

Politico - Economic Institutions and the Informal Sector in Albania

by

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“The historical laboratory of the transition economies has revealed that liberalization, stabilization, and privatization may be necessary but are by no means sufficient conditions for creating ‘market economies’”

- FEIGE (1997:22).

1. Introduction

New market economies are developing in many former socialist countries. Though these countries differ in essential features like culture, political background and economic potential, they are often characterized by a history of large government expenditures and massive bureaucratic intervention in the economy. Besides building up new and democratic institutions, countries in transition face major problems of overcoming the lingering influence of the former institutions.

Each country addresses these problems in distinct ways. The relevant politico-economic institutions - democratic decision-making bodies; central banking policies; the organization of privatization of industries; the regulation of private firms; and the role and influence of private banks – all have an impact in this transition period.

When these institutions prove unfavorable for the development of free market economies, one reaction in many countries is the spontaneous development of informal economies. ‘Institutional economics and underground economics are highly complementary. The former examines the rules of the game, the latter the strategic responses of individuals and organizations to those rules’ (Feige, 1997:25).

This paper aims at studying the role of the informal sector in transition from a centrally planned economy to a market economy and the importance of institutions in the evolution of the informal sector. The Albanian case is used to demonstrate some of the characteristics of this transition.

The organization of this paper is as follows. The following section gives a brief description of the politico-economic situation in Albania during the last decade. Section 3 provides a brief literature review of the informal sector in general. An analysis of the informal sector in post-socialist Albania follows in section 4. Section 5 provides two illustrative examples of the informal sector in Albania in 1992-1996: a brief overview of the financial pyramid schemes and an investigation of the street vending business. Based on these examples, section 6 analyzes the significance of the informal sector for the Albanian economy as a whole. Section 7 concludes.

2. Albania: A Brief Politico-Economic Overview

For about four decades, Albania was an isolated country, due to the highly repressive communist regime of Enver Hoxha. The political regime was a dictatorial one, while the economic system was completely socialized. No other country in Eastern Europe had a socialisation of property as complete as Albania did.¹ In the early 1990s, Albania was one of the last of the Central and Eastern European countries to allow political pluralism, to try to establish democratic institutions and introduce market mechanisms.

As a consequence of the grave political and economic recession that Albania suffered in the last years of communist rule, the newly established Democratic Party of Albania (DPA) won the democratic elections in March 1992 by a landslide. While the Democratic Party was in office (1992-1997), dozens of new parties were established, an open foreign policy was followed and democratic freedom was provided to everybody, at least at the beginning of DPA's governance.² Similar to the communist party, government policies of the DPA during the democratic period favored clans³ with partisan spillovers to the south and north, respectively. As a result, Albanian society was polarized.⁴

The new democratic government started the implementation of a profound market-oriented economic program, including macroeconomic stabilization and price liberalization. One of the main strategies considered by the government in order to reach its goal of stabilization and liberalization was privatization and the development of the private sector. A further analysis of this aspect will be provided below. The liberalization process, on the other hand, proved to be a complicated and delicate procedure with respect to both economic and social aspects. This reform, despite the social consequences, aimed at the transformation of the planned economy into a market economy, where free prices would regulate supply and demand, and would also try to be as close as possible to the world market prices. Consequently, the

¹ For a survey of this period, see Schnytzer (1982).

² For more details, see Gërzhani and Schram (2000).

³ 'Clan' is a group of people related through kinship, culture, religion, race and language, as well as through political interests.

⁴ For a broader qualitative and quantitative evidence of clan-based policies in Albania, see Gërzhani and Schram (2000).

Albanian system of foreign trade was legally free of restrictions, followed by some protectionist measures to help domestic production later on (Gërzhani, 2002).

Table 1 presents the main macro-economic indicators of the 1990s. In the early 1990s, previous export-import arrangements could no longer be sustained, state enterprises went bankrupt and closed down, agricultural collectives collapsed, and there were no investments.

Problems of high unemployment, poverty and social insecurity, caused by economic contraction, were extremely severe. They were initially exacerbated by policies of trade and price liberalization and later by the anti-inflationary measures required by the International Monetary Fund. It is estimated that nearly half of the working population was unemployed in 1992, while many of those employed did not receive their full wages or salaries. Per capita GDP had fallen to US\$ 258 annually, a level comparable to the poorest developing countries (ACER, 1996).

Table 1 shows how the government led by the DPA managed to turn around the economic decline reasonably well after coming to power in 1992. Especially successful were the results with respect to inflation and unemployment. On the other hand, major problems still existed up to 1997, with respect to the trade balance and budget deficit. There are various reasons why reality may have been less positive than these aggregate indicators seem to imply (Gërzhani and Schram, 2000).

- First of all, this table only shows the aggregate numbers.
- Second, it was relatively easy to get impressive growth rates, due to the very poor initial state of the economy.
- Third, the official unemployment rate is relatively low due to a very widespread informal labor market.
- Fourth, emigration and international financial assistance had a positive effect on the overall economic indicators in the early years.
- Fifth, it has been argued that the short-term goals typically pursued in transition economies are more easily achieved by redistributive activities than by productive ones (Knaack, 1996). This appears to be true for Albania in the period under consideration (until 1996).
- Vaughan-Whitehead (1999) provides a sixth reason by arguing that the systematic presentation of exaggerated figures by the democratic government was a political

manoeuvre.

- Finally, Vaughan-Whitehead (1999) also argues that the impressive figures of table 1 were achieved at the expense of very high social costs.

All in all, whatever the extent of success by the DPA government, the collapse of the pyramid schemes in 1997 led to complete economic and political chaos in Albania. All the main macroeconomic indicators in table 1 demonstrate the economic crisis the country fell into in 1997. After some dramatic and violent events (close to a civil war) that took place after the collapse of the pyramid schemes, and under international pressure, new elections were held in 1997. The Socialist Party of Albania -the largest opposition party- won by a landslide. Since then, the government has been a coalition of mainly left-oriented parties, where the SPA has dominated. During their governance, there has been a constant growth of 8%, an abrupt decrease of inflation, an appreciation of the currency, a decrease in the trade imbalance, and a decrease in the budget deficit. However, unemployment has remained high. According to UNDP (2000), this is due to a lack of large investments, shortage of skilled labor, a large informal market, a lack of coordinated state policies on employment, inefficient labor market institutions and a low level of credit. In addition, the standard of living of Albanian families has remained low. As a result, internal migration has increased, mainly from rural to urban areas. Also, the traditional phenomenon of emigration remains.⁵ A recent development with dramatic consequences is the brain drain. During 1990-1999, approximately 40% of the overall number of professors and research scientists of the universities and science institutions in the country have emigrated (UNDP, 2000).

The political and economic situation became fragile again during the Kosovo crisis in 1999. According to UNDP (2000), **Error! Bookmark not defined.** the number of Kosovo refugees reached 450,000, which represented 15% of Albania's population. However, this crisis strengthened the ties between the peoples of Albania and Kosovo, and built for the first time a better and more trustworthy relationship and partnership between Albania and the international community (UNDP, 2000).

⁵ According to UNDP (2000), emigration is a phenomenon that has occurred throughout Albania's history, originating in the 15th century.

After -September 2000- joining the World Trade Organization (WTO), the main focus of international policy in Albania is to gradually become a serious candidate to enter the European Union in the future.

3. The Informal Sector: A Brief Literature Review

Starting from a complete neglect, the phenomenon of informal economic activity has become an issue studied by many researchers, both governmental and non-governmental. Aside from the term informal, this phenomenon is studied under various other names such as subterranean, shadow, hidden, parallel, black, clandestine, second, underground, and household. In light of the manifold appearances of the informal sector and consequently the variety of criteria describing each of them, several definitions have emerged. Most of the criteria used are related to the labor market, tax evasion, anti-state regulation, survival-seeking, and illegal activities.

The reasons to go informal can be economic and non-economic. The main economic reasons are: (a) to evade taxes; (b) to circumvent regulations and licensing requirements; and (c) to deal with unemployment and an inflexible formal labor market. The main non-economic reasons are: (1) greater flexibility and satisfaction at work; (2) the opportunity of free choice; (3) the complete utilization of one's professional qualification; and (4) political dissatisfaction.⁶

Several methods are used to analyze and measure the informal sector, depending on the way it is defined. Besides the difficulties stemming from confusion in terminology, inconsistency in definitions, and several measuring methods, 'the irregular and obscure conditions make it difficult for the researcher to collect data on the informal sector' (Bremner, 1980). There are two approaches for studying the informal sector: the direct approach and the indirect approach. The direct approach uses surveys to gather information about individuals' behavior. Its advantage is that it gives a specific and inside information about the informal sector, whereas its disadvantage is related to a potential respondent jeopardy⁷ (Lee, 1985). The indirect approach focuses on available economic statistics and derives conclusions about the informal sector from an analysis of these data. This is the most commonly used

⁶ For more comments, see Gërçhani (2002).

⁷ In other words this means the respondents' impression of being threatened by questions.

approach (mainly in OECD countries). A recent method –as part of the direct approach- involves laboratory experiments. The experimental method is mostly applied to study tax evasion. It offers the opportunity to study individual behavior in a controlled environment, where tax evasion is made possible. Its advantage is related to the possibility of controlling external factors, which might otherwise affect the circumstances governing behavior (as in real life). A disadvantage is that the laboratory setting might not be applicable to the real world setting it aims at studying. Nevertheless, an appropriately designed experiment is a good complement of research using other methods. For a recent experimental study, see Gërxhani and Schram (2001).

Finally, the effect of the informal sector on the economy as a whole is a topic of many debates. Some give a negative evaluation based on its negligible and marginal character with respect to the main macroeconomic indicators. Therefore, its reduction in size is suggested. Others, instead, have a positive view of its significance based on the dynamics, flexibility and the possibilities for accumulation that it yields. In this view, the informal sector should be supported and integrated into the formal economy (see Lubell, 1991). These contradictory opinions become stronger when considering different types of countries. Gërxhani (2002) argues that the informal sector in developed countries is often characterized by its potential for economic investments and growth as well as the comparable levels of income with the formal sector. In less developed countries, the features of the informal sector indicate the contrary. Finally, she concludes that on the basis of its positive implications in the short run, but negative consequences in the long run, the integration of the informal sector into the formal sector is considered a necessity.

4. The Informal Sector in Albania

For the majority of formal or legal business in Albania, an important problem, in both money and time, is dealing with bureaucratic obstacles. The former governments of Albania and other similar countries were undemocratic, legislating behind closed doors and reacting and responding to interest groups with only limited account of the needs and desires of the majority of the population.

Currently, because of the deficient legal institutions in these countries, public funds are often used inefficiently⁸ and economic opportunities are missed.

Although there is no official evidence on the existence of informal activities during the communist period in Albania, it is believed that it also existed then. This belief is based on the similar situations characterizing Albania and other countries for which the evidence does exist (Gërxfhani, 2002). Under a dictatorial political regime and an economic situation of continuous consumer shortages and poverty, individuals' reactions involved hidden exploitation of the system, personal usage of state property and living a double life. During the transition period in Albania, the level of this 'hypothetical' informal sector was further increased due to economic and financial factors such as the United Nations embargo on Yugoslavia, a high level of unemployment, the closure of several former state enterprises and the privatization of others, and the extended contacts with neighboring countries. Social factors such as the overall dissatisfaction with the previous regime and the informal pre-transition norms and behaviors of the population have played a substantial role as well.⁹ In addition, the government's inability to build up the proper institutions, for example to establish the rule of law and define and enforce property rights, contributed to encouraging the growth of the informal sector in Albania.

Private sector activities and the employment gap

New private business development is the primary source of job growth in the Central and Eastern European countries, because it serves as the principal mechanism for reallocating labor and capital from the state to the private sector (Johnson and Loveman, 1995). Indeed, the private sector emerged as the most dynamic and significant engine for economic growth in Albania.

⁸ For more insights, see Sadiraj (1999).

⁹ These norms and traditions originated in a centrally planned system. New norms and behaviors were required with the change of this system. This is when the clash between the two occurred and phenomena like tax evasion emerged. For example, the tax mentality of the population during the socialist period was non-existent due to the fact that all taxation was indirect or deducted at source. This is one potential reason why people often do not pay direct taxes even during transition although it is legally required (see EBRD, 1996).

In the period up to 1996, good results were achieved in the establishment and gradual extension of the private sector in agriculture, trade and services, accompanied by some joint ventures between former state enterprises and foreign enterprises. Privatization of state enterprises had also begun. However, according to Johnson and Loveman (1995), Albania (like Bulgaria and Romania) continues to have a very weak private sector primarily because these activities were tightly controlled under the old regimes and because the new economic policies have not clearly encouraged it. Only a few of the new enterprises in Albania could generate a surplus that could be invested in other private businesses and in enlarging the scope of the private sector as a whole, particularly to include capital-intensive sectors. The majority of new private enterprises were concentrated in trade and services. This is mainly a result of the lack of substantial financial support. Foreign investments in Albania did not have the same strategic and significant role they had in some other Eastern European countries. The reasons include the lack of an adequate legal system, especially in attracting foreign investors; bureaucratic procedures and a high level of corruption; the flow of foreign investors mainly aimed at short-run and very profitable investments, sometimes even illegal ones (e.g., money laundering); and the unstable political situation in the country and generally in the Balkans. Table 1 shows that the amount of the foreign direct investment (FDI) inflows to Albania is not that big and it has sharply decreased after 1996. This amount is particularly small if compared to the remittances of Albanian emigrants. The latter represent approximately one fifth of GDP, almost twice as much as foreign exchange revenues from exports and almost four times more than the value of direct investments in 1999 (UNDP, 2000). Although emigrants' remittances have been an important source of finance for domestic investment, they are considered more as private transfers than as capital flows. Meanwhile, the financial support from banks has been almost zero because of the very strict limit on banks' ability to give credits, and their reluctance to support new and potentially risky private enterprises. This financial situation got even worse when most of private savings were deposited in pyramid schemes instead of banks. Aside from the financial problem, new entrepreneurs were facing management problems as well. The old methods used in the centrally planned system were not appropriate anymore, therefore, they had to adopt a new managerial style. Consequently, due to very limited financial support, lack of managerial abilities, corruption, and confusing and

repressive legislation starting over in the private sector was limited and did not have the same importance and influence as in other countries of Eastern Europe.

Fast privatization of farmland was another major element of government policy in this period. This was completed by 1994 and there were 466,670 private farms in 1998 (INSTAT¹⁰, 1999). A substantial portion of their produces is traded in the market by street vendors.

In addition, the privatization of small, medium, and later on, large enterprises was another important component of the government's economic strategy. The total number of licensed private businesses in Albania was 30,535 in 1996 (Luçi and Kraja, 1999). In that year, 70% of the formerly state enterprises were privatized, and 75% of GDP was generated by the private sector, where small enterprises dominated. The main activities of registered private enterprises in 1996 in Albania were: trade (52.2%), services (17.5%), transport (14.9%) and industry (10%), followed by construction and agricultural activities (INSTAT, 1999).

However, this economic progress did not have an immediate effect on reducing official unemployment. The shrinking of the state sector played an important role. By 1993, over 60% of state sector employees had lost their jobs (ACER, 1996). The level of unemployment benefits (for those registered in the Labor Office) was 66% of the minimum wage (about US\$ 33 a month), where even the latter is insufficient for basic human needs (ACER, 1996).

The newly privatized enterprises gave priority to the employees of the former state enterprises rather than to the redundant labor force. On the other hand, *de novo* private enterprises were relatively small, hence they could not absorb much labor. All in all, the potential for obtaining remunerative full or part time employment in registered state or private enterprises was very limited, both due to the non-availability of jobs and the low level of wages. There was thus a need for the unregistered and registered unemployed to seek ways of gaining some income to supplement unemployment benefits, such as being involved in informal activities. In addition, although registered private activities developed rapidly, it is hard to believe that they by themselves led to a reduction- from 30% in 1991 to 12.4% in 1996- of

¹⁰ INSTAT is the Albanian abbreviation of the Albanian Institute of Statistics. Given that this abbreviation is often used in both Albanian and English literature, we will also keep using it throughout this paper.

the official unemployment rate. It is therefore apparent that either the official statistics on unemployment are a substantial understatement of the real situation or those who are not employed in registered formal activities are actually employed elsewhere, i.e. the informal sector. According to UNDP (1995), hidden employment was about 34% of the labor force in 1994. Albanian people were obliged to find their own ways to survive. They went out on the streets to sell whatever they could, they set up their shops/kiosks, and they built their houses without permission. Consequently, a great variety of illegal or informal economic activities came into existence or became more widespread. Some were harmful. These included smuggling, production and sale of narcotic plants, prostitution (inside and outside of Albania), informal money-lending and extensive corruption by government officials and the police. Others were more legitimate, including a proliferation of small-scale street vendors in Tirana and other major cities and towns (ACER, 1996).

5. Illustrative Evidence

This section discusses two examples of the significance of the informal sector in post-socialist Albania. The first is a brief description of one of the extreme appearances of the informal sector in Albania: financial pyramid schemes. The second example is a more extended study related to street vending. This study is based on a field survey of street vendors in Tirana, conducted by the Albanian Center for Economic Research (ACER) in 1996. These examples provide an illustrative contribution to the long-running controversy over the pros and cons of the informal sector.

5.1. The money market: pyramid schemes¹¹

Originally, private businesses could borrow money from three secondary banks in Albania: the Savings Bank, Commercial Bank, and Rural Bank, as well as from the 'Small and Medium Enterprises' (SME) foundation. Due to a lack of experience and incompetence, banks found themselves with more than 30% of their loans not being serviced on time in 1996 (ACER, 1996). These problems, along with diminishing households savings/deposits and strict government regulations, put the banks into a difficult situation. As a result, they reduced the available credit to businesses. While

¹¹ For a detailed analysis of pyramid schemes in Albania, see Bezemer (2001), Jarvis (1999) and Sadiraj (1999).

grants and inexpensive credit were available from German, Italian and American funds, it was not enough to fulfill the borrowing needs of the business community. The only joint-venture bank -between the National Commercial Bank and Banca di Roma- dealt exclusively with money transfers and payments. In 1996, three new private banks were licensed as branches of their headquarters' banks in other countries. Despite many requests and applications from different firms, no license was given to establish an Albanian owned private bank.

As in other Central and Eastern European countries, the state sector in Albania provided most of the physical capital for the new emerging private businesses. This physical capital was not sufficient: it was redistributed only to a few people, and furthermore, additional capital was needed to start a business. Attracting financial capital, either for starting up a business or for extending an existing business, remains the largest problem for Albanian entrepreneurs. In some other Central and Eastern European countries, foreign investors have played a catalyst role by providing the essential initial capital, whereas in Albania this phenomenon was highly problematic, because foreign investments did not take place at any significant level. In May 1996, the Tirana stock exchange was opened, but it has not shown any ability to attract capital for business growth. The Tirana stock exchange has focused its activity on trading in Treasury Bills, and the second level banks are its only clients.

As a result, most individual savings were not deposited into the banking system to support economic investments and hence to contribute in higher rates of overall growth. They were mainly concentrated in the informal market, which emerged in Albania. Due to the incapable formal financial institutions, the system of investing in pyramid schemes became very popular.¹² It is believed that the money-borrowing firms and foundations absorbed more than US\$ 1.2 billion (Jarvis, 1999).

The main reasons why this market emerged in Albania are (briefly):

1. path dependence - Albanians had been isolated for about forty-five years and had no experience with market institutions;
2. high and attractive rates of interest offered by the companies (5 – 10% per month) and foundations (about 50%) involved; and interactions with money laundering and other suspicious activities;

¹² The informal money-lending market was introduced in Albania in 1992 by a Swiss businessman of Albanian ancestry (Reca, 1997).

3. the inefficiency of the banking system (e.g., delays in services and the lack of a modern payment system, which led consumers to make their transactions in cash);
4. tight monetary and fiscal policies and restrictive bank legislation in 1992-95 (Bezemer, 2001);
5. the government's failure to prevent the extension of pyramid schemes (e.g., through better law enforcement) and moreover its implicit support of the schemes; and
6. the ambiguity of legal system, which often left room for several pragmatic interpretations.

5.2. Survey of street vendors in Tirana

5.2.1. Role of street vendors in the informal sector

Retail services in Tirana are an extremely important part of the economy. In 1996, there were about 19,328 private businesses registered in Tirana, more than half of which were involved in the retail sector (INSTAT, 1998). They appeared as anything from the most exclusive fashion shops, general stores, expensive restaurants and bars and cafes, to kiosks and ambulant vendors selling a few cigarettes, packs of chewing gum or bananas. Little is known about the commercial activities of all these different types of registered retail outlets. Competition is extremely fierce, which leads to expectations that many will not survive. However, up to 1996, most commercial businesses appeared to be prospering (ACER, 1996).

Street vending has been one of the most visible activities in the Albanian informal sector. There was hardly a street in Tirana without a full complement of street vendors, where the total number in 1996 was probably over 5,000 or 50% more than the number of registered vendors (ACER, 1996). Street vending started when people began to invade the public thoroughfare, the use of which is open to everybody, in order to sell goods and services and for commercial transactions - without obtaining permits, giving receipts, or paying taxes. Most of them are fruit and vegetable sellers, closely followed by sellers of cigarettes, soft drinks, snacks and common consumables. Even within street vending, there is a certain range of activities consisting of some vendors selling newspapers, books, clothing, kebabs, plumbing and electrical equipment, and second hand goods or hardware. Nevertheless, street vending is often characterized by a low level of capital outlays, turnover and profits.

5.2.2. The ACER survey

The Albanian Center for Economic Research surveyed 373 street vendors of Tirana in 1996. The survey covered about 7% of the total number of vendors in the city. Street vendors of diversified products were randomly selected and interviewed by 13 interviewers (students) at the same time of day in different regions of the city. 50 out of 373 observations appeared to be inadequate or incomplete and omitted from the analysis.

5.2.3. Survey results

- *Registration processes and informal alternatives*

80 percent of the interviewed street vendors declared that they possessed no official license or registration for their activity. This does not mean that they did not have to obtain and pay for some form of ‘permission’ to locate where they were.¹³ In order to give an idea of what it takes to be formally registered as a street vendor,¹⁴ a brief outline of the official requirements in 1996 is given below.

- (a) The prospective entrepreneur presents her/his proposal verbally to the district law court;
- (b) The lawyer appointed by the chairman of the district law court decides whether to accept the proposal or not on the basis of commercial law;
- (c) If accepted, the prospective entrepreneur pays a fee of 500 Albanian Leks (about US \$5) and receives a written permit to be used in the local tariff and tax office;
- (d) The local tariff and tax office gives the prospective entrepreneur a license to carry out the private business in her/his selected field of activity; and finally
- (e) The prospective entrepreneur can start her/his own business and is obliged to contact, on a monthly or quarterly basis, the tariff and tax office to report her/his income and, consequently, pay the relevant tariffs and taxes.

However, due to features of bureaucracy partly inherited from the communist period, this formal process seemed to be very slow and often costly because officials wanted

¹³ As it will be shown later, one way of providing this ‘permission’ is by bribing the state officials.

¹⁴ The process is more complicated for other types of entrepreneurial activities.

to be bribed to process the license application. It was for these reasons that the majority of vendors preferred to use informal alternatives. The most common informal alternative was to bribe the local license inspector or policeman, who, in return, would ignore that the business was unregistered. Another alternative was to associate a stall with a fixed or temporary retail outlet, which was formally registered. In this case, payment would depend on the type of family (or other) relationship between the street vendor and the owner of the retail outlet.

- *Tax evasion*

90 percent of the interviewed street vendors said that they did not pay any state or municipal taxes. A few claimed that they paid only the compulsory social security payments in their formal employment. Overall, payment of taxes and social security represented 6% of family expenditures.

- *Reasons for becoming a street vendor*

49% of the street vendors interviewed claimed to have lost their previous job and only some of them were receiving unemployment benefit. A further 26% had changed occupations to increase family income. A few (5%) were school-age children not attending school. Most of the rest proved to be in the age-group 20 – 30, where one is either unable or unwilling to attend university or other types of useful training, as an alternative to being involved in the street vending.

Being a street vendor was not the only informal activity for 61% of respondents. Most of them (68%) refused to say what else they did. The rest (32%) appeared to increase the monthly income by renting living space in houses or apartments, or were involved in trading (usually imported) goods.

- *Education levels and working experience*

The survey results indicate a very high level of education among street vendors. 68 percent of street vendors have completed secondary education, 20% had finished university and only 12% had only completed elementary schooling.

Previous working experiences of street vendors varied widely. Most of them (60%) had worked as blue-collar workers, 14% used to be military officers and 16% used to be government officials.

- *Family situation*

42 percent of the respondents were members of families with five or more persons, none of whom were formally employed. Males were mostly involved in street vending (81% of the total number of males of these families), while females often took more responsibility for other family duties.

83 percent of those surveyed reported a family monthly income of more than 8,000 Leks (about US \$77), 15% of 5,000 (about US \$48) - 8,000 Leks and 2% under 5,000 Leks. However, street vending yielded on average only 45% of this income. This supports the evidence in the literature that street vending often serves as an income-supplementing activity rather than as a primary source of income (Gërzhani, 2002). Some important additional sources of income were remittances from family members who worked abroad, activities in the informal credit market, renting of living space and various state financial benefits.¹⁵

6. The Significance of the Informal Sector in Albania

The effect that the collapse of the informal money-lending activities (pyramid schemes) had on the whole Albanian society is an extreme example of how the informal sector can have a crucial influence on the political, economic and social aspects of a society. On the other hand, the results of the ACER street vending survey in Tirana in 1996 show that the informal sector has helped the Albanian economy during its difficult years of transition. They reveal that the informal sector activities provide families with employment and supplementary income, in the absence of other possibilities. People learn to use their initiative and creativity to produce more jobs and wealth. As De Soto (1989) states in general, the social problems are enormous, but the situation would be infinitely worse without the informal marketeers. In addition, the results show that joining the informal sector is a way to protest against the inefficiencies and high transaction costs caused by unnecessary state regulations and bureaucratic procedures. When free initiative and entrepreneurial creativity (as

¹⁵ Another survey (on second jobs of government officials), conducted by ACER in 1996, confirmed that many people are involved in informal activities to supplement their incomes from formal employment. This survey indicated that 33% of government officials in ministries had a second job. In addition, their incomes earned from these second jobs were equal to or greater than their official incomes.

part of informal institutions) are not supported by the formal state institutions, people flee to the informal sector.

If the informal sector can have positive effects, the question is: to what extent? Again, the negative experience of Albania with the informal financial market raises important questions. With respect to economics, due to the existence of this market in Albania, money invested in the pyramid schemes did not support economic investments. Politically, it caused serious political instability in the country, which was almost transformed into a civil war. Socially, a majority of people lost their savings and wealth accumulation, and therefore many social problems emerged.

Despite the undoubted benefits, the mushrooming of street vending activities can have serious consequences for Albanian society. A very high level of unlicensed activities (as the survey indicates) among street vendors is correlated with a very high level of unrecorded income-earners. Consequently, there will be financial losses in the state revenue; public goods may be under-provided; the main macroeconomic indicators (e.g., unemployment rate, tax rate, inflation and growth rate) will be distorted; and as a result, the policy makers will base their decisions on a misleading view of the country's economy. In addition, the large contingent of uninsured today will create a great burden for social assistance and welfare programs. Albanian society will have to pay a high cost to reduce poverty (UNDP, 2000).

As it appears from these two examples of the informal sector in Albania, the cons outweigh the pros, therefore the informal sector needs to be formalized.

7. Conclusion

The communist regime in Albania was much stronger than in other Eastern European countries. Although late, Albania joined these countries toward a free market economy. Despite many difficulties, progress was achieved in the beginning.

However, in the meantime, the governing political class was failing, the economic capacity of the country was not able to attract substantial internal and external resources, and the state was institutionally weak. As a result, financial pyramid schemes emerged and then collapsed in 1997, which in combination with the Kosovo war in 1999, set the country back seriously.

Another outcome, which could be considered negative in the long-run but positive in the short-run, is the large development of the informal sector overall. The results of the ACER street vending survey in Tirana in 1996 show how large and how significant this phenomenon was. Its significance is two-fold: (1) it has helped Albanian families to make a living and survive in the difficult years of transition, but (2) it has not been sufficient to support long-run economic investments and growth. However, the informal sector in Albania is here to stay.¹⁶ Therefore, its integration into the formal economy is a necessity.

The establishment of the proper legal and institutional framework accompanied by the appropriate monitoring and enforcement procedures, is the first step to the legal development of the private sector and the whole economy of a country like Albania. The lack of an adequate system of private banking and stock exchange (financial market) and the related success of pyramid schemes in Albania are good examples of how institutional development is of essential importance in countries in transition.

¹⁶ For some recent evidence, see Gërxhani (2002).

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Table 1: Some macroeconomic indicators for the period 1990-1999

| | 1990 | 1991 | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 |
|-----------------------------------|-------|-------|------|-------|-------|-------|-------|-------|--------|--------|
| Real GDP growth (%) | -10.0 | -28.0 | -7.2 | 9.6 | 8.3 | 13.3 | 9.1 | -7.0 | 8.0 | 8.0 |
| Annual average inflation (%) | 0 | 35.5 | 226 | 85.0 | 22.5 | 7.8 | 12.7 | 32.1 | 20.9 | 0.4 |
| Exchange rate (Lek/US\$-end year) | 8.9 | 24.2 | 75.0 | 102.1 | 94.7 | 92.8 | 104.5 | 148.9 | 150.6 | 137.5 |
| Trade balance (Mil. US\$) | -150 | -308 | -471 | -490 | -460 | -474 | -692 | -519 | - 621 | -205.5 |
| Unemployment rate (% - end year) | -- | 30.0 | -- | 22.0 | 18.0 | 13.0 | 12.4 | 14.9 | 17.8 | 18.3 |
| Budget deficit (% GDP) | 15.3 | 20.7 | 15.8 | 13.7 | 7.7 | 8.6 | 12.3 | 12.0 | 8.6 | 7.4 |
| Minimum official wage (in Lek) | -- | -- | -- | 1.200 | 2.400 | 3.300 | 4.400 | 4.400 | 5.800 | 5.800 |
| Average monthly wage* (in Lek) | -- | -- | -- | 3.084 | 4.778 | 6.406 | 8.638 | 9.558 | 11.509 | -- |
| FDI inflows (Mil. US\$)** | -- | -- | 32.0 | 45.0 | 65.0 | 89.0 | 97.0 | 42.0 | 45.0 | 43.0 |

(*) indicates the average monthly wage in state sector

Sources: UNDP (2000) as obtained from Ministry of Finance, Ministry of Labor and Social Affairs, Institute of Statistics and Bank of Albania. EBRD (European Bank for Reconstruction and Development) Transition Report 1999 and Albanian Observer (2000).

(**) FDI - Foreign Direct Investment

