

THE REFORM IN FINANCIAL SYSTEM

Hormoz Aghadey
Program Director, World Bank

Ladies and Gentlemen,

Let me start by saying how pleased I am to be here today at the invitation of Albanian authorities, to review and celebrate the progress made by Albania in implementing economic and structural reforms since its membership in the Fund and the World Bank ten years ago. In particular, I would like to thank Prime Minister Meta and Governor Cani for organizing this event, which brings together so many members of the Albanian and international community who have been associated with Albania's reform efforts over the last decade.

The main purpose for my being here today is to review the progress made by Albania to date in reforming its banking sector and on Albania's more recent efforts in reforming its non-bank sector.

To begin with, I would like to mention that Albania is considered as one of the countries in the region which have achieved in a relatively short period of time, tangible results in implementing broad-based structural reforms. However, despite this overall good performance, Albania made very limited progress towards developing a functioning banking system at the outset of the recovery program, between 1992 and 1996.

THE PRE-1997 OUTLOOK

During this period, the banking sector was unable to function effectively in terms of domestic financial intermediation. Private banks, which consisted of six small foreign or joint venture banks without branch networks, were reluctant to lend and focused mainly on foreign exchange transactions and trade financing. State-owned banks were engaged in domestic lending but they operated as state agencies with soft budget constraints and failed to implement prudent lending practices. Some estimates indicate that at the end of 1996, non-performing loans of state-owned banks represented about 8-0 per cent of their total loan portfolio.

Aside from the poor performance in credit intermediation, the provision of other financial services to the public was also very poor. Most financial activities in the economy took place outside the licensed financial institutions, in the informal financial market. The financial infrastructure, including the payment system, accounting and audit was particularly weak.

The absence of a functioning formal banking system, combined with an inadequate regulatory and supervisory framework, contributed to the mushrooming of informal financial schemes.

These included the pyramid schemes, the collapse of which triggered the civil crisis that erupted in early 1997, which eroded many of the achievements made during the early years of transition. However the events triggered by the collapse of the pyramid schemes may have represented a watershed for the reform of the banking sector.

REFOCUSING REFORMS AFTER THE 1997 CRISIS

Since mid-1997, the new Government quickly began to dismantle the pyramid schemes, with assistance from the donor community, and, together with the Bank of Albania, affirmed its full commitment to implementing a comprehensive reform program for the banking sector.

The new Government's commitment towards a broad-based structural reform program in the banking system was instrumental in restoring public confidence in financial services and institutions.

The program which the Government has adopted since 1997 focuses on three main objectives: improving the legal and regulatory framework, building sound and reliable institutions and strengthening the financial infrastructure.

As a first priority, the authorities took resolute action to improve financial sector laws and regulations, and should be commended for their efforts in this area. The Law on Bank of Albania and the Banking Law were approved, respectively, in end-1997 and 1998.

A new Insolvency Law, in harmony with relevant EU legislation, has been prepared and will be shortly submitted to the Parliament for approval. Finally, the Secured Transactions Law became effective in January 2001.

Thanks to the concerted efforts of the Albanian authorities, the legal and regulatory framework for the financial sector now reflects many of the regional and international standards considered as "best practice" and is generally adequate for the existing level of banking activities.

Subsequently, the Government adopted a program for a quick divestiture of state-owned banks, which led to the liquidation of the Rural Commercial Bank (RCB) and to the creation of an agency for the resolution of bad assets of the state owned banks. Their balance sheets were cleaned up and the banks were prepared for privatization. The National Commercial Bank (NCHB) was recapitalized and privatized in 2000. The Savings Bank (SvB) will be privatized in 2002. With its privatization, the state presence will be completely removed from the banking business.

As I mentioned earlier, the Government's strategy for financial sector reforms has and will continue to focus on institutional building and strengthening. In 1998 the Government established an agency, the Bank Asset Resolution Trust (BART), for the

resolution of bad portfolios of the state-owned banks. However, BART has not functioned effectively as an aggressive liquidator of assets. In order to improve its performance, a new law is being drafted and will be shortly presented to the Parliament for approval.

The third area of reforms embarked upon by the Government aims at strengthening financial infrastructure. During the last four years, the Bank of Albania has focused its efforts on improving the effectiveness of the banking regulatory and supervisory framework. Strengthening of the supervisory capacity is a crucial task given the dominant role of the banking sector in the Albanian financial sector and in light of an expected dynamic private banking environment. Work on the preparation of an institutional development plan for banking supervision is ongoing. In order to enhance quality and transparency of regulatory reporting from banks, the Bank of Albania has adopted a new chart of accounts for banks consistent with International Accounting Standards. Another important element of a modern financial infrastructure is the payments system. In this regard, the Bank of Albania has developed a program to establish an efficient and reliable Real Time Gross Settlement (RTGS) system.

With donor support, the Government will soon establish a Credit Information Bureau (CIB). The CIB would provide information on current and potential borrowers, thereby enabling lenders to allocate their resources more efficiently and creditworthy enterprises to easily access credit. Finally, since 2001, a Register of Securing Charges has been operating satisfactorily. It will further contribute to making the environment more conducive for commercial banking.

Finally, the Government has directed its efforts at developing and reforming the non-bank financial sector. Albania deserves special recognition for its early support for micro-credit programs., which are among the most successful in the region. Over the last ten years, over 20,000 small farmers and urban micro-entrepreneurs in Albania have received micro-loans. Repayment rates have been remarkably high – over 90% – because micro-credit relies on peer pressure and other non-traditional forms of collateral. Micro-credit has proven an effective tool to reduce poverty and develop the small private sector. In recent years, the Government is supporting the development of Savings and Credit Associations, which could be the basis for a sustainable rural credit system. The Government passed a new Law, and the Bank of Albania is working to finalize regulations.

Within the non-bank financial sector, the Government has also directed recent efforts at the development of a market-based insurance sector. In this area, Government's efforts has so far been limited to preparing INSIG, the State-owned insurance company, for privatization and to improving the regulatory and supervisory framework. Much more will have to be done in the years ahead, and the Government is addressing this new challenge with resolve and determination.

EVALUATING THE OUTCOME OF REFORMS

Let me now turn briefly to an assessment of the outcomes of the reform efforts and, particularly, to evaluating the impact of banking sector reforms on the availability of financial intermediation to the private sector. I am pleased to report that results to date have been generally encouraging. The overall successful implementation of the Government's reform strategy, together with macroeconomic stability and growth, has contributed to the restoration of confidence in the banking system, as evidenced by the substantial increase in total household deposits. In 2000, the level of deposits held by individuals (Lek 229,135 million) was nearly double the 1997 level (Lek 118,466 million). In addition, the aggregate intermediation levels have increased, although from a very low base. In 2000 the growth of loans to the private sector amounted to 65.2%, although their level was still low. This is due to the more active lending policies adopted by the private commercial banks, which have also gradually resulted in the availability of more diverse banking products and better services for the population. Finally, the private banks have begun opening new branches in the secondary cities.

Competition in the banking system has been increasing steadily. In 2000, the rate of growth of total assets, deposits and T-bills for the private banks far exceeded that of the Savings Bank and the newly privatized NCB.

As I mentioned earlier, these results are encouraging. However, much more needs to be done in order to consolidate past achievements and to foster a better engagement of the financial sector in the development of the Albanian economy.

THE CHALLENGES AHEAD

This leads me to my last point, which deals with the future of financial sector reforms, and to briefly outline the measures and policies that the Government tends to pursue. Such actions and

policies are in line with Albania's long-term goal of establishing a market-based financial system, operating under laws and regulations harmonized with the EU guidelines, with robust institutions, integrated with international financial markets. A financial system which has the public's confidence, and which can contribute to the continued growth of Albania through effective allocation of resources. A system which responds to the needs of the population and the business community alike.

Immediate efforts towards this goal will focus, among others, on the consolidation of reforms in the banking sector, the enhancement of the bankruptcy and resolution framework, and the further development of the non-bank financial sector. The program will strengthen the Bank of Albania's supervisory capacity to identify, measure, monitor and manage the risks of the individual banks and the system as a whole. The program will also improve the implementation and enforcement of bankruptcy and debt resolution legislation. With regard to the further development of the non-bank financial sector, the Government's strategy will be focused on improving the regulatory and supervisory framework for the insurance sector and on the privatization of INSIG. Regulation on insurance supervision will be reviewed and brought closer to EU standards, and the independence of the Albanian Insurance Supervision Commission will be further strengthened.

In its efforts to reform the banking system, the Government has requested and obtained the full support of the World Bank Group, as well as the other donors. In particular, the World Bank is assisting the Government in designing and implementing the above program through the proposed Financial Sector Adjustment Credit. In the past, the World Bank has provided advice and assistance to Albania's financial sector through two additional ongoing operations, the Financial Sector Institution Building Technical Assistance Project and the Recovery Program Technical Assistance Project.

To conclude, I would like to commend the Albanian authorities for their commitment to the financial sector reforms program and for their past efforts, which have produced good results so far. Of course there have been setbacks in the process, and many more challenges are laying ahead. However, I am confident that, collectively, we as donors can continue to make an important contribution in supporting Albania to move forward with its financial sector reform agenda. Provided that there is continued strong commitment on the part of the authorities, let me reassure you that

the World Bank will stand ready to continue to assist Albania in achieving its ultimate goal of establishing a market-based banking system and a viable financial sector. I would like to express my appreciation for the excellent collaboration we have experienced in the past with the Albanian authorities, and hope that our future collaboration will be equally fruitful.

Thank you.