, one could say that all these facts influence the Albanian transition in different ways; however, it makes it unique. This conclusion implies the idea already accepted by the literature that large schemes and standard packages of stabilization and restructuring proposed by international institutions have to take these specifics into consideration to get the better result and facilitate the painful transformation process. Furthermore, the application of economic transformation schemes, carrying clear political and social dimensions need a large degree of political support.

3.2. The New Role of Politics in the Economic Life: Political Constraints.

As time passes for the countries involved in the transition to a market economy, the importance of political sustainability of economic reform surfaces. A wider area, sometimes called "new political economy" is becoming more interesting for researchers. In a volume edited by Williamson (1994) as in the Kornai's work (1990) and also in some articles written by Rodrik (1993), Roland (1993, 1994), Dewatripoint

and Roland (1992a, b), Coricelli and Millesì-Ferreti (1993), Bruno (1993), Wyplosz (1993), Gomulka (1994), etc., the interaction between political and institutional factors and macroeconomic policy choices is discussed extensively. All this literature, as well as the experience of the first years of transition in Eastern Europe, although the issue is far more general, emphasizes the complexity of the interactions, especially during the implementation of a stabilization package and the design of the speed, sequencing of reforms and the role of state in transition.

In the case of Albania, economic policy is determined endogenously as an outcome of the interaction among all the above factors. Exogenous agents, however, such as external assistance or international political events, might have a considerable effect on the policy choices. International economic support, after the political changes took place, still has a large positive effect in decreasing political tensions and improving financial situation. The tolerant attitude towards large waves of Albanian migrants in the early days of transition, in particular by neighbor countries, Italy and Greece, is another relevant contribution in reducing social discontent and unemployment. At the other side, the political situation in Balkan region: the political instability and war in former Yugoslavia, and several tensions caused by old minority discussions, have their negative effects on Albanian transition.

Although exogenous elements have a great importance, endogenous factors have a clear priority in defining the well-going economic transformations. **The political feasibility and credibility of reform, as a very active endogenous factor, interplay between initial conditions, institutional structure and stabilization programs.** A politically sustainable reform package can be defined (Asilis and Milesi-Ferreti, 1994), as one for which there is sufficient political support to carry out the reforms to their implementation. This political support can take various forms:

1. Number of re-elections and changes in government in a certain period,
2. Parliamentary support for reforms, especially in creating the necessary legal framework and proper institutions,
3. Large degree of social acceptability and credibility.

How are these working in the Albanian case?

First, Following the changes that Albania witnessed after the replacement of its 45 years old Enver Hoxha' communist leadership by Ramiz Alia, on March 31,1991, enforced by political and economic circumstances in the country and in the ex-communist block, the country had its first free democratic elections since 1920s⁶⁰.

⁶⁰ These elections restored the power of the old Party of Labor of Albania, ex-communist party, but revealed a sharp divide between town and country. The main urban areas opposed to the new

From December 1990 to March 1992, at the second **parliamentary elections** four governments were changed, reflecting a large political instability. Political instability had dramatic reflection in economy. Obviously the uncertainty and tensions raised and the production was practically blocked. Legal system was already inadequate with new political structures that were creating and with new emerged market economy relations. Reform program initiated during 1991 by the Government of Stability, second after the elections ceased for four months because of discords between political parties. This period, although it represents the first serious effort for an economic transformation of Albania toward market economy, was accompanied mostly with confusion and half measures without a clear and transparent economic strategy. Moreover the difficult state of inherited crisis aggravated the situation. A rise in inflation expectations and a virtual drop in production accompanied both electoral campaigns⁶¹. In this situation the propensity of state enterprises to adjust to the economic and political changes fell sharply. After the second parliamentary elections political changes were smaller and with a lower intensity. The last government that resulted from the solid victory of Democratic Party, the main anticommunist opposition was formed on April 13, 1992 but reshuffled on April 6 1993. At the end of 1994 it changed considerably again. The referendum on Constitution failed for Democratic Party forces and it was a sign for a lower political support by population especially to the most sensitive points of the overall transformation, means economic reform⁶². Changes in the government come after that showing a reflection by political forces in power and their firmness to continue the ongoing reform. Thus, from the elections of 1992 up to mid 1995 several changes took place included three ministers of Finance and three governors of the Bank of Albania. Involving of Albania in a serious program reform after 1992 and its apparent progress until the 1996 elections reflected to some extent the more stabilized political situation. However the most debatable reform issues showed controversial political positions inside and outside

government with the majority of votes. A general strike in May forced the government of F. Nano to resign. As a result a multi-party coalition government, named the Government of National Stability, was formed. That government collapsed in December, when the Democratic Party, the main opposition withdrew its representatives. This caused a parliamentary crisis and brought about new elections. Meanwhile, a government of technocrats, till March 22, 1992 leaded country, when the new elections gave power to the Democratic Party with a solidly majority of votes. The Democratic Party (DP) won 92 seats in the People's Assembly, the Socialist Party (SP), as the PLA renamed itself at its tenth congress in June 1991, won 38 seats, the Social-Democratic Party (SDP) seven, The Union for Human Rights (UHR) which represent the Greek minority, two, and Republican Party one. From 1992 to 1994 several deputies announced themselves "independent". Some of them are members of the recently created Party of Democratic Alliance, and some others are part of the right wing of DP, which support the old pre-war nationalist Albanian Movement.

⁶¹ According to official statistics in 1991 GDP decreased by around 30 percent, as in 1992 by 10 percent more. Inflation at the end of 1991 was 104 percent as at the end of 1992, 237 percent. (INSTAT and BoA, 1994)

⁶² For a detailed political analyze of this failure see Vickers and Pettifer, 1997, pp. 258-265.

political parties in that period. Poverty, unemployment and particularly privatization and restitution problems were centered in political discussions highlighting controversies and giving signs for future plausible crisis. Voices of a superficial economic success started to cast doubt on what has been achieved⁶³. New ordinary elections caused an enormous discussion not only inside the Albanian political circle but outside also, in European Council, OSCE, State Department in USA, government of member countries of EU, various international organizations. Albanian political opposition and international observers reported a lot of fraud and irregularities as well. In the new parliament were 122 seats out of 140 taken by Democratic Party, 9 by Socialist Party but always empty, and 9 others as Republicans, Human Rights Party, old nationalistic movement Party, etc. After this one-party parliament and opposition boycott it is too difficult to speak for political parliamentary support to the economic reform. After a deep political, economic and institutional crisis at the end 1996 and half 1997 re-elections will take place at the end of July 1997. Political instability is more present than ever. As a result economic deterioration and confusion is accompanying Albanian transition.

Second, Despite this political instability in the first years of Albanian economic transformation, in both parliaments of 1991 to 1996 periods, **parliamentary support** for the core of reforms was relatively high. The last parliament of 1996 was almost one color that did not create problems and discussions. As for political problems some extreme contrasting positions between political parties in power and in opposition were demonstrated, for economic issues with technical character more consensus and agreement were showed. Legal framework created during these years consists of many laws where all parliamentary forces, even in different scale, have contributed enormously. This is a result of the fact that the necessity of a transition process toward a market economy, though in different nuances, is reflected in all programs of the main different political parties, position and opposition, including the Socialist Party, the successor of the old Party of Labor of Albania. The natural differences and controversies between them reflect, though still palely, the interests of different social stratum in the Albanian society they have chosen to represent. At the other side, relative convergence of their ideas about some main points of economic reform, especially about emergency phase of stabilization, and clear lack of alternatives, is based also on the scarcity of theoretical knowledge and experience about market economy. Differently from some other countries of Eastern Europe that are passing through comparable processes, theoretical discussions about the roads of reform, strategies and separated elements of it, appeared lately in Albanian press, both of

⁶³ See for instance interview by Gramoz Pashko in Vickers and Pettifer, 1997, pg.242.

political parties or independent. These discussions, when it was one, remained mainly in closed cycles, on high hierarchy levels of government or political parties. On the eve of reform, following the old totalitarian 45 years tradition, economic thought showed a propagandistic character and to some extends a populist one. It had not a theoretical and debatable rationale politicizing unnecessarily technical and economic aspects of reform. While deepening the transformation and consolidating institutions expectations of diversities between political forces increase as the social interests of their electorate outline better. For instance, in Albanian case where inherited a total vacuum on property rights and their regulation, at the beginning elements that separated political and economic considerations on the subject, was less in number. All together agreed to privatize with all means but when the process threatened the interest of certain social groups because of non-transparency and dishonesty their representative political parties, where had, started discussions and discords. Initial general agreement and support in the main points of economic reform shows also the urgent need of the country for recovery and for a better standard of living that was evident for all political parliamentary forces and Albanian electorate.

After May1996 events political debate on the eligibility of elections were culminated with opposition parties boycott in the parliament. Despite some mini-parties that were present the main opposition forces did not take part in the approval process of economic laws. This creates a vacuum and loosing of credibility and legitimacy leading to a further political instability. Years 1996-1997 represent a difficult period of political discords that is a serious obstacle in the ongoing economic reform. It contributed in slowing down economic reform or making it from already debatable in some points, to an illegitimate one.

Third, The degree of social acceptability, political support and credibility of an economic reform especially of an overthrow of large dimensions as it was the Albanian case, is an important determinant to the success of it. At this point more interested is in particular the political force that makes transformations, represented by the government, as opposition has always a favored role of the criticizer. It is already accepted by the literature and researchers that the level of public support for economic reforms of transition could not be uniform. It changes over time, especially when people begin to experience the pain of unemployment and inflation. At this point an important factor that affects the level of acceptability might be considered the way and range in which political and economic changes came. In some of socialist countries, as Hungary, to some extend Poland, or China, economic adjustments and openness began before political breakthrough (practically in China there is not yet any radical political change). As a result after political events in these countries the public was relatively

prepared and more likely to criticize and discuss earlier about policy choices. Albania belongs to the countries where no significant economic changes before political events were occurred. This aspect, besides isolation and crisis suffered for a long time, facilitated the enthusiastic entrance into the new order, providing easily a large level of acceptability and sustainability for economic reform. For instance, at the very beginning people did not oppose the liberalization of prices. This happened in Albania because they were not aware of the consequences and the open inflation was unknown.

The experience of the other countries in similar conditions, but that started reforming before Albania, suggests that this period of "extraordinary politics", as emphasized by Balcerowicz and Gelb (1994), is not a long one. The first wave of reform, in particular the intervention to normalize inflation and stabilize the budget deficit, is widely sustained. When the "normal politics" re-emerges uncertainty and hesitation for the future grew. Various political groups begin to show distrust of further reforms; especially their readiness to accept radical economic measures that bring distribution implications, thus increase social costs of economic reform for them is substantially lower. It is not an isolated case when the hope and enthusiasm have been replaced by delusion and after that by contest. The impatience of public, as reform passes, a case of what Bruno (1993) calls "reform fatigue", is seen mostly in the period of "normal politics" in Albania, after its extraordinary impetuous experience between December 1990 and the end of 1992, when the enthusiasm was obviously higher. According to some polls and surveys, however, carried by some serious organizations like Eurobarometer or Gallup, this objective expected loose in Albania was much smaller than in other countries of Eastern Europe in similar conditions⁶⁴. This phenomenon could be explained by the hope and confidence that a lower standard of living nation have toward changes as the initial conditions was desperate. Many voters who may not have seen themselves as natural supporters of Democratic Party nevertheless voted for the party because they believed promises of immediate and massive outside help for Albania. They also showed a great desire to change once and forever the state of one party, totalitarianism and centralism suffered for about half century. About political support on changes was cast doubt in the first opportunity the Albanian people had, in 1994 constitutional referendum when they have seized it giving something more than 40 percent for the DP proposal. It was officially accepted that these votes were not directed to the constitution itself but first of all it was a sign

⁶⁴ Nevertheless other indications show that for most of the period between April 1992 and 1994 effective voter support for the DP was between 25 and 35 percent. See Vickers and Pettifer, 1997, pg. 246, pg.277.

a certain level of political support for the economic transformations and the pains of transition.

Still a certain level of enthusiasm and support is present in today's Albania. Even during the recent crisis of 1996-1997 when economic reform was practically blocked it was difficult to find many people thinking against the ongoing economic transformation in principle. Main critics go to the way of doing economic transformation. They were expected less slow privatization and land restitution by the government as well as energetic measures for rising investments, fighting corruption and decreasing unemployment.

Without ignoring the fact that in some certain phenomena other factors that are not subject of this study have affected the process, the **mutual influence of political factor and Albanian economic reform** is occurred in several democratic development periods. Phenomena that in a first view seem without any direct connection to economic reform, like relative changes of political spectrum in the results of local elections during July 1992; further fragmentation of political forces; results of Referendum at the end of 1994; pro-democratic results of some polls and surveys; debatable elections of May 1996; boycott of parliament by the opposition parties; and other, reflect the level of credibility and social acceptability of it. At the other side, merely economic phenomena like sharp decrease of inflation; fast development of small businesses; low price of privatization vouchers; large development of informal sector; increasing level of both investment and private deposits; and lately a deep crisis caused by collapse of some pyramidal schemes in financial sectors, which seem not having any clear connection with political factors, in fact carry results of a certain level of political stability and a natural political volatility in the background of an overall transformation of the Albanian society.

Large adjustments of economic decision-making during transition, especially after March 1992 elections, is another sign of influence and link between level of social acceptability and credibility as an important endogenous factor and economic reform in Albania. Economic transformation program designed and implemented after 1992 with specialized international institution consultants was adjusted gradually but unavoidably to the specific political and economic Albanian conditions. Notwithstanding it has broken traditional budget schemes, the big moral and economic debt that Albanian society has to the people who suffered from the old regime, could not get ignored by the economic decision-making of the program. All this appeared as economic support for the ex political prisoners and the pressure for rising it. There are many other examples illustrating the idea: the wage indexation time to time, though insufficient, toward the pressure for increasing wages and small pensions; the level of social assistance benefited by vulnerable groups affected by

economic reform and without other financial means; the economic support that students provide in order to afford the study and living expenses, which in the new conditions are very higher for many of their family incomes⁶⁵; the level of social assistance in general; different decisions on the privatization program like those of preferences to buy-out type privatization to the benefit of employees; not announcing of bankruptcy for some non efficient state enterprises; higher pressure for organized immigration; etc. All these adjustments show smoothing of social costs during transition to the market economy. Pressure of other population stratum lead also to the reviewing and adjustment of legal framework of economic reform, as for instance, the laws on fiscal system, changes on the Land distribution law, returning and compensation of ex-owner inherited assets, etc. High pressure by poor population because of the standard of living to the politics, however in opposite direction, might be considered the opposing attitude of the public when pale efforts against pyramidal activities appeared. Their everyday life was strongly supported by the money coming from so-called foundations and companies, as other opportunities were irrelevant. This made political forces in Albania to stay inactive toward loosing of political credibility.

Such pragmatic solutions imposed by different political circumstances accompanied traditional macroeconomic stabilization package that was applied in Albania. They reflect inevitable social adjustments applied on concepts and standard economic programs of transition, in small country like Albania, underdeveloped and extremely poor, just passing from a full totalitarian and self isolated economy in liberal market one. They also show the large importance and determination that public acceptability and political support have for the reform implementation. Nevertheless the social components of Albanian economic reform were not sufficient from the beginning⁶⁶ as to create the proper environment and behavior of citizens against financial fraud and wide participation in pyramidal schemes later in 1996-1997.

3.3. Old and New Mentality Barriers.

⁶⁵ After the reform started and the inflation was going up, it was a large pressure from the students who were not residents of Tirana to get scholarships to cover living expenses. (The Universities are public and there is no tuition fee.) In order to prevent protests and strikes of the students, government approved this payment, then released and changed it in September 1993 and re discussed and approved it again by the end of 1993.

⁶⁶ See Muço, 1997.

The radical economic transformation in Albania proceeded by the political transformation. This act asked for a redefinition of the role of state not only in society but also in economy. The re-establishment of private property rights in the monarch throne dethroned the old demons of totalitarian state but yet this act brings the urgent need for related institutions. The old economic institutional system must be completely revamped and a new one should be adopted. In the beginning of the process there were not rare the naïve ideas that it would be enough simply to remove the old ruling class from state enterprises, old institutions, local authorities and the various central state administrations. It was considered often that together with the renewal of old property rights this removing process could create fast and automatically the new market economy. Both steps were necessary but, as the experience of earlier reformers in Eastern Europe showed, it was not a sufficient condition. It is difficult to accept that democracy and the new market economy can only be achieved if institutions are completely overhauled and the new ones must be reorganized. Along side with deep economic transformations the newly emerging Albanian democratic society must fight for changing and recreating mentalities.

Although Albania has an old and authentic culture in the Balkans, historical circumstances have imposed a lack of the traditions of a real democratic and civil society. The totalitarian communist system after the Second World War reinforced the old Albanian psychology of a prolonged "fighting against enemies". Part of this idea was imposed objectively under the pressure of several invasions. For centuries the only way of solving the problems was the resistance and the force of weapons. The traditional pride of the Albanian people has faced for centuries, from the Roman Empire to the Soviet Union Empire, the injustice and discriminations of the great powers toward a small country (Pollo and Puto, 1981, Pano 1992). This fed the intolerance, continuous doubt and the lack of democratic solutions in the Albanian mentality. The extremes, rather than a spirit of discussions and compromise, are still appearing in the political and economic life in Albania. The inherited idea "with us or against us" is still widespread and represents a serious obstacle in the new and fragile Albanian post-communist society. This entire culture and mentality legacy is strongly connected, although with invisible chains, with the ongoing economic transformation, and above all with the replacement and creation of the new institutions.

The first step required is the reform of the legal system. The new economic order needs an adequate legislation, which will ensure the continuation of economic reform. Such legislation is indispensable for the replacement of old socialist production structures with the various forms of private ownership characteristic of a market economy, and legalizes the new institutions. Therefore, one of the priorities of the new Albanian parliament was to set up this essential legal framework. This task is

mostly implemented with laws on land distribution, privatization, foreign investment, tax system, social security, companies, wage regulation, bankruptcy, banking system, etc., but much still has to be done. The recent financial crisis during 1996-1997 showed the weaknesses of the legal system concerning corruption, contraband, the functioning of the banking activities and financial pyramidal schemes. However, the real problem here is not only establishing the legal system per se but also who will implement these laws. At this point many obstacles, caused by the old and recent mentalities of the post-communist Albanian society, will appear objectively.

It is clear that the period of economic and institutional transformation will be a time of experiments. But systemic changes affect people's lives and make them impatient with experiments, which tend to slow down the economic reform as they adjust their knowledge, experience and their behavior towards it. Yet, in order for reform to be successful, the attitude of the people must change and it seems that this will take a long time. The entire process of transformation is influenced by social factors and mentalities, deeply rooted in the past, but also recently created by the new environment of transition. Both are strongly disruptive of well-known theoretical schemes. For example, in the beginning of reforms, as a result of the old mentalities and the inherited practice, almost no one seems to understand that wages could not increase *a priori* unless production increased or quality improved. Still after three years, the practice of paying regularly taxes is not rooted in the individuals and firms behavior in the market. Yet, the new rules for interpersonal relations in enterprises and different levels of government offices have not fully replaced the old experience. It was difficult to understand that raising profits as the main motivation in the new system has nothing to do with dishonesty and the abandonment of individual moral values. Still, in certain levels of Albanian society new experiences of market economy often get confused with fraud, falsification, and lack of honesty and sincerity toward the client.

Other barriers of new and old mentalities are becoming real obstacles for the progress of economic reform in Albania. Part of them has clear objective reasons coming from the ignorance and the lack of experience in facing a new market reality. Some of them, for instance: individualistic psychology of small clerks, lack of motivation and devotion, lack of work willingness, psychology of waiting, ignoring necessity of marketing, studies and information of markets, lack of the new manager mentality, negligent treatment of intellectual employee values as a reminiscence of the old system, accompany markets creation and consolidation. Another expression of intolerance might be considered the attitude towards the monopolistic behavior and the process of the new firms' entries in the market. The importance of competition and the special place of marketing in it is neither yet well understood nor institutionalized.

Let see more in detail and try to generalize some main mentalities in the today's transition in Albania:

- The most widespread mentality that could be considered as a serious barrier for the economic reform is the **nostalgia for a paternalistic model**, manifesting itself in a veneration of authority and, therefore, the state. The demise of this model made people feel abandoned, under the daily threat of unemployment and full of uncertainty of tomorrow, which are new feelings for them. They unconsciously seek someone to intervene to stop spiraling prices, to bring wage policy under control, to curb currency devaluations, and to draw food and raw materials from abroad. This mentality, inherited from socialism, is the result of an ideology in which the state was considered as a parent, and represent a danger on the road to the market and democracy tent to suffocate individual free initiative as well as his adjustment and motivation in the market. As a result of this legacy sometimes a new way of paternalism seems to appear among the new decision-makers and politicians in their tendency to control economic decisions avoiding the role of market. There is a tendency for a new wave of centralization and control of decisions, especially over the state enterprises sector, on wages, on partial privatization of their assets, on the use of profits, on the nomination of the board of directors, etc., as well as on other aspects of relations between the center, ministries and local government. This tendency fuels uncertainty and encourage rather gradualism and slowness in economic transformation. Nevertheless, these considerations are not meant to cast doubt upon the important role of the state in economic transition. On the contrary, the role of the state is essential in major points of transition especially in macroeconomic, legal and institutional aspects. Thus managing and preparing the process of privatizing the large public sector, which, as experience has shown, could not be completed in a year or two, macroeconomic stabilization, the social safety net and the problem of poverty in Albania are another broad area. The role of the state there is still indispensable. A large dose of state regulation is still needed to shift from a hyper centralized planned economy, as Albania was, to a market economy.
- Another way of thinking, which tends to slow the economic reform, is the **populist mentality**. It is connected with a strategy and political means used everywhere in the world. This is a strategy used also by all Albanian political forces especially during the electoral campaigns. After that, as the stabilization and liberalization progress and some hard times of social and economic costs came, populism expects the government to do what the crowd in the street asks. It becomes a barrier to the

deeper reform while some politicians or trade unions are worrying for their popularity and are seeking for easy ways. This mentality is clearly reflected in the position of the newly created trade unions. The idea "friends or enemies" rather than tolerance and round table discussion weak their important role in the inexperienced bargain process. Instead of fighting for constructive ideas in the creation of the labor market, often they become the carriers of the populist mentality or, in the worst case as in the past regime, political servile of the government.

Populist mentality was present more than ever during the last crisis. At the one side neither government nor the opposition tent to explain to the people the danger of uncertain financial schemes rather seeking for political credibility. At the other side the raged public considered the delayed interference of government sometimes indispensable and other time inappropriate.

- In the beginning of reforms a **welfare mentality** about capitalism was widespread. Everything was expected in return for nothing as a result of a 50 years old mentality when inefficiency and hypocrisy in labor and income relations predominated. Behind this idea was the illusion that there are no problems in a market economy, that it is easy to establish, and that once established, it can supply miracles. Other partisans, however less in number, believe that the market must be completely free and that once this condition has been achieved, the market will by itself resolve all other problems. According to this classical view of "laissez faire", once a law on private property has been passed, no further regulations of economic life are needed. But some people are developing new fears. Fears of a hyper centralized state and of a return to the past make it more difficult to accept the principle that the new society must be organized by an active legal state. Old and new revenges and jealousies make them to criticize every government regulation, blaming it for all difficulties. More than ever this mentality appeared in people's behavior during 1996-1997. Led by populist ideas of a false and easy welfare life in the new market environment all the savings went to fraudulent activities causing an economic disaster and a popular discontent. Almost everybody was sure that it was the right time of getting quick reach without working while waiting for their monthly incredibly high interests coming by some so-called "charity foundations". **Laziness mentality** with its roots in the distant and near past of Albania fed passive and waiting solutions.
- In a case like Albania, with a very low standard of living and extreme inherited income equality even in poor levels, people entered in the new economy practically without owning anything. The uncertainty of the unknown, the fear for the future,

and difficulties that come with the transition, make the Albanians to mobilize their forces and reply successfully to the new market reality. At the other side these factors have controversial effects making them anxious to capture something. In many cases during transition years it was stolen and maltreated part of public property. Yet, this easily feeds **corruption** and the tendency to use the political power or any simple position in the government or public offices to benefit economically in the short possible period of time. The bureaucratic barriers and the weak legal system assist the process, above all. Every state in the world has its own bureaucracy. The problem is not in its existence but how effective it is. In the Albanian case the new bureaucracy carries the old legacy, the lack of experience while the rules are changing, and the **mentality of poverty** which makes it easily corrupted. All this is a serious obstacle for the new and fragile economic reform, especially in the practices of the tax payment, in the way of receiving loans for the private sector, and in the implementation and speed of privatization.

To change the mentality of Albanians, **transparency and honesty** are still needed to avoid illusions during economic reform. Very expensive lesson that Albanians took during extraordinary political and economic events in 1996-1997 make clear the necessity for fighting old and new mentality barriers to the economic transformation. It has to be clearly explained that sacrifices will be needed to achieve the transition to a market economy. In the case of Albania where the standard of living is lower and the pain of transition, for many of the reasons we mentioned, is expected to be greater than, say, Hungary or Czechoslovakia, the need of that explanation is a necessity, at least for the continuity of reform. One of the lessons of the delayed Albanian entrance in the economic transformation must be the failure of the populist illusion of "transformation without pain" existed in the other ex-communist countries. This might not be true for China but because of the large differences this example is not relevant for the European ex-communist countries. Considering the extremely difficult starting conditions of Albania, it's political, institutional and mentality constraints and the last crisis consequences the **complete** transformation and the recovery of Albanian economy belong to a long-term projection.

Summary and Concluding Remarks

Although with similar socialist legacy, the peculiarities of Albania and its low level of incomes set it apart from other ex-communist countries in Eastern Europe. Considering the initial conditions, the path to a new market economy along with a new democratic society will be painful and not short. Besides the macroeconomic imbalances, several political, social and mentality constraints determine endogenously the speed and the strategy of the reform. The economic changes in Albania began after the political breakthrough and are strongly effected by it. The delayed entering and rapid changes are accompanied with social uncertainty. Yet, the initial political instability and the lack of democratic tradition set their own marks on the Albanian transition and make it more difficult.

The incited implementation and half measures as well as the slowdown of the economic reform are equal "enemies" for the Albanian economic transformation. The corruption and other new and old mentalities represent a serious barrier that, given the circumstances, has to be removed gradually together with the implementation of institutional and legal system transformation.

The economic changes that began in 1991 were the first serious step towards a market economy. Interrupted by political events the process began in mid 1992 with a coherent and comprehensive program. The stabilization elements were the main issues in the short and medium term program. Although based on the well-known packages, stabilization measures in Albania are more painful than in other Eastern European countries. In the background of a sharp decline in output production, the tight monetary and fiscal policies combined with rigorous wage control policy had been successful in slowing the growth of the inflation rate. As a result the fiscal balance began to adjust reducing considerably the deficit of the budget. Despite the initial success the hard budget constraint and the use of direct instruments of monetary control had their influence on the supply-side. Especially they might have created obstacles for the dynamic part of the economy and above all for the new private sector.

Serious attempts were made in the price liberalization and the market reform. In the shortest possible time most of the prices were freed and the foreign trade was liberalized. The rapid openness and liberalization created the possibilities to raise the availability of goods in the market and to eliminate the shortages. Under the new conditions the Albanian goods began to confront international standards but their ability to compete is very poor. This might be another repressing factor causing the output and exports collapse.

The unemployment and the income policy are some of the main dilemmas of the economic reform in Albania. The shrinking of the state sector and the privatization combined with other reform measures contributed to the increase of the unemployment rate. The new private sector is still weak to absorb the excess supply in the labor market. Meanwhile the proper balance between the stabilization measures and the increase of the efficiency in allocation of labor remains a challenge. The tight income policy though helpful for the stabilization still provides obstacles in introducing incentives and developing an active labor market. To reduce the costs of the transition for the most vulnerable groups of the Albanian population an effective social safety net is needed.

Privatization was considered as the main action in the Albanian economic transition toward a market economy. The performance of this action is complex and influences strongly all the elements of the economic reform. Considering its fast implementation as a priority, the Albanian privatization began immediately after the political changes in 1991. But restructuring process and the large-scale privatization are going slowly in Albania. This is connected with the lack of financial possibilities of the state to support the action and the poor household financial capacity to take part in the privatization of the large enterprises' assets. The further deterioration of the capital conditions in these enterprises during the transition with already outdated equipment makes the sales more difficult and less attractive. Corruption could be considered also as a strong enemy to a transparent and honest process of privatization in Albania.

The role of the state during the Albanian transition seems to remain important for some time. From view point of the over centralization of the previous economy and its overall heritage combined with serious stabilization problems it seems not proper for the moment to adopt a full laissez-faire approach. The creation of a complete legal framework and the strengthening of the newly created market institutions still need the regulatory role of the state.

The role of the foreigners will continue to have a significant importance for the Albanian recovery and more in general for the transition to an open market economy. Direct investment and other forms of assistance such as financial and technical assistance seem to determine the speed of the Albanian economic reform.

The recent crisis of 1996-1997 had some painful costs for Albanian economy. The complete demise of state in a short time and political instability ruined the results achieved in a five-year effort of transition. The main conclusion is that political instability could lead to an economic slowdown and that lack of institutions is a clear obstacle to a successful economic transition. Results of the first phase of economic transition in Albania turned to be quite fragile and in some points debatable.

Financial crisis and pyramidal schemes activities jeopardized the best results achieved with great sacrifice by the whole Albanian people.

The progress and problems of the Albanian transition lead to the conclusion that the process can not be implemented in a short time. A pragmatic approach is urgently needed. Energetic measures by all Albanian political forces and more consensus and support by international sources are necessary for a better performance, but the costs of the transition will continue to be high for Albania.

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Statistical Appendix

TABLE 1: THE MAIN ECONOMIC INDICATORS DURING TRANSITION

INDICATORS/YEARS	1990	1991	1992	1993	1994	1995	1996
GDP¹							
•in current prices, in millionLek	16,813	16,404	50,697	125,334	184,393	229,793	300,802
•in constant prices, 1990	16,813	12,105	11,235	12,309	13,331	15,107	17,224
GDP GROWTH¹							
•% change in constant prices	-10.0	-28.0	-7.2	9.6	8.3	13.3	14.0
industry	-14.2	-42.0	-51.2	-10.0	-2.0	6.0	15.8
agriculture	-5.4	-17.4	18.5	10.4	8.3	13.2	9.2
construction	-12.0	-30.0	7.0	30.0	15.0	21.2	18.3
transportation	-10.0	-30.0	-15.0	13.0	18.0	18.8	8.5
others	-8.0	-14.0	9.0	16.0	11.0	13.5	25.0
INFLATION²							
•average		35.5	226	85.0	22.6	7.8	12.7
•end period	104.0	104.1	236.6	30.9	15.8	6	17.4
FISCAL DEFICIT³							
•in % of GDP	-6.1	-20.7	-17.0	-9.3	-7.5	-7.5	-10.1
TRADE BALANCE³							
•in million USD	...	-308 ⁵	-470.5	-489.9	-459.7	-475.0	...
CURRENT ACCOUNT BALANCE³							
•in million USD	...	-213	-50.8	14.7	-42.7	-14.6	...
DIRECT FOREIGN INVESTMENT⁴							
•in million USD	-	...	32	45	53	46	70
UNEMPLOYMENT²							
•in % of total labor force	...	9.1	26.5	22.3	18.6	13	12.4(Sept.)

NOTES:

1. Source for GDP is from Economic Developments Department and Foreign Aid Coordination

2. Source: INSTAT, 1996

3. Source: Bank of Albania, 1996

4. Data on foreign investment is from "Future Investment Prospects in Albania", International Investment Conference, June 28-30, 1995 Tirana. Data for 1992 is a cumulative for years 1991-1992.

5. Value at the official U.S.\$ exchange rate.

TABLE 2: CONSUMER PRICE INDEX

	Index						
	1991	1992	1993	1994	1995	1996	1997
January	100.0	224.4	733.5	102.0	117.9	125.3	146.5
February	106.0	256.2	765.3	103.8	120.6	127.4	154.3
March	110.0	285.0	771.9	104.4	120.9	129.4	175.9
April	115.0	310.6	770.9	113.8	123.0	131.3	
May	123.0	334.8	767.1	115.8	122.4	132.7	
June	128.0	354.1	768.2	117.7	120.2	131.7	
July	135.0	377.4	828.3	113.8	116.2	135.0	
August	140.0	549.7	838.8	111.4	117.1	138.2	
September	145.0	588.0	874.6	111.6	118.4	141.6	
October	150.0	655.3	891.4	112.7	119.2	143.9	
November	170.0	678.0	896.7	113.7	121.9	143.2	
December	204.1	687.1	899.4	115.8	122.8	144.2	
	Monthly change (%)						
January		9.9	6.8	2.0	1.8	2.0	1.6
February	6.0	14.2	4.3	1.7	2.3	1.7	5.3
March	3.8	11.2	0.9	0.6	0.3	1.6	14.0
April	4.5	9.0	-0.1	9.0	1.7	1.5	
May	7.0	7.8	-0.5	1.7	-1.8	1.0	
June	4.1	5.8	0.1	1.7	-1.8	-0.7	
July	5.5	6.6	7.8	-3.3	-3.3	2.5	
August	3.7	45.7	1.3	-2.1	0.8	2.4	
September	3.6	7.0	4.3	0.1	1.1	2.5	
October	3.4	11.4	1.9	1.0	0.7	1.6	
November	13.3	3.5	0.6	0.9	2.3	-0.5	
December	20.1	1.3	0.3	1.9	0.7	0.7	
	Year to year change (%)						
January		124.4	226.9	25.1	15.5	6.3	16.9
February		141.7	198.7	21.9	16.2	5.7	21.1
March		159.1	170.8	21.6	15.8	7.0	35.9
April		170.1	148.2	32.8	8.0	6.8	
May		172.2	129.1	35.7	5.7	8.4	
June		176.6	116.9	37.8	2.1	9.6	
July		179.6	119.5	23.5	2.1	16.2	
August		292.6	52.6	19.5	5.1	18.0	
September		305.5	48.7	14.7	6.1	19.6	
October		336.9	36.0	13.7	5.8	20.7	
November		298.9	32.2	14.0	7.2	17.4	
December		236.6	30.9	15.8	6.0	17.4	
Memo items:							
Annual inflation (Year average)		226.0	85.0	22.6	7.8	12.7	
Annual inflation (Year end)	104.0	236.6	30.9	15.8	6.0	17.4	

NOTE: Starting January 1994, a new method is used for computing price index, so the CPI series begin at January 1994 is not comparable with historical series.

SOURCE: Institute of Statistics

TABLE 3: NET MATERIAL PRODUCT AND GROSS DOMESTIC PRODUCT BY FINAL USE, 1980-1990
(Summary indicators of output and expenditures)

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990
(In current prices)											
Net material product	12,862	13,265	13,625	13,696	13,300	13,602	14,013	13,700	13,631	15,223	13,229
Gross domestic product	15,538	16,074	16,544	16,724	16,510	16,863	17,390	17,254	17,008	18,681	16,813 ¹
(In constant 1986 prices)											
Net material product	12,198	12,929	13,281	13,350	12,964	13,200	14,013	13,700	13,631	15,223	13,229
Gross domestic product	14,881	15,737	16,200	16,378	16,174	16,462	17,390	17,254	17,008	18,681	16,813 ¹
(Annual percentage change in constant 1986 prices)											
Net material product	...	6.0	2.7	0.5	-2.9	1.8	6.2	-2.2	-0.5	11.7	-13.1
Personal consumption	...	1.9	0.8	6.6	2.5	0.8	4.6	3.4	1.1	6.9	2.0
Social consumption	...	2.7	1.9	3.3	2.7	0.4	0.4	3.1	-1.7	2.2	0.4
Total net investment	...	9.0	19.2	-13.6	-27.0	17.3	3.6	-17.0	13.3	30.6	-30.5
Net fixed investment	...	-8.6	19.9	2.5	-0.1	-13.8	6.6	5.1	3.1	10.9	-20.1
Gross domestic product	...	5.8	2.9	1.1	-1.2	1.8	5.6	-0.8	-1.4	9.8	-13.1

Source: State Planning Commission.

¹IMF staff estimate.

TABLE 4: INITIAL (PRE-PROGRAM) CONDITIONS IN EASTERN EUROPE

MACRO BALANCE	Poland 1989	Hungary 1990	Czechoslovakia 1990	Romania 1990	Bulgaria 1990	Albania 1991
CPI Inflation (%)	640	35	16	8	88	104 ¹⁾
Money M2/GDP (%) in December	30	42	64	46	84	69
Deflated wage index 1987 = 100	90.5 ²⁾	100.4	96.6	107.2	113.1	97.9 ³⁾
Current account/GDP (%)	-1.7	1.2	-2.9	-8.5	-3.7	-26
Fiscal balance/GDP (%)	-7.4	0.5	-0.4	1.2	-8.5	-44 (cash bases)
External debt /GDP 1990 (%)	80	65	19	3	50	30
External debt service ratio 1990	56	57 (to merchandise exports)	23	NA	116	37.7 (to exports)
STRUCTURAL						
GDP change (%)	0.2	-3.3	-1.6	-5.6	-9.1	-27.7
Industry/GDP 1988 (%)	52	36	57	61	58	44.8 ⁴⁾
CMEA/Total exports 1990 (%)	41	43	60	61 ⁵⁾	69	46.3 (1989)
SYSTEMIC						
Administered prices (% of total)	100 (Excluding food prices)	15	100	80	100	100 ⁶⁾
Degree of institutional reform (pre-program)	Somewhat reformed "Market Socialism" after 1981	Considerable market socialist reforms after 1968	Unreformed	Unreformed	Unreformed	Unreformed
OTHER						
Population (in million, mid 1989)	37.8	10.6	15.6	23.2	9.0	3.2
GNP per capita (1989 US\$)	1,790	2,590	3,450	2,290	2,320	623 ⁷⁾
Political power of labor	very strong unions and workers' councils in state enterprises	weak	weak	Unions strong, especially in mining and heavy industry	Unions fairly powerful; had assisted political transition	weak

1. Percent change from 1990, end of period. 2. 1990 figure. 3. Estimate by author, data, from Ministry of Finance 1993. 4. Industry/NMP, 1989, at constant prices. 5. 1988 figure. 6. First liberalization in September 1991. 7. Estimate by Blejer et al, for GDP in 1990 current US\$. Recent estimates by IMF show a GNP per capita 302 (in SDRs) in 1993 or \$ 422 from WB publication. **Sources:** Balcerowicz and Gelb, 1994 and Bruno, 1993. For Albania, the author from different estimates, mainly IMF staff, Bank of Albania and Ministry of Finance.

**TABLE 5: NUMBER OF PRIVATE ENTERPRISES ACCORDING TO
ECONOMIC ACTIVITY AND LEGAL FORMS (1995)**

Sector	Physical Persons	Local Company	Join Venture Company	Foreign Company	Total	%
Agriculture	1194	283	26	7	1510	2,7
Manufacturing	3255	1394	292	123	5064	9,0
Construction	152	961	71	53	1237	2,0
Trade	24762	3655	1002	592	30011	53,0
Transport	8654	280	64	48	9046	16,0
Services	8551	505	77	57	9200	16,3
Total	46568	7078	1532	890	56068	100,0

Source: INSTAT, 1995

TABLE 6: FOREIGN AID (distributed, in millions of US \$)

	1992	(%)	1993	(%)	1994	(%)	1995 Estim.	(%)	Total
Technical Assistance	11.7	0.6	37.0	16	66.4	33	73	25	188.1
Development Projects	0	0	17.4	0.7	43.9	22	140.8	49	202.1
Food Aid	139.9	69	71.7	31	20.7	10	0.4	0	232.7
Others	52.0	26	107.5	46	72.5	36	73.7	25	305.2
Total	203.6	100	233.5	100	203.6	100	287.4	100	928.2

SOURCE: Report on Human Development, Albania 1995. (Tirana: UNDP, 1995)

TABLE 7: FOREIGN TRADE ACCORDING TO SECTORS IN ALBANIA

	1994		1995	
	Value (ml. Lek)	% of Total	Value (ml. Lek)	% of Total
EXPORTS	13,386	100	18,709	100
Private sector	6,423	48	11,123	59
Public sector	6,963	52	7,586	41
IMPORTS	51,890	100	60,311	100
Private sector	40,601	78	48,803	81
Public sector	11,289	22	11,508	19

Source: Trade Policy & Statistical Commercial Data, May 1996, Albanian Center for Foreign Investment Promotion, Tirana, Albania

TABLE 8: FOREIGN TRADE ACCORDING TO THE GROUPS OF COUNTRIES, YEAR 1995

Countries	EXPORTS		IMPORTS	
	Value(ml.Lek)	% of Total	Value(ml.Lek)	% of Total
EC Countries	14,865.91	79.46	46,363.92	76.87
EFTA Countries	1,347.44	7.20	2,970.68	4.93
East-Europe Countries	102.31	0.55	5,925.66	9.83
Former URSS Countries	120.96	0.65	465.33	0.77
OPEC Countries	23.33	0.12	17.61	0.03
Rest of the world	2,249.85	12.02	4,568.74	7.57
Total	18,709.80	100.00	60,311.93	100.0

Source: Trade Policy & Statistical Commercial Data, May 1996, Albanian Center for Foreign Investment Promotion, Tirana, Albania

**TABLE 9: FOREIGN TRADE ACCORDING TO THE MAIN COUNTRIES,
YEAR 1995**

No	Countries	EXPORTS		IMPORTS	
		Value(ml.Lek)	% of Total	Value(ml.Lek)	% of Total
1	Italy	9,641.00	51.53	22,845.95	37.88
2	Greece	1,857.69	9.93	16,153.73	26.78
3	Turkey	1,160.84	6.20	2,475.53	4.10
4	Germany	1,142.82	6.11	2,752.41	4.56
5	FRY Macedonia	742.35	3.97	1,531.40	2.54
6	USA	638.89	3.41	201.75	0.33
7	Austria	170.56	0.91	1,184.63	1.96
8	Bulgaria	17.6	0.09	4,833.57	8.01
9	Other	3,338.05	17.85	8,332.96	13.84
	Total	18,709.80	100.00	60,311.93	100.00

Source: Trade Policy & Statistical Commercial Data, May 1996, Albanian Center for Foreign Investment Promotion, Tirana, Albania.