

## **Legal and Judicial Reform in Europe and Central Asia**

*Poonam Gupta, Rachel Kleinfeld, and Gonzalo Salinas*

---

Director-General, Operations Evaluation: Robert Picciotto  
Director: Gregory K. Ingram  
Acting Manager: Rene Vandendries  
Task Manager: Poonam Gupta



## OPERATIONS EVALUATION DEPARTMENT

### ***ENHANCING DEVELOPMENT EFFECTIVENESS THROUGH EXCELLENCE AND INDEPENDENCE IN EVALUATION***

*The Operations Evaluation Department (OED) is an independent unit within the World Bank; it reports directly to the Bank's Board of Executive Directors. OED assesses what works, and what does not; how a borrower plans to run and maintain a project; and the lasting contribution of the Bank to a country's overall development. The goals of evaluation are to learn from experience, to provide an objective basis for assessing the results of the Bank's work, and to provide accountability in the achievement of its objectives. It also improves Bank work by identifying and disseminating the lessons learned from experience and by framing recommendations drawn from evaluation findings.*

OED Working Papers are an informal series to disseminate the findings of work in progress to encourage the exchange of ideas about development effectiveness through evaluation.

The findings, interpretations, and conclusions expressed here are those of the author(s) and do not necessarily reflect the views of the Board of Executive Directors of the World Bank or the governments they represent.

Contact:  
Operations Evaluation Department  
Partnerships & Knowledge Programs (OEDPK)  
email: [ecampbellpage@worldbank.org](mailto:ecampbellpage@worldbank.org)  
e-mail: [eline@worldbank.org](mailto:eline@worldbank.org)  
Telephone: 202-458-4497  
Facsimile: 202-522-3125  
<http://www.worldbank.org/oed>

## Contents

<b>Summary</b> .....	v
<b>1. Introduction</b> .....	1
<b>2. Lending and Nonlending for Legal and Judicial Reform in Europe and Central Asia, 1990-2001</b> .....	3
Lending.....	3
Analytical work.....	6
<b>3. Relevance and Efficacy of Legal and Judicial Reform Strategy</b> .....	7
Relevance .....	7
Efficacy .....	11
<b>4. Effectiveness of Legal Reform in Albania and Romania</b> .....	13
<i>How to Increase Effectiveness of Bank Intervention in Albania and Romania?</i> .....	17
<i>Potential Problems with Adjustment Lending to Promote Legal Reform: Romania</i> .....	19
<b>5. Preliminary Conclusions and Issues to Debate</b> .....	21
 <b>Boxes</b>	
3.1 Some Elements of a Relevant Strategy .....	3
3.2 Albania Bankruptcy Law.....	9
3.3 Partners in Legal Reform .....	10
3.4 European Bank for Reconstruction and Development Evaluation Findings .....	13
4.1 Albania: A Mixed Picture of Donor Coordination .....	17
4.2 The Romanian Financial and Enterprise Sector Adjustment Program— Legislative Instability .....	18
4.3 Existing Guidance on Good Practice.....	20
 <b>Chart</b>	
3.1 Legal Reform by Areas .....	5
 <b>Tables</b>	
3.1 Commercial Legislation .....	5
3.2 Financial Sector Legislation .....	5
 <b>Annexes</b>	
Annex A .....	22
Annex B .....	24
Annex C .....	25
<b>References</b> .....	26
<b>Endnotes</b> .....	27

Alice Galenson, Gita Gopal, Rene Vandendries, Simeon Djankov, Rick Messick, Linn Hammergren, Randy Reiterman, Sandra Bloemenkamp, Helga Muller, Cheryl Gray, Arntraud Hartmann and the Legal Department offered comments on a first draft that led to changes.



## Summary

Between 1990 and 2001, 95 projects for US\$ 10.8 billion in 21 European and Central Asian (ECA) countries included legal and judicial reforms. (Note that all dollar amounts in this paper are U.S. unless otherwise stated.) The Bank supported legal reform of commerce, the financial and other sectors, privatization, and property rights; support was also provided for legal education and assistance with legislative drafting. In 89 projects, legal and judicial reforms were designed as components of larger projects; the remaining 6 projects, at a cost of \$113 million, were stand-alone. Commercial and financial sector legal reform, comprising 56 percent of legal reform interventions, emphasized bankruptcy, company, banking, and securities market laws. Privatization, sectoral regulation, property rights, legal education, and assistance for legislative drafting encompassed the remaining 44 percent of interventions. Judicial reform was addressed in 17 of the 95 projects and focused on improving the management capability of judges through the provision of training and equipment.

This preliminary assessment report found that many of the laws subject to reform were important to the development of a market economy, as determined by the Bank's research and other analytical work. Bank interventions also responded to the changing needs of transition countries. By 1998, Bank attention had shifted from bankruptcy law toward legislation for foreign direct investment, taxation, licensing, and from banking regulation toward microcredit and pensions. Country Assistance Strategies (CASs) for 21 out of 26 transition countries produced in the 1998–01 period identified deficiencies in specific laws in contrast to the earlier CASs. Since 1997, the Bank has also directed more attention to judicial reform.

However, the Bank might have provided similar laws (concerning bankruptcy, company, banking, and securities markets) for a number of countries without a prior review of country-specific conditions, on the assumption that these laws would eventually be needed by any modern market economy. Evaluations and fieldwork suggest that when supporting these laws, the Bank might not have addressed key questions, such as: Is there demand for a particular law? If there is no demand, does the Bank expect to create demand through supporting the law? How appropriate is law change as a tool, given the state of legal institutions and governance environment within a country? How would a particular law fit into the overall framework of laws, and societal understandings? Is Bank action needed in the field chosen, or are other actors with a comparative advantage in that area already working on the same thing? How is the law drafted, who is consulted, which branch of the government should pass the law, and is additional implementing legislation needed? In designing judicial reform interventions, the Bank has focused too narrowly on training and supplying equipment.

Evaluation reports suggest that the majority of laws supported by the Bank have been passed or submitted but that legal reform has not yet met Bank objectives as stated in loan documents. Land laws, for example, have so far not led to dynamic land markets, and bankruptcy laws have not been used much in a number of transition economies. Fieldwork in Albania and Romania indicated that the effectiveness of the myriad of laws supported by the Bank has been mixed. Moreover, in Romania, laws in adjustment

lending were passed by executive decrees rather than by parliament; the resulting laws were then subject to change, which contributed to the instability of the business environment. In a volatile political environment such as in Albania, a shorter process for judicial reforms would have capitalized on commitment, public interest, and reform champions within the government.

Four questions that merit debate are as follows:

- How can diagnostics be improved so that questions of demand, supply, societal understandings, governance, legal institutions, and the process by which laws are made might be addressed, and how can the mechanisms by which disputes are resolved be traced so as to inform legal and judicial reform programs?
- How can implementation of legislative reform be monitored at the country and thematic level to develop lessons and best practices?
- How can planning and analysis be intensified to capitalize on the unpredictable momentum and will to reform?
- How can the correct time and circumstances be determined for using conditionality in adjustment lending to promote legislative reform?

## 1. Introduction

There is a substantive body of empirical evidence that attests to the importance of legal and judicial reform in achieving a high rate of economic growth (Barro 1991; Havrylyshyn and van Rooden 2000; Campos 2000; Svejnar 2001). The argument is that weak or nonexistent laws and judicial institutions not only create a bias against new firms that have no means by which to persuade clients of their reliability, but also a bias in favor of simple over more complex transactions, since it is unlikely that legal remedies can be invoked in cases of nonfulfillment of contracts (Posner 1998). Impartial judicial systems are also necessary to advance equality and allow a voice for the poor, thereby making a fair and functioning legal system an element of a comprehensive developmental framework..

The Bank has responded to the priorities of legal and judicial reform. In 1989, the Legal Department prepared a discussion paper entitled “The Role of Law in Private Sector Development” that showed the importance of an appropriate legal system (properly administered and enforced) in creating an environment conducive to business development. The General Counsel’s opinion in 1990, and his accompanying remarks, confirmed the Bank’s role in supporting legal and judicial reform. A number of papers were prepared in the 1990s in these areas (Shihata 1993, 1995; Vorkink 1997; World Bank 2000). As of 2000, more than 300 operations Bank-wide that deal with or include legal and judicial reform components were identified by the Legal Department.

In light of the growing importance of lending for legal and judicial reform, it is appropriate to take stock of the areas targeted by such reform, as well as what has been accomplished, so as to raise issues for further debate. In 2001, the Bank sponsored the Second International Conference on Law and Justice, entitled “Empowerment, Security, and Opportunity Through Law and Justice,” in St. Petersburg, Russia. This conference and the Papers on the Bank’s legal and judicial Web site show that a consensus on a methodology to evaluate legal and judicial reform has not yet been reached. Thus, this paper uses the approach embedded in the Bank’s Comprehensive Development Framework (CDF) and asks the following questions (see also Box 3.1):

- Did we take into account client ownership, partnerships, and results orientation?
- Did we adopt a strategic approach (that is, look carefully at the state of legal institutions and the governance environment within a country and assess how a particular law would interact with societal understandings)?
- Did governments eventually pass the laws sought by the Bank and were these laws used?

Choosing a database of legal and judicial projects for this paper was difficult. If legal reform is broadly defined as changes in laws through the amendment of existing laws or

promulgation of new laws, support for legislative drafting, and legal education, then in ECA alone, almost all the 549 operations approved through fiscal year 2001 could be included in the database. Most Bank operations are predicated on a reform of some type of legal norm, whether it is an explicit part of the operation or a prior condition of it. Compiling a database of only capacity building and institutional development projects that include components relating to legal reform was also not appropriate, because it would exclude many adjustment loans that included conditions about the preparation and adoption of certain laws reflecting policies agreed upon with the Bank. Of the investment projects, relatively few were stand-alone projects. In ECA, for instance, there were only six such projects.

For this paper's database, we included ECA-Region projects with legal reforms concerning the financial and other sectors, commerce, privatization, property rights, and capacity building. All projects with assistance to the judiciary were also included in the database. The ECA Region and these legal initiatives were chosen for four reasons. First, transition economies face the imperative and unique challenge of adopting legal frameworks from scratch. Second, the lessons learnt from this paper could be used in the larger Operations Evaluation Department (OED) study of transition countries. Third, about a quarter of the projects in ECA included the legal initiatives discussed above. Fourth, these legal initiatives were important for functioning market economies.

Judicial reform interventions were classified using a methodology suggested in a background paper prepared for the World Development Report, 2002. Judicial reforms were classified as follows: reforms based on enhancement of the managerial capability of judges; reforms based on incentives to judges; reforms based on incentives to the parties and other actors of the judicial process; reforms based on structural modification of the judicial system; reforms based on modification of rules of procedures; and other reforms (Botero and others 2001).

The rest of this paper is organized as follows: Chapter 2 outlines the focus of lending and nonlending activities; Chapter 3 assesses whether activities were broadly relevant and effective; Chapter 4 evaluates the effectiveness of laws in case studies of two countries; and Chapter 5 summarizes preliminary conclusions and emerging issues for debate.

The analysis is based upon a desk review and fieldwork in two countries, Albania and Romania. The desk review and analysis attempted to answer the questions listed above in this Introduction and elaborated in Box 3.1. Effectiveness was judged in relation to legal reform objectives in loan documents and was based on information presented in Implementation Completion Reports (ICRs), OED assessments, and on fieldwork in the two countries.<sup>1</sup> The main data reviewed were projects documents, CASs, all 47 ICRs, and selected analytical work (such as Country Economic Memorandums, private sector assessments, judicial assessments, and the various policy research working papers produced in the World Bank). Analyses of these documents were supplemented with interviews, OED country assistance evaluations completed for 6 transition economies, 15 OED project assessments, U.S. Agency for International Development (USAID) assessments of commercial law, and European Bank for Reconstruction and Development (EBRD) evaluation of its own legal reform activities. Fieldwork in Albania



### **Box 3.1. Some Elements of a Relevant Strategy**

*Ownership:* Is there demand for a particular law? If there is no demand, does the Bank expect to create demand by supplying the law? How is the law drafted? Who is consulted? Who should pass the law?

*Strategic:* How appropriate is law change, given the legal institutions and governance environment within a country? How would a particular law fit into the overall framework of laws, and societal understandings? Is additional implementing legislation needed?

*Partnership:* Is Bank action needed in the chosen field, or are there other partners with a comparative advantage who are already dealing with the same issue? Should the Bank undertake broad interventions to stimulate major reforms that improve the functioning of the judicial system? Should it leave specific capacity building activities such as judicial training, infrastructure construction, curriculum reform, law preparation to other donors?

*Results Orientation:* How should results be monitored?

and Romania was carried out in 2001.<sup>2</sup> In Albania, the Bank addressed a range of laws (collateral, bankruptcy, secured transactions, banking, agricultural), in addition to judicial reforms. With its large numbers of donors working on legal and judicial reforms, the country has some unique problems of coordination. The Bank also addressed several laws in Romania, primarily through adjustment lending.<sup>3</sup> Both countries have governance issues, and case studies could shed light on how these issues might impede the implementation of laws. The studies that contributed to this paper were qualitative, and were primarily based upon interviews with beneficiaries, as well as makers and users, of law.<sup>4</sup>

## **2. Lending and Nonlending Projects for Legal and Judicial Reform in Europe and Central Asia, 1990–2001**

Legal reform *in itself* has not been a Bank strategic objective. There is no formal country-level economic and sector work (ESW) that describes the existing legal framework, and articulates a strategy for changing it. However, legal reform in the 1990s has been *a tool* to implement policy reforms being sought by the Bank (such as bankruptcy laws to provide an exit mechanism for insolvent enterprises, banking laws to promote a sound banking system, and land and property rights laws to develop land markets). Thus, to understand the Bank support for legal and judicial reform, lending operations and analytical work are first examined.

### **Lending**

*Allocations:* Between 1990 and 2001, 95 projects in 21 countries for \$10.8 billion included legal (commercial, financial sector, privatization, sectoral regulation, and

property rights laws, as well as legal education and assistance for legislative drafting) and judicial reforms. In 89 projects, reforms were components of larger projects; the remaining 6 were stand-alone. About 17 of the 95 projects, all approved after fiscal 1996, included assistance to the judiciary. In addition, 6 Institutional Development Fund (IDF) grants for \$1.58 million have been approved.

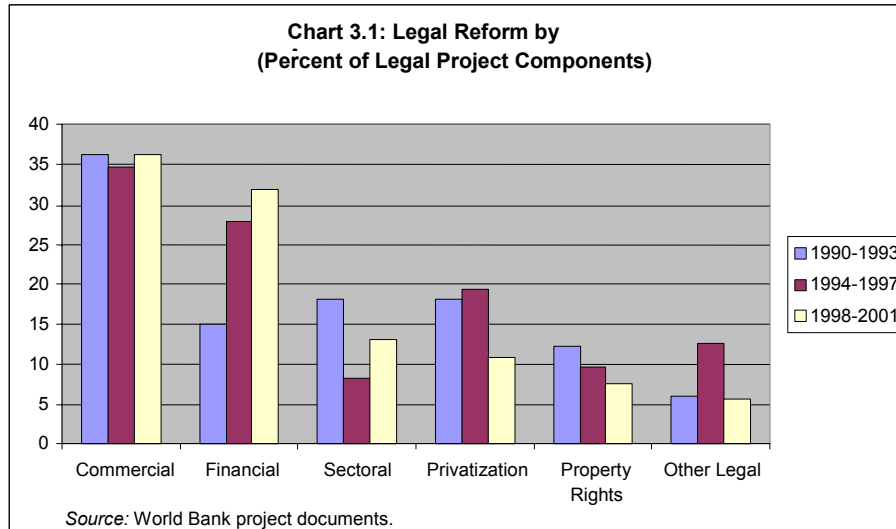
Of the 95 projects, 45 were adjustment, 49 were investment, and one was a learning and innovation loan. The 45 adjustment operations were for \$8.86 billion; of these, 2 were programmatic Structural Adjustment Loans (SALs) for Latvia, approved in fiscal 2000 and fiscal 2001. Of the 49 investment operations, three were Adaptable Program Loans (APLs), of which two were in 1998 (Latvia and Kazakhstan) and one in 1999 (Azerbaijan). The six stand-alone projects, all investment operations approved between fiscal 1996–2001, totaled \$113 million. The first and the largest for The Russian Federation in fiscal 1996 for \$58 million supported drafting of legislation, design of a system for classifying legislation, legal education, public awareness, judicial training, and alternative dispute resolution mechanisms.

*Focus:* Commercial and financial sector legal reform, comprising 56 percent of interventions, emphasized bankruptcy law (15 countries), company law (11 countries), banking law (15 countries) and securities market law (9 countries). Privatization law (17 countries), sectoral law (18 countries), property rights law (13 countries), legal education, and assistance for legislative drafting comprised the remaining 44 percent (Annex Charts 1, 2, and 3).<sup>5</sup>

Laws supported specific reform areas. Banking laws emphasized the creation of an independent central bank with powers to establish and enforce prudential regulations; these laws also gave powers to the central bank to set licensing requirements for new banks, and for banks to be audited by external auditors. In addition, banking laws supported mechanisms to deal with illiquid and insolvent banks.<sup>6</sup> Privatization law assistance included laws for privatizing state-owned enterprises and legal advisory service for the process of privatization. Sectoral laws addressed legal frameworks in the agriculture, energy, oil and gas, telecommunications, and utilities sectors. Property rights included laws for the issuance of property rights, registration of land or real estate, and cadastre laws.

The reform focus changed during the transition period. Privatization-related legislative assistance has declined (Chart 3.1); within commercial laws, bankruptcy interventions have also declined, while legislation for foreign direct investment (FDI), taxation, and particularly legislation related to licensing, has increased significantly (Tables 3.1 and 3.2). In the financial sector, emphasis on legislation increased, shifting from banking in 1990–93 towards microcredit, pensions, and other non-Bank financial institutions in 1998–01 (Tables 3.1 and 3.2).

The Bank's judicial reform initiatives were focused on improving the management capability of judges (Annex Chart 4), primarily through the provision of training and



**Table 3.1. Commercial Legislation (Percent of Legal Components)**

	<i>Bankruptcy</i>	<i>Collateral</i>	<i>Company</i>	<i>Competition</i>	<i>Contract</i>	<i>FDI</i>	<i>Licensing</i>	<i>Taxation</i>
1990-93	17	8	25	17	25	0	8	0
1994-97	32	12	20	8	8	8	0	12
1998-01	21	6	18	9	3	15	15	12

*Source: World Bank project documents.*

**Table 3.2. Financial Sector Legislation (Percent of Legal Project Components)**

	<i>Banking</i>	<i>Microcredit</i>	<i>Other financial institutions</i>	<i>Pension</i>	<i>Securities</i>
1990-93	80	0	0	0	20
1994-97	55	5	5	10	25
1998-01	37	11	19	15	19

*Source: World Bank project documents.*

equipment.<sup>7</sup> Training was provided in nine countries, and equipment in seven. Training usually targeted judges, lawyers, bailiffs, and in one case mediators. In Croatia, training was aimed at strengthening the judges' understanding of the legal and institutional aspects of bankruptcy proceedings. In The Russian Federation, arbitrators and mediators were trained in techniques of alternative dispute resolution. The goal of training in Kosovo was to familiarize judges with the new regulations concerning companies, contracts, pledges, and foreign investment, and to retrain accountants in the new accountancy law. In Albania, the Bank targeted training toward law faculty and the Magistrates School. In Latvia, the objective was to familiarize judges with new laws that had been passed.

### **Analytical work**

Working and discussion papers were prepared for Bulgaria, Romania, Slovenia, the Czech Republic, Hungary, Poland, the Slovak Republic, and The Russian Federation; these papers described the framework of commercial laws (such as laws regarding property rights, companies, bankruptcy, contracts, foreign investment, and competition). Weaknesses in judicial institutions and in the legal profession were also identified (Gray 1992; Gray and Ianachkov 1992; Gray and others 1992; Gray and others 1993; Gray and Hendley 1995; Gray and Holle 1996).

Private Sector Assessments in six countries (Bulgaria, the Kyrgyz Republic, Lithuania, Kazakhstan, Turkey, and Uzbekistan) also contained legal reform issues.<sup>8</sup> In Turkey, the issue was the legal framework for the energy sector. Others issues were the framework for collateralized transaction (Bulgaria and Lithuania); securities laws (Lithuania); licensing laws (the Kyrgyz Republic); tax codes (Lithuania and the Kyrgyz Republic); pledge laws (Uzbekistan); and corporate governance, bankruptcy, and liquidation issues (Kazakhstan). In five countries, difficulties in new business registration and enforcement issues were also highlighted.

Since 1997, ESW has focused on reform of the judiciary. In six countries, judicial assessments have been completed or are currently underway (Armenia, Azerbaijan, Bulgaria, Georgia, Romania, and the Slovak Republic).<sup>9</sup> In other countries, judicial reforms were discussed in the context of other ESW.<sup>10</sup>

In some countries, preparatory work for lending looked at legal and judicial reform. The Albania Technical Assistance Recovery project financed a detailed and highly useful assessment of the state of the judiciary that was finalized in 1997. The fiscal 1999 Structural Adjustment Credit (SAC) did a thorough analysis of the judicial sector, building upon the 1998 analysis in the Country Economic Memorandum (CEM).<sup>11</sup> The Legal and Judicial Technical Assistance Credit of fiscal 2000 updated the earlier analyses and provided resources to implement the program. The Russian Federation and Kazakhstan's legal reform projects also included a useful diagnosis of problems, although there was no formal ESW in this area.

### **3. Relevance and Efficacy of Legal and Judicial Reform Strategy**

#### **Relevance**

Lending operations targeted some of the laws determined to be important in the Bank's work. Bankruptcy, company, and property rights law, highlighted in research work, were prominent concerns in lending. Lending also responded to changing needs of the transition economies.<sup>12</sup> Interviews indicated that this shift was also informed by the Foreign Investment Advisory Service (FIAS) reports, informal country work, and shifting priorities in the countries themselves.

Operations that provided assistance to the judiciary were based on analytical work. The judicial assessments for Armenia and Georgia, for instance, were used in Judicial Reform Projects in both countries.<sup>13</sup> The ESW on Latvia's regulatory institutions and procedures in 2000 informed the design of the legal and judicial reform components in programmatic Structural Adjustment Loans (SALs) (fiscal 2000 and fiscal 2001).

Nevertheless, there were shortcomings in legal reforms as conditionality requirements. Given the short time frame of adjustment loans, conditionality was most frequently structured around submission and passage of laws.<sup>14</sup> Supervision and completion reports generally reported on fulfillment of conditions and less frequently on whether the objectives sought through changing legal frameworks were met. Thus, the Bank has been unable to assess political commitment as revealed by how laws were implemented, whether the Bank had supported the right law, and the need for additional legislation. In drafting laws, the Bank's good practice guidance (Box 4.3) suggests that the help of foreign experts should be combined with knowledge provided by the local legal community. In cases where loans financed legal work, it was unclear from most documents whether the Bank was financing foreign or local consultants, or both.<sup>15</sup>

Support for laws in lending was informed by prior analytical work in only a few countries. Bankruptcy laws, for instance, were supported in 15 countries and company laws in 11 countries, but bankruptcy was discussed in the ESW and research work of only 6 countries. Banking and securities market laws, promoted in several transition economies, were unimportant elements in ESW. Contract and competition laws emphasized in research were not prominent in lending conditionality. Thus, the Bank set forth similar laws (regarding bankruptcy, company, banking, and securities market) as conditions for a number of loans to different countries, assuming that these laws would be needed by any modern market economy without a prior review of country conditions. However, country review was needed, because the Bank had moved from laws governing trade and utility pricing in the 1980s to laws in the 1990s that required sophisticated enforcement institutions, societal understanding, public debate, and understanding on the part of the Bank of local culture, as well as legal and political traditions.

Interviews for this paper and OED country assistance evaluations revealed a myriad of reasons why reviews of country conditions was not undertaken earlier in the transition. Many of the reasons are applicable more generally to reforms. First, the pace of transition was rapid and there were external pressures to respond quickly. Second, staff believed

that in most transition economies—starting with middle-income per capita levels institutions and human capital were generally quite well developed and it was therefore assumed that once laws were drafted, societies would demand and enforce them. Third, some countries lacked the will and ability to respond to the need for complementary reform (Nellis 2002). Fourth, the Bank role in legal reform for countries with historical ties to Western Europe was limited. Fifth, it was opined that the problem lay with “the mindset and incentives of Bank staff and management, with their emphasis on action, indeed on action this day” (Nellis 2002, p. 44). Finally, the rapid pace of transition, uncertain and fluctuating government commitment, and high turnover in officials in some countries meant that the Bank had to take advantage of opportunities to support laws in the hope of later tailoring them to country conditions.

Evaluations suggested that Bank objectives for legal reform stated in loan documents were not met. ICRs and OED assessments noted that the bankruptcy law had not yet facilitated the Bank objective of liquidation of insolvent enterprises; securities market legislation had not met the objective of developing capital markets; and land laws had not yet led to active markets for the sale of land as was hoped in Bank documents. Fieldwork in Albania indicated little understanding of bankruptcy (Chapter 4). USAID assessments of commercial laws for six transition economies that also received Bank support found that in five of the six, the demand for commercial laws was low.<sup>16</sup> Scores on implementing and supporting institutions were also low in the same five countries. Evidence from Albania and the European Bank for Reconstruction and Development (EBRD) evaluation suggested that multiple donors were supplying laws.<sup>17</sup> In Albania, this created an overly complex bankruptcy law, which is one reason why it is not used (Box 3.2).

New CASs take a more strategic approach to legal and judicial reforms. About 80 percent of the CASs from the 1998–2001 period explicitly mention deficiencies in specific laws or factors impeding implementation. CASs link legal reform needs explicitly with specific ESW, lending operations, and IDFs in their programs for 7 of the 26 transition countries.<sup>18</sup> Constraints to implementation of laws due to an inadequate governance environment and weaknesses in legal institutions were also highlighted in 7 of the 26 CASs.<sup>19</sup> Similarly, judicial reform was not discussed in the CASs until 1997. Since then, 17 studies suggest the need for judicial reform, although only three (Albania, Lithuania, and Moldova) identify problems in the judiciary. The most exhaustive discussion is found in the 1998 Albania CAS.

Partners in legal and judicial reform were identified in only a few CASs. Only four of the 26 CASs (the Kyrgyz Republic, Turkey, Albania, and Ukraine) mention the role of other partners (Box 3.3).<sup>20</sup> EU-PHARE support for legal and judicial reforms could have been discussed because the European Union (EU) will likely take an increasingly important role in these areas in accession candidate countries. While CASs were prepared in the majority of countries through a consultative process, it was unclear whether legal and judicial reforms were discussed in this process.

### **Box 3.2: Albania Bankruptcy Law**

This law was initiated by donor interest rather than government request. The legal drafting began with German lawyers sponsored by GTZ. The German bankruptcy laws conflicted with those in America, leading to conflicts between German lawyers and USAID and World Bank lawyers. The final law reflected multiple legal traditions, with the liquidation portion following a Continental structure and the restructuring portion following an American structure. The law was ineffective and has never been used. Not only did judges and lawyers not understand the complex legal style, but the law itself was patched together from multiple traditions, making the law difficult to interpret. Businesses and banks do not understand this law, or even the concept of bankruptcy.

A new bankruptcy law and implementation action plan have been included in the Financial Sector Adjustment Credit of FY02.

*Source:* Rachel Kleinfeld, September 2001, "An Assessment of Legal Reform in Albania," background paper.

Another issue concerns gaps in analytical work. Past judicial assessments have not presented reforms in the context of the broader public sector/governance agenda, and have not linked their judicial reform strategies and recommendations to expenditures.<sup>21</sup> All spending, including judicial, must take place within existing budget constraints; but currently, country budgets do not typically produce data on expenditures allocated or spent on the judiciary, in part because the budget codes were not created with this purpose in mind.

ESW has also not yet looked systematically at country-level regulations for dispute resolution.<sup>22</sup> In the context of lending for court and case management in a few countries, these regulations might have been examined.<sup>23</sup> Studying these regulations in more countries, deciding which disputes should be subject to judicial enforcement, and finding nonjudicial ways to deal with the other regulations would have been more relevant and efficacious than providing equipment, infrastructure, or training in an inhospitable context.<sup>24</sup> Preliminary results from a study involving two simple every-day disputes (the collection of a bounced check and the eviction of a non-paying tenant) showed that transition economies lagged behind worldwide averages in the amount of time it took to pursue simple claims through the judicial system.<sup>25</sup> These averages also varied considerably across transition countries depending upon how legal structures regulated the resolution of disputes.<sup>26</sup>

### **Box 3.3. Partners in Legal Reform**

*European Bank for Reconstruction and Development:* legal assessment, outreach activities, standard setting, and legal and institutional reform.

*European Commission:* PHARE for institutional support, legal advice, and training for European Union (EU) accession candidate countries; TACIS (an EU program providing grant-financed technical assistance to 13 countries in Eastern Europe and Central Asia) for newly independent states of the former Soviet Union and Mongolia, and CARDS (a program similar to TACIS) for Southeastern Europe Stability Pact countries.

*Asian Development Bank:* Human resource development in judicial and legal sectors, publication and dissemination of laws, legal training, banking, governance.

*Council of Europe:* Legislative drafting; legal and institutional advice.

*Bilateral:* United States Agency for International Development, British Know-How Fund, DFID, Danida, GTZ (the German Development Agency), and others. Good governance, civil society development, law and institutional reform, legal education.

*NGOs:* Soros, ABA/CEELI, Advocates International, and others. Legal education, conferences, handbooks, training.

In lending for judicial reform, the Bank has not used many of the tools at its disposal to achieve its goals.<sup>27</sup> Deregulation of legal services, which could promote competition and choice, has not yet been supported in any country, although the Bank is considering it in the context of the Slovak Republic reform. Measurement of results, important for accountability, was supported only in Albania, Bulgaria, and Croatia, and individual calendars that make explicit the link between judges' case-management habits and their public reputation have not yet been targeted in any country.<sup>28</sup> While the Bank has provided assistance for land titling, which reduces the people's chances of ever needing to use the legal system, specialized courts were supported only in Kosovo and simplification of laws in only Latvia. Improved access to courts through a reduction in court fees was supported only in Armenia. The enforcement of court decisions was addressed in Albania, Armenia, Georgia, and Kazakhstan, but primarily through the provision of training and equipment.<sup>29</sup>

Although focusing on the minutiae of judicial reforms might be premature in these countries, the Bank could have considered the use of peripheral reforms with large impact, such as the "professionalization" of notaries. This would entail legal training, adoption of an ethics code, and professional committees to enable notaries to carry out their duties and to reduce potential corruption.<sup>30</sup>

A final point relates to monitoring the results of judicial reform. This paper did not assess the appropriateness of monitoring mechanisms in loan documents with judicial reforms in



part because it was unclear which goods the Bank desired from judicial systems: efficient justice, or consistent and predictable judgments, or judgments based on law, or judgments that are enforced, or a combination of some or all of these.

In conclusion, lending for legal reform has reflected many of the priorities established in the analytical work. Lending has responded to changing country needs. Nevertheless, legal reforms could have addressed questions of demand, supply, enforcement, governance environment, and comparative advantage. Judicial reform could have been deepened. A focus on training and equipment takes the judicial structure as a given and does not address how the structure can be changed.

### **Efficacy**

While ICRs and OED assessments did not report on the status of all the specific laws that were supported in the projects, the majority of reports (44 of 47 ICRs) stated that Bank conditions on legal reform were fulfilled. Consequently, transition economies with Bank support will have a set of laws (such as bankruptcy, company, securities markets, banking, and sectoral laws), deemed important to a market economy.<sup>31</sup>

Information on effectiveness of commercial laws in Bank evaluations was fragmentary. ICRs and OED assessments generally provided little information on the number of bankruptcies filed and resolved, and of the impact of company laws on corporate governance or the rights of minority shareholders. Evaluations for some countries noted that although bankruptcy law had been passed, bankruptcy was a little-used mechanism (Kazakhstan, Croatia, Romania, Macedonia, Albania, the Russian Federation, Ukraine, and Bulgaria), in part because of inadequacies in the court system and vested interests.<sup>32</sup>

Information on the impact of financial sector laws was also available only for a few countries. In Romania, the National Bank of Romania continued to suffer from understaffing, high turnover, insufficient training, and lack of experience. In the Russian Federation, implementation of banking laws was frustrated by legal challenges, and in the Kyrgyz Republic, enforcement through off-site and on-site surveillance had lagged. Banking laws in Hungary, however, had promoted sounder banking practices and private sector participation in the banking sector. In Kazakhstan also the banking sector was stronger but small.

Securities market legislation had created an independent regulatory body like the SEC (in Croatia, Romania, Ukraine, for example), but impact on the development of capital markets was not yet evident due to the small volume of publicly traded shares.<sup>33</sup> In some countries, the privatization method might not have been conducive to development. Feedback received for this paper suggests that the Bank should not have insisted and actively supported the development of capital markets in some small countries in relatively early stages of transition.

In general, Romania, the Russian Federation, the Kyrgyz Republic, and Kazakhstan, along with other countries of South Eastern Europe and the Commonwealth of

Independent States, have a smaller and less-developed financial sector. The sector's overall size is reflected in broad money-to-GDP ratios. The information, monitoring, and risk management services provided by the sector could be seen in private bank credit relative to GDP (Annex C).

The impact of sectoral laws varied across sectors. The impact on the telecom sector was substantial (Bulgaria, Poland, the Slovak Republic). In agriculture, while conditions for leasing and selling of land had improved, an active market for the sale of agricultural land did not yet exist (Kazakhstan, Bulgaria, Moldova, Macedonia, Albania, the Russian Federation, and Ukraine). In some countries (Kazakhstan, Bulgaria, Macedonia, Albania, and Ukraine), this was in part due to delays and problems in registration and cadastre systems, lack of trust towards government land administration agencies, and unwillingness to sell land. In the energy sector, petroleum legislation was successful in attracting foreign direct investment in Kazakhstan, but recent revisions to the legislation were a disincentive to new investment. In Kazakhstan's transport sector, the government's discretionary and arbitrary power in enforcing contract and property rights in the urban public transport sector deterred the private sector from making the necessary large-scale and long-term investments needed to maintain the quality of services. Electricity and gas laws were passed in Moldova with substantial impact.

Reviews for two countries assessed progress in judicial reforms. In Latvia, many of the steps in reform turned out to be more complicated than envisaged. In Georgia, while substantial progress was achieved under a technical assistance credit to support judicial reform, sustainability of some of this support was doubtful because beneficiaries of equipment have had no budgetary resources to finance repair or upkeep in the future.

An important finding from ICRs was that conditionalities in adjustment operations for the Russian Federation, Kazakhstan, Romania, and Ukraine prompted the use of decrees, with poor subsequent implementation. The ICR for Ukraine questioned the usefulness of adjustment operations when a majority of the parliament opposes reforms.

Of the five stand-alone investment projects that were ongoing, two had not been able to deliver the desired results because of the rapid pace of reforms. Supervision reports and interviews indicated that the Russian legal reform project became effective in September 1996, but between 1996–99, important developments took place in the area of judicial reform. As a result, the project could not provide a significant contribution to the development of judicial reform in the Russian Federation. By 2000, only \$24 million had been disbursed from the Russia Legal Reform Project. In Kazakhstan, the court system was restructured in 2000 and 2001, after the project became active in 1999.

In sum, there was relatively little information pertaining to the effectiveness of legal and judicial reforms in ICRs. The available information suggested that the desired impact had not been achieved in a number of countries. Using adjustment lending in the absence of parliamentary support could create implementation problems.

The EBRD's evaluation report found that the impact of legal and judicial reforms needed more study, and that mechanisms for pooling experience could be useful (Box 3.4). This finding applies to the Bank as well.

#### 4. Effectiveness of Legal Reform in Albania and Romania

Fieldwork in Albania and Romania indicated that laws have been passed but have not been effective in promoting reform in areas targeted by the Bank in lending. Interviewees in both countries, however, highly respected the Bank's analysis and initiatives, and agreed that without the Bank, legislative frameworks would not have moved so steadily towards a market-oriented path.

*Commercial laws:* Albania's Law on Collateral did not boost the credit market because of the difficulties on foreclosing many types of collateral. Albania retains a law against taking possession of a home until the resident has found another abode. Courts will rarely issue judgment against agricultural land or homes, and if they do, bailiffs will rarely help enforce the judgment. Because of the poor law-and-order situation, bailiffs fear for their personal safety when acting to gain assets, as do judges, who have been known to let off serious offenders also out of fear. Bailiffs tend to ask for the 7-percent share of the court judgment before even attempting to enforce the lien. Therefore creditors might not only lose their loan and collateral, but they may also have to pay 7 percent of a court judgment that they have not collected and are unlikely to ever see. Finally, there are strict rules on selling foreclosed properties. Even if the laws themselves are made less strict, people in rural areas will not purchase foreclosed property, as they tend to still regard it as owned by the debtor.

##### **Box 3.4. European Bank for Reconstruction and Development Evaluation Findings**

###### *A. Internal Process*

1. Lack of an overall strategic approach.
2. Insufficient resources in relation to activities.
3. Lack of self-evaluation and mechanisms for pooling experience.
4. Relative isolation of Legal Transition Team from other departments.
5. Insufficient attention to environmental issues.
6. Little coordination with other international financial institutions.

###### *B. Projects*

1. Rudimentary project preparation
2. Time overruns or termination of projects before achieving results
3. Narrow participation—confined to the counterpart and the government.
4. Excessive focus on drafting laws rather than implementation and enforcement.
5. Lack of ex post monitoring.

*Source:* EBRD Project Evaluation Department special study.

However, Albania's Law on Secured Transactions, concerning movable property, did have a significant impact on the expansion of the credit market by providing a new form of collateral, *despite the fact that it has never been tested in court*. Even without going to court, the law has had a significant psychological effect, because debtors are notified by mail of the lien against their property.

In Romania, privatization, banking, property, and securities market laws have all been enacted, but have been undermined by vested interests, which render them ineffective in creating an equitable playing field for a market economy. However, Romania's bankruptcy reform has recently been successful. Prior to the Bank-sponsored reforms, inexperienced judges were responsible for divesting liquidated companies of their assets and managing the liquidation process, which included the reselling of the business, atop a huge caseload and administrative duties. The bankruptcy reform put administrative duties related to bankrupt companies in the hands of private liquidation companies with the business skill and knowledge to handle these cases. Fieldwork showed that thousands of cases have been processed subsequent to the reform, and since the revised law was passed in 1998, a field of 132 registered private liquidators has emerged.

*Financial sector:* Although laws were passed, the impact is still unclear. The Albania Bank Assets Resolution Trust Law was passed to aid in collecting bad loans that state banks made to pyramid schemes. The Loan Agency was created, but little money has been collected because the agency has sent 40 percent of its cases to be settled in the notoriously slow courts, where judges can be bribed by private debtors. In Romania, the National Bank (NBR) was professionalized, and its ability to intervene in problem banks was strengthened through banking laws. However, despite enabling legislation, the NBR has failed to react quickly and intervene effectively in several troubled banks. Lax incentives to resolve troubled banks and strong political pressures on state-owned banks to sustain large, state-owned companies persisted in 2001. Credit cooperatives can still be established with minimal capital and no solvency requirements.

A bank accounting law was passed, requiring Romanian banks to adopt a new chart of accounts conforming to international accounting standards (IAS). Members of the business community, however, remain skeptical of Romanian banks and continual susceptibility to political manipulation.

The Bank also improved legislation for the supervision of capital markets in Romania, although the supervising agencies created to monitor the Bucharest Stock Exchange and the RASDAQ have not been effective. The listed companies lack transparency due to poor accounting and auditing standards. This problem has been exacerbated by poor disclosure requirements, a result of the desire of drafters of the security and exchange law to rapidly increase the number of traded stocks, in the process allowing lax listing regulation and policy. Many listed companies are neither trusted nor traded; two or three stocks provide the bulk of trading volume. The State Ownership Fund and the state-controlled Private Ownership Funds at the local level constitute the major players in the market.

In addition, a lack of attention to the choice of supervisors opened the newly created agencies to political cronyism. The Romanian Securities Exchange Commission is largely staffed by political appointees with no background in a modern, capitalist securities market. These appointees are occasionally asked to intervene in the market for political reasons. Investors are dismayed by privatizations which allow the State Ownership Fund to sell privately without obtaining the approval of the Securities Exchange Commission as required by Romanian legislation.

Finally, the majority of shareholders on the capital market gained their shares as a result of the Mass Privatization Program; consequently, most shareholders are extremely diffused and ignore the market altogether. Lack of legislation and conflicting laws regarding minority shareholders in banking and privatization have left minority shareholders unprotected from abuses by the state agencies that constitute the majority of shareholders. In 2000, market capitalization was \$363.2 million, while the turnover on Bucharest Stock Exchange (BSE) was only \$86.2 million. Only 114 companies were listed on the BSE as of the end of 2000.

*Agriculture:* Despite appropriate laws, the sale of land in both Albania and Romania remains rare. In Albania, a dynamic agricultural land market has not been created due to widespread public ignorance of their rights and the laws, uncertainty caused by ex-owner claims, slow progress in property registration, and rampant corruption in the registration system. All these pale, however, beside the strong reluctance of Albanians to sell their land.

In Romania, despite land laws, the sale of land remains difficult and rare, leasing remains largely informal, and transactions continue to be subject to reports of fraud as well as deceit. Land restitution legislation, initially blocked by political divisions, was eventually passed, but the legislation has been subject to challenges by the state in courts, and state farms lack interest in returning lands under their control. Local leaders and institutional managers benefit from the clientilistic system and gain no benefit from enforcing “fair playing field” legislation. Even at the central government level, politically influential agricultural lobbies continued to influence legislation and enforcement, thereby undermining project goals. The Ministry of Agriculture and Food remains the mechanism for continuing price controls and allocating subsidies to politically influential individuals and groups, regardless of the laws. Tax breaks and other preferential treatment of individual companies have continued.

Despite Romanian legislation on secured transactions in movable securities, which allows for greater use of the kind of collateral generally available in rural areas, most farmers are still unable to obtain credit. Land reforms have created tiny farms of only a few hectares, making most landholders into peasant subsistence farmers that can only raise animals and tiny, subsistence harvests as a collateral (which banks are understandably unwilling to accept). These people do not have the mechanized equipment, extensive inventory, accounts receivable, and consumer goods that are covered by the law.

*Property rights:* An interesting finding from Albania is that homeowners on disputed land, usually in peri-urban areas, are investing to *create* rights. Particularly on the part of

homeowners, there is a view that the state will not take away their homes, even if built on land that is not legally the homeowners. The more substantial a home they build, the less likely the government is to take it away. The majority of commercial investment exists in urban areas, and on lands that are disputed among multiple owners. A robust market therefore exists on both peri-urban agricultural land and on disputed urban land, despite the absence of property rights; the existence of this market suggests that the absence of secure property rights creates a situation that undermines the rule of law.

It might also suggest that ECA land-titling program might not have focused sufficiently on urban and peri-urban land. In 13 countries where there is provision for land rights, support was exclusively directed to rural areas in 6 countries, exclusively to urban areas in 2, to both rural and urban areas in 4 countries, and in one country the documents did not specify whether land right support was urban or rural.<sup>34</sup>

*Judicial reform:* The Albanian government undertook tough institutional reforms with Bank support. These reforms entailed creating the position of court chancellor (or senior administrator) in each court, creating a judicial inspectorate, and testing of the judges. The Bank is also working on the enforcement of court decisions in civil cases by supporting the Execution of Judgments Office of the Ministry of Justice, and through it the services of bailiffs. Creating a State Publications Center to publish laws has also been relevant and effective. In addition, the Bank is supporting the early establishment of an Alternative Dispute Resolution Center as a potentially important future means of resolving commercial disputes by mediation and arbitration.

In Albania, the Bank might be working in too many areas, some of which do not deserve staff time and resources. The Magistrates School and law faculty are two such areas.<sup>35</sup> While improvements in the training of future lawyers and judges and in continuing judicial education are essential in Albania, several donors are willing to support the Magistrates School and are also working with the law faculty. In addition, the law faculty has not shown any willingness to reform. Interviewees noted the high politicization of the faculty leadership and of appointments. In a donor-saturated country such as Albania where improvements are needed in every area, the Bank could pick areas where it would have the most leverage, rather than spread its efforts across many areas. The Bank's comparative advantage is on tough institutional issues (which it did address in Albania), whereas other donors might be better situated to deal with judicial education, curriculum reform, and law preparation.

The Bank might have also missed other important issues in Albania. The court users' survey to identify actual problems in the courts, for instance, remains in the drafting stage, although preparation of the judicial reform program has been underway for five years.<sup>36</sup> Such surveys can yield surprising results on cases and judges, as it did in Mexico and Argentina, with implications for areas that need reform.<sup>37</sup>

*Partner coordination:* At the country level, the two case studies show a mixed record of coordination. In Albania, the Bank's institutional technical assistance is well coordinated with other major donors, although this is not the case for legislative reform (Box 4.1). In

Romania, large NGOs such as ABA/CEELI, as well as local lawyers and judges, reported generally little contact with the Bank.

### ***How To Increase Effectiveness of Bank Intervention in Albania and Romania***

The Albania Legal and Judicial Reform Project did carry out a Law Faculty assessment, a legal information assessment, an alternative dispute resolution report, a functional review of the Ministry of Justice, and an assessment of enforcement of judicial decisions in civil cases, but a court users survey should have been carried out.

The Bank could also have addressed enforcement, demand, and supply. In legal reform, there have been problems in enforcing the Collateral Law because of difficulties in foreclosing and weaknesses in supporting institutions, such as bailiffs and the auction system for seized property.<sup>38</sup> There is little demand for the Movable Securities Law because local businessmen do not understand its potential. There is little understanding of the bankruptcy law; people do not support bankruptcy if eviction proceedings involve residential property. Many creditors are not interested in reorganization or liquidation. Bankruptcy cases are assigned to the Commercial Section of the Civil Division of District Courts, and in September 2000 this section had only six judges. There are no separate bankruptcy courts and no separate bankruptcy division (USAID 2000).

#### **Box 4.1. Albania: A Mixed Picture of Donor Coordination**

The coordination was better in institutional technical assistance than in legal reform.

*Property Registration:* EC-Phare, USAID, and the Bank jointly agreed on a policy framework, on staffing the project unit for the loan, on preparing the terms of reference, and on selecting the consultants. Property laws were passed quickly and with little difficulty, partly because of this coordination, in which the Bank took ownership of the policy framework while the EU primarily focused on the mapping and cadastral survey.

*Judicial Reform:* The Bank has sought to complement its own judicial reform program with that of the EU. The EU is beginning to prepare Albania for integration, and it has a joint program with the Council of Europe for holistic judicial reform.

*Bankruptcy, Collateral Laws, and Laws Governing the Structure of the Judiciary:* These issues involved significant donor conflicts, frequently between U.S. and European legal approaches. In bankruptcy, these clashes have resulted in unwieldy laws from multiple legal traditions that are neither used nor understood. The Secured Transactions Law was passed after using much government time and resources. Clashes over judicial organization laws have resulted in watered-down compromise legislation.

*Property Laws:* Although the Bank, USAID, and EC-PHARE coordination was strong, a bevy of bilateral European donors and NGOs brought alternate property laws to the Government of Albania. This forced the Bank group to speed its work and rush to push the laws through the government process.

*Source:* Rachel Kleinfeld, September 2001, "An Assessment of Legal Reform in Albania," background paper.

In Romania, additional staffing by the Bank probably would have led to more favorable outcomes. The Bank lacked lawyers that could interact with local lawyers seeking guidance. This situation led to a guessing game in which underpaid and unprepared executive-branch lawyers attempted to discern the Bank's needs, and passed poorly written legislation that failed to fully meet the Bank's hopes. As time passed and the effects became evident, the Bank focused on improving the law once more. This action led to an asymptotic progression toward an ideal law rather than a single, solid reform, as has occurred with privatization legislation (Box 4.2). The lack of local lawyers also undermined the Bank's goals because they questioned its seriousness in achieving reforms since qualified lawyers had not been sent to do the work. In Albania, this problem was eliminated through the designation of a former judge and clerk to the Chief Justice of Albania as Director of the PIU.

**Box 4.2. The Romanian Financial and Enterprise Sector Adjustment Program—  
Legislative Instability**

The Financial and Enterprise Sector Adjustment Program (FESAL) had the support of the Prime Minister and the Minister of Justice, although there was little local support because of lack of consultation with enterprise managers, lawyers, and other legal professionals. Bank conditionality also lacked support from the parliament, which was rife with cross-party alliances that reduced government control and made law passage unpredictable. Thus, the government passed many legal reforms through ordinances rather than through parliamentary action. These ordinances were then subject to change when the parliament voted on them, leading to unstable and conflicting legislation.

*Foreign Investment Law:* This law was passed as an emergency ordinance per FESAL second tranche conditions, and was subsequently changed four times (by the parliament and by additional emergency ordinances). The rapid changes, along with other factors (such as a reduction in emerging market investment following the financial crisis in the Russian Federation), had a negative impact on the investment climate. In January 2000, foreign portfolio investments were a quarter of the previous year's monthly average.

The law that was passed was slipped into the legislation investment incentives to foreign and domestic investors, which were then subsequently removed by another emergency ordinance and another law. After an outcry from investors over the retroactive removal of incentives, however, the government passed another ordinance reinstating some of the incentives.

*Privatization Law:* A government ordinance was approved into law in 1997, but it was amended five times by emergency ordinances, and then a sixth time by parliamentary law in May 1999. Each change, although generally improving on and simplifying the privatization framework, resulted in further privatization delays. Legislative uncertainty led the managers and staff of the State Ownership Fund (SOF) to readjust transactions that had begun already to fulfill the new legislative framework. SOF staff and management also feared decisionmaking and passed decisions onto more powerful and connected Board members, thereby slowing privatization. Romania's industrial sector continues to be dominated by state-owned enterprises (SOEs), and privatized companies represent less than 20 percent of the capital stock owned by the State Ownership Fund and less than 10 percent of the total capital stock of SOEs.

*Source:* Rachel Kleinfeld, September 2001, "An Assessment of Legal Reform in Albania," background paper.



If the Bank had acted more rapidly in Albania, it might have been able to take greater advantage of reform opportunities. A long planning process can be essential for addressing fundamental institutional weaknesses, but in a volatile political environment a shorter planning process can capitalize on commitment, public interest, and reform champions within the government. In Albania, the judicial reform project was initially discussed with the government and legal community in 1997 when the political desire to reform was high. After two years of preparation and difficulties with bidding and procurement, however, the fruits of reform are not yet visible to many five years later.<sup>39</sup> While the Bank staff have worked hard, momentum has been lost and public impetus to reform is not as acute as it was after the 1997 crisis. Beneficiaries in donor-saturated environments go donor shopping, and if the Bank does not deliver quickly enough then tensions arise between donors, and between the beneficiary and the Bank.<sup>40</sup> The chief justice of the Albania Supreme Court suggested that the Bank could condense its planning schedule by sending out a team at the beginning of a judicial reform process for a substantial period of time, to carry out a number of diagnostic studies all at once, rather than send an expert for a week, and then another expert a few months later to assess a separate area.

***Potential Problems with Adjustment Lending to Promote Legal Reform: Romania***

Problems with legal reform in adjustment lending are two-fold.<sup>41</sup> First, this kind of conditionality does not work well to change systemic problems. Second, it tends to increase governance by ordinance, particularly in countries with weak government control over parliaments.<sup>42</sup> Ruling through ordinances can undermine democracy and distort the roles of the various branches of government by bypassing the parliament and increasing executive control over the judiciary. In addition, when laws are passed quickly without parliamentary debate, they frequently lack support of stakeholders and legal professionals. Consequently, these laws are subject to change by the parliament or future ordinances due to lobbying by businesses. The laws are therefore likely to contribute to legislative instability (Box 4.2).

Furthermore, to meet the loan conditions, the government passes primary legislation through executive decree or even the parliament without the accompanying secondary legislation. Most primary legislation (for example, a law calling for an oversight board for the Exchange Commission), will need secondary legislation to identify the members of the Exchange Commission, how they are appointed, how many people can serve, and so forth. Without the secondary legislation, the primary legislation cannot be implemented. This leads to delay and distortions in the secondary legislation, which is passed later and with less oversight. Conditions can be slipped in that pervert the intentions of the law, as has occurred with the Bank-sponsored Foreign Investment legislation in Romania.

The Bank can exacerbate this problem by continuing to focus on one area and pushing for legislative change until the outcome is “right.” The constantly changing legislation, though an improvement over the previous legislation, results in an unstable business environment. In Romania, foreign businessmen declared that legislative stability is more important than the content of the foreign investment law. They wanted to be able to plan

their business around a consistent set of legislation rather than constantly reacting to new legislation. Poorly written and frequently changing laws have created implementation problems. The lack of a clear precedent, combined with a poorly functioning judiciary, has led to confusion and poor judicial decisions. Corruption is difficult to detect, given the range of legal interpretation possible under overlapping laws.

The ongoing Bank's Private Sector Institution Building Loan, approved with the Public Sector Adjustment Loan (also ongoing), appears to have been more successful. A "full court press," multiple studies, attention to drafting, in-country consultation with legal professionals, and focus on the writing and implementation of laws led to successful passage of legislation in 1999–2001. OED evaluations in some countries (namely Ukraine, Bulgaria, and Kazakhstan), however, found that authorities are reluctant to accept Bank-financed technical assistance even when it has been effective in building capacity for legal reform.<sup>43</sup> Legislative reform in these countries by way of adjustment lending might have to be carefully synchronized with the provision of grants by other donors for capacity building.

In conclusion, laws might have been more effective if demand, the state of legal institutions and governance environment, societal understandings, comparative advantage, and the law drafting process had been addressed. For the future, it might be useful to provide more specific guidance on legal and judicial reform (Box 4.3). Such guidance could also advise on when and how various instruments should be used (for

**Box 4.3. Existing Guidance on Good Practice**

1. Legal and judicial reform is a long-term process. Sequencing should take into account priorities as well as the country's capacity to implement such reforms.
2. The reform must come from within the country. In order to determine which elements need the most reform, a prior review of country-specific conditions is helpful.
3. There is need for government commitment. It is important to build coalitions to overcome vested interests.
4. Projects should be conducted through a participatory approach. Ownership can be achieved through workshops and town meetings. Participation should include those at the grassroots level as well.
5. Wholesale importation of legal systems may not be appropriate. Laws should be adapted to national legal systems while the particular requirements of the society must be taken into consideration. Benefits of foreign experts should be fused with the knowledge of the local legal community.
6. The effectiveness and coherence of legal reform require a comprehensive approach.
7. Economic growth generates greater demand for a consistent legal framework and reliable legal tools.
8. These projects are difficult to evaluate, and the Bank is constantly developing and refining performance indicators to allow objective evaluations.

*Source:* World Bank (2000).

example, advising when adjustment lending is not appropriate as an instrument of legal reform).<sup>44</sup> Guidance could also influence the type of analytical work undertaken, how impact should be monitored, and how donors' comparative advantage can be taken into account. Good practice guidance might also clarify that a holistic or comprehensive approach should not be interpreted as doing a little bit of everything, and how the Bank could choose areas of intervention that will likely have the greatest impact on the legal system.

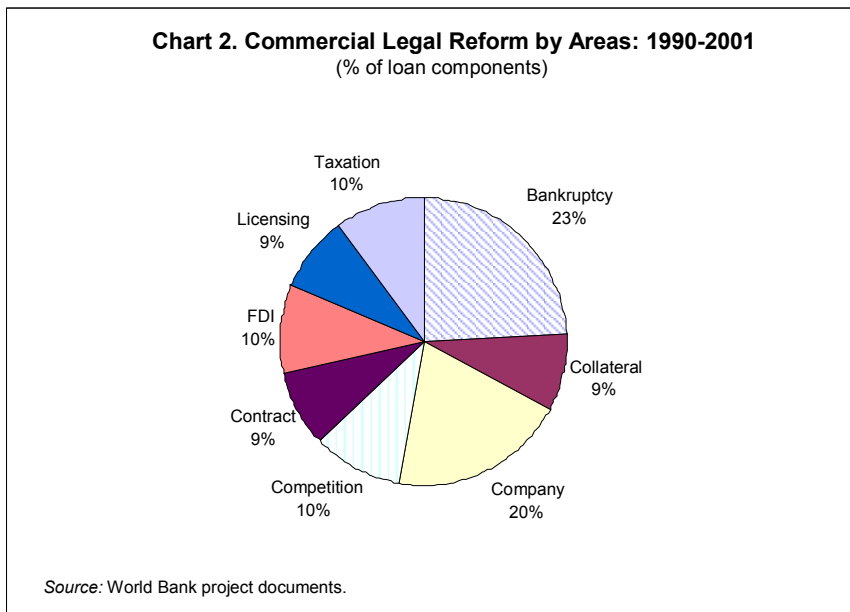
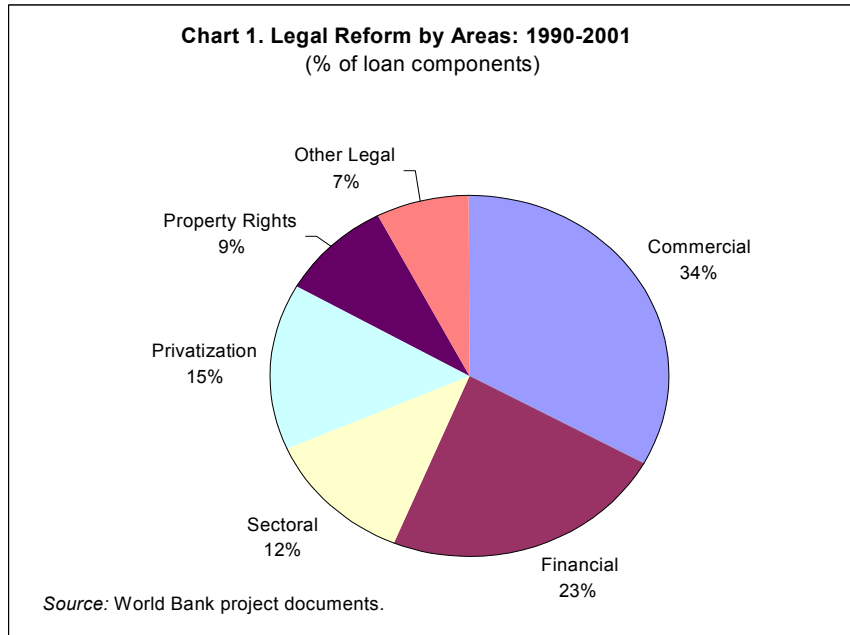
## **5. Preliminary Conclusions and Issues To Debate**

The Bank has responded to the priorities for legal and judicial reform. The initial step of passing laws is necessary for accomplishing market reform. However, the passage of laws has not yet significantly improved their effectiveness.

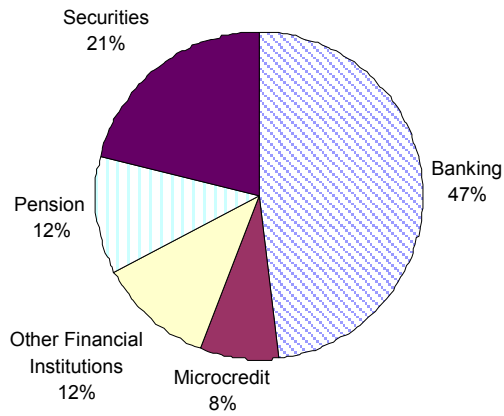
Four issues that could be debated are:

- How can diagnostics be improved so that questions of demand, supply, societal understandings, governance, legal institutions, and the process by which laws are made might be addressed, and how can the mechanisms by which disputes are resolved be traced so as to inform legal and judicial reform programs?
- How can implementation of legislative reform be monitored at the country and thematic level to develop lessons and best practices?
- How can planning and analysis be intensified to capitalize on the unpredictable momentum and will to reform?
- How can the correct time and circumstances be determined for using conditionality in adjustment lending to promote legislative reform?

## Annex A

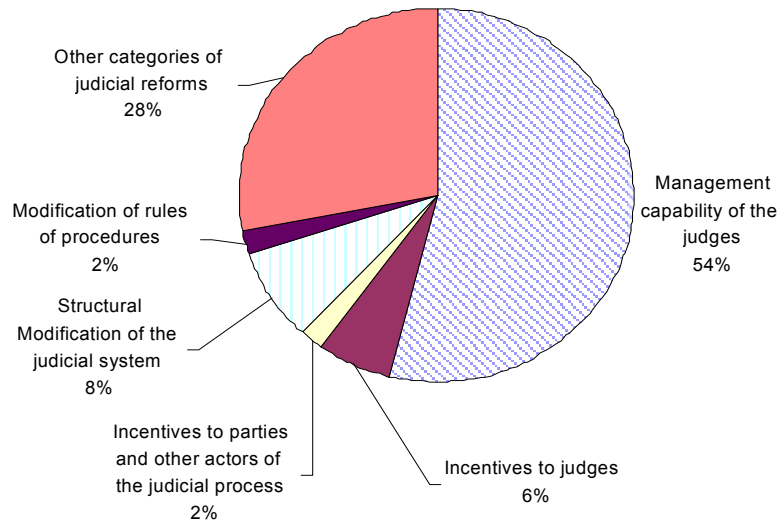


**Chart 3. Financial Legal Reform by Areas: 1990-2001**  
 (% of loan components)



Source: World Bank project documents.

**Chart 4. Judicial Reform by Areas: 1990-2001**  
 (% of loan components)



Source: World Bank project documents.

**Annex B****Legal Bankruptcy Rules and Enforcement Experience**

<i>Annual number of petitions filed</i>	<b>1998</b>
<i>High (+1,000)</i>	Hungary The Russian Federation Ukraine
<i>Médium (51–1,000)</i>	Bulgaria Croatia Kazakhstan Kyrgyz Rep. Lithuania Macedonia, FYR Romania Slovak Rep. Uzbekistan
<i>Low (0–50)</i>	Albania Azerbaijan

*Note:* Overall scores on commercial law and financial regulations from EBRD are not presented because commercial indicators comprise the three EBRD areas of active involvement (pledge, bankruptcy, and company law). EBRD financial regulations comprise banking and securities regulation.

*Source:* EBRD (1999).

## Annex C

## Countries in Transition: Average Annual Growth Rates and Structural Reform Indicators, 1994–98 Averages

	<i>Average growth</i>	<i>EBRD transition indicators</i>	<i>FDI per capita</i> <sup>1</sup>	<i>Annual growth of fixed investment</i>	<i>Broad money-to-GDP ratio</i>	<i>Private sector credit-to-GDP ratio</i>
<b>Central and Eastern Europe and Baltics</b>						
Croatia	5.5	3.0	393	4.1	32	33
Czech Republic	2.2	3.5	818	6.2	72	60
Estonia	4.2	3.3	555	10.1	28	24
Hungary	3.1	3.5	1,113	6.9	43	23
Latvia	3.2	2.9	646	8.8	27	11
Lithuania	2.1	3.0	318	7.8	21	13
Poland	6.0	3.4	321	14.3	36	15
Slovak Republic	5.9	3.3	144	9.1	68	36
Slovenia	4.3	3.2	530	11.2	39	29
Average	4.0	3.2	538	8.7	41	27
<b>South Eastern Europe</b>						
Albania	5.7	2.5	103	...	50	4
Bulgaria	-2.1	2.6	140	-6.2	32	13
Macedonia, FYR	0.4	2.7	58	4.2	13	28
Romania	0.2	2.6	208	1.6	25	11
Average	1.1	2.6	127	-0.1	30	14
The Russian Federation	-4.2	2.7	92	-15.2	19	10
<b>CIS</b>						
Armenia	5.7	2.3	64	8.0	10	8
Azerbaijan	-2.9	1.8	406	32.6	21	2
Belarus	-0.2	1.8	42	-7.0	24	11
Georgia	3.1	2.2	37	12.7	5	4
Kazakhstan	-4.2	2.4	312	-15.4	11	10
Kyrgyz Republic	-1.3	2.8	69	-15.4	14	8
Moldova	-9.5	2.5	113	-13.2	17	8
Tajikistan	-6.3	1.7	16	...	11	5
Turkmenistan	-11.1	1.3	108	...	9	...
Ukraine	-10.0	2.2	43	-18.4	16	4
Uzbekistan	0.4	2.2	23	4.2	16	26
Average	-3.3	2.1	112	-1.3	15	9

1. Cumulative FDI in U.S. dollars for the period 1994–98.

Source: IMF (1999).

## References

- Barro, Robert J. 1991. "Economic Growth in a Cross Section of Countries." *Quarterly Journal of Economics* 106:407–43.
- Botero, Juan Carlos, Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer, and Alexander Volokh. 2001. "Judicial Reform." Paper presented at the Consultative Meeting on Judicial Systems, World Bank Headquarters, May 18. Public Sector Group, PREM Network.
- Campos, Nauro F. 2000. "Context Is Everything: Measuring Institutional Change in Transition Economies." Policy Research Working Paper 2269. Washington, D.C.: The World Bank.
- Djankov, Simeon, Rafael La Porta, Florencio Lopez-de-Silanes, and Andrei Shleifer. 2001. "Legal Structure and Judicial Efficiency: The Lex Mundi Project." Paper presented at the Consultative Meeting on Judicial Systems, World Bank Headquarters, May 18, 2001. Public Sector Group, PREM Network.
- European Bank for Reconstruction and Development (EBRD). 1999. *EBRD Transition Report*. European Bank for Reconstruction and Development, London, UK.
- Gray, Cheryl W. 1992. "The Legal Framework for Private Sector Activity in the Czech and Slovak Federal Republic." Policy Research Working Paper 1051. Washington, D.C.: The World Bank.
- Gray, Cheryl W., and others. 1993. "Evolving Legal Frameworks for Private Sector Development in Central and Eastern Europe." World Bank Discussion Paper 209. Washington, D.C.: The World Bank.
- Gray, Cheryl W., and Kathryn Hendley. 1995. "Developing Commercial Law in Transition Economies: Examples from Hungary and Russia." Policy Research Working Paper 1528. Washington, D.C.: The World Bank.
- Gray, Cheryl W., and Arnold Holle. 1996. "Bank-Led Restructuring in Poland: Bankruptcy and Its Alternatives." Policy Research Working Paper 1651. Washington, D.C.: The World Bank.
- Gray, Cheryl W., and Peter Ianachkov. 1992. "Bulgaria's Evolving Legal Framework for Private Sector Development." Policy Research Working Paper 906. Washington, D.C.: The World Bank.
- Gray, Cheryl W., Rebecca J. Hanson, and Michael Heller. 1992. "Legal Reform for Hungary's Private Sector." Policy Research Working Paper 983. Washington, D.C.: The World Bank.
- Hammergren, Linn. 2002. "Reforming Courts: The Role of Empirical Research." PREMnotes No. 65. Washington, D.C.: The World Bank.
- Havrylyshyn, Oleh, and Ron van Rooden. 2000. "Institutions Matter in Transition, But So Do Policies." Working Paper 00/70. Washington, D.C.: International Monetary Fund.
- International Monetary Fund (IMF). 1999. *IMF World Economic Outlook*. October. Washington, D.C.: International Monetary Fund.
- Nellis, John. 2002. *The World Bank, Privatization, and Enterprise Reform in Transition Economies: A Retrospective Analysis*. The World Bank Operations Evaluation Department. Washington, D.C.: The World Bank.



- Posner, Richard A. 1998. "Creating a Legal Framework for Economic Development." *Research Observer* 13(1):1–11. Washington, D.C.: The World Bank.
- Svejnar, Jan. 2002. "Assistance to the Transition Economies: Were There Alternatives?" Background paper on Transition Economies. Operations Evaluation Department, Washington, D.C.: The World Bank. Unpublished.
- Shihata, Ibrahim F.I. 1993. "Judicial Reform in Developing Countries and the Role of the World Bank." Paper presented at the Seminar on Justice in Latin America and the Caribbean in the 1990s, Inter-American Development Bank, San José, Costa Rica, February.
- Shihata, Ibrahim F.I. 1995. "Judicial Reform: Issues Addressed in the World Bank Projects." Paper presented to the Inter-American Development Bank Conference about Justice, Montevideo, Uruguay, October 19–20.
- United States Agency for International Development (USAID). 2000. Commercial Legal Reform in Assessment for Europe and Eurasia. Diagnostic Assessment Report for Albania. September. Conducted by Booz-Allen and Hamilton, Inc.
- Vorkink, Andrew N. 1997. "The World Bank and Legal Technical Assistance: Current Issues." Legal Department. Washington, D.C.: The World Bank.
- World Bank, 1989. "The Role of Law in Private Sector Development: Implications for the Bank's PSD Action Program." Discussion Paper. Legal Department. Washington, D.C.: The World Bank.
- World Bank. 2000. *World Bank Initiatives in Legal and Judicial Reform*. Washington, D.C.: The World Bank.

## Endnotes

<sup>1</sup> Interregional comparisons and the comparisons of the effectiveness of Bank operations with operations of other donors were not undertaken. In the Albania and Romania case studies, the effectiveness of the adopted laws was assessed in the context of the institutional framework in the country. More evidence on law implementation is in the background papers prepared for Albania and Romania. These papers are available from the authors on request.

<sup>2</sup> Fieldwork was carried out by Ms. Rachel Kleinfeld, an OEDCR consultant. She assessed some of the questions listed in the introduction and did not evaluate the quality of the laws the Bank supported, or their sequencing.

<sup>3</sup> The Romanian Financial and Enterprise Loan included 17 legislative changes, and the Agricultural Sector Adjustment Loan 5 legislative changes.

<sup>4</sup> This paper did not undertake cross-country comparisons of judicial efficiency or the number of bankruptcies. Court systems, the definition of a judge, and record keeping differ from country to country. The number of bankruptcies across countries might not capture the complexity of the case, the time taken to resolve the case, and the process by which it is resolved.

<sup>5</sup> Commercial law included taxation, bankruptcy, licensing, foreign direct investment, collateral, contract, competition, and company laws. Financial sector laws included banking, securities, pensions, microcredit, and other non-Bank financial institutions.

<sup>6</sup> Collateral and bankruptcy laws can also be classified under financial sector laws. Pension laws were included because provisions for establishment of private pension fund management and laws for investment of pensions funds were important for the development of financial markets.

<sup>7</sup> The classifications are based on Botero and others (2001). Management capability included increased resources, computers, training, administrative improvement, reduced filings per judge, and case management.

<sup>8</sup> Three assessments appeared to be stand-alone and three were prepared as annexes to the CASs. Sectoral studies in agriculture, energy, and so forth were not reviewed in this paper.

<sup>9</sup> A total of 13 assessments Bank-wide have been conducted or are underway. Completed assessments in ECA have not yet been rated by the Quality Assurance Group (QAG).

<sup>10</sup> Judicial reform issues were discussed in Latvia by ESW on regulatory institutions and procedures in 2000, and in Kyrgyzstan, by the private-sector assessment. Judicial reforms in other countries might have been discussed in anticorruption strategies and diagnostic reports. These reports were not reviewed for this paper.

<sup>11</sup> It recognizes the long, slow, process of judicial institutional reform, and the inherent difficulties in reforming a sector that is generally corrupt, has little government oversight, and is staffed by low-skill but high-status professionals.

<sup>12</sup> It is too early to discern trends in lending for judicial reform.

<sup>13</sup> The Bank could not follow up with a judicial reform project in Bulgaria because of a lack of government commitment.

<sup>14</sup> About 55 percent of conditions related to submission and passage of laws, 15 percent only to submission, and 30 percent to submission, passage, and implementation.

<sup>15</sup> Out of 8 appraisal reports, 4 do not specify if advisors/consultants were to be foreign or local, 2 state that foreign advisors/consultants are needed without stating whether locals are needed or not, and 2 say that both foreign and local advisors/consultants are to be recruited.

<sup>16</sup> A reviewer for this paper noted that demand has to be interpreted carefully. In Peru in the 1980s, residents of Lima's squatter settlement said that they needed credit. This demand for credit was translated into a demand for secure titles that would allow residents to use their land for collateral.

<sup>17</sup> In the Russian Federation, a senior official of the Federal Service of Russia on Financial Rehabilitation and Bankruptcy reported to the EBRD evaluation team in 2001 that 20 different donors were involved in the development of Russian bankruptcy law. In Albania also, many donors were involved in drafting the bankruptcy law.

<sup>18</sup> Federal Republic of Yugoslavia, Ukraine, Albania, the Kyrgyz Republic, Croatia, Tajikistan, and the Slovak Republic.

<sup>19</sup> The Russian Federation, Romania, Ukraine, Uzbekistan, Latvia, Tajikistan, and Albania CASs in 1998–2001.

<sup>20</sup> In Turkey, the EU would take the lead in judicial reform; in Ukraine, TACIS would support legal and judicial reform; in Albania, IMF would support banking legislation; and in the Kyrgyz Republic, the Asian Development Bank would support corporate governance.

<sup>21</sup> The Bulgaria judicial assessment recommends establishing a judicial training centre, a satisfactory pay scale for judges, and computerization of case tracking, but does not discuss cost implications in relation to the government public expenditures program.

<sup>22</sup> These regulations govern the use of professional judges and lawyers, the need to make written as opposed to oral arguments at various stages of the process, the necessity of legal justification of various actions, statutory interventions during dispute resolution, and so forth. See Djankov (2001). These regulations are *distinct* from regulations governing registration of businesses.

<sup>23</sup> Albania, Armenia, Croatia, Georgia, and Kazakhstan.

<sup>24</sup> A reviewer noted that a “major weakness in the Bank’s legal and judicial reform work is the single-minded focus on legal institutions.” For instance, both a credit bureau and a court can help ensure debts are repaid—the credit bureau by holding out the threat that a nonpaying debtor will be shut out of the credit market, the court by enforcement of action. The Bank’s focus has been on court reform.

<sup>25</sup> It could be argued that this example is not really relevant for ECA since checks are rarely used and easy eviction of a tenant might not be the goal of legal reform, given the importance of refugees in some of the countries. Nevertheless, the data has the advantage of being comparable across countries. Also, the resolution of these cases involves low-level civil courts and it is the functioning of these courts that is most relevant to a country’s citizens.

<sup>26</sup> In transition economies, the averages for collection of a bounced check and eviction of a nonpaying tenant were 361 days and 342 days respectively, compared to the worldwide average time of 273 business days and 246 business days. In Hungary, both averages were 365 days, and in Poland 990 days and 1,080 days respectively (Djankov 2001).

<sup>27</sup> It is possible that other donors were supporting these judicial reforms, or that the country already had in place many of the institutions that promote judicial efficiency. This limited review could not assess whether the Bank was filling the right gaps in a particular country at a given point in time.

<sup>28</sup> Bank projects supported surveys of public satisfaction in Albania, setting of performance standards in Bulgaria, and performance monitoring in Croatia.

<sup>29</sup> In Armenia, lending will support training of bailiffs and automation of enforcement. In Georgia, a master plan would be developed for an efficient court enforcement function, including assessment of technology and training needs. Bailiffs would be provided with training and equipment needed for their activities. In Kazakhstan court management training and work shops for budgeting and planning, enforcement of judgments were planned. In Albania, enforcement officers would be provided with technical assistance, training and equipment.

<sup>30</sup> Freer entry might yield better outcomes than attempts at professionalization because it would cut costs on legal services and also cut corruption but notaries are generally a highly organized group who have successfully resisted past attempts to erode their

monopolistic position. Professionalization, therefore, might be a more feasible intermediate solution.

<sup>31</sup> OED ratings for loans with legal reform components are high. Outcomes were satisfactory in 81 percent, institutional development was substantial in 45 percent, while sustainability was likely in 75 percent of the projects. It is important to note that these ratings apply to projects as a whole, not just to the legal and judicial reform component. Of the 45 ongoing operations, only three were rated to be at risk by the Quality Assurance Group (QAG). Five stand-alone projects are currently ongoing and none of the five is at risk. The sixth project for Kazakhstan has been cancelled.

<sup>32</sup> Bulgaria lacked commercial courts until recently and bankruptcy claims were filed in civil courts where 80 percent of the judge's time was spent in adjudicating domestic disputes. Kazakhstan lacked effective institutions to enforce the law (supported by the Bank in its fiscal 95 SAL). In a large number of highly publicized liquidation cases, even the government chose to operate outside of the framework of the bankruptcy law. The courts in Albania and Croatia also could not facilitate implementation of the bankruptcy law.

<sup>33</sup> Comments for this paper indicated that this was also the case in the Kyrgyz Republic, Georgia, and Armenia.

<sup>34</sup> A commentator for the paper noted urban rather than rural land titling should have been a Bank priority. "This is how land titling developed in Europe in the 16<sup>th</sup> through the 19<sup>th</sup> century."

<sup>35</sup> Staff were of the view that this support was essential to secure the rule of law in Albania.

<sup>36</sup> According to Albania staff, the survey is under preparation now.

<sup>37</sup> In both Argentina and Mexico, the contested amounts tended to be far smaller than originally believed. Banks and corporations turned to courts less often than expected, delays were nowhere as excessive as portrayed by judges and lawyers, there were a large number of cases that were abandoned early in the proceedings, and appeals were less common than generally thought (Hammergren 2002).

<sup>38</sup> Difficulties in implementing the law on collateral are also being encountered in Bulgaria.

<sup>39</sup> Staff believe that the correct sequence was followed (CEM, CAS, TA credit). Interlocutors in multiple areas, however, repeatedly claimed that "the World Bank has a big project in the pipeline, but so far we have seen nothing."

<sup>40</sup> In a meeting of all relevant donors called by the Law Faculty, for example, the dean sent around a proposed program of reforms to try to get donor commitments of expertise and funds. Nearly all the reforms had been suggested by the Bank's program and were on hold pending the School's approval of consultants and the process of choosing a twinning partner. A number of donors began to offer their services, until the Bank explained that most of the proposed reforms would be covered by the Bank's own program. Donors then backed away from supporting most of the proposed areas of reform, although they were prepared to begin sooner.

<sup>41</sup> This section draws on the Romania case study, but interviews with Bank staff showed that the problems with adjustment lending were applicable to some other transition economies as well.

<sup>42</sup> Between January and August 1999, the Romanian Government issued 293 Ordinances, of which 123 were Urgent Ordinances.

<sup>43</sup> In Bulgaria, the Technical Assistance Loan (TAL) supported the securities market, notaries, and procurement. The combination of a long-term advisor, recruitment of specialized legal expertise familiar with EU practices, and setting a consultative process through a working group of stakeholders proved effective in initiating many new and good-quality laws. During this process, know-how was transferred and further amendments were made.

<sup>44</sup> A reviewer for the paper noted that adjustment lending might be more appropriate for changing laws governing utility prices and trade, but not bankruptcy laws.