

INSTITUTIONAL REFORM IN ALBANIA

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About 11 years ago the history of Albania turned a new page with the movement aimed at overthrowing the dictatorial regime which culminated in March 1992 --the month of the first democratic parliamentary elections in Albania.

The elections were won by the Democratic Party which paved the way for pluralism, legal state, and economical reforms, that would turn the economy from a centrally planned economy into a market economy. Between April 91 and March 92 the foundations for a new market-oriented state were created, due to the agreement between the political position and opposition. This cooperation was extremely beneficial to the approval of Constitutional Dispositions

which made possible the economical, legislative and institutional reforms in the following years.

We were in charge of running a country that was in seriously difficult economical, social and political conditions, at a time when everything was in crisis. Albania was suffering from unemployment, high prices, low wages, lack of consumption goods, water, electricity and heating.

It was clear to us that these problems could not be solved in a matter of days, through administrative orders. We were convinced that there was only one option ahead of us: radical political and economical transformation of the country—a mission that could only be completed with audacity. Without this quality there would be no foreign aid, and no utilization of human and physical resources of the country.

These difficult tasks that we were facing at the beginning of the transition process, could not be realized outside of a free market economy. And the free market economy required the employment of economical mechanisms, an orderly legal system, free competition and obliteration of state bureaucracy in economy.

All the above factors taken together make it possible for our economy to integrate itself in the world economy. Transition demanded, in the first place, the creation of political and economical institutions totally different from the ones that operated in the proletariat dictatorship. Albania and its people, having been closed and isolated for a long time, realized however that the creation of these new institution required new laws, new structures, and most importantly people with a new mentality. We took on these tasks and started the long journey that transformed and is still transforming Albania today. The results of our work could be seen and felt from the very beginning. At this point I would like to emphasize that without the help of the IMF and the World Bank, the Reform would have been close to impossible for Albania. This help was materialized in financial and intellectual terms. The abovementioned institutions offered their assistance in the compilation of sectorial strategies, in different projects and in the management of specific sectors.

Between 1992 and 1996, the legislative authorities have continuously worked for the establishment of a new legal basis that would support the fundamental changes that would be made in the structure of the Albanian economy. This legal basis would assist

the creation of new economic structures and relations. Of special importance in this context, were the new Civil and Penal Codes along with the Procedures Codes that make up the basis of market economy and legal state. International financial institutions and the European Union offered their valuable help during the legislative reform in Albania, especially for the approximation of the Albanian constitution to European standards.

The transformation of a centralized economy into a market economy in Albania, was a radical change that took place in a very short time period. At a point where the socialist system had failed and the country was in deep crises, the first step of the reform would be the stopping of the crisis and economic recession through liberalization of the economy. Liberalization of the economy meant elimination of state control over prices and delegation of this competence to the market (the demand and supply factors), while stimulating supply and restricting demand in order to achieve macroeconomic stability, foreign trade and exchange rate liberalization. It also meant that state enterprises would not receive state support and that the state would terminate the 80 per cent system of payment for idle workers and replace it with unemployment payments. The first agreement with the IMF forecasted a yearly economic growth of no less than 4-5 per cent, decrease of inflation to the level of 15 per cent by the end of year 1996 and finding a solution for the external debt of the country.

These extremely difficult targets required the support of private initiative, as well as prudent use of foreign financial assistance. Economic indicators during 93-95 reached very high levels, especially compared to the expectations at the beginning of the reform. These achievements were made possible through the rapid and radical structural changes such as privatization in agriculture, construction, transport, and services. Unemployment from 30 per cent in 1993, reached the low level of 12 per cent in 1995.

We must admit that price liberalization resulted in a considerable increase of the Consumer Price Index (CPI) – 104.5 per cent in 1991 and 237 per cent in 1992. However, as the reform continued, the price level fell to single digit figures by the end of 1995, despite the high price of bread, energy and several public services. This was made possible through structural changes, remittances from immigrants working abroad, control of money expansion, restrictions in expenses and subventions, tight public investment policy, creation of taxation administration, quick privatization, stimulation of foreign investments etc..

As the reform evolved, the Albanian economic scene of year 1991, witnessed the appearance of new economic actors such as the taxation system. This system which was established with the multifaceted assistance of the IMF and the World Bank not only through medium term fiscal consolidation strategies, but also through direct financing of parts of the balance of payments deficit, thus contributing to maintaining macroeconomic stability. Changes in the economic system in Albania and the fact that the country opened its doors to international trade, inverted the import/export ratio. This ratio changed over time as the economy grew further. The opening up of the country was a marked event because it followed a complete closure of half a century. The outcomes of this u-turn were observed in commodities exchange, in prices, in technology as well as in social political and economical relations.

A distinctive impetus to the Albanian economy came from privatization or the shift of ownership rights from state to individuals. This process has been one of the economic reform pillars in the countries of Central and Eastern Europe. Having in mind the importance of this process in the economic transformation, which was paralleled to that of price liberalization, the rapidity of the implementation of this strategy was deemed as more crucial than the collection level or efficiency. The country, lacking institutions and appropriate laws, made use of completely new laws, schemes, instruments and structures that were changed or improved according to the achieved results.

Privatization was a significant qualitative, conceptual change. People became owners of land, houses, enterprises which today constitute wealth. A system was changed and people received in their hands real wealth with which they started the new life of market economy. This change is very significant and it marks the basis of development. The process began with the privatization of small trade units (1991) and continued with the privatization of buildings (around 200,000 valued at 4 billion usd). It was succeeded by the privatization of small and medium enterprises. In years 1991-92, 18,654 objects and machineries were privatized and in 1993 around 31,231. In 1994 a privatization strategy was designed and in the next few years it was followed by laws for strategic enterprises and national wealth. These measures aimed to create as quickly as possible a wide spectrum of owners, through different techniques such as direct sales, auction sales, public offers and massive privatization. One feature of privatization in Albania came in the shape of vouchers, which, along with

securities, served for the appropriate distribution of national wealth, and were accompanied with economic and social effects. All these changes in the ownership system were followed or accompanied by legislative changes in the fields of economy and trade, and were also based on the experience of other countries where market economy had been developing for hundreds of years.

Structural transformations in the Albanian economy could not take place, nor be sustainable without a transformation in the legal system that the country inherited from the dictatorial regime. After the abrogation of the 1976 constitution in 1991, and the approval of Constitutional Dispositions the Albanian Parliament was free to abolish the obstacles that stood in the way of market economy, and compile laws and regulations that projected new economic relations, such as ownership rights, rights for trade and production liberalization apart from price liberalization. The Parliament also passed laws that regulated the financial system and turned it into a two level system; laws that supported a monetary policy aimed at stabilizing the value of domestic currency, the creation of an independent Central Bank, commercial banks etc.. We can not however, leave out of this list of changes, a number of decisions and provisions in the field of social rights protection for the unemployed, and the poor people; the system of social security designed after a very progressive model in 1993 along with the supplements and voluntary raise in pensions; the new Labor Code in 1995' the Law on Civil Service in 1996, the provisions for employment and wages etc.. A thoroughly new set of institutions was put at the center and periphery of the system and the new acts and laws that were passed made possible activity in the social field of labor.

The great overturn in the economical activity of the Albanian society started with the trade liberalization and price reform which aimed to create a commodity market through incentives for trade and production. The reforms also aimed to support privatization and foreign investment, to gradually abolish state subventions, to achieve price regulations and to restrict monopoly. We must clarify that along with price liberalization, measures were taken that would cope with the effects of this process – impoverishment of the population and aggravation of social tensions. In this aspect, the country received and supplied the citizens with consumption commodities (mostly from foreign humanitarian aid), pensions and social support were increased.

In order to meet market demands the government abolished state control over foreign trade, i.e. restrictions and licenses. At the same time the foreign exchange market was liberalized. This change brought about domestic convertibility of the lek which affected domestic production positively.

We can not speak about Albanian economy reforms without mentioning fiscal reform. Albania inherited from the past a very inadequate customs system with no legislative regulation, infrastructure and assets and with unqualified personnel. The reform aimed at a modern fiscal and trade instrument and full reorganization. Within a short time span the Parliament passed the Customs Code and the Law for customs tariffs. These laws were improved and reformulated in the coming years in compliance with EU standards.

Albanian taxation system was a fresh start because the socialist state, theoretically disapproved of taxes. The first legal acts were passed in January 1992 and they were laws on movement tax, profit tax, excises, personal income tax, and tax system. From the end of 1992 until march 1993, the whole fiscal system was reviewed. Fiscal legislation had to be simple to understand and to implement, similar to that of OECD countries, be supported on the Civil Code and on the law on trade societies, guarantee horizontal and vertical equality and not discriminate against anyone. This legislation has been continuously under revision (with the assistance of foreign institutions) and has been adapted to changes in the economic reform of the country. The movement tax was replaced with the Value Added Tax. The implementation of the VAT only four years after the birth of the taxation system proved that the system in place was mature.

Taxation Administration, under the auspices of the General Taxation Directory, was perfected through the years. In February 1997 it reached the highest level of collections. Fiscal reforms are closely connected with the notion of the state budget which went through significant changes in terms of its financing scheme, methodology, and classification procedures. In order for the country to have a contemporary state budget, the Law on State Budget was approved as well as numerous acts, articles and regulations all aimed to create a proper budget. From this time on, the state budget included the budget for social security and medical insurance.

An important aspect of the budget was its division into two levels, local and central. The local budget ended with the communal budget which increased its revenues year after year, mostly due to the implementation of local taxes law. In order to further increase revenues, a package of local law improvements was prepared with the assistance of EU experts. This package aimed to also increase financial decentralization.

In order to create a complete system of market economy, the state established a core state function: the issuance of securities starting with Treasury Bills that serve to finance budget deficit, as well as other securities tied to the liabilities of ex- agricultural co-operatives and the capitalization of the National Commercial Bank. In 1993 the Service of State Treasury was established which carried out financial transactions, categorized in a standard fashion all the expenses and realized the report of these expenses.

As the formerly paralyzed Albanian economy recovered, public investments reached a high level since 1993. This achievement was made possible at a time when foreign assistance was not allocated to humanitarian aid as was the case in 1991-1992. As soon as the country came out of emergency, the foreign aid was transferred to investment and development projects.

Public investments played an important role in economical development programs in the period 1994-94. Programs in the field of public investment were three-year programs and they were revised yearly. Sectorial programs were compiled with the assistance of institutions such as the World Bank, European Union etc., and for this reason they constituted a sound basis for the allocation of financial sources and for a better co-ordination of foreign assistance. We have to admit that, since the country lacked adequate experience in the construction of contemporary objects, the budget allocated to local units initially was low. This budget was used for the financing of the Albanian counterpart. Negotiations on development projects have been made, financing has been secured and the work on these projects is still in progress.

From this overview of economic and institutional reform in the years 1991-1996 we can conclude that:

1. At the onset of the reform, special attention was paid to the creation and strengthening of institutions based on advanced laws and regulations. Since Albania had

lacked these institutions in the former decades, a long time was needed to make them function properly.

2. A special feature of transition in Albania is that Albanian policymakers did not seek to adopt or implement new development strategies. The country proceeded with orthodox economic reforms policy, i.e. liberalization, stabilization, and quick privatization of economic units previously under public ownership. This method is known with the name “the Washington Consensus” and it is different from the institutionalist reform which states that reforms in transition countries, especially at their first stage, should concentrate on the creation of markets and institutions. However, in Albania, due attention was paid to the creation and strengthening of institutions.
3. Albanian Government from the very beginning asked for and enjoyed the continuous assistance of the IMF and the World Bank and judging from the reform results, we can say that this tight co-operation was successful. In the reports of the above institutions in 1995, Albania was classified as one of the most successful countries in Central and Eastern Europe.
4. Albanian Government during 1996 had very clear programs for all sectors of the economy, with the objective of deepening and taking the reform further. These programs were very realistic because they had been prepared by a very qualified and experienced staff, and moreover, they received full internal and foreign financial support. From the way the economy proceeded after 1997, we can state with conviction that this reform program was partly implemented in Albania with a two-three year lag.
5. The other important conclusion is that Albania overcame the first phase of economical instability very quickly. Economic growth, inflation and budget deficit in 1993, i.e. only one year after the implementation of the first liberalization reforms, were at much better levels than the ones forecasted by the IMF. After this period the focus of the government attention was the consolidation of these achievements and the creation

of conditions for the functioning of institutions and markets.

This short summary of the results accomplished in Albania's attempts to meet macroeconomic targets, and to achieve quick liberalization, and institutional and legislative reform, does not aim to solely promote the successes of the government in charge. Neither does it attempt to compare these achievements to those of the governments that succeeded it after year 1997. It is rather a summary of the experience of this country during those tough years.

We must acknowledge the weight and role of the political factor which, in the shape of the Democratic Party leadership helped the materialization of fundamental economic reforms. The Democratic Party, in 1991, managed to secure the consensus of the majority – the Socialist Party, and together the two wings approved the Constitutional Dispositions. The same co-operation took place in 1992, when the Democratic Party, unlike any other party to this day, won the majority of the votes in the Parliamentary Elections.

In conclusion I would like to state that transition is not a simple technical-economical process. It is a multidimensional process, which can be successful, if and only if the premises for a wide political consensus are in place. This consensus must be based on a social contract supported by the majority of the population. The only way to achieve market economy and human and economic development is through basic principles of democracy expressed through the free vote: legal state and human rights.