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The articles presented in this publication, do not necessarily reflect the official opinion of the Bank of Albania. Please refer to them as personal views of the authors.

Dear readers,

It is already 10 years that the Economic Bulletin of the Bank of Albania is being published for an audience of business and banking professionals, academics and for the public at large. Most of the time, it contains articles, surveys and analysis of the employees of the Bank of Albania. Hoping that these studies could be used or easily accessed even after such a relatively long period from their first official publication, we thought to publish this compendium of articles in a unique format.

We want to call your attention in this occasion, that these articles not only express the views and conclusions of the authors, but they have to be seen placed in the time frame they have been written, with reference to the events or to the phenomena analysed.

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A REVIEW OF ALBANIAN MONETARY TARGETING REGIME WITH INSIGHTS INTO THE FUTURE

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Erjon Luçi

Key words

- Monetary targeting - Inflation targeting - Alternative regimes - Monetary policy -

1. INTRODUCTION

An effective intermediate target should comprise all the necessary information for forecasting inflation. This may not be the case for monetary aggregates. For this reason, Albania like many other countries, is considering eventually abandoning the reliance solely on monetary targeting and probably moving towards an inflation targeting regime in conducting its monetary policy. The Bank of Albania has already started to announce the end year objective of inflation to the public. However as Mishkin (2002) argues, just reporting an inflation objective might be insufficient to classify a country as inflation targeting. Going from this implicit inflation target regime toward an explicit inflation target regime requires several other important elements which bear some costs if certain conditions are not met beforehand.

In this paper we try to scrutinize the feasibility of inflation targeting (IT) implementation in midterm by describing the potential problems that might emerge in adopting a formal inflation targeting in Albania. The paper is organised as follows. The next Section gives a general outline of monetary policy in Albania. Section 3 analyses the potential difficulties of communication that the actual regime of monetary targeting

may have in conducting monetary policy. Section 4 summarises some of the benefits and the problems that characterise the inflation targeting regime. In Section 5 we concentrate in more detail on problems that are mainly related to Bank of Albania ability in adopting IT regime. Section 6, looks at other threats to IT regime beyond Bank of Albania control. We briefly consider some alternative regimes in Section 7. Section 8 concludes.

2. GENERAL OUTLINE OF MONETARY POLICY IN ALBANIA DURING TRANSITION

Albania has been particularly successful in bringing inflation down. From 237 percent in 1992, inflation was reduced to just 6 percent in 1996. The inflation caused by the uncertainty after the collapse of pyramid schemes was rapidly reduced as well. McNeilly, et al. (1998) attribute the success of Albania in achieving low inflation to the early price liberalisation associated with supporting policies for fostering competition and an early aggregate supply increase in goods and services alongside a restrictive monetary policy implemented by the Bank of Albania (BoA).

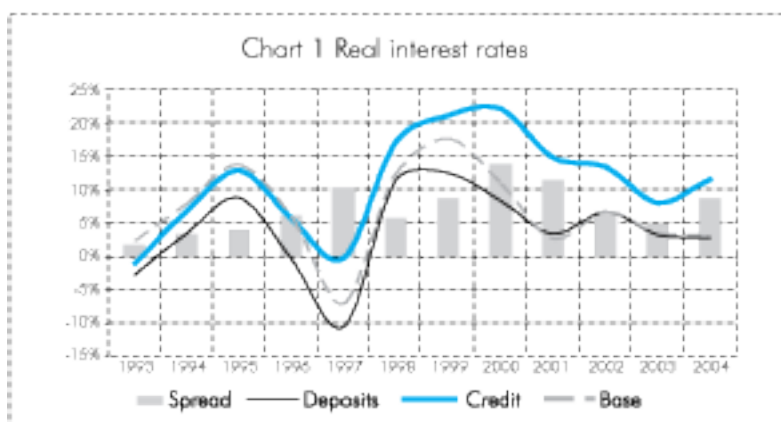
Table 1 Albania main economic indicators

	1998	1999	2000	2001	2002	2003	2004
Real GDP growth (%)	12.7	8.9	7.7	6.5	4.7	6.0	6.0
GDP per capita (USD)	842	1,052	1,086	1,329	1,460	1,833	2,434
Unemployment rate	17.8	18.0	16.9	14.6	15.8	15.0	14.5
Inflation rate (Dec. to Dec.)	8.7	-1.0	4.2	3.5	2.1	3.3	2.2
General govt. balance (% of GDP, excluding grants)	-11.4	-12.1	-9.2	-8.2	-6.9	-4.5	-6.5
General govt. balance (% of GDP, including grants)	-10.9	-9.3	-8.2	-7.6	-6.3	-4.1	-5.85
Domestic debt (% of GDP)	36.2	37.4	42.6	39.5	38.8	38.0	37.2
Trade balance (% of GDP)	-22.8	-19.3	-22.3	-24.2	-23.9	-22.8	-21.5
Current account balance (% of GDP excluding grants)	-7.1	-7.9	-7.4	-6.2	-9.0	-7.6	-7.5
Current account balance (% of GDP including grants)	-3.9	-3.9	-4.4	-3.2	-6.5	-5.1	-5.5
External debt (% of GDP)	36.9	32.3	31.8	28.2	24.4	20.2	21.0
Exchange rate lek/usd (av.)	150.6	137.7	143.7	143.5	140.1	121.9	102.8
Exchange rate lek/euro (av.)	-	146.9	132.6	128.5	132.4	137.5	127.7
Foreign direct investment (% of GDP)	1.5	1.4	3.7	4.8	2.6	2.7	5.0

Source: Ministry of Finance, INSTAT, Bank of Albania

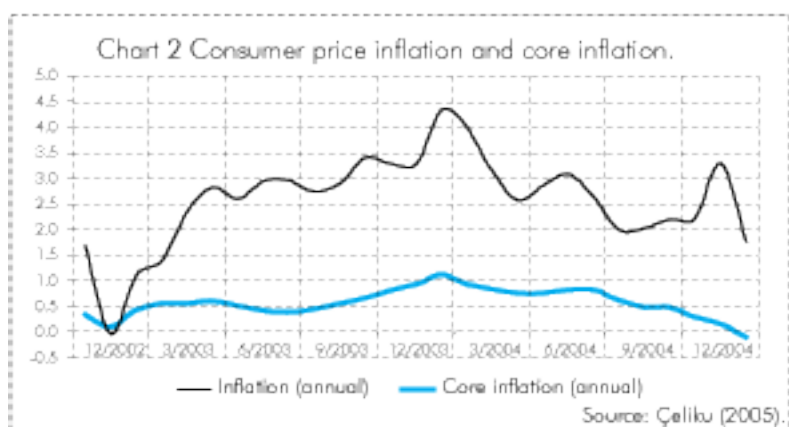
The BoA, initially, relied on direct instruments in conducting monetary policy. Before mid-1995 the supply of broad money (M3) was controlled by ceilings imposed on the total domestic credit expansion of the whole banking system. Credit ceilings consistent with targeted inflation rate and output growth were imposed on banks' total lending to the economy – including the government. Once the ceiling on the Central Bank's lending to the government was subtracted from the total ceiling, the remaining amount was divided among commercial banks by imposing sub-ceilings on a bank-by-bank basis. From 1995 the BoA tried to enhance its control over M3 through adjustments to bank deposit interest rates.

As far as the interest rate policy is concerned, the BoA aimed at keeping interest rates imposed on SOBs' deposits positive in real terms in order to avoid outflows of domestic monetary assets and to prevent disintermediation (Fig. 1). In 1999 the BoA removed credit ceilings to second tier banks while issuing a rule that banks with a ratio of bad loans to total loans of over 20 percent could not extend new loans. In the second half of 2000, the BoA also completely removed direct control over the deposit interest rates switching to indirect instruments for conducting monetary policy. Currently the BoA tries to influence interest rates through open market operations in T-bills (e.g. repos).



So far this regime has shown impressive results in terms of price stability. Inflation has stabilized at moderate levels as measured both at the end and average period figures, though it sometimes has diverged from the target due to unforeseen shocks and speculative factors that have been mainly beyond the central bank's control (e.g. higher bread prices, electricity and telecommunication tariffs) as differences between headline and core inflation in Fig. 2 show. Monetary policy will continue to aim inflation within 2-4 percent target.

However, the bank is trying to foresee threats that may prevent the bank from reaching the target in the future and adapt its monetary strategy accordingly. These threats could be related to the effectiveness of the actual monetary policy regime and/or external threats. The rest of this paper will try to analyse both these issues in more detail.



3. THE COMMUNICATION PROBLEM WITH THE ACTUAL MONETARY TARGETING REGIME

According to Estrella and Mishkin (1997), as inflation is brought under control the informative role of monetary aggregates diminishes because the velocity shocks' relative noise increases. This, according to them, could be an important reason why industrial countries and many emerging market

economies do not rely on monetary targeting in the era of price stability. The velocity shocks could be attributed mainly to the instability of money demand that has increased especially with the advances and structural changes of the financial systems.

It is often claimed that Albania is one of the countries that has successfully relied on monetary targeting to bring inflation down. However, it is unclear whether this success can be attributed solely, or to a large degree to this strategy and whether it is going to remain successful also in the future, considering the flaw recognized by Estrella and Mishkin (1997).

The Bank of Albania (BoA) has pursued several objectives over the years such as, reducing inflation, increasing its international reserves, easing exchange rate volatility, improving financial system stability and finally boosting economic development. Regarding its main objective stipulated by the law, stability of prices, communication with the public is carried out by announcing the annual growth rate of broad money (M3) based on the monetary program designed at the beginning of each year and updated quarterly. The money growth is determined based on a quantity equation consistent with a certain level of annual inflation, and projections of the potential output growth and money velocity. This kind of monetary targeting is analogous to the targeting of nominal GDP. Some authors, (Taylor, 1985) argue that this regime works better in accommodating supply shocks since a decline in real GDP automatically leads to expansive monetary policy. In the recent years BoA has also made its official target inflation level public, which has led Stone (2003) to classify Albania as an inflation targeting lite country as compared to the full fledged IT countries.

As can be seen from Table 1, the strategy of targeting monetary aggregates apparently have worked reasonably well considering that the level of end year inflation has been brought under control twice, after 1992 and after 1997. Nonetheless, other observations can also be made. First, the actual growth rate of M3 until 2000 has diverged widely from its target. In contrast, the official inflation objective during the same period

has most of the time been undershot. This raises doubts about the relative significance of the nominal anchor used in achieving low levels of inflation.

Second, although from 2000 M3 growth has been fairly close to its target, the growth rates have varied widely, from 5 to 13 percent, compared to the relatively stable inflation rates. This makes it very difficult for the public to understand the real intentions of BoA by merely relying on the announced M3 growth targets. For instance, the 3 percent objective level of inflation can be associated with a wide range of targeted M3 growth rates, from 9 to 15 percent. This brings some support to Estrella and Mishkin (1997) argument, that monetary aggregates lose their informative function at low levels of inflation.

Table 2 Planned vs. actual monetary aggregates and inflation (end year, % change)

Year	Monetary base		M3		Inflation	
	Project	Actual	Project	Actual	Desired level	Actual level
1993	-	-5.9	44.1	74.4	-	30.9
1994	-	-2.0	29.0	41.0	24.0	15.8
1995	-	-1.1	23.0	51.8	10.0	6.1
1996	-	2.6	22.0	43.8	12.0	17.4
1997	-	12.0	-	28.5	53.0	44.6
1998	-	14.1	23.0	20.6	10.0	8.7
1999	-	21.6	15.0	22.2	7.0	-1.0
2000	-	24.1	12.1	12.8	2-4	4.2
2001	11.4	18.1	15.4	19.9	2-4	3.5
2002	10.8	11.2	6.2	5.1	2-4	1.7
2003	-0.6	-1.9	9.5	8.3	2-4	3.3
2004	7.9	11.2	10.6	13.5	2-4	2.2
2005	5.7	-	8.3	-	2-4	-

Source: Bank of Albania

BoA has recognised the above problem in so far as the decisions about changing the monetary policy stance have been based on a wider range of information besides the M3 growth rates. In particular, from some time now, BoA pays particular attention to inflation forecasting which includes various extra information such as: inflationary pressures coming from exchange rate movements, price changes in different markets, including foreign markets, supply shocks, and so on. This running of monetary policy has very much the flavour of an inflation targeting regime. However, there are two important

elements that distinguish Albania from formal IT regimes. These are the communication of monetary policy strategy including the publication and explanation of its inflation forecast and a formal mechanism that makes BoA accountable to the announced inflation target.

Although it may seem straightforward, the implementation of IT has several drawbacks too, especially for emerging market economies. In the following Sections we will try to analyse in more details some of the benefits and the problems that BoA may encounter by switching to a formal IT regime.

4. INFLATION TARGETING REGIME: PROS AND CONS FOR ALBANIA

As far as monetary aggregates do not contain all the necessary information to predict future inflation, relying on a monetary targeting regime could be suboptimal. For this reason, BoA has been considering switching to an inflation targeting regime in the medium term. This is based on the idea that the best intermediate target for a monetary policy that aims at controlling inflation is an inflation forecast (Cukierman and Liviatan, 1992; Svensson, 1997). An inflation forecast, in contrast to monetary aggregates, is unrestricted in its coverage of information. Any information that could be relevant for the future inflation can be taken into account.

In the last decade there has been a large body of literature exploring the benefits of an IT regime compared to the other regimes, summarised in a series of paper by Mishkin et al. (1997, 2000, 2002). Some of the major benefits of IT are: the broader information base it utilises, its relatively higher flexibility with regard to supply shocks, the fact that it is easily understood by the public, improved accountability etc.

However, the adoption of an IT regime also poses several problems. The major problem for Albania is related to the increased risk that it may place on BoA's reputation compared

to the actual regime of monetary targeting. As mentioned earlier, although the M3 targets have been missed repeatedly up till 2001 (see Table 1) inflation has decreased which shows that BoA's reputation at least has not deteriorated; at best it has improved. This is probably related to the low understanding of the public about the relationship between M3 and inflation, which leaves the bank more scope to explain the missing of the target. In the case of IT regime the missing of the target could be much more costly in terms of bank reputation.

In recent years, BoA's reputation in terms of reaching its inflation objective around the 3 percent level has undoubtedly strengthened. However, claiming that the level of actual reputation is adequate for adopting an inflation targeting regime would be premature. There are several problems that may restrict the BoA's confidence in meeting the low inflation objective and endanger its reputation in the future reaching the inflation targeting. Some of these problems are related to BoA and some others are related to external factors. Let us concentrate in more detail on some of these problems.

5. OBSTACLES WITHIN BANK OF ALBANIA

The problems related to BoA in terms of adopting IT are mostly technical and less institutional. BoA enjoys a relatively high level of independence and by law has price stability as its main objective. However, BoA's high degree of legal independence is not fully translated into actual independence which may still be lower from that stipulated by law. Some empirical evidence (Luci, 1999) suggests that BoA tries to keep its independence from government although the lack of appropriate instruments and the uncertainty about the transmission mechanism makes it difficult to reach its objectives. An important step in improving the real independence of BoA would be the complete abolition of government financing, which at the moment is at 5 percent (of the last 3 years' average revenues). This would better insulate BoA from government interference with its monetary policy and would increase pressures to the latter to consolidate further

its fiscal policy by either increasing its revenues or reducing the expenditures. Adopting an IT regime may require some further amendments to the actual law but we do not foresee any particular obstacle in this regard. As far as the technical part is concerned, a successful IT regime requires a good understanding of the monetary policy transmission mechanism, a rather good forecasting model for inflation, and an efficient communication framework with the public. While the bank has been working to improve all these components, a lot remains to be done especially in relation to the first two. The Research Department in collaboration with Monetary Policy Department and the Monetary Operation Department has compiled a list of technical problems that need to be tackled, which generally aim at improving our understanding of monetary policy transmission mechanism, of inflation sources, and of the functioning of the Albanian economy as a whole.

The work on these issues may require some time before good results are claimed. In particular two critical problems need to be tackled sooner rather than later to accelerate progress. These are: the inadequate technical expertise to build up the necessary tools for IT implementation, and the poor state of economic data. The former is being addressed through technical expertise of international institutions like IMF. However, to make technical progress sustainable over time, a strategy for developing in-house human capital is also being considered. Regarding statistical data drawbacks, several steps are being taken to improve data sources such as: carrying out surveys, interviews, and assisting INSTAT to improve national account statistics frequency and quality.

6. OTHER CHALLENGES IN ADOPTING IT

Provided BoA puts itself in a position for adopting an IT regime effectively, there may be other external problems that could prevent it from reaching the target. This might involve changes in the administrative prices and structural reforms in general, lack of fiscal discipline, dollarisation, a decrease in

foreign remittances and the potential exchange rate volatility, financial system development and stability, etc.

Government-controlled prices could pose a serious threat at targeting the headline inflation. This has already caused difficulties for the BoA in the past. One solution to this problem is to target an inflation definition which excludes the administrative prices. However, this makes the target less clear to the public. Another solution may require the government to endorse a more precise plan for future price liberalisation so that BoA could adjust the final target accordingly.

Several authors (Masson et al., 1997; Stone, 2003) have pointed out the importance of fiscal discipline to the success of the IT regime. Although the fiscal discipline has been a crucial factor in bringing inflation down in Albania several future events, especially certain structural reforms, may force the government to relax its discipline. Among these events an important one is related to the method the new law on compensation is going to take place. If the government is going to cover most of the compensation expenses through its budget this would really put a lot of pressures on inflation.

A high degree of foreign currency substitution (euroisation, dollarisation) can cause serious problems for IT (Mishkin, 2000). Partial dollarisation has the potential to make inflation targeting regime, which requires some degree of exchange rate flexibility, vulnerable to financial instability (Mishkin and Sevastano, 2002). In Albania the level of dollarisation in terms of foreign deposits to total banking assets is around 20-36% (Sojli, 2003). The problems related to dollarisation need to be treated with caution in the prospect of the declining foreign remittances that so far has cushioned the impact of deterioration of current account deficit and have ensured a relatively stable exchange rate.

A sound financial system is important to the success of IT for several reasons. A sound financial system could better sustain the negative impact of eventual exchange rate volatility related to the high dollarisation. Also, considering the several

objectives BoA is pursuing, it might be important to examine whether Albania has missed or could miss the inflation target if it conflicts with reaching other objectives such as financial stability. A sound financial system would put BoA under less pressure to trade off between its objectives.

The development of the financial system is also an important factor for the conduct of monetary policy. The actual level of financial development in Albania is far from being adequate for an effective monetary policy. The level of competition among banks at the moment is very low while the money and stock markets are virtually nonexistent. Thus, a lot remains to be done to increase the depth of financial system especially that of the money and stock markets.

The recent privatisation of the Savings Bank is expected to improve the competition of the Albanian banking system and boost credit to private sector. There are some concerns though, about the possibility of credit growth becoming 'excessive', looking at experiences of some other transition countries (Cottarelli, et al., 2004). This is a very critical issue which needs particular attention and further investigation (see Box 1).

Even so, Mishkin and Sevastano (2002) argue that the above mention problems are important issues for other monetary policy regimes too, under the IT regime the cost in terms of central bank reputation could be much higher.

Box 1: Potential credit growth

Fast credit growth, which not a long time ago was considered to be a great achievement, now is becoming a major concern among many transition countries, including Albania that so far has been lagging behind. The volume of credit to the private sector in Albania in percentage of GDP has remained virtually unchanged from the beginning of transition until recently at a low level of around 6%. Underdeveloped business culture and the low transparency of the newly emerging private enterprises seem to have been important

obstacles for the expansion of banks' lending activities. Other problems with property rights, law enforcement and poor infrastructure in Albania have also contributed to this outcome. The inefficiencies that characterised SOBs led to the accumulation of a large amount of bad loans by these banks which in turn induced regulatory authorities to first constrain and then completely block their lending activities. At first sight, the delay in the privatisation of SOBs that could have enabled the freeing of their funds for lending seem to have been the main reason for the low level of credit in Albania. However, private banks that were not particularly restricted by regulatory authorities also have a large proportion of their funds not channelled to commercial loans.

	2002	2003	2004 -Q1	2004 -Q2	2004 -Q3	2004 -Q4
Domestic credit to M3	70.8	71.5	71.6	69.5	67.4	68.7
to government	61.5	60.2	59.9	57.1	54.9	55.0
to economy	9.3	11.3	11.7	12.3	12.5	13.7
Credit to economy as % of total assets	11.5	13.7	13.7	14.6	14.7	16.6
Credit/Deposit ratio	13.5	15.7	15.8	16.6	16.8	18.8
Credit to economy as % of GDP	5.7	6.8	6.3	6.7	7.2	8.2

Source: Bank of Albania

Bank of Albania has made continuous efforts to increase the intermediation level of the banking system. This has consisted in clarifying the regulatory framework that regulates the loan activity of banks. Some measures are already taken with the removal of required fixed amounts of collateral for the loan. It is now the responsibility of the bank to judge about the need of collateral and to make sure that its value is appropriate to cover the amount of the loan and any other cost related to its execution. However, in every instance, we shall insist that banks keep high and strengthen their lending administration processes, in order to ensure a balanced and solid growth of the activity. Due to the currency composition of the loan portfolio, mostly extended in foreign currency, banks are pushed to put particular attention on the cash-flow of their borrowers, as this may not be denominated in the same currency of the loan. Any unexpected adverse change in the exchange rate could lead to difficulties, if not foreseen in time.

Furthermore, Bank of Albania has tried to promote lending in domestic currency. Among others things it will improve the effectiveness of monetary policy transmission mechanism. Looking at a broader macro-financial picture, Bank of Albania has contributed to that goal

by reducing its REPO rate to historic low levels and closing the lending interest rate differential between domestic and foreign currency.

Despite the easing of monetary policy and the lowering of the policy rate (the repo rate is lowered by 3.25 pps during the last 2 years), the spread of Lek-foreign interest rates on credit remains noticeable. Another factor that supports the interest in FX credit is the nature of the business activity. According to the statistics, the most credited sectors mostly operate with foreign currency. Bank of Albania will continue to support the growth of Lek credit to the economy. We expect Raiffeisen Bank to contribute to a greater expansion of Lek credit since it holds 67 percent of the Lek deposits of the banking system. Roughly, 86 percent of the deposits in this bank are in Lek currency.

Regarding the credit growth over the medium term, we expect it to accelerate considerably starting from 2005, as Raiffeisen Bank begins its lending activity and adds more supply to the market. Although, the impact of this change in the overall bank credit to the private sector, is subject to different uncertainties that relate to the evolution of the institutional and legal environment within which the lending activity takes place. Problems in regulations and practices affecting the creditors' rights aggravate risk conditions in the economy, making it difficult to assess the speed at which the credit expansion will occur. Some preliminary estimates based on the performance in credit growth during the last 3 years, and the credit growth projections revealed by Raiffeisen Bank, and a certain degree of substitution to other banks credit growth, show an annual private sector credit growth at around Lek 30-35 billion, or 45-50 % for 2005.

In the medium term the credit growth is estimated to stabilise at about 3 to 4 percentage points of GDP annually. This is below the critical threshold of 5 percent; However, we are also taking into account the possibility of what has occurred in other countries in the region. To this end some measures are undertaken to get a closer insight of housing market which has already seen a considerable increase in prices in the last two years. If banking lending expands rapidly in housing loans the risk is that it may lead to a dangerous bubble. On one side, if most of the credit is extended in foreign currency it will make difficult for our bank to contract this loan expansion and probably to recur to some sort of direct measures which would mean a step back for the monetary policy. On the other side, it will put some strains on banking

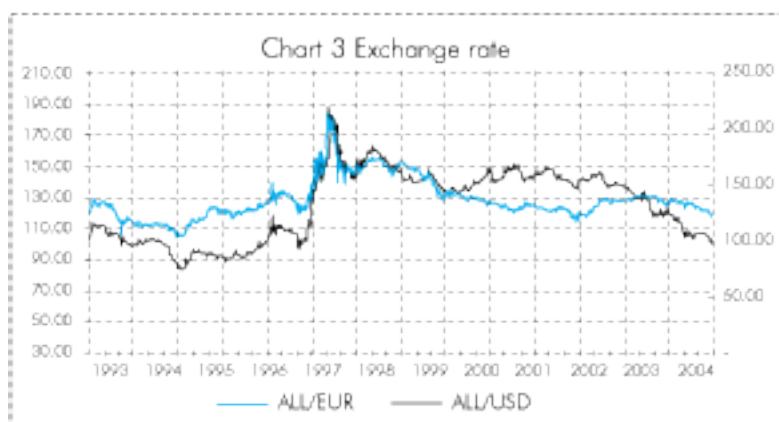
supervision to ensure the soundness of banking sector in case of a potential decline in housing prices.

(Source: Various documents of the Banking Supervision Department and the Monetary Policy Department, BoA)

7. ALTERNATIVE REGIMES

The other alternatives to IT and monetary targeting are exchange rate pegging and the so called just do it policy applied by FED (Mishkin, 2002). Exchange rate pass-through in Albania is thought to be high, though asymmetric, given the large proportion of imported goods in consumer basket (approx. 70%). This would make this regime an effective way of conducting monetary policy. However, exchange rate pegging so far has been rejected as a suitable strategy to Albania for different reasons. Initially due to insufficient international reserves and later on the bases of real exchange rate appreciation risks, especially when the fundamentals of RER remain still largely unknown.

While we believe that to leave the exchange rate being decided by market forces is the best strategy to follow, under certain circumstances intervention may prove an effective way to curb inflation, especially when spirals between exchange rate



depreciation and unfounded inflation expectation are observed. However, in cases when the source of inflationary pressure is of structural nature such strategy could cause more harm than good.

Most of exchange rate discussion, however, refers to scenarios of controlling depreciation to curb higher inflation. From some time now though, Albania like several other transition countries is seeing appreciation of its currency instead (Fig. 3). While this has helped easing inflationary pressures, concerns about external competitiveness are raising. This has pushed BoA to occasionally intervene in the market and to reduce the local currency interest rates to prevent the lek from appreciating too strongly in nominal terms against the euro. However, it remains unclear whether this appreciation is a return to some kind of long term equilibrium supported by fundamental changes. This shows that exchange rate developments cannot be ignored that easily in monetary policy decision even if committed to the free floating regime.

The other 'just do it' strategy might characterise the actual Albanian monetary policy case rather well. Although there is an explicit monetary target and an implicit inflation target, as mentioned earlier, the way the monetary policy operates has a lot of discretion elements in it to achieve the main objective of low inflation, while allowing for some sort of supply shocks adjustments. The advocates of this regime oppose the US switching to a formal IT regime by simply saying 'if ain't broke don't fix it'. However, in the case of Albania maintaining the effectiveness of this strategy for a long time may not be viable considering that BoA does not enjoy the same degree of reputation as FED. According to Stone (2003) this kind of regime should come after a full fledged IT, and it is very difficult and risky for an emerging market country to switch directly to this strategy.

8. CONCLUSIONS

Albanian reliance on monetary targeting, although so far seem not to have experienced any serious problem, may prove

to be insufficient to maintain low inflation in the future. In particular, the signalling power of monetary aggregates targeted by BoA may start to deteriorate. Therefore, alternative regimes such as IT that could transmit central bank signals better may be considered. However, premature implementation of these alternative regimes could cause more harm than good to the reputation of the bank. In the particular case of IT, due to the more explicit and understandable target, there is a higher risk of damaging the reputation of the central bank compared to the other regimes. For this reason, its implementation should carefully assess all the necessary institutional and technical criteria and the adverse scenarios that could jeopardize the success of this regime.

From our short analysis we conclude that despite the difficulties BoA may be facing to comply with the requirements of this new regime, its implementation in medium term is viable, provided that in the meantime the work on this direction is intensified.

NOTES

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The views expressed in this paper are those of the authors and do not necessarily reflect those of the Bank of Albania.

In this paper we try to analyse whether the monetary targeting regime currently applied in Albania may become inadequate in light of upcoming economic developments. Although its performance thus far has been satisfactory, alternative regimes like inflation targeting could be more appropriate to preserve price stability in the future. We then, concentrate on requirements, problems and the possibility of switching from the actual regime toward a full fledged inflation targeting regime.

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BANK OF ALBANIA SIGNALS, PUBLIC EXPECTED INFLATION VERSUS FACTUAL ONE FOR 2004

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Key words

- Perceived inflation - Business expectations - Consumer expectations - Wage indexing -

1. INTRODUCTION

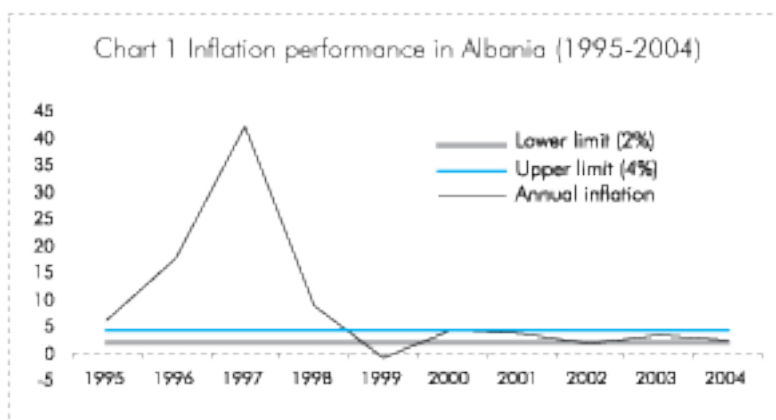
One of the main issues on which the monetary policy should be clear, before and during the application of the decisions made for the analysis of its stance, is related to the fact of how and how much the economic agents, businesses and population in general absorb and understand signals that “it launches” during the decision-making process.

The monetary policy efficiency, especially under “Inflation Targeting” is closely related to the communication channel with public. Public and businesses not only absorb signals by using them to estimate the coming financial situation, but also through their behavior and perceptions on the market, they create some inertness or incentives that affect the monetary policy and other aspects of the country economic life in the future.

To what extent are those signals understood by businesses exercising an economic activity in the production, building and service fields or even by Albanian public at the simple role of consumer? To give an answer to this question, we will rely on the analysis of the information taken during the survey of businesses and consumers, in the special column created for this purpose in

the respective questionnaires of the confidence indexes (BCI and CCI). The information taken from 540 businesses and roughly 1200 consumers, focuses on their opinions about questions such as: "How is the Bank of Albania information perceived by the public?"; "Does the published information on inflation affect future inflationary expectations?"; "What do the surveys suggest concerning the way of forming and using the agents expectations in their financial decisions?".

Through this effort we would like to understand whether the inflation history of the last years, which has had a low and stable annual rate (Chart 1), has been transmitted even to public and business expectations. So, in a certain way we would like to judge on the business and public confidence degree towards decisions made by the central bank. If the situation turns out positive (so that the Bank has a satisfying confidence), do the market actors (businesses and consumers) uphold these decisions by assimilating their economic effects at the right direction?



2. OUTCOME ANALYSIS

The survey outcomes are characterized by an asymmetry between expectations on inflation, based on the expected amount of wage rise that these two groups of the Albanian

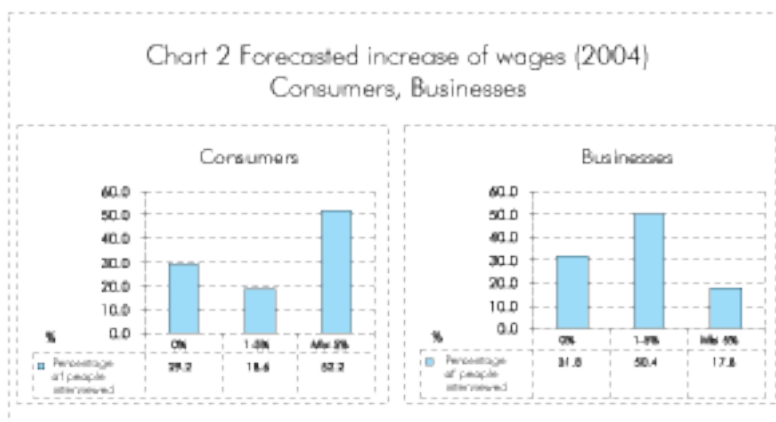
public forecasted to have during 2004 (Question 3, Table 1). To a certain extent, this is expected, as long as consumers and businesses make up two different groups of economic interest in the market.

Table 1 Outcomes of the answer's elaboration

Questions of the special column	Consumer Answers	Business Answer
1 Frequency of wage's review		
a. Every year	65.4%	24.4
b. Every 2 years	3.8%	7.14
c. Over every 2 years	1.1%	12.6
d. There no specific policy	29.7%	56.0
2 Factors inducing the increase of wages	(average degree of importance)*	(average degree of importance)
a. Forecasted increase of prices	4.3	2.6
b. Increase of prices in the past	3.9	2.3
c. Work age	3.2	3.2
d. Incitement of devotion at work	3.7	3.7
e. Increase of wages by competitors	N/A	3.1
f. Increase of wages at the public sector	N/A	2.6
3 Current forecasted increase for the 2004		
a. 0%	29.2 (0.0)** %	31.8 (0.0) %
b. 1 - 5%	18.6 (26.3) %	50.4 (73.9) %
c. 5 - 10%	29.8 (42.1) %	17.8 (26.1) % (Over 5%)
Over 10%	22.4 (31.6) %	N/A
Dispersion statistical indicators***		
Average forecasted increase	7.89 %	4.17 %
Standard deviation of the average increase	3.61	1.97
Variance coefficient (in %)	45.7 (%)	47.19 %
4 Most attended information of the Bank of Albania	(average degree of importance)	(average degree of importance)
a. Increase of prices	4.0	3.3
b. Interest rates	2.6	3.2
c. Exchange rate	2.7	3.9
Note:		
*The higher the average degree of importance, the more relevant the factor in comparison to other listed factors. The average degree of importance was measured as a weighted average of the degree value with the respective frequency (number of persons that have chosen it).		
**in parenthesis are the normalized weights in percentage, after excluding the group (a).		
***In accounting, statistical indicators on expectations for wage increase, because the group that is for a zero increase is a group qualitatively different from the others.		

For 2004, consumers expected an average increase of wages at the degree of about 7.9 per cent, while businesses argue that this increase could arrive at about 4.2 per cent. If we compare

the allocation of expectations (chart 2 and 3) between these two economic groups, we can see their concentration towards extreme intervals, while business expectations are found accumulated at the interval of 1-5 per cent. This is also witnessed by the standard deviation values for the respective groups. Nevertheless, if we consider the variation scale, it is presented almost invariable even at high levels to both consumers and business (about 46 per cent). This means that average expectations on possible increases of wages over 2004, should be considered with reserve, starting by the assessment of these actors.



If we refer to the estimations on the historical tendency of wage increase at the private sector, it is clear that after 1999, private businesses applied average annual growths that fluctuated around a value of 10 per cent. If we suppose that this increase continues at the same pace even over 2003-2004, it seems that expectations on wage increase for both groups are found within the historical values.

Table 2 Wages according to sectors

Economic activity	Year					
	1997	1998	1999	2000	2001	2002
Industry	9411	10792	12203	13230	14839	15882
Construction	8340	10617	10936	12489	13416	15014
Transport and communication	9350	11744	14503	16225	18124	23434
Trade	8819	9653	10901	10889	12856	13924
Services	7814	11856	10718	13012	13140	14453
Total	9063	10894	12118	13355	14820	16541
Growth (in %)		20.2	11.2	10.2	11.0	11.6

Source: www.instat.gov.al, ASN 1997-2002.

Analysis of the enlisted factors influencing the potential increase of wages shows that:

- “The perceived inflation” is the primary factor, according to consumers, that would cause this increase. This is a fact complying with the economic theory on the consumer behavior. The presence of the perceived inflation shows that there is a sort of increasing inertia influencing the inflation figures, due to consumer expectations;
- The increase of prices in the past, definitely should be reflected on the actual indicator of inflation and according to consumers, it should be reflected on the increase of wages;
- The use of wage increase remains an incentive at work or an estimator of the work performed by consumers;
- Consumers once again consider the increase of wages due to the working age, an element that should accompany the wage scheme in both public and private sectors.

If both factors have a lower weight than that of the actual value (respectively 0.3 and 0.15), then the increase of wages due to the expected inflation could be roughly at 1.88 per cent. Meanwhile, due to the current inflation (November 2003 = 3.4 per cent), weighted with (0.55), the inflation resulted about 1.87 per cent. So, in total, the inflation perceived by consumer was expected to be about 3.7 per cent for 2004. This indicated that consumer expectations on inflation, were within the band, aspired by the central bank.

It seems that high inflation perception of consumers, contradicted to some extent the business opinion. Businesses considered the increase of wages, closely related to the fact that the latter boost the work incentives. On the other hand, even businesses (all from the private sector of the economy) consider that an increase of wages addresses more to a higher experience at work. Competition and increases of wages in the public sector were also listed by businesses among the factors influencing the increase of wages. This policy resulted to be far off the wage-indexing problem for the effect of past and

expected price increase. At some extent, it reflected lack of the real role of trade unions at the job market in Albania. So the right of negotiation and renegotiation was evidenced as too weak.

Nevertheless, if we go back to a weighted accounting of an increase of wages due to the increase of prices, we can note that even businesses have had a perceived inflation in 2004, although lower than that of consumers. If weighted factors for past and expected increases (of inflation and wages in the public sector) of prices would be respectively 0.2, 0.2 and 0.1 (because they are at the end of the rank), the perceived inflation for the business group would be about 1.27 per cent. While, due to the current inflation (November 2003 = 3.4 per cent), weighted with (0.5), it would result in roughly 1.7 per cent. In total, businesses would estimate the expected inflation, for the 2004, of about 2.97 per cent.

For both groups, by weighting their opinions concerning expectations on inflation², the expected inflation for the 2004 could result about 3.4 per cent, a signal indicating that, although this category of inflation resulted within the band of 2-4 per cent, the monetary policy during the 2004, should not skip it. Actually, it is obvious that during the forecasting process, these were carefully considered. By reflecting on the factual figure of the annual inflation rate, which resulted only 2.2 per cent in December 2004, one year later, we can assess that inflation resulted lower than public expectation and as well as by predictions of central bankers themselves on it, at the year-start (January 2004).

It is important to verify how public (business and consumer) expectations will be reflected on the inflation of the following year. Starting by the existence of a low negotiated power during the defining of wages, we can conclude that the transmission channel of public inflationary expectations at the level of wages and then of prices, is not complete. Hence we can explain the fact that the level of expectations is not fully reflected at the current level of inflation. Therefore, expectations on a more

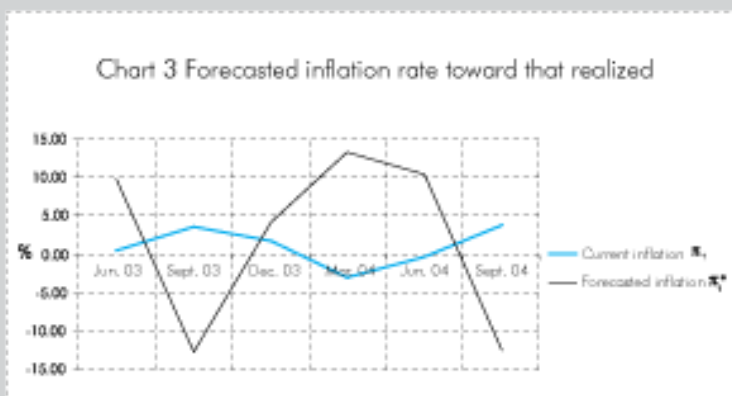
increased inflation by the public exist at relatively high levels, but they will not be fully transmitted through the income's channel.

Declaring a quantitative objective on inflation by a central bank, helps in the improvement of expectations converging (Castelnuovo, Altimari & Palenzuela 2003)³.

This means that, in the near future, even the Albanian public will be more oriented toward its expectations on inflation, although it is part of a process based on its confidence towards the Bank of Albania, and the transparency the latter has towards the public.

Box 1 Surveys of BCI and CCI and expectations on inflation.

Chart 4 presents an effort made for exploiting the surveys of BCI and CCI to measure the public inflationary expectations. Through this chart, we note a phasing-out in the expected and factual inflation tendencies. The modification of the questionnaire on inflation is expected to bring a clearer view of the expected inflation through surveys⁴. In addition, the increase in the number of surveys would enable the application of the expectation's quantification methodology, on more complete time-series making them more confident.



Question 1 on the wage review frequency offers more information concerning wage policies in our country. From the survey results, it comes out that, in general, companies do not apply defined indexing policies and this is especially highlighted in the construction industry, where 70 per cent of businesses affirm lack of reviewing policies. Even here is noted an asymmetry between consumers and employers. Therefore, 65.4 per cent of consumers affirm the need of annual basis indexing, while 56 per cent in average of businesses affirm the lack in reality of indexing policies.

The choice by consumers of annual basis indexing could express a sort of uncertainty for the future or knowledge of annual indexing practices at the public sector. The discrepancy with the business opinion witnesses, once again, the low negotiated power in the job market.

Public (consumer and business) opinion suggests that in lack of indexing policies or in presence of annual basis policies, it exists a high degree of wage flexibility. This fact is of a certain interest for the Bank of Albania monetary policy, as at the anchored expectation conditions, its monetary policy effects could be transmitted more rapidly at the wage level and consequently at the price level.

It seems as a positive signal the fact resulting from question 4, that the published inflation is information regularly attended by consumers. It is ranked first among indicators, the Albanian consumer is more interested in. This information holds up the fact that, by one hand, the educative aspect of the Bank of Albania is increasing annually, on the other hand, it seems that in the near future, this prepared public itself become an active part in understanding signals "transmitted" by the monetary policy.

Although the inflation indicator is attended even by businesses, it is ranked after the exchange rate. The high interest of businesses towards the exchange rate is explicable by its importance in defining costs, especially for businesses having an import

activity, while the information on interest rates is interesting for the impact they have on the borrowing level for business.

Regarding the information on interest rates, it seems that consumers are still far off. The limited familiarization of the Albanian public with these rates is judged to be linked to the lending, currently limited in the Albanian economy, and to the lack of an active financial market.

3. CONCLUSIONS

This analysis addresses some preliminary ideas on inflation expectations and public perceptions, in relation to this indicator. We suggest that these ideas can serve as a comparative point for further studies at this aspect.

Asymmetry between consumer and business expectations is related to the different interests that these groups have on the market. On the other hand, the analysis verifies that the job contract's market favors the employers, evidencing the very weak aspect of the trade unions. The wage-indexing problem against the expected increase of prices is not supported by businesses, while consumers require it.

This leads to the fact that the transmission channel of public inflationary expectations, regarding the wage level and then prices, is not complete.

The expected inflation perceived for 2004, would be about 3.4 per cent, within the margins forecasted by the central bank. Compared to the factual inflation, at the end of 2004 (2.2 per cent), it seems that expectations turned up stronger, a fact which verifies, to a certain degree, the overestimation of this indicator by the public.

For the Bank of Albania, as the institution responsible of the monetary policy, it is important the knowledge of the inflationary expectation level and their effect at the price level or

in other terms, the knowledge of expectation-wage-price spiral elements.

While the present material brings out some conclusions on the first link of this spiral, it would be interesting to bring forward the study of the second link and concretely considerations on which the business setting-price behavior is based, in order to identify potential risks that the maintenance of the price stability in Albania is faced with.

It is interesting for the Bank of Albania that the attendance of the inflation indicator by the public, gives a very positive signal for the increasing degree of its awareness. Perhaps, the bank of Albania monetary policy would be at the same level as interested to the public awareness on interest rates. This fact is not witnessed by the information brought in by this analysis. There are signals given through the interest rates, which transmit messages for the maintenance of inflation at the forecasted levels.

We would recommend that such questionnaire should be applied not only quarterly to evidence tendencies and to estimate them quantitatively, as it is really done at the BCI and CCI surveys, thus creating, step by step, a sequence of expectations on inflation. It should be more quantitative at the end of the year, in order to get a specific information only on expectations and resources they would create over the next year. Such estimations could help in enriching the forecasted scenarios on inflation, by clarifying the expectation channel in the transmission scheme of monetary policy.

NOTES

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This analysis made first efforts to estimate inflation expectations from the quantitative viewpoint, and evidenced some of the main sources of their creation. The analysis is a reflection on indicator elaborations and results of inflation expectations for 2004, of roughly 1200 consumers and 540 businesses¹, comparing them to factual inflation figure of this year.

¹ Survey of December 2003 for business and consumer confidence indexes (BCI and CCI).

² Weighted elements are 0.3 for businesses and 0.7 for consumers (the weight of each group toward the total).

³ Actors support this conclusion, for a number of industrialized countries.

⁴ Details on the method used for the measurement of expectations through surveys, and expected modifications on its application are found at the in-depth paper "Measurement of expectations" (R.Nasto, RD).

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THE EVALUATION OF DISSEMINATION STANDARDS OF STATISTICS IN THE BANK OF ALBANIA

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Hilda Shijaku
Endrita Xhaferaj

Key words

- Statistics - GDDS - SDDS - Data dissemination -

INTRODUCTION

The compilation and dissemination of economic data is increasingly becoming a determining factor in economic decision-making. In addition, countries aspiring to access international capital markets are advised to improve statistical data dissemination, because through it, they could build confidence with investors. Because of its importance, the process of data dissemination has drawn the attention of international organizations, which have built standards based on the best countries practices.

The International Monetary Fund, in October 1995 begun the work on creating the standards related to economic and financial data dissemination. These standards consist in two levels: GDDS standards (General Data Dissemination System)¹ in which participation is opened to all member countries of IMF and SDDS (Special Data Dissemination Standards)², to guide members that have, or that might seek, access to international capital markets in the provision of their economic and financial data to the public. Both standards are expected to increase the availability of timely and comprehensive statistics and therefore contribute to the pursuit of sound macroeconomic policies; the SDDS is also expected to contribute to the improved functioning of financial markets.

Albania is a member of the GDDS project since 1999, being classified as a pilot country in this project. Through this system, the enhancement of the transparency of institutions producing statistics (Bank of Albania, Ministry of Finance and INSTAT) has been achieved, the priorities and plans for improvement related to existing shortcomings have been settled and the needed assistance is received in this direction. ROSC³ (Reports on the Observance of Standards and Codes) missions have been created to evaluate the countries practices related to statistical data dissemination. They have visited Albania for the last time in May 2000. Besides the positive appraisal, the mission evidenced the building of a system of national accounts, the improvement of the legal framework and the coverage of economic activities, with particular reference to statistics of real and external sectors, as well as the efficient use of information sources, as further needs.

This paper aims at providing an assessment on the quality of the practice of data dissemination including the collection, compilation and final dissemination of financial and balance of payments data, through their comparison with the best international practices.

Standards of the IMF project DQAF (Data Quality Assessment Framework) have been used for this assessment, standards which cover institutional environment, statistical processes and characteristics of statistical products. A summarizing table of standard indicators used by DQAF is given in the Annexes.

The paper is divided into 6 parts, which relate to the assessed dimensions related to data dissemination, with the aim to assess the efficiency of the dissemination of the statistics of financial and external sectors in Albania.

1. PREREQUISITES OF QUALITY

The prerequisites of qualitative statistical data dissemination are the existence of a legal and institutional environment

supportive of statistics, the existence of commensurate human and material resources, the relevance of the data that are disseminated and the good quality management.

1.1 THE EXISTENCE OF A LEGAL AND INSTITUTIONAL ENVIRONMENT SUPPORTIVE OF STATISTICS:

First, an environment supportive of statistics implies that the responsibility for collecting, processing, and disseminating a category of data is clearly specified by law.

i) The Law “On the Bank of Albania”, clearly gives the right and responsibility to the Bank of Albania to compile and disseminate financial and balance of payments statistics, as well as obliges all banks, institutions, physical and legal persons, to report statistical data to the Bank of Albania. The Law “On official statistics” is also included in this framework⁴.

Second, data sharing and coordination among data-producing agencies are adequate.

ii) This indicator implies both the existence of procedures of data exchange and the maintenance of contacts (e.g., regular meetings and workshops) with other data producing agencies to promote a proper understanding of data requirements, the common use of information sources, and to take into account reporting burden. In the Bank of Albania there exist such procedures described in the respective regulations, which cover, for the time being, the flow of statistics which are subject of current work. In order to lower the costs of reporting by entities it has been intended to achieve the coordination of the reports of commercial banks and savings and credit associations for supervisory purposes, balance of payments purposes and financial statistics purposes.

Currently, the monetary and financial statistics sector is in the final phase of the inclusion of “other financial institutions” in the statistical indicators. For this purpose, it has been sought to use all existing data of bodies that license or supervise groups

of financial institutions, such as the Supervisory Council of Insurance Companies. This kind of positive experience has been followed for the reports from savings and credit associations, by collecting the information from the respective unions (in which savings and credit associations are members). In the same way collection of information for balance of payments needs is being conducted.

It is worth noting that such working practices for the exchange of statistical information have been settled in collaboration with INSTAT and the Ministry of Finance.

iii) Third, individual reporters' data are to be kept in strict confidentiality and used for statistical purposes only.

This assertion is particularly important for the entities that are not supervised or licensed by the Bank of Albania, which cannot be subject to penalization for delays or deficiencies in reporting. The Bank of Albania ensures the confidentiality of individual data based on the Law "On the Bank of Albania", the "Code of Ethics of the Bank of Albania" and the "Regulation for Transparency and Confidentiality in the Bank of Albania".

Besides the protection by law, there exist procedures that prevent the dissemination of individual information. These rules prevent the illegal dissemination of information, e.g. by guaranteeing the security of databases, by limiting the number of personnel that have access to individual data, etc. In addition, the prevention of indirect dissemination of individual information is also taken into account. As regards the regulatory protection, the Law "On the Bank of Albania" and the above-mentioned regulations ensure the confidentiality of individual data by forbidding Bank of Albania's staff to disclose or transfer individual data to third parties for any purpose. However, in terms of regulatory basis it should be specified the "prevention of indirect disclosure of confidential information", e.g. in the case when a bank or group of banks has a dominant position in a given instrument which allows the disclosure of individual information even when the data are aggregated.

iv) Fourth, statistical reporting is ensured through legal mandate and/or other measures that encourage response.

The statistical reporting could be obligatory or not. More specifically, for monetary statistics, the entities that report so far are obliged by law to report to the Bank of Albania. Penalties are in place if problems are evidenced. The Law “On the Bank of Albania” also provides that every institution, physical or legal person, is obliged to report to the Bank of Albania (Article 27, Law “On the Bank of Albania”), but there is no indication of what would happen in case of non-reporting (i.e., penalties on entities which do not meet this requirement).

In the case that the law has no power to oblige the entities to report, the statistical agency is obliged to take a number of measures to make reporting more easily and lower the costs of reporting by entities. More specifically, for other financial institutions (for their inclusion in financial statistics) the reporting system has been built not only by using the existing legal basis but also by offering collaboration with entities or by adjusting statistical needs with their existing accounting systems.

1.2 RESOURCES – RESOURCES ARE COMMENSURATE WITH STATISTICAL PROGRAMS.

i) Human resources should be sufficiently qualified to perform their duties in accordance with statistical programs.

The number of statistical staff and their qualification is commensurate with the actual processes performed by the statistical units. Their basic qualification has been conducted principally through collaboration with IMF (IMF qualification courses, missions, distance assistance), work experience, as well as through different seminars organized by other international institutions. In this way, a staff capable to manage the conduct of work in statistical units has been created. More organized training programs remain to be conducted, in order to cope with future tasks.

In addition, it should be thought about a complete recruitment of staff in order to cope with the full coverage of the statistical spectrum, based on international standards, such as international investment position, external debt statistics, and other statistics of the economy.

Statistical units have a limited number of staff with a wholly statistical educational background. Ideas that relate to qualitative future developments of human resources should be clarified.

Salaries for the specialists of statistics are for the moment at the same level as those of the public administration in general.

Revaluations related to forms of the structure of statistics and its complete frame could be considered.

ii) Technology – Computing resources for compiling the statistics are adequate to perform required tasks.

In terms of the statistics technology development, several projects for the implementation of solutions for the statistical information are carried out in the recent years. Currently, the technology at our disposal is indeed what is needed for statistical requirements (including computers, programs and information storage) and for the moment at adequate levels for the requirements of statistical programs⁵. At the same time, further work for the development of technology should continue, to meet more advanced standards⁶.

iii) Physical facilities and other resources such as transport, communication, etc. are adequate to perform required tasks.

For the moment the physical conditions of work are not adequate as regards the physical conditions of offices and the distribution of staff according to the functions they perform. Their improvement will certainly bring better possibilities for the enhancement of the quality of statistical work. Meanwhile, there exist normal conditions of communication and transport for the implementation of duties.

iv) Funding for compiling the statistics is adequate to perform required tasks.

The funding for statistics is done according to the requests submitted and the problems to be solved. There are clear ideas relating to the needed budgets for the support of statistics in a mid-term period.

v) Measures to ensure efficient use of resources are implemented.

Mechanisms are in place for the different ways of periodic measurement of the quality of work of the statistics staff. On the other hand, a number of measures have been taken to improve the organizational aspects of the statistics personnel, such as the merging of these units in one department, to perfect the regulatory documentation, etc. In the framework of effective use of information sources, there is a closer collaboration with INSTAT for the enhancement of the quality of statistical surveys. On a national level, there is still much to do in order to provide the decision-making with effective and sufficient statistical information⁷.

On the other hand, for specific tasks, collaboration is being developed with foreign experts such as IMF and FSVC specialists.

1.3 RELEVANCE OF DATA:

i) The relevance and practical utility of existing statistics in meeting users' needs are monitored.

In the production and dissemination of statistics, any statistical agency should take into account user requirements and for this purpose appropriate ways should be found (e.g., through surveys, seminars, or with their feedback on public reaction, through contact persons). In this framework statistics in the Bank of Albania do meet the needs of internal users, IMF and in absence of an active reaction by the public, seek to comply with

international standards of compiling and disseminating of data. Bank of Albania statistics staff take part in statistical meetings organized by international institutions and are active in seeking experiences of other countries related to characteristics of the statistics that are compiled.

On the other hand, the organization of meetings with external users such as academic institutions, media and the private sector would be a good test for the relevance of the published statistics. With the creation of this experience, gradually it should be necessary to design some respective procedures for the implementation of a periodic and structured process for the consultation with different users (including regional and international organizations).

1.4 OTHER QUALITY MANAGEMENT – QUALITY IS A CORNERSTONE OF STATISTICAL WORK

First, in the Bank of Albania there is an already-consolidated mentality as regards the management of statistics, due to the fact that “quality creates confidence” and this is a cornerstone of statistical work. The Bank of Albania is insightful regarding the quality of information and is seeking for a better management of it. To the statistical units of the Bank of Albania is made available the appropriate documentation and information for the improvement of the quality of statistics.

Also, there are procedures of information review, taking into account users needs⁸ and reviews of information sources.

2. ASSURANCES OF INTEGRITY

To assure the integrity of the disseminated data, the agency publishing them should guarantee professionalism, transparency and compliance with ethical standards.

2.1. PROFESSIONALISM:

- i) Statistics are produced on an impartial basis:

First, the terms or conditions under which the statistics are produced are in accordance with professional independence. This should be guaranteed by law or in the absence of a law or formal provision to support professional independence, there should be in place a recognized tradition respecting professional independence (a typical example in this case can be the fact that government agencies understand the importance of non-interference).

In this framework, the Bank of Albania by law has the right of producing and disclosing monetary and financial statistics and the balance of payments statistics. Thus, it guarantees professional independence and prevents interference by other parties, including government agencies.

Second, professionalism should be promoted and supported inside the agency producing statistics.

This criterion includes first the professional development of statistical staff in the Bank of Albania. This has been enabled through the on-job training or through seminars organized by the IMF about issues of the methodology of compilation of statistical indicators, as well as many other aspects related to statistics. The continuous collaboration with statistics specialists of the IMF has made possible the availability of the most recent literature regarding contemporary standards. In this framework is also included the support of IMF specialists for some of the plans of the Statistics Sector such as the fulfillment of SDDS standards, the inclusion of other financial institutions in financial statistics, the adoption of the new methodology for the Albanian financial data published to the IMF, etc.

Also, as regards the promotion and support for statistics staff, statistical units have been classified in the second category of salaries, differently from some years ago, (indicating the

importance assigned by the Bank of Albania). It is worth noting that the employment of specialists and their development in career in the structure of statistics is based in their curricula in the field of statistics. Also, the initiatives for research analysis and choice of appropriate methodologies have been supported.

ii) Choices of sources and statistical techniques as well as decisions about dissemination are informed solely by statistical considerations. Independently from decision-making needs, the unit producing and disseminating statistics should have independence in the choice of its standards, methodology, periodicity and way of disclosure.

Statistical units in the Bank of Albania, enjoy quite sufficient independence in this direction. Generally, it is aimed to follow the broadly recognized standards, which have enough room for satisfying user needs.

Revaluations related to forms of structure and further improvements could be considered. Decisions on the dissemination of statistics are based only on statistical considerations and international experiences.

iii) Third, another criterion of professionalism is the possibility for the institution to react to the misuse and misinterpretation of statistics.

For this aim, to the data should always be attached a guide (methodology, metadata), which generally applies to the publications of the Bank of Albania. The misinterpretation of the published data could also be avoided through contacts with selected groups from the public such as the media, academic and scientific institutions, etc. Even though the presence of the Bank of Albania to the public has increased in the recent years, statistical processes in the Bank of Albania are scarcely known, taking also into account the scarce education of the public related to statistics in general.

Under the conditions of frequent changes of the statistical

methodology, the building of the data history and repeated reviews of the series, it is very easy for the statistical indicators to be misinterpreted. Important initiatives in this direction are: seminars with journalists, different programs in collaboration with the media and particularly the First Conference on "Statistical Information in Albania"⁹.

The Bank of Albania continuously monitors the use of its publications in the media. In response to public articles, with respect to the raised problems, explanatory and informative articles on the Bank of Albania activities, clarifying articles in case of misinterpretations, participations in debates for financial and economic issues, etc. have been prepared.

2.2. TRANSPARENCY OF STATISTICAL PROCESSES:

i) First, the terms and conditions under which statistics are collected, processed, and disseminated should be available to the public.

Currently, in the Bank of Albania's website there exists a complete information on the regulatory basis on which the entire statistical process is performed. Furthermore, the preparation for the SDDS requires not only the listing and publication of these regulations but also, their possible review from this point of view.

ii) Second, the public should be noticed in advance on the internal governmental access to statistics prior to their public release.

For monetary statistics and balance of payments statistics there is no internal government access to the data prior to their publication.

iii) Third, the agency should identify the statistical data that are compiled and disseminated, in order for the public to clearly know what responsibilities are assumed by the agency.

The statistical data in the Bank of Albania carry the name (logo) of the Bank of Albania when they are released. In particular, in the case of common publications it should be clearly identified the part pertaining to Bank's statistics.

iv) Major changes in methodology, data sources and statistical techniques should be noticed in advance.

Currently, for the statistics in the Bank of Albania there is no such a policy. The users are informed about changes and explanations of changes only when publication comes to light.

2.3. ETHICAL STANDARDS – POLICIES AND PRACTICES ARE GUIDED BY ETHICAL STANDARDS

i) First, any agency that prepares and discloses statistical information has ethical standards, approved by the institution. In the Bank of Albania there is a regulation on ethics according to the standards. On the other hand, it is required from the employees to have a complete level of formation for the preservation of ethical standards and the avoidance of political interferences.

ii) Also, these standards should be well known from administrators and employees of the institution.

3. METHODOLOGY

This dimension in monetary and financial statistics is assessed through the comparison of the practices of the country with the best international practices. First, methodologies disclosed by the IMF are mentioned¹⁰. However, other standards of the best international practices are also referred¹¹. The criterion of comparison includes concepts and definitions, coverage, sectorisation and classification of financial instruments and accounting rules. Supported by IMF standards, the Bank of Albania has approved the "Methodic of monetary and financial

statistics, Bank of Albania July, 2003". Based on these standards, since December 2002, the compilation of monetary statistics according to the new standards has initiated. Currently, the publication on the internet of these standards and the creation of "bridge-tables", which would enable the link between the old standard and the new standard, is in process. On the other hand, in collaboration with the IMF, the tables for publication in the IFS¹² according to the new standard¹³ have been prepared. Finally, it is worth noting that although the system of assessment DQAF, and the standards of SDDS and GDDS are limited to only cover the "depository corporations" sector, the inclusion of "other financial institutions" in monetary and financial statistics is under way.

The balance of payments is compiled in the methodological framework defined in the international standards of the IMF in the Balance of Payments Manual No. 5. In this framework, the standard components of the balance of payments are classified and sectorised in accordance with those recommended by the manual. The statistical table of the balance of payments is based on the principle of double entry, observing, in all cases, the concept of residency. Uniform principles are also used for the evaluation and time of recording of transactions that are recorded in the balances as well as the inclusion of all transactions (free exchanges and transfers). However, in practice, as a consequence of limits in the data sources, the recording of transactions in due time is not always possible. Even the deviations from the most detailed categorizations of the manual are always subject of revision and improvement. In this framework, it can be mentioned the entry of the new reporting form of banks, and consequently the detailing of the items of the balance of payments, and plans of the sector for additional detailing and updating of the reporting form in the future.

The balance of payments in Albania covers in principle all transactions between residents and non-residents, however, some illegal activities remain not covered. For informal imports of goods (smuggled goods) in Albania estimates are conducted.

4. ACCURACY AND RELIABILITY

This dimension relates to the assessment of the accuracy and credibility of the data sources and statistical techniques used.

4.1. DATA SOURCES:

i) Source data are taken from comprehensive data collection programs that take into account country-specific conditions.

The existence of a relatively small number of banks and the grouping of the savings and credit associations in two unions¹⁴ has allowed conducting a good control of monetary statistics on the sources of information. Accounting records (in the form of balance sheet) of commercial banks, Bank of Albania and savings and credit associations serve as such sources for monetary statistics. In the design of those tables, the major requests of monetary and financial statistics, which regard to the sectorisation and classification of financial instruments, have been taken into account. As regards the other financial institutions, it has been intended that the reporting information have the needed details to comply with the statistics requirements, but at the same time to be met within the existing possibilities of reporting by the institutions.

The existence of an office that administers the reports and controls them on the basis of an approved full documentation and the use of the same information for bank supervision, not only enables consistency in reporting, but also creates room for the timely signaling of monetary statistics for both the accuracy of statistics and new issues appearing in the bank balances.

As regards the statistics of the balance of payments there is no strict rule that clearly defines the sources of information in order to fill in the table of the balance of payments. Sources vary from one country to another based on the specificities of each economy and on the legal and regulatory framework adopted in different countries. Currently, the Office of the Balance of

Payments collects the information from customs for the imports and exports of goods, from the Albanian Electro-Energetic Corporation for the import of electric power, from some different forms of the banks for different items such as services, income, private transfers and financial accounts, using also reporting of some public and private agencies. In addition, the information is received from the Ministry of Finance for official transfers and government debt, from the Ministry of Economy for grants, etc. Statistical surveys are the broadest source of information and as such, they are conducted in compliance with the best practices. Generally, it has been aimed for the sample chosen for the survey to be a representative of the intended population and as much updated as possible.

ii) Source data reasonably approximate the definitions, scope, classifications, valuation, and time of recording required.

Generally for monetary statistics the data are appropriate with regard to the above-mentioned criteria. Since for other financial institutions the existing data (that is without claiming changes in the accounting and valuation rules) are being used, attention has been focused on the deviations from the standard and the use of alternative statistical techniques for their adjustment.

As regards the balance of payments statistics, although the used methods of collection (based on reporting forms and surveys) are in conformity with the guidelines of the 5th BoP Manual of the IMF, the data that are collected are not always sufficient to meet a broader coverage. Hence, it always remains a problem for the private sector the gathering of information related to a part of services, flows of liabilities, incomes from emigrants, foreign direct investments, etc.

iii) The data should be reported on a timely basis.

Deadlines of reporting for the entities that report to the Bank of Albania are fixed taking into account their real possibilities and the requirements of the statistical standards for their timely

dissemination. In monetary statistics this is done almost entirely for the data of the central bank (accounting balance), but sometimes there are problems in meeting the deadline from the commercial banks, especially for the end of the year. Also, the savings and credit associations are required to submit a quarterly reporting. Based on their weight in the credit and deposit activities, it has been deemed that the current periodicity is sufficient for both supervisory and statistical purposes.

4.2. ASSESSMENT OF SOURCE DATA:

i) Source data reported by entities are routinely assessed, and the results of the assessments are monitored and made available to conduct statistical processes.

For monetary statistics this task is performed by the Office of Reporting Administration. Also, through the SARS database, the automatic control of the consistency of individual reports is implemented. The documentation of this control is regularly kept by this Office and is made available to the Supervision Department.

Also, the compilation of the monthly data for the monetary authority is monitored on a quarterly basis by the Audit Department.

5. SERVICEABILITY

5.1. PERIODICITY AND TIMELINESS:

i) Periodicity

The periodicity of reporting for banks and savings and credit associations, as well as their dissemination, is on a monthly basis and in compliance with the standards of data reporting of SDDS and GDDS. However, savings and credit associations report on a quarterly basis. The statistics of the balance of payments

are disseminated on a quarterly basis and this periodicity is in compliance with GDDS and SDDS standards.

ii) Timeliness

As regards the timeliness, the data for the banking system are reported 40 calendar days from the last date of the month. Though in compliance with the GDDS standards (2-3 months), the timeliness according to SDDS standard has not been met, especially for the data of December, however the data for the central bank are disseminated in time. It is worth noting that by using the internet as a means of publication, a reduction of timeliness for the statistical indicators has been achieved. The data of the balance of payments are reported in about 2 months from the reference date, being so in compliance with GDDS and SDDS standards.

1.1. Integrity:

The integrity of monetary and financial statistics indicators and that of the balance of payments statistics is assessed within a group of statistical indicators in a given moment in time or, through different sources, e.g. among the balance of payments and government indicators or monetary and financial statistics indicators.

i) Statistics should have integrity within a group.

In monetary statistics, given that the financial sector data have not yet been compiled regarding the check of integrity within a group, the check integrity is limited only in the comparison of the data of commercial banks and the Bank of Albania data.

As regards the balance of payments, the concepts, definitions and classifications are the same in both quarterly and annual statistics. A good control criterion would be the comparison of balance flows with the changes of stocks in the "International Investment Position", which is not yet compiled in the Bank of Albania.

ii) Statistics should have integrity within a reasonable period of time (as a rule five years).

Consistency within a period of time means the extension back in time of the changes in methodology or in data sources, the detailed explanation of the major breaks of the time series, including their causes and the needed adjustments in order to ensure consistency in time and the explanation of the unusual changes in the trend of statistical indicators. Given that building new series for earlier periods is impossible, the work on the creation of detailed “bridge tables”, which should enable the continuity of the indicators after the changes in methodology, is in process. For the indicators of monetary and financial statistics a first analysis has been completed, an analysis aiming at describing the trend of indicators, at explaining “events” in time, etc.

5.2. THE EXISTENCE OF A POLICY FOR THE DATA REVIEW AND ITS PUBLICATION:

i) Reviews should follow a regular calendar and should be transparent.

The users of statistics should know the practices of data review. Also, it should be known if the data are preliminary or definitive. Reviews in monetary and financial statistics as a rule are made when there are changes in the balances of commercial banks due to auditing from chartered auditors or after the on-site inspection of the Bank of Albania. In monetary statistics changes are included in the regular publication. Hence, the data are viewed as definitive in the first moment of release and are reviewed if needed. Since there is not a clear and approved methodology for the data review, it is not known in advance when their review is expected to happen. The documentation of reviews, that includes reasons of changes, amount of changes, etc., even though is regularly kept by the office of monetary and financial statistics, is not published together with the data. For the statistics of the balance of payments, revisions are made in a regular basis regarding

preliminary estimates, updating, changes in methodology, etc. The revised tables are published, but the documentation of revisions is not published.

In this framework, the publication of a calendar that should cover the changes and the respective reasons is needed.

6. ACCESSIBILITY

This dimension means that the data and information on them (metadata) are easily accessible by the users.

6.1. ACCESSIBILITY

i) Statistics are presented in a way that facilitates proper interpretation and meaningful comparisons (layout and clarity of text, tables, and charts).

Generally, the statistics published by the Bank of Albania are released in a clear way and in different levels of aggregation in order to respond to different categories of users. Statistical bulletins also include comments on the development of the current periods.

ii) Dissemination means and forms are adequate.

Statistics produced in the Bank of Albania are disclosed through the internet and in hardcopy. These are accessible to any interested user without distinction. The current way of disclosure and the different levels of detailing the statistical indicators published on the internet, are easily accessible to different groups of users.

iii) Statistics should be disseminated according to an advanced released calendar.

For the statistics published by the Bank of Albania there is a calendar that indicates in advance the date of publication of the indicators. A requirement of the SDDS provides that such a

calendar should be made known to users, as a rule, three months before the release of the data.

iv) Statistics are made available to all users¹⁵ at the same time.

Through the publication on the website of the Bank of Albania, which is also the first release of statistical data, the simultaneous release of the data is made available to all interested users.

6.2. METADATA ACCESSIBILITY:

i) The documentation on the concepts, coverage, classification, recording methods, sources of data and statistical techniques should be published. Also the deviations from international standards should be published in the same way.

For monetary and financial statistics it could be said that there exist complete information on the way of compilation of statistical indicators. The “Methodic of monetary and financial statistics, Bank of Albania, June 2003”, that is the basis of the methodological work of monetary and financial statistics and the analytical metadata for the compilation of the indicators, are published on the internet.

As regards the statistics of the balance of payments, the methodology of compilation of statistics – an adaptation of the 5th BoP Manual of the IMF – exists for the internal use of the sector; it is not published on the internet.

ii) Levels of detailing are adapted to the needs of the intended audience.

Besides the “Methodic of monetary and financial statistics, Bank of Albania, June 2003”, in the database “Time series”, the relevant content and meaning is given for each table and indicator. These metadata are adapted for a broader category of users. Similar descriptions (metadata) exist for the statistics of the balance of payments.

6.3. ASSISTANCE TO USERS:

Contact persons for each subject field are publicized and there also should be catalogues of publications and other services for statistics users.

As regards the statistics disseminated by the Bank of Albania, there are contact persons for each group of statistics. Also, the list of all periodic and non-periodic publications of the Bank of Albania, including those related to statistics, is published on the website of the Bank of Albania. The assistance given in the framework of the GDDS project of the Fund in this direction should be considered, since it has increased the number of users for Albanian statistics, as well as due to the fact that the publication of contact persons as per sectors of statistics is required according to the respective publishing standards.

The indicators of the quality of data, according to the standards of the DQAF project of the Fund, are disclosed in the table attached to the Annex.

ANNEX: THE INDICATORS OF THE QUALITY OF DATA:

Dimensions:	Dimensions elements:	Criteria:
1.1. Prerequisites of quality	1.1. The existence of a legal and institutional environment supportive of statistics	<p>i) the responsibility for collecting, processing, and disseminating a category of data is clearly specified by law.</p> <p>ii) The coordination and exchange of data between agencies producing the data should be appropriate.</p> <p>iii) Individual reporters' data are to be kept confidential and used for statistical purposes only.</p> <p>iv) Statistical reporting is ensured through legal mandate and/or measures to encourage response.</p>
	1.2. Resources – resources are commensurate with statistical programs	<p>i) Human resources should be in the adequate professional level in order implement their duties in accordance with statistical programs.</p> <p>ii) Technology – Computing resources for compiling the statistics are adequate to perform required tasks.</p> <p>iii) Physical facilities and other resources such as transport communication etc. are adequate to perform required tasks</p> <p>iv) Funding for compiling the statistics is adequate to perform required tasks.</p> <p>v) Measures to ensure efficient use of resources are implemented.</p>
	1.3. Relevance of data	i) The relevance and practical utility of existing statistics in meeting users' needs are monitored
	1.4. Other quality management – Quality is a cornerstone of statistical work	
2. Assurances of Integrity	2.1. Professionalism	<p>i) Statistics are produced on an impartial basis.</p> <p>ii) Choices of sources and statistical techniques as well as decisions about dissemination are informed solely by statistical considerations.</p> <p>iii) The possibility for the institution to react to the misuse and misinterpretation of statistics.</p>
	2.2. Transparency of statistical processes	<p>i) The terms and conditions under which statistics are collected, processed, and disseminated are available to the public.</p> <p>ii) The public should be noticed in advance on the internal governmental access to statistics prior to their public release.</p> <p>iii) The agency should identify the statistical data that are compiled and disseminated, in order for the public to clearly know what responsibilities are carried by the agency.</p> <p>iv) Major changes in methodology, data sources and statistical techniques should be noticed in advance.</p>
	2.3. Ethical standards – policies and practices are guided by ethical standards.	<p>i) The agency that prepares and discloses statistical information has ethical standards, approved by the institution.</p> <p>ii) Also, these standards should be well known from administrators and employees of the institution</p>
3. Methodology		

4. Accuracy and Reliability	4.1. Data sources:	<ul style="list-style-type: none"> i) Source data are obtained from comprehensive data collection programs that take into account country-specific conditions. ii) Source data reasonably approximate the definitions, scope, classifications, valuation, and time of recording required. iii) The data should be reported on a timely basis
	4.2. Assessment of source data:	<ul style="list-style-type: none"> i) Source data reported by entities are routinely assessed, and the results of the assessments are monitored and made available to guide statistical processes.
5. Serviceability	5.1. Periodicity and timeliness	<ul style="list-style-type: none"> i) Periodicity ii) Timeliness.
	5.2. Integrity	<ul style="list-style-type: none"> i) Statistics should have integrity within a group. ii) Statistics should have integrity within a reasonable period of time (as a rule five years).
	5.3. The existence of a policy for the data review and its publication	<ul style="list-style-type: none"> i) Reviews should follow a regular calendar and should be transparent.
6. Accessibility	6.1. Accessibility	<ul style="list-style-type: none"> i) Statistics are presented in a way that facilitates proper interpretation and meaningful comparisons (layout and clarity of text, tables, and charts). ii) Dissemination media and format are adequate. iii) Statistics should be disseminated according to an advanced released calendar. iv) Statistics are made available to all users at the same time.
	6.2. Metadata accessibility	<ul style="list-style-type: none"> i) The documentation on the concepts, coverage classification, recording methods, sources of data and statistical techniques should be published. In the same way should be published the deviations from international standards. ii) Levels of detail are adapted to the needs of the intended audience.
	6.3. Assistance to users	<ul style="list-style-type: none"> i) Contact points for each subject field are publicized and there should be catalogues of publication and other services for statistics users.

NOTES

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Articles published in this bulletin do not always reflect the Bank of Albania's official opinion. Please consider these articles as merely being the authors' personal views.

This paper aims at providing an evaluation on the quality of data dissemination practices including the collection, compilation and final dissemination of financial and balance of payments data, through their comparison with International Monetary Fund's standards.

¹ Relevant reference: <http://dsbb.imf.org/Applications/web/gdds/gddshome/>

² Relevant reference: <http://dsbb.imf.org/Applications/web/sddshome/>

³ ROCS – Reports on the Observance of Standards and Codes.

⁴ Law No. 9180, dated 05.02.2004.

⁵ We refer to: SARS – Automatic System of Statistical Reporting and "Time series".

⁶ As a reference, the SDDS project standards are mentioned; see <http://dsbb.imf.org> for details.

⁷ SDDS standards are as an objective on international level; see <http://dsbb.imf.org> for details.

⁸ Normally requests are taken from major users, such as Monetary Policy Department, Supervision Department, Research Department and IMF. In some cases other requests have been made from external users.

⁹ The First Conference, "Statistical Information in Albania", organized by the Bank of Albania and INSTAT, was held in Tirana, during 2-3 November 2000. See www.bankofalbania.org for details.

¹⁰ They include "Monetary and financial statistics manual, IMF" publications of 1984, 2000, "Balance of Payments Manual, IMF, Fifth edition, 1993" as well as other additional documentation.

¹¹ They include standards such as "European system of accounts 1995 (1995 ESA).

¹² International Financial Statistics, publications of the IMF.

¹³ Note that in this collaboration Albania has been chosen as a pilot country, having been esteemed for doing a qualitative work.

¹⁴ According to yearend report of 2004, Bank of Albania has licensed two unions. "Jehona" Union, composed of 42 members of savings and credit associations and "Albanian Savings and Credit Union", composed of 90 members of savings and credit associations.

¹⁵ We refer here to external users, which can use this information for business purposes. This criterion aims at preventing one particular user (or group of users) from being favored through giving him an advantage in time.

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BANK OF ALBANIA AND ITS COMMITMENT WITHIN THE FRAMEWORK OF THE STABILIZATION AND ASSOCIATION PROCESS

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Key words

- European Integration - SAA - European Union - Acquis Communautaire -

The “European integration”, the “Stabilization and Association Process”, the “negotiations on the Stabilization and Association Agreement”, are only a part of the terms which Albanians are facing with every day, not only in the press and audiovisual media, but also in the discourses of the politicians and indeed in their everyday conversations. The purpose of this brief article is to give a general and understandable information to the common reader, with regard to the role of the Bank of Albania, as a very important monetary and financial institution in the Republic of Albania, which has its own obligations in the context of the European integration process in general and in the framework of Stabilization and Association Agreement in particular.

THE FIRST STEP TOWARDS EUROPEAN WESTERN BALKANS: THE STABILIZATION AND ASSOCIATION PROCESS

The 1990s were characterized by a period of violent ethnic conflicts and of significant political instability in almost all the countries of the Western Balkans. Under these conditions, in May 1999, the European Commission agreed on the main leading principles that would constitute a more ambitious strategy of the European Union (EU) with regard to the relations

of this organization with the region countries. These principles consisted of:

- a recognition by the European Commission that the main motivator for reforms in these countries – including the establishment of the rule of law, stable democratic institutions and a free and open market economy – would be offering a credible perspective for the membership of the region countries in the European Union as soon as the conditions established by this organization are fulfilled. This clear perspective for the future EU membership of the Western Balkans countries was firstly offered at the Feira European Council of June 2000 and was further reconfirmed at the Thessaloniki European Council of June 2003.
- the need for the region countries to establish bilateral relationships between themselves, which would allow greater economic and political stability in the Western Balkans.
- the need for a more flexible approach which, though anchored to a common set of political and economic conditions applicable to all these countries, would allow each country to move ahead at its own pace towards the European Union. Simultaneously, financial and technical assistance programs should be designed based on specific needs of each country.

All these principles materialized at the Zagreb summit of 24 November 2000, where the elements of Stabilization and Association Process (SAP) were presented. In return for the EU's explicit offer of a prospect of accession on the basis of the Maastricht Treaty and of the Copenhagen criteria and in response to the assistance provided by the European Union, the countries of the region committed themselves to fulfil the EU's conditions and use the Stabilization and Association Process, and in particular the Stabilization and Association Agreements (SAA), in order to prepare themselves for future accession to the EU.

The Stabilization and Association Process consists of the following elements:

- a) Stabilization-Association Agreements: The Stabilization and

Association Agreements represent the backbone of the SAP and a key step towards its full completion. The conclusion of Stabilization and Association Agreements represents the signatories' will and commitment to accomplish within a transitory period a formal association with the EU. SAAs offer formal mechanisms and benchmarks, which allow the EU to work with each country to bring them closer to EU standards.

- b) SAAs focus on observance of the fundamental democratic principles and basic elements of EU's single market. Through creating a free trade area with the EU, associated with the relevant areas (competition and state aid rules, intellectual property, etc.) and benefits (for example, the right of being established in the EU countries), this process will allow the economies of the whole region to begin their gradual integration with the EU's. For those areas where the agreements do not impose specific obligations in respect of *acquis communautaire*, there are provisions dealing with detailed cooperation with the EU, having the granting of assistance to these countries to move closer to EU standards as their primary objective.

SAAs are prepared according to the specific circumstances of each country. However, as cited above, achieving a formal association among each country of the Western Balkans and the EU is the objective of each SAA, and this association will be accomplished through the implementation of a series of obligations that are similar to each country.

The mechanisms established by these agreements, starting from specialist sub-committees to the political organs, such as the Stabilization and Association Council, will allow the EU to prioritize the reforms, to shape them according to EU models, to solve eventual problems and monitor their implementation by the signatories. Full implementation of SAAs is a precondition for assessing the potentiality of the country's accession to the EU.

- c) EU assistance: The EU program "CARDS" (Community Assistance for Reconstruction, Development and Stabilization) has added to the assistance for the SAP countries a

component that aims at facilitating their path towards the EU. This assistance is mainly used to support financially and technically the implementation of reforms and the building of the institutional capacities provided by the SAA.

- d) The regional dimension: The SAP is not simply a bilateral process between the EU and the Western Balkans countries, but it puts at the same time a special emphasis on regional cooperation. SAAs include special provisions that provide for the clear commitment of each country to closely cooperate with other SAP countries. Simultaneously, CARDS has also a significant regional component.

More specifically, according to the SAP's regional dimension the region countries must sign regional cooperation conventions and establish a network of bilateral free trade agreements (as part of the above-mentioned conventions). This implies that there will not be barriers to the free movement of goods among the SAP countries themselves and with the EU. The integration of the Western Balkans countries into the European infrastructure networks (transport, energy, border management) constitutes another important element of the SAP's regional dimension.

ALBANIA AND THE STABILIZATION AND ASSOCIATION PROCESS

The first contractual relations between Albania and the EU were established in 1992 through the signing of Trade and Cooperation Agreement. Immediately after the SAP adoption in 2001, the European Commission decided to proceed with the negotiations on signing the SAA with Albania, whereas the EU approved the directives on the negotiations in October 2002. These negotiations started on 31 January, 2003, and until now 6 official and 9 technical rounds of negotiations have been held, where the most part of the SAA articles have been negotiated and completed.

In addition, as so did with the other countries of the region, the European Commission presented in 2004 the European Partnership Document for Albania. This document defined in detail the areas where reforms had to be carried out together with their respective

deadlines. In response to this document, the Albanian government adopted in September 2004 the Action Plan on the Implementation of Priorities of the European Partnership. This Plan contained all the listed measures that the Albanian institutions (including the Bank of Albania) would have to implement in the framework of the obligations arising from the European Partnership Document. However, despite the approval of this Action Plan, based also on the recommendations of the European Commission and on the experience of the countries that had previously gone through a similar process, the Albanian government continued its work in designing and adopting the National Plan for the Approximation of Legislation with the EU acquis and the implementation of the obligations arising from the SAA, which would complete and enhance the commitments undertaken under the Action Plan.

This main objective of the National Plan for the Approximation of Legislation (NPAL), which was approved in May 2005, consists in ensuring the consistency and the approximation of the national legislation with the acquis as well as its effective implementation. At the same time, this Plan offers an explicit timetable, with well-defined deadlines (short-term, mid-term and long-term periods), based on which each responsible institution will work in the future on this document with regard to the obligations arising from the European integration process.

BANK OF ALBANIA AND THE STABILIZATION AND ASSOCIATION AGREEMENT

Since the beginning of negotiations on the signing of the SAA in January 2003, Bank of Albania has been represented as part of the Albanian negotiating team, thus participating in all the official and technical rounds of negotiations that have taken place so far. Bank of Albania has been particularly involved in negotiating the transitory periods under some articles of the agreement, and among them articles 57 and 61 are of a particular relevance.*

Article 57, which covers the service provision area stipulates that the signing parties will take the necessary steps to allow

progressively the provision of services by EU or Albanian companies or nationals in their respective countries. At the same time, this article stipulates that as from the beginning of the third year after the entry into force of the SAA, the Stabilization and Association Council will take the necessary measures to implement progressively the above-mentioned obligations.

As regards the banking services provision by Community operators in Albania, a field for which Bank of Albania is directly responsible according to this article, it should be noted that pursuant to the existing Albanian legislation, there are no barriers, limitations or any discrimination concerning the provision of these banking services in the territory of Albania. As a consequence, the implementation of this article does not seem to pose any problem for the Bank of Albania.

Article 61, which covers the liberalization of capital and financial account of the balance of payments, is of a particular relevance.

According to this article:

- as from the entry into force of the SAA, the parties will ensure the free movement of capital concerning direct investments made by companies established in accordance with the laws of the host country as well as the liquidation or repatriation of these investments and of any profit stemming therefrom.
- as from the entry into force of the SAA, the parties will ensure the free movement of capital concerning credits related to commercial transactions or the provision of services as well as financial loans and credits, of maturity longer than a year.
- as from the beginning of the second transitory period (five years after the entry into force of the SAA), the parties will ensure the free movement of capital concerning portfolio investments and financial loans and credits, of maturity shorter than a year.
- as regards the real estate acquisition by EU nationals, Albania is constrained to allow progressively within a 10-year period from the entry into force of the SAA the acquisition of agricultural land, pastures, coastline land and forests by EU nationals, under the same terms and the same procedures that applies to Albanian nationals.

The Albanian legislation on capital movement is represented by the Regulation "On Foreign Exchange Activity", approved by the Supervisory Council of the Bank of Albania in July 2003. According to this regulation, the inflows of capital in Albania are totally liberalized, while as far as outflows are concerned, this process no longer requires any authorization from the Bank of Albania, but this transfer is carried out by the entities, banks and non-banks, licensed by the Bank of Albania, upon the completion of the required documents. The Bank of Albania has deemed necessary to adopt the Law "On Foreign Exchange Activities", which will reflect the EU acquis in this field, aiming at the total liberalization of this process and its full compliance with the acquis, as well as taking in consideration the fact that capital account transactions are not under the sole responsibility of the Bank of Albania, but there are also other institutions that are responsible for the land sale and purchase, the physical capital movement activities, direct investments, etc.

The design and adoption of such an important law has certainly been included in the National Plan for the Approximation of Legislation (NPAL), together with other laws (for example, the "Banking Law in the Republic of Albania") and regulations (mainly in the field of banking supervision and payment system), which will have to be amended by the Bank of Albania and approximated to the acquis within the terms defined in this Plan.

THE PATH TOWARDS THE EU: WHAT LIES AHEAD?

As mentioned above, upon the signing of the SAA between Albania and the EU, a formal association will be created between the parties, which certainly will constitute a higher degree of bilateral relations. Once this agreement enters into force, the focus will be on its implementation in practice. Bank of Albania, like the other responsible institutions, will carry out its obligations to the implementation of the respective provisions based on the National Plan for the Approximation of Legislation. A new development that relates to the preparation of the Instrument for Pre-Accession by the European Commission should also be mentioned. The most significant part of this instrument is

the recognition that Albania (along with Bosnia-Herzegovina, FYROM and Union of Serbia & Montenegro) is a “potential candidate for accession”, which confirms the clear prospect of membership that was offered to the countries of our region at the Feira summit and especially at Thessaloniki in 2003.

Based on the experience of the region countries (Bulgaria, Romania and Croatia) which are expected either to become soon EU members or start accession negotiations, we may predict the series of events that will follow the entry into force of the SAA. The subsequent steps in the integration process will be as follows: application for the status of ‘candidate for accession’, the approval of this status by the EU, the initiation of the accession negotiations, the negotiation and the closing of the 31 chapters of the *acquis communautaire*, the official closing of the accession negotiations, the signing of the accession treaty, the ratification of this treaty by all the EU Member States and finally, the potential accession to the EU. The time this process will take depends particularly on the speed by which the reforms are implemented by the country that aspires EU membership, but at the same time, the decision of the EU Member States related to the speed by which the enlargement process will proceed towards new membership will also be a factor that will considerably affect the process.

In conclusion, we may say that the European integration process requires a very large commitment by each aspirant country, which should not only express its desire and show willingness for EU membership, but at the same time should possess the necessary institutional, financial and professional capabilities in order to carry out the essential reforms required for full EU membership. In this context, even Bank of Albania will certainly engage in a continuous improvement of its institutional, operational and legal framework, which would allow an unproblematic approximation and convergence of the Bank of Albania with the EU’s best standards, models and practices in general and those of the European System of Central Banks in particular.

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* Since the SAA has not been signed yet, it should be considered that the provisions of the articles to be discussed below represent the latest, but not necessarily the final version.

SOVEREIGN CREDIT RATING: IS IT TIME FOR ALBANIA TO GET ONE?

*Laert Dogjani**

Key words

- Sovereign Credit Rating - Credit rating companies - Rating process -

Albania is the only country in Europe that does not have a Sovereign Credit Rating. Even though some attempts have been made to acquire such a credit rating, because of a number of factors the analysis of which is not a subject of this paper, our country has not yet made any serious moves in this direction. Meanwhile, there is a company in the private sector (banking system) that has already acquired a credit rating (though through its central group). Procredit Bank in Albania has a credit rating from Fitch since December 15, 2004.

WHAT IS A SOVEREIGN CREDIT RATING?

The Sovereign Credit Rating is an index which shows the ability of the government of a Sovran state to service and return the debt or in other words, the probability of default. When a government issues the debt the whole process of assigning a credit rating is wider and deeper than for private or public companies. The world market leaders in issuing credit ratings are Standard & Poors, Moody's, and Fitch Ratings. Of course, these companies offer this service for a fee and the index assigned by them is recognized on a worldwide scale because it is simple, easily comparable, credible, transparent, and independent. For this reason, the credit rating index plays a major role as

an advertiser of the country towards attracting foreign direct investments.

Here is how the companies themselves define the index:

S&P- "Reflects its opinions on the ability and willingness of sovereign governments to service their commercial financial obligations in full and on time."

FITCH- "Opinion on the creditworthiness...constitute opinions, not recommendations to buy or to sell..."

Moody's "...declaration of opinion, not fact..."

So, the index should not be viewed as a recommendation on the ability of a country to service debt in the future, but as only one of the indicators that an investor should look at before it makes a decision on a possible future investment in the debt issued by a certain country in international money markets.

INDEX VALUES

Each of the companies has its own way to express the value of the index. It is usually shown as a combination of letters from A – D and numbers from 1 – 3. For example the highest credit risk index for Standard & Poors is AAA. Such an index would represent the lowest probability of default for the debtor. Even though the combination of letters and numbers is different for the three companies, it is quite easy to compare across indexes among them as the table below shows:

Fitch	Standard & Poor's	Moody's
AAA	AAA	Aaa
AA+	AA+	Aa1
AA	AA	Aa2
AA-	AA-	Aa3
A+	A+	A1
A	A	A2
A-	A-	A3
BBB+	BBB+	Baa1
BBB	BBB	Baa2

BBB-	BBB-	Baa3
BB+	BB+	Ba1
BB	BB	Ba2
BB-	BB-	Ba3
B+	B+	B1
B	B	B2
B-	B-	B3
CCC	CCC	Caa
CC	CC	Ca
C	C	C
D	D	D
NR	NR	NR

NR stands for not rated.

WHEN SHOULD SUCH AN INDEX BE REQUESTED?

The Albanian Government promised the IMF to “officially request a sovereign rating before the end of 2004” as written in the Supplementary Memorandum on Economic and Financial Policies, Feb. 3, 2005. Needless to say, it is difficult to argue that in this era of globalization and integration a country may fulfill its needs for funds without tapping the international money markets. The debate on when a country should start to raise funds in international markets is not very long but since the Albanian Government has not fulfilled its promise to request a sovereign rating (which is the first step in this direction) let us stop and discuss the issue a bit.

Of course, the answer to the question is simple, that is the rating should be requested when it is necessary. But, to argue that the index is not necessary as long as Albania may still raise funds from other sources (IMF, WB, EBRD, foreign government grants) at a lower cost than that of international markets is not entirely correct. The rating assigned to a sovereign directly affects the rate of return requested by foreign investors on debt issued by the government since it reflects the probability of default (credit risk). Even if a country officially requests a rating for its debt before it starts to issue bonds in international financial markets, the only cost to be covered is the yearly fee to the company that offers the rating service. If the service would be requested from one of the companies (as the countries of the region have done) the cost would not exceed 50,000\$ a year.

Meanwhile, the Albanian Government would know the exact rating and would know in detail all the steps that must be taken to improve the rating so that when it issues debt in international money markets the rate of return it would have to pay on its debt would be lower. In other words, it would gain from experience. The economic and financial parameters that must be improved so that the rating improves are quite a few.

(RE)EVALUATION CRITERIA DURING THE RATING PROCESS

The rating companies gather data and conduct meetings at a number of institutions. The data and information gathered by them during the rating process are grouped as follows by Fitch Ratings.

- Political Risk
- Income and Economic Structure
- Economic Growth Prospects
- Fiscal Flexibility
- General Government Debt Burden
- Offshore and Contingent Liabilities
- Monetary Flexibility
- External Liquidity
- Public-Sector External Debt Burden
- Private-Sector External Debt Burden

Credit rating companies divide each of these areas into sub-fields when they conduct the rating analysis. The better the performance in each of the fields the higher the rating to be assigned and, consequently the lower the rate of return to be paid to foreign investors.

The Albanian Government has so far fulfilled its needs for funds in foreign currency to finance investments (mainly in infrastructure and energy) through various grants and soft loans by international institutions and foreign governments. But, for the first time, at the end of June this year, the Albanian Government approved the financing of the new Tirana-Durres railway through a commercial loan. Let us consider this fact as

proof that Albania now may not receive any more soft loans (or may not fulfill all its needs for funds) without arguing on the return (commercial terms, LIBOR +5) of this investment, which has not been recommended by the IMF and the World Bank.

However, even if our country may for a period of time be able to secure soft loans, a Sovereign Credit Rating should have been requested from one or two of the companies that offer such a service. Let us rank the reasons below:

1) Marketing

Is the main reason to request a Sovereign Credit Rating even though a country may obtain soft-term loans. Right now, Albania is the only country in Europe that does not have a Sovereign Credit Rating. The countries of the region have acquired such a rating during the last two years even though they continue to receive grants and soft-term loans. Even Moldova, the poorest country in Europe, has a Sovereign Credit Rating being acquired years ago. A quarter of a page add in Financial Time costs 15,456£ while the rating fee is around 50,000\$ a year depending on the specifics of the rating. It is clear that from the advertisement point of view, the cost of acquiring a Sovereign Credit Rating is justifiable. If we would add here the problems of credibility and short series of economic and financial data in Albania, a credible and independent rating would increase the presence of the country in economic and financial analysis of foreign institutions. In a few words, there would be one more indicator which foreign investors can look at and the first step would be taken towards establishing a presence in international money markets.

Once the rating has been acquired, a re-evaluation is conducted regularly every year or even more often at the request of the government. Had the rating been acquired earlier, its value would have increased considering the positive reforms implemented over the last years in Albania. Having said that, Albania would have secured a presence in global economic-financial news at least once a year. The news would more or less

have been of the type, “Moody’s increases the Sovereign Credit Rating of Albania by one notch.” Regardless of the possibility that Albania may have issued or not bonds in international markets, this presence or publicity very well justifies its cost (assuming that the trend in the ratings would have been positive).

Furthermore, we would have an independent credible indicator to evaluate from foreign private companies and institutions the work of government in terms of the financial credibility and ability of Albania to issue and service foreign debt. A number of international institutions issue country financial ratings (EBRD and other investment banks) but the rating of Moody’s, Standard & Poors and Fitch is the first index international money market the investors look at. The work conducted towards improving this index (reforms in the fields mentioned above) would be immediately reflected in the ratings of other institutions as well because the index is not an objective in itself but the reforms which improve it are, and consequently, the ability of our country to raise funds in international markets, to use them in fields of interest towards long-term sustainable development.

2) Experience gained during the rating process

Presence in international money markets requires we have a number of local experts in the field. Once we officially acquire a rating, these experts would be involved in providing information and analysis to the rating agencies and in the near future, in the process of issuing bonds in international markets, usually through a consultant specialized in the field.

3) Credit Worthiness

The index constitutes only one of the factors analyzed by foreign investors when investing in foreign debt. Another very important factor is the creditworthiness of the country. If a country is punctual in servicing and fully returning debt, it may even acquire funds at interest rates that are lower than the one implied by the probability of default shown in a Sovereign Credit Rating. At a micro level the best comparison would be credit

cards. So, once the creditworthiness of the individual in returning debt has been evaluated, credit card companies increase the standing of the customer (raise the amount of credit allocated, lower fees and interest).

PROBLEMS WITH SOVEREIGN CREDIT RATING¹

- The rating only determines the probability of default. For example, AAA 5-year 0.10 %, BBB- 5-year 3.02 %, B 5-year 30.23 %.
- Statistical tests conducted so far are insufficient (lack of data series)
- It is not able to foretell crises: 1997-2002, Pakistan, Russia, Ecuador, Ukraine, Moldova and Argentina, the Asian crises (delays in servicing debt in local currency).

In conclusion, the above analysis supports the argument that our country is far behind in time in acquiring a Sovereign Credit Rating. If Albania would officially request it now, the index would be in the band of Ba2 – B2 (according to Moody's)². The process of acquiring the rating normally takes 3 months. In the meantime, Albanians are now servicing the first commercial terms loan.

WORKS CITED/CONSULTED:

- 1) www.fitchratings.com
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- 5) Ashok Vir Bhatia - IMF working papers (WP/02/170)
- 6) Personal emails with staff from the rating agencies
- 7) www.biznesi.com.al
- 8) www.setimes.com
- 9) Supplementary Memorandum on Economic and Financial Policies, Feb. 3, 2005.

NOTES

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Articles published in this bulletin do not always reflect the Bank of Albania's official opinion. Please consider these articles as merely being the authors' personal views.

¹ Ashok Vir Bhatia - IMF working papers (WP/02/170)

² Personal informal emails with staff from the rating agencies.

A FEW WORDS ON DEPOSIT INSURANCE

*Silva Seiko**

Key words

- Deposit insurance - Insurance scheme - DIA – Failure - Compensation -

What is deposit insurance? In simple words, it is the protection of depositors when the bank is not able to pay.

In such cases the deposit insurance system, if it exists, and has been previously institutionalized, compensates the depositors. The amount of compensation or insurance differs from country to country. In many countries, in fact, in most developed countries, deposit insurance is a crucial and essential actor of the financial insurance net (safety net player) – which supports the stability of the financial system.

The primary connections of this insurance net are the legal regulative system, the strict system of supervision and internal decision-taking authorities, as well as the banks examination mechanism, mainly exercised by the Central Banks.

Under the position of the lender-of-last-resort, the Ministry of Finance might also grant its assistance.

If the above mentioned connections of the financial insurance net are not able to prevent a bank from being incapable of paying (insolvent), - something which in fact is rare to occur in a sound banking system, - the deposit insurance system becomes

an actor as the last source for depositors. In general, deposit insurance systems focus their attention on the utmost protection of depositors. This is since these depositors are not able to assess the bank where they have invested or want to invest their savings, due to their limited knowledge of the financial activity and the financial banking operations.

The primary goal of the insurance scheme is the protection of small depositors. Banks are obliged to be members of the deposit insurance scheme and pay the insurance premium according to the law applicable to that country. Thus, if a bank is unable to pay (insolvent), we would have enough funds worth of compensating the depositors; as a result the insurance scheme is funded by the bank itself and the beneficiary is the depositor (its client). For the most part of the depositors, the coverage amount enacted by the law covers almost all the deposited funds, always according to the coverage amount actual limit. Therefore, if a bank is not able to pay, the deposit insurance is able to prevent the panic unrest or at least the effect of upheaval; thus, contributing to the maintenance of the financial system stability.

In our country, the coverage amount is up to ALL 700.000 or its equivalent in a foreign currency. Basic characteristic is that this limit is calculated on the aggregated amount of the total deposits per depositor. The legal administrator of deposit insurance in Albania is the Deposit Insurance Agency DIA.

SOME WORLD HISTORY

Since the 19th century, the economic developments or instabilities have often led to crisis, upheavals or collapse in the banking system or in some big banks. Failures and in particular the small depositors losses apparently ask the need to prevent such losses or facilitate the collapses' consequences when they occur.

As a result, the need of regulating and supervising the deposits and loan financial institutions is becoming more and more severe.

In the second half of the 20th century, it was understood that the banks and the world banking system are closely connected and interdependent, and as such their examination could not be limited to the national state borders. For this reason it was established the known-as Basel Agreement which represents the first agreement on rules and principles of international banking.

The second effort was the establishment of financial legal institutions in order to initially facilitate the losses in some of the countries and later on, in the end of the 20th century, in most countries.

In the light of facts, regardless of the legal initiatives from particular countries to compile the necessary regulations for the savings deposit insurance, it is a surprise that the introduction of deposit insurance schemes held in banks was established only after a relatively long time and it was the banking crisis in the USA, which reached catastrophic dimensions leading to failure of more than 10.000 banks, the one that minimized the trust in the banking system, caused panic by forcing crowds of people leave their banks.

Right at this time, the USA took the initiative to protect the depositors in a legal institutional level by making deposit insurance mandatory by means of establishing one institution to enable the deposit insurance called FDIC (Federal Deposit Insurance Corporation).

Later on, deposit insurance schemes and their institutions were established in different European countries, such as in Germany 1974, Spain 1977, France and the Netherlands 1980, Great Britain 1982, Belgium 1985. Nevertheless, these systems were very different from each other. In some of them, there was a state scheme, and in others private ones; membership was mandatory or voluntary.

What is observed is that there are significant changes in different schemes regarding products, calculations and premium payment in the insurance scheme.

In the mid 90s, after a long preparation of work, Western Europe undertook other steps regarding the deposit insurance. Directives no 94/95 EEC entered in force on 1 July 1995. The new Directive enabled the collection of deposits to be stipulated by their insurance.

This Directive determined that there should be at least one deposit insurer in every country.

In the end of 1995 the last countries of Eastern Europe, Hungary, Czech Republic and Poland established their institutions of deposit insurance. This period corresponds with the time when under the recommendation of international financial institutions such as World Bank and International Monetary Fund, Albania started the preliminary work for the establishment of the deposit insurance institution, which was finalized on 29 March 2002 when the Albanian Assembly approved law 8873 On Deposit Insurance.

WHAT IS DEPOSIT INSURANCE AGENCY AND THE SETTINGS WHERE IT WAS ESTABLISHED?

Deposit Insurance Agency in Albania, as an institution having an entirely public character, was established in October 2002 as enforced by law 8873 date 29.03.2002 On Deposit Insurance approved by the Albanian Assembly and enacted by the President of Albania, in an economical and banking environment bearing minimal risk for the insurance fund. However, the possible changes in the banking sector combined with a few weaknesses in the regulative system created in medium terms a less safe surroundings.

Being a member of prestigious international organisms, such as IADI International Association of Deposit Insurers centered in Basel and headquartered in BIS (Bank of International Settlements) as well as EFDI European Forum of Deposit Insurers, the agency is intensifying its efforts in developing and enhancing the activities of deposit insurance to contemporary international levels.

The relatively conservatory nature of funds administration, prime capital investment from the state budget and banks for the deposit insurance fund raise, as well as the insurance premium cashing from Banks, are all factors which affect the risk minimization and the financial system stability in the country.

Support to the financial system stability and the administration of hard times is a responsibility of different institutions which are actors in the financial system insurance net, and DIA plays a very crucial role in this net. Its mission is to protect the depositor from failure of the bank where his money has been deposited in, compensate the deposits in the established level and according to the provisions of the law, and help the country's financial system stability.

Its vision is to enhance the public trust in the banking system, in particular, and the national financial system on the whole.

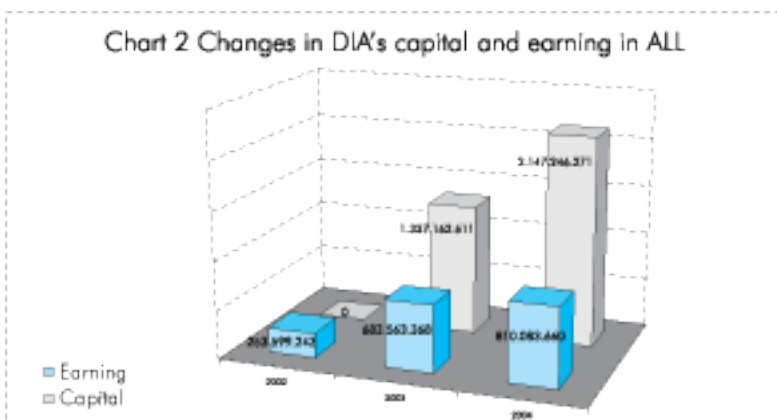
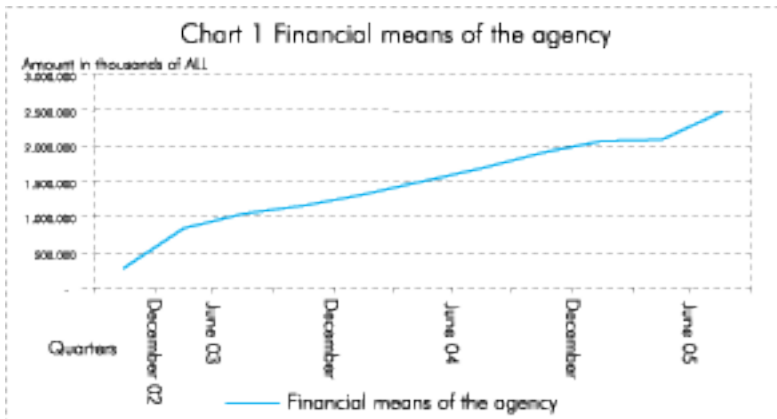
Its goal is to focus the attention on the utmost protection of depositors through offering the deposit insurance scheme to people, thus performing their savings insurance.

OBJECTIVES

- Improvement and perfection of deposit insurance deposit scheme of the banking system.
- Improvement and perfection of the existing legal basis.
- Improvement and perfection of deposit compensation procedures.
- The establishment of a computerized program for the insured deposit compensation, and in its function the feasibility study for the project and the software purchase which would facilitate the payment procedures in the compensation phase.
- This software requires the development of a system capable of managing the individual phases of the compensation process separately and easy to be used and modified.

MEMBERSHIP

Members of the Deposit Insurance Agency are all banks, which are actually licensed by the Bank of Albania and perform banking activities in the Republic of Albania. They are the Savings Bank, National Commercial Bank, Italian-Albanian Bank, Dardania Bank, American Bank of Albania, ProCredit Bank, Tirana Bank, Branch of the National Bank of Greece, Branch of Alpha Bank, Commercial Bank of Greece, International Commercial Bank, United Bank of Albania, First Investment Bank, Credit Bank of Albania.



In case a new bank or branch of a foreign bank applies for license at the Bank of Albania to operate in the territory of Albania, at the same time it applies for the deposit insurance. With the beginning of its activity, the deposits deposited in it, shall be insured according to the respective law.

In its investments portfolio administration, Deposit Insurance Agency, as a public institution, is guided by the principles of responsibility and transparency.

Financial means of DIA are:

first, the state budget contribution with 400.000.000 ALL;
second, primary contribution of newly licensed banks;
third, insured banks premiums; and
fourth, earnings from their investment.

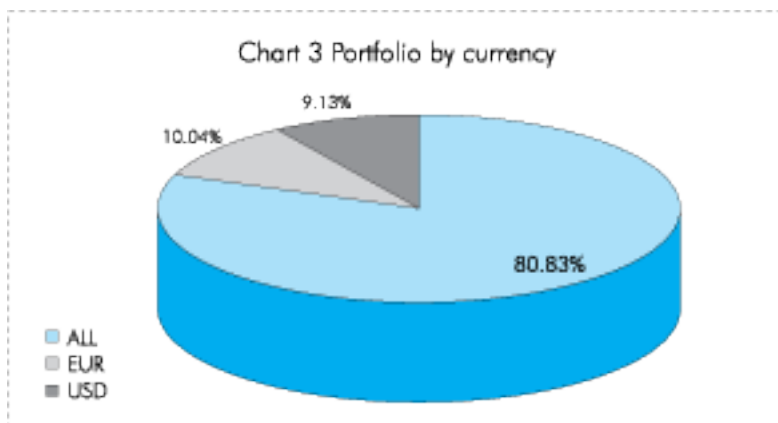
The Agency is responsible for the efficient administration of funds and in accordance with the accepted standards of risk management. This is achieved by investing the financial means of Deposit Insurance Agency in securities of the Albanian Government, as well as of the governments and institutions of other countries, the currency of which is deposited in insured banks. Financial means of Deposit Insurance Agency in December 2004 compared to December 2003 had an increase of 58 percent. In June 2005 DIA's financial means reached 2.480.000.000 ALL and its earnings in the same period were 439,918,794.65 ALL, marking an increase of 47% compared to the same period in the previous year.

The objectives of DIA's administration policy regarding its financial means are to establish a portfolio with the following terms:

1. zero risk.
2. maturity term, from the moment of purchase, not more than a year.
3. high liquidity.

PROGRESS OF INSURED DEPOSITS

Total deposits of the banking system in the end of June 2005 were ALL 414 billion, which compared to end of June 2004 marked an increase of 20 percent. In this total of deposits 81 per cent constitute the individual deposits, with the respective amount of ALL 336 billion, whereas the insured deposits reach the amount of 178 billion lekë, which expressed in percentage represent around 53 per cent of individual deposits. Deposits in lek represent the most part of individual deposits and the currency deposits only 29 percent. For the one-year period June 2004 – June 2005 it is noted an increase of 7 per cent in currency deposits, and a decrease of 3 per cent in Lek deposits, a phenomenon which might be explained by the decrease of interest rates in Lek deposits.

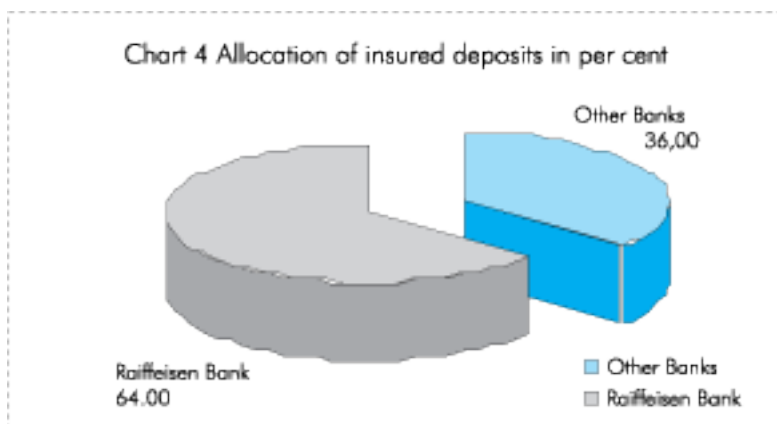


Individual deposits, during this one-year period marked an increase of 16 percent, and the insured ones 14 percent. Deposits over ALL 700.000, dominate by holding around 75 per cent of the total in individual deposits.

Whereas the depositors who have deposits up to ALL 700.000, dominate by holding 82 per cent of the total number of depositors, marking an increase of 9 per cent compared to June 2004. An influence on the growing trend of the small depositors' number might be the existence of deposit insurance

scheme. In the banking market, Raiffeisen Bank continues to have a dominant role, by holding 64 per cent of the insured deposits in the system.

Denomination	December 2004	June 2005
Total deposits in the system (1)	375,843,000	414,000,000
Total individual deposits in the system (2)	309,871,406	336,436,214
Total insured deposits in the system (3)	167,250,478	177,508,204
Ratio (3)/(2) in percentage	54	53



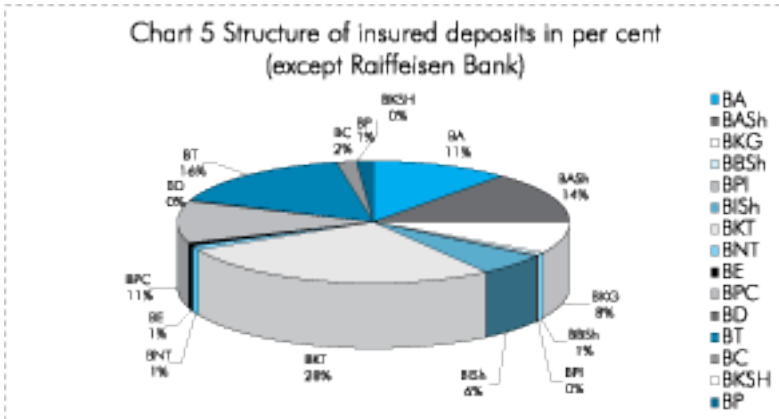
STRUCTURE OF INSURED DEPOSITS

In the insured deposits structure of the banking system, as well as in the total deposits structure, Raiffeisen Bank continues to represent the biggest holding.

This bank holds 64 per cent of total deposits.

THE STRUCTURE AND NUMBER OF DEPOSITS BY COMPENSATION LEVELS AS DEFINED BY THE LAW

The law “On deposit insurance” determines the deposits compensation levels, with a maximal level of ALL 700,000, and insuring:



100 per cent of deposit up to ALL 350,000 and 85 per cent of the part over ALL 350,000.

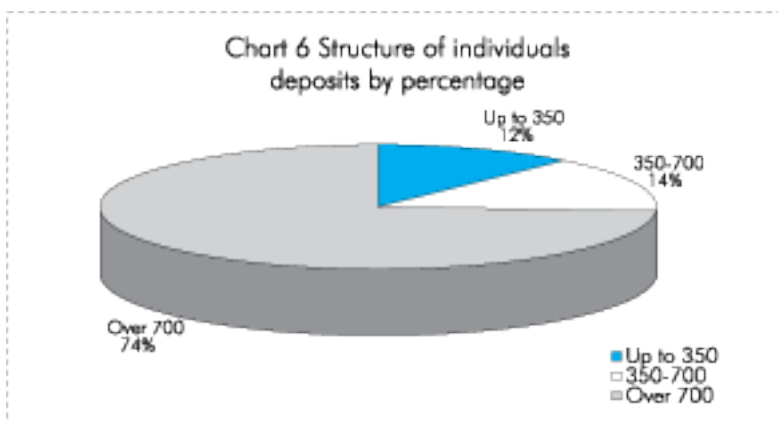
Noting the deposits structure by compensation levels as defined by the law, it is observed the domination of deposits over ALL 700,000 (seven hundred thousand), the amount of which marks around 74 per cent of the total amount in individual deposits.

Since the Deposit Insurance Agency is in its third year of activity, and the depositors' acquaintance with the insurance scheme is not in a high level, it is noticed the lack of portfolio allocation of their deposits. The opposite of this phenomenon is present in the countries having a long practice in the insurance schemes.

The analysis of the number of individual deposits, according to compensation structure, shows that the small depositors, whose deposits reach up to ALL 700,000 (seven hundred thousand) mark the biggest holding with 77 per cent of the total number of depositors. This is in line with the objective of the law, which is to protect at first the small depositors, who are more exposed to lack of economic information risk.

CHARACTERISTICS OF THE PREMIUM RATE

According to Article 24 of the Law "On Deposit Insurance", for every insured bank, the annual insurance premium rate



is 0.5 per cent of the arithmetic average amount of insured deposits, registered at the end of every business day for the last quarter of the year. The Deposit Insurance Agency has the right of lowering the premium rate to 0.1 per cent, only if its financial resources amount to not less than 5 per cent of these deposits' average (at present this ratio is 1.4 per cent). Along with its insurance policies, Deposit Insurance Agency might increase the premium rate up to 0.7 per cent, when it is deemed that the risk sustained by the banks is considered too high. In both cases this is achieved by proposing statutory acts, which are approved by the Supervisory Authority.

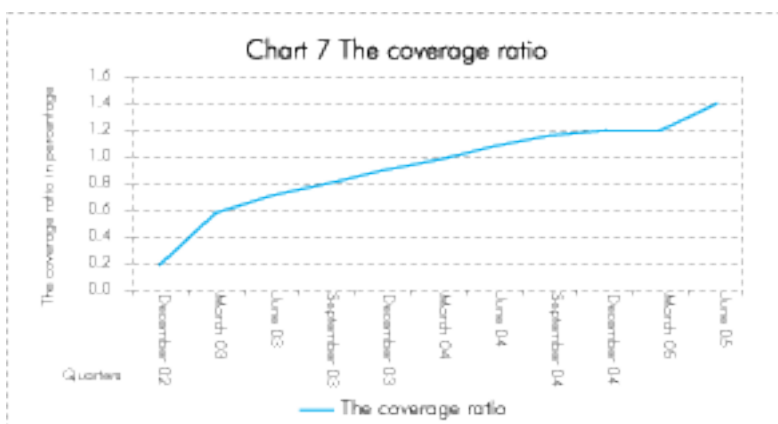
It is applied the 0.5 per cent non-based risk premium, the same for all insured banks.

COVERAGE RATIO AT THE END OF 2004, AND SOLVENCY FOR SPECIFIC BANKS

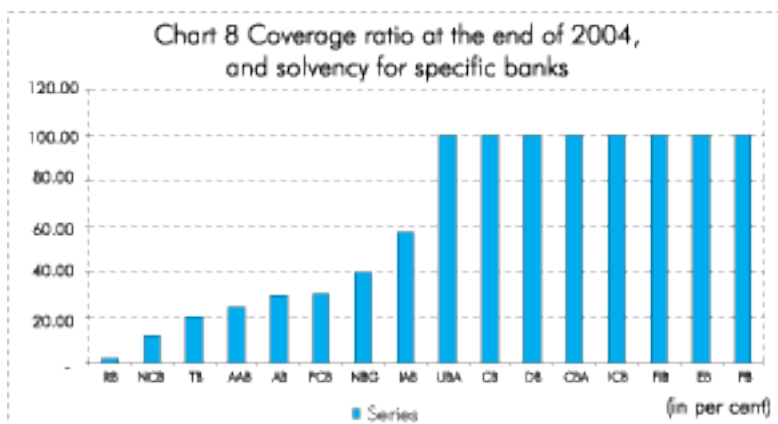
The coverage rate is a significant indicator to the deposit insurance scheme. This indicator is similar to the provision funds established to face the risk and it is calculated as the ratio between the agency's financial means and the total deposits.

This indicator is advantageous because it is easy to be calculated and it is meaningful in the fund exposure scale to risk, though it does not provide information on the risk that the

agency faces from the concentration on the banking sector or crediting capacities of the member banks.



During 2005 Deposit Insurance Agency increased its revenues from contributions of new banks, deposit insurance annual premiums, as well as from its investment policies (in accordance with the provisions of the Law “On Deposit Insurance”), an increase which has implied the growth in coverage ratio. This ratio expresses the ratio between the Deposit Insurance Agency financial means and the total insured deposits. The coverage ratio in December 2004 was 1.2 per cent in comparison to 0.9 per cent at the end of 2003. This coverage ratio in June 2005 reached 1.4 per cent compared to 1.1 per cent of the same period in the previous year.



The financial situation of the Deposit Insurance Agency at present allows coverage of every bank in the system in case of failure, as presented in the following graphic:

Deposit Insurance Agency in its third year of activity is able to entirely compensate the insured depositors of the above mentioned 8 banks from 16 present in the system.

COMPENSATION, DIA'S PRIORITY OF OBJECTIVES

One of the obligations of Deposit Insurance Agency is the compensation of insured deposits according to the level and procedures as defined by the law, not later than three months from the day of intervention of the Supervisory Authority in the insured bank.

In function to this process Supervisory Authority, Bank of Albania approved two proposed instructions by the Deposit Insurance Agency; instruction "On the admission procedures of banks in the deposit insurance scheme" and the instruction "On DIA's relations with the insured banks". Together with their respective annexes, these instructions were distributed to all insured banks. The instruction annexes "On DIA's relations with the insured banks" contain information on the deposit and depositor, and such information shall facilitate the compensation in a short time, with no difficulties, in case of any possible failure of one or more than one bank. In order to accomplish the compensation process there is the need of creating a computerized program in accordance with the provisions of the law "On deposit insurance", defining in this way the priority of our institution's objectives.

In this way, the computerized program of the compensation process shall easily perform the accomplishment of all clauses in article 6, "Compensation of the insured deposit", starting from:

- the aggregation of all client's deposits in one,

- determination of credit surplus and the calculated interest from the day of intervention,
- the exchange in lek of all deposits insured in a foreign currency, according to the official exchange rate as determined by the Supervisory Authority in the day of intervention,
- detailed data storing for every depositor, in order to avoid incorrect and deceitful data.

According to article 7, compensation of insured deposits is performed by the Agency within a short period of time, but at any case not later than three months from the day of intervention. The Agency compensates the insured deposit by acknowledging the ownership over it, as well as according to the compensation levels.

The computerized program that we aim to implement shall check all the data received from banks, in order to satisfy the requests for the deposit and depositor.

It shall enable the intervention in case of subsequent amendments in some articles of the law, such as the article on the calculation procedures of the insurance premium, or the change in the increase of the insurance premium.

Protection of depositors' interests as the final goal of the activity of our institution, developments of the banking and financial system in Albania, observance of western countries best practices aiming at our country's integration in the European community, makes the application of modern procedures and techniques indispensable and easily executable.

GENERAL INFORMATION

What does the Deposit Insurance Agency insure?

Deposit Insurance Agency in our country, provides the savings insurance of individuals and small depositors.

The agency insures savings deposits in lek and other currency, deposits which are not used for commercial purposes.

Thus, the savings deposited from individuals in an insured bank in the form of:

time deposits in Lek,
time deposits in foreign currency,
demand deposits in Lek,
demand deposits in foreign currency,
deposit certificates in Lek,
deposit certificates in foreign currency

are insured according to the law.

The above mentioned types of deposits are insured for both resident and non-resident depositor. Resident is considered anyone who has resided in Albania for at least one year.

What does not DIA insure?

Uninsured deposits are mainly commercial deposits, the main function of which is the execution of settlements, transfer etc. More concretely they comprise the deposits of private companies and businesses, the accounts of which are used for production, trade, servicing activities, deposits of governmental and non-governmental organizations, the part of deposits over ALL 700,000, deposits used for criminal purposes, deposits belonging to the insured bank's shareholders, bank's administrators, auditors and accounting experts of the insured bank, deposits of every depositor with preferential interests, deposits of people having obligations to the insured bank, deposits held with the branch of the insured bank out of the territory of the Republic of Albania, deposits deposited on the day of bank's liquidation, and other similar deposits.

Who bears the cost of deposit insurance?

The client or the depositor is not charged for the deposit insurance. The compensation expenses of the Agency are mainly

covered by the banks, but it might also be granted a loan, or be financed by the state budget.

What is the coverage amount?

According to the law, the agency pays the deposit's principle and the current (aggregated) interests from this deposit per depositor, to the day of intervention, up to ALL 700.000.

Can the coverage amount be increased?

According to the principle that insurance is applied per depositor per bank, this amount can be increased. There are two possibilities for such an increase: the deposit in more than one Bank and the increase in the number of deposit holders (depositors).

If a person deposits the money in more than one bank, the coverage amount might be increased to the maximum limit per bank.

If a depositor/family member puts the money in different deposits held by each family member, the total insured deposits per family shall be increased.

*Silva Seiko, Head of DIA.

The views expressed in this paper are those of the authors and do not necessarily reflect those of the Bank of Albania.

A COMPARATIVE APPROACH BETWEEN THE STATISTICS STANDARDS OF THE BANK OF ALBANIA AND THE SDDS PROJECT STANDARDS OF THE INTERNATIONAL MONETARY FUND

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Key words

- Statistics - SDDS - Compilation methodology - Data dissemination -

ABSTRACT

The purpose of this material is to compare the existing practice of the statistics dissemination at the Bank of Albania and the SDDS standards, as well as to identify the standards deviations. The evaluations expressed in this material are the views of the statistics' specialists of the Bank of Albania and the respective SDDS specialist at the International Monetary Fund and they do not necessarily express a final evaluation.

The first section of the material takes a glance on the work of the Fund regarding data dissemination and it describes the requirements of the SDDS standard.

The second section describes the existing data dissemination practices at the Bank of Albania, compares them to the standard and identifies the possible deviations. Finally, section 3 lists a number of responsibilities that the units generating statistics at the Bank of Albania need to assume in the context of Albania's membership in the SDDS.

ACRONYMS

SDDS – Special Data Dissemination Standards.

GDDS – General Data Dissemination System.

DQAF – Data Quality Assessment Framework.

DSBB – Dissemination Standards Bulletin Board.

NSDP – National Summary Data Page.

ROSC – Report on Observance of Standards and Codes.

BoP – Balance of Payments.

IIP – International Investment Position.

1. DEFINITION OF THE SDDS

1.1 A GENERAL FRAMEWORK ON THE DEVELOPMENT OF STATISTICAL DATA DISSEMINATION

Special data dissemination¹ standards (SDDS), based on countries' best practices, were set by the International Monetary Fund in 1996, for those countries participating in the international financial markets and those applying to participate in them. Given that the existence of similar standards while compiling the statistical data enhances transparency and facilitates the macro-economical policies monitoring, the implementation of the SDDS is deemed to improve the functioning of financial markets. By means of the SDDS, investors are provided with control instruments on each link of statistical data dissemination and the IMF enables their quality monitoring. As a consequence, investors' reliability and their interest for the country implementing the SDDS increase. Various empirical studies show that participation in the SDDS, decreases one country's lending cost and it has a positive effect over the evaluation of the country by the listing crediting agencies. Observing the accomplishment of certain aspects of the SDDS by member countries, Allum and Agca (2001) came to the conclusion that the improvement of statistical data compilation has a positive effect over the authorities' decision-taking process and the public debate over them.

A country subscription to the SDDS is made on voluntary basis, but it requires its commitment in order to meet the standards and provide the IMF will all necessary information regarding data dissemination. Member countries to the SDDS publish this information in the IMF web page, in its electronic bulletin (DSBB) and they have provided a web site connection to the data, called "National Summary Data Page" (NSDP). Today, there are 61 member countries part of SDDS, out of which 17 are countries in transition² and those which have overcome this phase.

Apart from the SDDS, International Monetary Fund has established another set of standards, the General Data Dissemination System (GDDS), aiming at developing the statistical systems as a basis to data dissemination. In the fifth review of the Fund's data standards initiatives, the purpose of the GDDS is defined as follows:

- (1) Encourage member countries to improve data quality;
- (2) Provide a framework for evaluating needs for data improvement, setting priorities in this respect, and mobilizing technical assistance; and
- (3) Guide member countries in the dissemination to the public of comprehensive, timely, accessible, and reliable economic, financial and socio-demographic statistics³.

The GDDS is focused on improving statistical systems, whereas the SDDS is focused on the dissemination of data used by financial markets. In comparison with the SDDS, the GDDS could be implemented for all countries without exceptions, and it is considered as an intermediate link to the membership in the SDDS, since its aim is to increase transparency for the existing practices of the member country and strategy compilation for their development in order to accomplish the SDDS standards. Until currently, four⁴ countries participating in the GDDS are members of the SDDS. In order to monitor the practices of these countries, reports on the observance of standards and codes (ROSC) are used, which are undertaken for the member countries to the SDDS and the GDDS. The ROSC assesses not only the

data dissemination practices against the SDDS/GDDS, but also the full range of statistical practices governing the production of specific macroeconomic datasets.

Regarding the assessment of countries' practices for statistical data dissemination was established the DQAF system (Data Quality Assessment Framework), which covers every aspect of the data production cycle. Despite its main function as a basis to the ROSC, the DQAF could be easily used by national agencies themselves, which disseminate statistical data to assess their performance against their standards and to identify the existing shortfalls⁵.

1.1 WHAT DOES THE SDDS CONTAIN?

The SDDS contains four data dissemination dimensions and to which of them the elements described in Chart 1 could be monitored.

Table 1 The SDDS dimensions and their monitorable elements

Dimensions:	Elements of dimensions:
1. Data	1.1. Coverage
	1.2. Timeliness ⁷
	1.3. Periodicity
2. Access by the public	2.1. Advance publication of a calendar for data dissemination.
	2.2. Simultaneous release of data to all interested parties.
3. Integrity of the data	3.1. Dissemination of the terms and conditions under which official statistics are produced, including those relating to the confidentiality of individually identifiable information.
	3.2. Identification of internal government access to data before release.
	3.3. Identification of ministerial commentary on the occasion of statistical releases.
	3.4. The provision of information about revision and advance notice of major changes in methodology.
4. Quality of the data	4.1. The dissemination of documentation on methodology and sources used in preparing statistics.
	4.2. The dissemination of component detail, reconciliations with related data, and statistical frameworks that support cross-checks and provide assurance of reasonableness.

The SDDS comprises the most important data in assessing the macroeconomic policies. The categories of these data include four sectors of the economy: fiscal sector, real sector, financial

sector and the external sector. A comprehensive statistical framework is used for each sector, respectively:

- national accounts for the real sector, where as a reference point is used "The System of National Accounts", IMF, 1993,
- government's accounts for the fiscal sector, where as a reference point is used "Government Finance Statistics Manual", IMF 2002,
- analytical data on banking and financial system, where as a reference point is used "Monetary and Financial Statistics Manual", IMF 2000,
- balance of payments data for the external sector, where as a reference point is used the fifth edition of "Balance of Payments Manual", IMF 1993.

In each of these sectors are identified two categories of data; category of base data and category of encouraged data, which the member country is not obliged to apply in order to accomplish the SDDS standards. To monitor the observance of the SDDS standards, the categories of base data are analyzed under the dimensions described in table 1. Another characteristic of the SDDS worth to be mentioned is the impossibility of one country to observe for some time one of the standards, such as, for instance, the standard relating to timeliness or periodicity for certain categories of data (possibility of tolerance). Through this possibility, a member country is given time to adopt its own practices being within the SDDS framework.

II. STATISTICS STANDARDS OF THE BANK OF ALBANIA VERSUS THE SDDS

Starting from 1999, Albania is a member of the GDSS, being a pilot country in the project. During all this time, the statistical processes at the Bank of Albania, Ministry of Finance and INSTAT have undergone important developments as to transparency and quality, human resources qualification and assistance to users. Regarding data dissemination, the ROSC

mission visited Albania in May 2000 and left a number of tasks, including the compilation of a national accounts system, improvement of the legal framework and coverage of economic activities, in particular statistics-related of the real and external sector, as well as the efficient use of sources of information. During this period, many important steps have been taken to the improvement of the statistics at the Bank of Albania, owing to the continuous support and cooperation with the IMF experts. Another step to be taken is the assessment of data dissemination practices for the financial and external sector, based on the elements presented in table 1, and the areas which need further improvement.

II.1 FINANCIAL SECTOR STATISTICS

Base categories of the data in this sector are the banking system analytical data, the central bank analytical data and interest rates. In Annex 1 are summarized the SDDS dimensions in relation to these categories, their monitorable elements according to the requirements of the SDDS standard (on the left of the table) and the actual practice at the Bank of Albania.

i) Data

Monetary and financial statistics in Albania cover other deposit corporations (savings and credit associations and commercial banks) and the Bank of Albania. The data relating to the banking system are released monthly, as a rule, 40 days from the last reference date for the first 11 months of the year and within two months from the reference date for December. The data on savings and credit associations are updated quarterly.

The data on the central banks are released monthly, and as a rule, within 10 days from the reference date.

The interest rates published by the Bank of Albania include the interest rates for the indirect instruments of the Bank of Albania monetary policy, interest rates of government's securities in the

prime market and the interest rates for loans and new deposits of the banking system in lek, usd and euro per every maturity and in total. The interest rates of indirect instruments and government's securities in the prime market, are released on the day when they are changed or on the day of their emission, while the interest rates for loans and the banking system deposits are published monthly, 40 days from the end of reference month.

First, regarding the coverage and periodicity, it could be said that for all categories our practice is in conformity with the SDDS standards. Moreover, the quarterly update of savings and credit associations' data to the analytical data of the banking system, does not imply a deviation from the SDDS standard since this standard requires only the coverage of commercial banks.

Regarding this dimension, the timeliness in the compilation of the banking sector indicators constitutes a deviation. This timeliness derives from the banks' impossibility to report sooner, which is mostly observed at the end of the year. However, in such a case it could be used the above mentioned tolerance possibility, for as long as the reporting time from the commercial banks is reduced. Concerning the central bank accounts, the compilation is made and released in due time.

ii) Access by the public

The monitorable elements with respect to this dimension are the advance and simultaneous information access by all parties.

The first monitorable element of this dimension relates to an advance publication of a calendar specifying the date (given in a fixed or interval form) in which the statistical data are to be published. Such a calendar is useful to the users out of the institutions, because it enables them to plan their time and activities. The standard provides that the calendar has to be published at least three months before the date of data release specifying the interval (within five days) in which the data shall be released or its due date. In a second step, a week before

the date of data release, the set date of release has to be made published.

Currently, the publication of such a calendar is not a practice to any of the data categories of the financial sector. The calendar may be published in the Bank of Albania web page or in the DSBB, and in one of the periodic publications of the Bank of Albania, for instance, the monthly report (bulletin).

Another monitorable element regards the simultaneous release of statistics to all interested parties⁷. In this respect, the release refers to the first data publication, regardless of the publication means. This element is necessary in those cases when the access to the statistical information provided to a party in advance, could cause the latter benefits to the detriment of other parties. As to the monetary and financial statistics and the interest rates, the release is made possible by publishing the statistical information in the Bank of Albania web page.

iii) Integrity of the data

With respect to this measure, the guide on the SDDS⁸ refers to it as:

“To fulfil the purpose of providing the public with information, official statistics must have the confidence of their users. In turn, confidence in the statistics ultimately becomes a matter of confidence in the objectivity and professionalism of the agency producing them. Thus, transparency of practices and procedures is a key element in creating this confidence”.

This measure regards the transparency of practices and procedures for the data release.

The first elements deals with the dissemination of terms and conditions under which official statistics are produced, including those relating to the confidentiality of individually identifiable information. More concretely, there is a comprehensive regulative basis for the financial sector statistics which regulates

the information collection, processing, dissemination and storage. In most cases, the relevant laws and regulations could be referred to through the Bank of Albania web page.

The Law "On the Bank of Albania" explicitly gives the right to the Bank of Albania to produce and disseminate the financial sector statistics. Moreover, the law on the commercial banks and the law on savings and credit associations oblige them to report the statistical data to the Bank of Albania. The Law on the Bank of Albania provides that, every institution, juridical or physical person shall be required to report to the Bank of Albania (Article 27, the Law on the Bank of Albania), but there are not any specifications if the opposite occurs (for instance, the penalties awarded to those entities which do not meet this requirement).

The Bank of Albania ensures the confidentiality of the individual data as provided by the Law "On the Bank of Albania", "The Code of Ethics of the Bank of Albania" and "The Regulation on Transparency and Confidentiality at the Bank of Albania".

Apart from the law provisions, there are procedures which prevent the release of individual information. These rules prevent the illegal information release, such as, for instance, by providing the database, by limiting the number of personnel consulting the individual data, etc. Something to be considered is the indirect release of individual information. Regarding the regulative protection, the Law on the Bank of Albania and the aforementioned regulations provide the confidentiality of the individual data, by prohibiting the Bank of Albania personnel release or transfer the individual data to a third party, for any purposes. Nevertheless, the regulative basis needs to specify "the prevention of confidential information indirect release" (as an illustration could serve the case when a bank has a predominant position over a certain instrument which enables the information disclosure even when these data are in an aggregated level).

The second element regards the identification of the internal government⁹ to access the data before release. By means of this

element it is aimed at the protection of the statistical data from the government influence, being fully transparent with the public on the list of units which enjoy the right of using the data before their release. Concerning the monetary and financial statistics, none out of the compiling agencies – the Bank of Albania, enjoys this right.

The third element relates to the identification of ministerial commentary on the occasion of statistical releases. Given that the government may not objectively assess the statistical data, in particular, in those cases when they relate to its responsibilities, the standard provides the identification of the commentary source on the data. For the monetary and financial statistics there are not any ministerial commentary regarding the data released.

The last element of this dimension relates to the provision of information about revision and advance notice of major changes in methodology. The users of the statistics need to be informed on the practices of the data revision. Moreover, they need to know whether these are preliminary or final data.

As a rule, the revisions of monetary and financial statistics are a consequence of the balance sheets revision of commercial banks after the auditing performed by the external auditors or by the on-site supervision by the Bank of Albania. In the monetary statistics, the changes are included in the following publication. Consequently, the data are considered to be final when they are published and, if needed, they are revised. Since, there is not an approved policy on the revision of the data yet, their revision cannot be known in advance. The revision documentation, which includes the reasons of changes, the measure of changes, etc., though it is regularly maintained by the Monetary and Financial Statistical Office, it is not published along with the data.

iv) Quality of the data

The quality of the data is the most complicated dimension to be measured, since the pressure to meet another element,

such as coverage or timeliness, results in consequences over the quality of the data.

First, the documentation on the concepts, coverage, classification, registration methods, sources of information and statistical techniques, must be published. The differences between the international standards must be published, too.

Regarding the monetary and financial statistics there is comprehensive information on the approach of compiling the statistical indicators. "Methodology of the monetary and financial statistics, BoA, July 2003", which is the methodological basis to the compilation of the monetary and financial statistics, and the analytical metadata for the compilation of the indicators are published in the Internet. It could be concluded that there are not any deviations from the international standard¹⁰.

Concerning the interest rates, their calculation methodology is in conformity with the regulation "On the indirect instruments of the Bank of Albania monetary policy" approved upon the decision no. 08 dated 07.02.2001, published in the Bank of Albania web page.

The calculation methodology of the government securities interest rates is stipulated in the agreements on "The issuance of long-term government bonds in the form of registration, dated September 25, 2002" and "The issuance of treasury bills in the form of registration, dated July, 8 2002".

The second element relates to the dissemination of component detail, reconciliations with related data, and statistical frameworks that support cross-checks and provide assurance of reasonableness.

The publication of the monetary and financial statistics indicators is performed according to a framework as stipulated in the "Manual on Monetary and Financial Statistics, IMF, 2000". According to the latter, the criteria on the monetary and financial statistics are provided within a short period of time.

Moreover, the data series of the Bank of Albania are published in the “Monthly Statistical Report”.

II.2 EXTERNAL SECTOR STATISTICS

In accordance with the manual and the first module of the SDDS, compiled by the International Monetary Fund in 1996, the main categories of the external sector statistics were: the balance of payments, international reserves, foreign trade, international investment position and the exchange rates.

In the second review of this standard, December 1998, was supported the proposal on the augmentation of the external debt, as a statistical category to be compiled within the external sector framework. Later on, in the third review in March 2000, the International Monetary Fund decided on a three-year transition period (until the end of March 2003) for the statistics quarterly reporting of the external debt, as a mandatory category of the SDDS standard. These statistics must be released with a lapse of no more than one quarter and cover the external debt of the general government, monetary authority, banking system, private sector and other.

Currently, the Bank of Albania compiles and disseminates the data on these categories: the balance of payments, foreign trade, exchange rates and international reserves, while it is far off the meeting of the SDDS requirements for the compilation of the international position and external debt statistics. As regards the international reserves statistics, the Bank of Albania disseminates only the monthly data on the net foreign assets, which include the monetary authority assets and liabilities, published by the Sector of the Monetary and Financial Statistics and the change of the net foreign assets in the framework of balance of payments statistics, published by the Sector of Balance of Payments.

Meanwhile, during the second review of the SDDS in March 1999, the IMF approved the inclusion of a new dissemination module on the international reserves statistics – the data module

on the international reserves and liquidity in foreign currency, and it determined a transition period ending at the end of March 2000. After the end of this transition period the member countries compiled the data according to this module. This database became operative in October 2000 and it included the data from the monetary authority and the government, too.

In the context of the membership to the SDDS, the Bank of Albania must compile such a module and set the respective inter-institutional contacts (with the Ministry of Finance) to the accomplishment of this mission.

Annex 2 presents, in a summarized way, the SDDS dimensions relating to the three categories of the external sector, which are closer to the requirements of this standard: the balance of payments, foreign trade and the exchange rates.

i) Data

In principle, the Balance of Payments of Albania covers all transactions between residents and non-residents, although some illegal activities are not covered. The balance of payments data are compiled in millions usd and they are classified according to the table structure of the balance of payments and the definitions of the standard components listed in the IMF Balance of Payments Manual, BPM5¹¹. These components are classified into three main categories: I – Current account, comprising goods and services, income and current transfers; II – Capital account involving capital transfers, where included are debt forgiveness and other transfers; III – Financial account with the financial claims and liabilities of Albania to non-residents, divided into international reserves and financial transactions.

The current account balance is equalized by the net capital and financial account balance. The statistical table of the balance of payments is based on the principle of double entries and the offsets are included in the “Errors and Omissions” item, according to the recommendations of the IMF Balance of

Payments Manual, BPM5. Moreover, the periodicity (quarterly) and timeliness (not more than a quarter from the reference period) are observed for the data release and dissemination.

Due to insufficient or weak source of data are made estimations for several units of the external sector. For the balance of payments, adjustments are made in the customs data relating to import and export, import evaluation on the contraband goods and electricity, as well as evaluation of imports on f.o.b. basis. Evaluations are also made for the compilation of some kinds of services, worker's remittances and foreign direct investments. However, there are not any seasonal adjustments for the financial data. Currently, work is being done to improve the sources of data in order to provide a wider coverage of the balance of payments statistics.

The exchange rates at the Bank of Albania are disseminated in accordance with the SDDS requirements regarding the data dimension. The current methodology of the official exchange rate calculation has been implemented since May 31, 2003, upon the approval of the Instruction "On the calculation method of the exchange rate at the Bank of Albania". According to this method, the exchange rate is calculated on the quotation average of six banks and four exchange bureaus, while the previous one calculated the average rate of the performed transactions from six banks and four exchange bureaus. The volume increase of the operations and the spread narrowing in quotations caused the second method to lead to a real exchange rate, less costly and in conformity with the world practice. The exchange rate of the usd against the lek is calculated on the aforementioned quotations, while the exchange rate of other currencies is calculated as a cross rate of the usd/lek exchange rate with the currencies exchange rate against the usd, at 12.00 of the respective day.

Foreign trade, in the form of statistics and statements relating to the merchandise trade, is compiled and released by the Bank of Albania and the Statistics Institute (INSTAT) based on the monthly information received from the Directorate of General

Customs, which reports the total of the customs statements during the period. The data are entered upon the completion of the customs statement. The information source is the same for both agencies for the compilation of these data. INSTAT publishes the monthly data on the external sector in lek, according to 21 commodity groups of the Harmonized System¹² and 30 countries. Imports are published in c.i.f. value and the exports in f.o.b value. The Bank of Albania refers to the balance of payments methodology by publishing the goods imports and exports in f.o.b. value in millions usd. Regarding the type of goods to be included or excluded from the commercial import and export, the Bank of Albania observes the methodological standards, defined by Eurostat, UN and IMF.

With regard to the estimation of imports in f.o.b. value, imports in c.i.f. value are exempt from the insurance and transportation costs. The coefficients for the goods insurance and transportation costs are provided through the foreign trade research. Moreover, the Bank of Albania uses estimation for the contraband or non-registered imports.

ii) Access by the public

Currently, there is not an advance publication of a calendar for the Balance of Payments. The compilation of a policy for the establishment and publication of such a calendar is to be made.

The first introduction of the public to the balance of payments data and the foreign trade statistics is the publication of the quarterly press statement along with the tables. The publication of trade statistics according to 21 commodity groups and countries is made monthly, two months after the reference month. Within three weeks from the press release there is the electronic release and its publication in the Bank of Albania web page, in the database and the statistical report, which is disseminated in a hard copy according to the users' list. Upon request (only after the publication date of the statistics) the users may have access to the published data in the standard format, electronically or

in hard copy. Actually, the balance of payments and the foreign trade data are accessible by all parties simultaneously.

With regard to the exchange rate, the requirement for the simultaneous release of data is met through the publication of the exchange rate in the Bank of Albania web page and in Reuters (NBAL) web page of the institution. Similar to the other statistics, the practice of an advance publication of a calendar is not applied.

iii) Integrity of the data

The compilation of the Balance of Payments data is made pursuant to Article 27 of the Law "On the Bank of Albania", according to which the Bank of Albania compiles the Balance of Payments of the Albania, organizes and directs the statistical system of this balance of payments. In this context, the compilation of the foreign trade statistics by the Bank of Albania derives from its obligation to compile the balance of payments of the Albania. For the collection of information in compiling the BoP and the foreign trade statistics, and with regard to the confidentiality in the data dissemination, the legal and regulative basis supporting this sector is the same as the one used for the financial statistics and it is published in the Bank of Albania web page.

There is no governmental units' preliminary access or any commentary over the published data. Relating to the adjustments in the balance of payments statistics, though final when published, they are continuously subject to adjustments due to changes in the preliminary evaluations, changes in methodology, and additional new sources of information or improvements of the existing ones. Similarly and for the same reasons there may be adjustments and revisions in the foreign trade statistics. The adjusted tables are released, but not the documentation on the respective adjustments history. Moreover, there are not any reliable adjustment policies which would determine an accurate revision calendar, and the users' information on the external sector statistics regarding these revisions. In the context of the improvement of the balance of payments statistics dissemination,

the compilation and implementation of this policy remains a task.

The Law "On the Bank of Albania" entitles it to calculate and publish the official exchange rate of the country. With regard to this statistical datum, governmental units do not have prior access to the publication. As to the adjustments to these data category, their dissemination is final upon the first publication instance.

iv) Quality of the data

The Balance of Payments of Albania is compiled pursuant to the "Balance of Payments Methodology", which is based on the standards of the "Balance of Payments Statistics Manual, IMF, Fifth Edition, 1993". It contains technical details in compiling the balance of payments statistics, basic concepts and definitions of the balance of payments items, as well as orientations on the information sources being used. This methodology is widely used by the sector, but it is not published.

In this context, in order to meet the SDDS standard requirements, the methodology must be published after the changes and amendments through the years have been displayed, and room has been left for any changes in the future. The publication of deviations of this methodology from the international standards relating to these statistics is recommended.

With regard to the publication of detailed data, the balance of payments statistics are detailed to the point where the comprehensiveness of information sources permits. Further details are expected upon their extension. In the Balance of Payments Statistical Bulletin and the aggregated series, published in the Bank of Albania web page, are presented detailed data and time series for the last four quarters and for at least the last 10 years.

Foreign trade statistics are compiled based on the recommendations in the "Balance of Payments Statistics

manual, IMF, Fifth Edition, 1993”, and in accordance with the details given in the “Balance of Payments Compilation Guide, IMF, 1995”. The data compilation is based on the methodology determined in the “International Merchandise Trade Statistics: Concepts and Definitions” (1998).

The methodology on the exchange rates calculation is published in the Bank of Albania web page. With regard to the working procedures, work is being done to enable the electronic entering and compilation of the commercial banks quotations and the rates in the international market, at the moment of calculation. The presence of the exchange rates time series in the Bank of Albania web page, in the “Monthly Statistical Report”, enables their control.

III. TASKS AND ISSUES TO BE SOLVED

Aiming at the improvement of the data dissemination in order to achieve the SDDS standards, below it is given a list of tasks deriving from the existing deviations:

- Completing the law on penalties in case of non-reporting from the entities for statistical purposes.
- Upgrading the regulations on the prevention of the indirect data dissemination and the limited access to individual data. Introduction of the personnel to the transparency rules.
- Creating the necessary conditions for the statistics compilation of the external debt IIP.
- Compiling the statistics of the international reserve according to the “International Reserves and Foreign Currency Liquidity” module.
- Updating the compilation methodology of the balance of payments, its approval and publication.
- Listing, publishing and reviewing the regulations regarding the terms and conditions in which the statistical data are collected, processed and disseminated.
- Reducing the reporting time of the commercial banks,

and setting due dates for end year.

- Increasing transparency for the statistics revision by publishing calendars, documentation commentary associated to the adjustment.
- Extending the coverage of the monetary and financial statistics to the other financial institutions.
- Advance publication of statistical publication calendar produced by the Bank of Albania.

ANNEX 1: FINANCIAL SECTOR

Notes:

1. The tables are given according to the breakdowns of table 1.
2. The presented estimations are made by the authors; some preliminary consideration are taken from the SDDS unit of the International Monetary Fund. In order to have the real estimations, the International Monetary Fund needs to be contacted.
3. In the third column of the tables below, the symbol “√” implies that the existing practice is in accordance with the SDDS standard, while the symbol “X” implies that the existing practice is not in accordance with the SDDS standard.

I) ANALYTICAL ACCOUNTS OF THE BANKING SECTOR

Data: coverage, periodicity and timeliness SDDS Requirements	Our Practice
<p>Characteristics of coverage:</p> <p>The standard requires as a minimum the involvement of: the monetary aggregates, domestic loan broken down into the general government/ the rest of the resident sectors or general government/ nonfinancial public enterprises/ private sector or public sector/ private sector; and the external position of the banking sector given in gross or net basis.</p>	<p>The analytical accounts of the banking sector are disseminated through the "Monetary situation", in million lek. The data cover the commercial banks operating in the territory of Albania and the Bank of Albania.</p> <p>The data include:</p> <p>(1) The monetary aggregates: (a) M1, which comprises money in circulation and the demand deposits (current accounts and the demand deposits) of non-bank resident sectors, (local government, nonfinancial public enterprises, other nonfinancial enterprises, other financial institutions and other resident sectors); (b) M2, which comprises M1 and time deposits of non-bank resident sectors; and (c) M3, which comprises M2 and currency deposits of non-bank resident sectors.</p> <p>(2) Net claims to central government (including claims to government, such as borrowings, securities and other accounts; and liabilities to the government, such as loan deposits and other accounts).</p> <p>(3) Domestic loan to resident sectors divided into claims to local government, claims to nonfinancial public enterprises, claims to other nonfinancial enterprises, claims to other financial institutions and claims to other resident sectors.</p> <p>(4) The external position of the banking sector in gross basis (including the monetary gold and assets and liabilities of the Bank of Albania to the IMF).</p>
Periodicity: Monthly.	Monthly
Timeliness: One month.	Not later than 40 days after the end of the reference month for the data of the first eleven months of the year and within 2 months from the reference date for December.
<p>Access by the public SDDS Requirements</p> <p>Advance release of the publication calendar: At least a quarter in advance, the participating members must announce the publication date or its due date. A period up to 5 business days could be identified, during which the publication is made, provided that the exact date is announced a week prior to the publication day.</p>	<p>Our Practice</p> <p>Not any.</p>
<p>Simultaneous release of data to all parties: The standard recommends the simultaneous release of data to all interested parties. In this case, the publication does not refer to the ministries or governmental agencies. Simultaneous release refers to the first instance when the data is accessible by all users at any kind of format (document, floppy disc, electronically, etc.)</p>	<p>The data are simultaneously released to all interested parties in the Bank of Albania web page. Information is also given in the Bank of Albania monthly bulletin.</p>

Integrity of the data SDDS Requirements	Our Practice
<p>Publication of terms and conditions, under which the statistics are produced and disseminated, including the protection of individual information:</p> <p>Terms and conditions may refer to issues, such as, the relationship between the statistical unit and one department or ministry in which it takes part. For instance, they might refer to the dependency (in the budget or human resources aspect) of the agency producing the statistics on an external authority, to the independence (in choosing the statistics methodology and decisions related to the publication of statistical results). Moreover, the terms and conditions may refer to the requirements to the agency to publish the data collected as a protection from the political pressure to hide certain results, qualification and terms of reference of the statistics director, and the revision of statistical programs by independent expert groups. Another issue concerning the conditions, in which the statistical agencies operate, refers to the procedures and processes related to the individual data confidentiality. These procedures cover various issues, varying from the computer security to the exchange of information between statistical agencies.</p>	<p>The compilation of monetary and financial statistics is in accordance with the "Monetary and financial statistics methodology, Bank of Albania, July 2003".</p> <p>The individual data confidentiality is provided by Article 58 of the Law No. 8269 "On the Bank of Albania" in 1997, where it is stipulated that the administrators, employees and agents are prohibited to release or transfer the information gained during their employment at the Bank of Albania to a third party or use and let the information be used for personal purposes. ✓</p> <p>The individual data confidentiality is also provided by the Regulation "On the transparency and confidentiality at the Bank of Albania", approved upon the Decision No. 53, dated June 21, 2000 of the Bank of Albania Supervisory Council.</p> <p>The Laws and Regulations are published in the Bank of Albania web page.</p>
<p>Identification of the government access prior to data publication: In order to be protected by the influences of the authorities out of the agency publishing the data, the standard recommends the listing of persons or officials with certain positions in the government, but out of the data compilation agencies, which have access to the data prior to the publication, and the reporting of an accessible calendar. This practice is recommended in order to grant full transparency to every prior access by the government, deemed as necessary.</p>	<p>None out of the Bank of Albania enjoys the right of using the monetary and financial statistics indicators prior to their publication. ✓</p>
<p>Identification of ministerial commentary related to the statistical data: Considering that the government may not objectively assess the statistical data, in particular in those cases when they are directly related to its responsibilities, the standard provides the identification of the commentary source over the data.</p>	<p>There are not any commentaries from the officials out of the Bank of Albania related to the data on the monetary and financial statistics indicators. ✓</p>

<p>The provision of information about revision and advance notice of major changes in methodology:</p> <p>Essential information regarding the data revision might be the one related to the observed policies and the extent of previous revisions. The adjustments are made in order to reflect the amendments or changes concerning different aspects of the statistical methodology, such as: fundamental concepts and definitions; sources of information; evaluation methods. The adjustment policies referring to these changes must determine the frequencies of the respective procedures that these adjustments have to observe and they must be made public. Notices on the above mentioned changes may vary from short press releases to public presentations and materials. The members are encouraged to provide quicker information on the revisions after they have been made (for example, via telephone, fax or internet by a contact person who could answer questions related to the adjustments).</p>	<p>The data are final upon publication. However, these data may be revised due to changes in the commercial banks reports after the auditing by their external auditors. The revised data are presented in the following publication, while the reasons for the changes are not published. Regarding the changes in methodology, they are announced at the moment when the data is released and not prior to that.</p>	X
<p>Quality of the data SDDS Requirements</p> <p>The dissemination of documentation on methodology and sources used in preparing statistics:</p> <p>The dissemination of documentation on methodology and sources used is the key to the users' awareness on the advantages and shortfalls of statistics. The recommended documentation may take different forms, including the summary notes accompanying the data dissemination, special disseminations or prepared materials to be released upon request. The members are encouraged to include and highlight statements on the most essential characteristics of quality. These statements may clarify the type of error, subject to which might be the data, reasons of the data non-comparativeness in time or the selection errors in cases of research, etc.</p> <p>The dissemination of component detail, reconciliations with related data, and statistical frameworks that support cross-checks and provide assurance of reasonableness:</p> <p>This element recommends the dissemination of component detail, emphasizing the release within a statistical framework and/or the dissemination of the comparison and reconciliation with other related data. The component detail must be in a way so that it does not cause conflicts to other elements and the individual information reliability and confidentiality.</p>	<p>Our Practice</p> <p>The methodology used for the compilation of monetary and financial statistics is provided in the "Monetary and financial statistics methodology, Bank of Albania, July 2003", available in the Bank of Albania web page.</p>	✓
<p>The dissemination of component detail, reconciliations with related data, and statistical frameworks that support cross-checks and provide assurance of reasonableness:</p> <p>This element recommends the dissemination of component detail, emphasizing the release within a statistical framework and/or the dissemination of the comparison and reconciliation with other related data. The component detail must be in a way so that it does not cause conflicts to other elements and the individual information reliability and confidentiality.</p>	<p>The data are disseminated according to the statistical framework of the monetary reporting, which ensures the base accounting identity: net foreign assets plus domestic assets, equals total liabilities plus capital account. Moreover, special data relating to the monetary authority and commercial banks are published in the Bank of Albania web page and in the "Monthly Statistical Report" of the Bank of Albania, as such allowing the cross-checks.</p>	✓

II) ANALYTICAL ACCOUNT OF THE CENTRAL BANK

Data: coverage, periodicity and timeliness	
SDDS Requirements	Our Practice
<p>Characteristics of coverage:</p> <p>The SDDS requires the involvement of these components:</p> <p>i) Monetary basis (monetary reserve) according to the concept used in the country.</p> <p>ii) Internal credit divided into public sector or central government (depending on the statistical framework of fiscal statistics) and private sector; and,</p> <p>iii) The foreign position of the central bank, in gross or net basis.</p>	<p>The analytical data of the central bank are given in million lek and are based on the accounting registrations of the Bank of Albania.</p> <p>The data are disseminated according to these components:</p> <ol style="list-style-type: none"> 1) Net foreign assets of the central bank, divided into assets to non-residents and liabilities to non-residents. 2) Net claims to the central government, divided into claims to the central government and liabilities to the central government. 3) Domestic assets to the rest of the economy (including claims to individuals, claims to nonfinancial public units, other nonfinancial units, other financial units and claims to other deposit corporations). 4) Monetary basis, including money in circulation, reserves of the commercial banks with the central bank and deposits included in broad money. 5) Deposits excluded from broad money, such as blocked deposits of resident sectors, other than the central government. 6) Loans to the central bank in the form of repurchase agreements. 7) Other payable accounts to other resident sectors, other than the central government. 8) Other net items. 9) Capital accounts. <p style="text-align: right;">✓</p>
<p>Periodicity: Monthly, weekly encouraged.</p> <p>Timeliness: Two weeks.</p> <p>Access by the public</p>	<p>Monthly.</p> <p>Not later than ten days after the last date of the reference month.</p>
<p>SDDS Requirements</p> <p>Advance release of the publication calendar:</p> <p>At least a quarter in advance, the participating members must announce the publication date or its due date. A period up to 5 business days could be identified, during which the publication is made, provided that the exact date is announced a week prior to the publication day.</p> <p>Simultaneous release of data to all parties: The standard recommends the simultaneous release of data to all interested parties. In this case, the publication does not refer to the ministries or governmental agencies.</p> <p>Simultaneous release refers to the first instance when the data is accessible by all users, at any kind of format (hard copy, floppy disc, electronically, etc.).</p>	<p>Our Practice</p> <p>Not any.</p> <p style="text-align: right;">X</p>
	<p>The data are simultaneously released to all interested parties through the Bank of Albania web page. This information is also given in the Bank of Albania Monthly Statistical Report.</p> <p style="text-align: right;">✓</p>

Integrity of the data SDDS Requirements	Our Practice
<p>Publication of terms and conditions, under which the statistics are produced and disseminated, including the protection of individual information:</p> <p>Terms and conditions may refer to issues, such as, the relationship between the statistical unit and one department or ministry in which it takes part. For instance, they might refer to the dependency (in the budget or human resources aspect) of the agency producing the statistics from an external authority, to the independence in choosing the statistics methodology and decisions related to the publication of statistical results. Moreover, the terms and conditions may refer to the requirements to the agency to publish the data collected as a protection from the political pressure to hide certain results, qualification and terms of reference of the statistics director and the revision of statistical programs by independent expert groups. Another issue concerning the conditions, in which the statistical agencies operate, refers to the procedures and processes related to the individual data confidentiality. These procedures cover various issues, varying from the computer security to the exchange of information between statistical agencies.</p>	<p>The data are compiled in accordance with the Law No. 8269 "On the Bank of Albania" in 1997, (Article 24) which stipulates the obligation of the Bank of Albania to prepare periodical analysis on economic and monetary issues, publish results and make proposals to the government.</p> <p>The compilation of monetary and financial statistics is in accordance with the "Monetary and Financial Statistics Methodology, Bank of Albania, July 2003".</p> <p>The individual data confidentiality is provided by Article 58 of the Law No. 8269 "On the Bank of Albania" in 1997, which stipulates that the administrators, employees and agents are prohibited to release or transfer the information gained during their employment at the Bank of Albania to a third party, or use and let the information be used for personal purposes.</p> <p>The individual data confidentiality is also provided by the Regulation "On the transparency and confidentiality at the Bank of Albania", approved upon the Decision No. 53 dated 21.06.2000, of the Bank of Albania Supervisory Council.</p> <p>The Laws and Regulations are published in the Bank of Albania web page.</p>
<p>Identification of the government access prior to data publication:</p> <p>In order to be protected by the influences of the authorities out of the agency publishing the data, the standard recommends the listing of persons or officials with certain positions in the government, but out of the data compilation agencies, which have access to the statistical data prior to the publication, and the reporting of an accessible calendar. This practice is recommended in order to grant full transparency to every prior access by the government, deemed as necessary.</p>	<p>None out of the Bank of Albania enjoys the right of using the monetary and financial statistics indicators prior to their publication.</p>
<p>Identification of ministerial commentary related to the statistical data:</p> <p>Considering that the government may not objectively assess the statistical data, in particular in those cases when they are directly related to its responsibilities, the standard provides the identification of the commentary source over the data.</p>	<p>There are not any commentaries from the officials out of the Bank of Albania related to the data on the monetary and financial statistics indicators.</p>

<p>The provision of information about revision and advance notice of major changes in methodology:</p> <p>Essential information regarding the data revision might be the one related to the observed policies and the extent of previous revisions. Revisions are made in order to reflect the amendments or changes concerning different aspects of the statistical methodology, such as: fundamental concepts and definitions; sources of information; evaluation methods. The revision policies referring to these changes must determine the frequencies of the respective procedures that these revisions have to observe. The revision policies must be made public.</p> <p>Notices on the above mentioned changes may vary from short press releases to public presentations and materials. The members are also encouraged to provide quicker information on the revisions after they have been made (for example, via telephone, fax or internet by a contact person who could answer questions related to the revisions).</p>	<p>The data are final upon publication.</p> <p style="text-align: right;">✓</p>
<p>Quality of the data</p>	
<p>SDDS Requirements</p>	
<p>The dissemination of documentation on methodology and sources used in preparing statistics:</p> <p>The dissemination of documentation on methodology and sources used is the key to the users' awareness on the advantages and shortfalls of statistics.</p> <p>The recommended documentation may take different forms, including the summary notes accompanying the data dissemination, special disseminations or prepared materials to be released upon request. The members are encouraged to include and highlight statements on the most essential characteristics of quality. These statements may clarify the type of error, subject to which might be the data, reasons of the data non-comparativeness in time or the selection errors in cases of research, etc.</p>	<p>Our Practice</p> <p>The methodology used for the compilation of monetary and financial statistics is provided in the "Monetary and Financial Statistics Methodology, Bank of Albania, July 2003", available in the Bank of Albania web page.</p> <p style="text-align: right;">✓</p>
<p>The dissemination of component detail, reconciliations with related data, and statistical frameworks that support cross-checks and provide assurance of reasonableness:</p> <p>This element recommends the dissemination of component detail, emphasizing the release within a statistical framework and/or the dissemination of the comparison and reconciliation with other related data.</p> <p>The component detail must be in a way so that it does not cause conflicts to other elements, and the individual information reliability and confidentiality.</p>	<p>The data are disseminated according to the statistical framework of the monetary reporting of the central bank, which ensures the base accounting identity: net foreign assets plus domestic assets, equals total liabilities plus capital account. Moreover, the detailed data relating to the monetary authority are published in the Bank of Albania web page and in the "Monthly Statistical Report" of the Bank of Albania, as such allowing the cross-checks.</p> <p style="text-align: right;">✓</p>

I) INTEREST RATES

Data: Coverage, Periodicity and Timeliness SDDS Requirements		Our Practice
Characteristics of coverage:		
The SDDS requires the dissemination of interest rates for short-term and long-term government securities.		The Bank of Albania disseminates data on: (1) 3, 6 and 12-month treasury bills annual rates, and 2-year governmental bonds; (2) monthly risk-weighted average rates of interests for new loans of commercial banks in lek, usd and euro, for every maturity and the total, too; (3) monthly risk-weighted average rates of interests for new deposits of commercial banks in lek, usd and euro, for every maturity and the total, too; and (4) interest rates of the monetary policy indirect instruments of the Bank of Albania, where included are:
The SDDS also requires the dissemination of a core interest rate, such as, for instance a loan rate of the central bank or a discount rate.		<ul style="list-style-type: none"> • The repurchase agreement interest rate, which is the base rate used by the Bank of Albania. • Overnight deposit, whose interest rate is 3.0 percent below the interest rate declared by the Bank of Albania for repurchase agreements. • Overnight credit, whose interest rate is 2.5 percent above the repurchase agreement interest rate. • Lombard credit, whose interest rate is calculated as 6 percent above the repurchase agreements rate, approved by the Bank of Albania Supervisory Council.
The SDDS encourages the dissemination of interest rates over loans and deposits.		The periodicity for repurchase agreements rate and the interest rate of the Bank of Albania is daily.
Periodicity: Daily.		The periodicity for the treasury bonds of the prime market is weekly (whenever they are issued). The periodicity for the governmental bonds of the prime market is monthly (whenever they are issued). The periodicity for credit and deposit interest rates of commercial banks is monthly.
Timeliness: Not specified.		The interest rate of repurchase agreements and the interest rates of the Bank of Albania are disseminated on the day of their change. The interest rates for governmental bonds and treasury bonds are disseminated on the day of their issuance. The interest rates for credits and deposits of the banking system are disseminated in no longer than 40 days from the end reference month.
Access by the public SDDS Requirements		Our Practice
Advance release of the publication calendar: At least a quarter in advance, the participating members must announce the publication date or its due date. A period up to 5 business days could be identified, during which the publication is made, provided that the exact date is announced a week prior to the publication day.		Not any.
Simultaneous release of data to all parties: The standard recommends the simultaneous release of data to all interested parties. In this case, the publication does not refer to the ministries or governmental agencies. Simultaneous release refers to the first instance when the data is accessible by all users at any kind of format (hard copy, floppy disc, electronically, etc.)		The data are simultaneously released to all interested parties in the Bank of Albania web page. Information is also given in the Bank of Albania "Monthly Statistical Report".

Integrity of the data SDDS Requirements	Our Practice
<p>Publication of terms and conditions, under which the statistics are produced and disseminated, including the protection of individual information:</p> <p>Terms and conditions may refer to issues, such as, the relationship between the statistical unit and one department or ministry in which it takes part. For instance, they might refer to the dependency (in the budget or human resources aspect) of the agency producing the statistics on an external authority or the independence in choosing the statistics methodology and decisions related to the publication of statistical results. Moreover, the terms and conditions may refer to the requirement to the agency to publish the data collected as a protection from the political pressure to hide certain results, and the revision of statistical programs by independent expert groups. Another issue concerning the conditions, in which the statistical agencies operate, refer to the procedures and processes related to the individual data confidentiality. These procedures cover various issues, varying from the computer security to the exchange of information between statistical agencies.</p>	<p>The data are compiled in accordance with the Law No. 8269 "On the Bank of Albania" in 1997 (Article 24), which stipulates the obligation of the Bank of Albania to prepare periodical analysis on economic and monetary issues, publish results and make proposals to the government.</p> <p>The individual data confidentiality is provided by Article 58 of the Law No. 8269 "On the Bank of Albania" in 1997, which stipulates that the administrators, employees and agents are prohibited to release or transfer the information gained during their employment at the Bank of Albania to a third party, or use and let the information be used for personal purposes.</p> <p>The individual data confidentiality is also provided by the Regulation "On the transparency and confidentiality at the Bank of Albania", approved upon the Decision No. 53, dated 21.06.2000, of the Bank of Albania Supervisory Council.</p> <p>The Laws and Regulations are published in the Bank of Albania web page.</p>
<p>Identification of the government access prior to data publication:</p> <p>In order to be protected by the influences of the authorities out of the agency publishing the data, the standard recommends the listing of persons or officials with certain positions in the government, but out of the data compilation agency, which have access to the statistical data prior to the publication, and the reporting of an accessible calendar. This practice is recommended in order to grant full transparency to every prior access by the government, deemed as necessary.</p>	<p>None out of the Bank of Albania enjoys the right of using the indicators prior to their publication.</p>
<p>Identification of ministerial commentary related to the statistical data:</p> <p>Considering that the government may not objectively assess the statistical data, in particular in those cases when they are directly related to its responsibilities, the standard provides the identification of the commentary source over the data.</p>	<p>There are not any commentaries from the officials out of the Bank of Albania related to the data on the interest rates.</p>

<p>The provision of information about revision and advance notice of major changes in methodology:</p> <p>Essential information regarding the data revision might be the one related to the observed policies and the extent of the previous revisions. Revisions are made in order to reflect the amendments or changes concerning different aspects of statistical methodology, such as: fundamental concepts and definitions; sources of information; evaluation methods. The revision policies referring to these changes must determine the frequencies of the respective procedures that these revisions have to observe. The revision policies must be made public.</p> <p>Notices on the above mentioned may vary from short press releases to public presentations and materials. The members are also encouraged to provide quicker information on the revisions after they have been made (for example, via telephone, fax or internet by a contact person who could answer questions related to the revisions).</p>	<p>The data are final upon publication.</p>	<p>✓</p>
<p>Quality of the data</p> <p>SDDS Requirements</p> <p>The dissemination of documentation on methodology and sources used in preparing statistics:</p> <p>The dissemination of documentation on methodology and sources used is the key to the users' awareness on the advantages and shortfalls of statistics.</p> <p>The recommended documentation may take different forms, including the summary notes accompanying the dissemination, special disseminations or prepared materials to be released upon request. The members are encouraged to include and highlight statements on the most essential characteristics of quality. These statements may clarify the type of error, subject to which might be the data, reasons of the data non-comparativeness in time or the selection errors in cases of research etc.</p>	<p>Our Practice</p> <p>The methodology used for the interest rates calculation of repos and other instruments of the Bank of Albania are provided in the Regulation "On indirect instruments of the Bank of Albania", approved upon the Decision No. 08, dated 07.02.2001 of the Bank of Albania Supervisory Council.</p> <p>The methodology on the interest rate calculation of the treasury bonds in the prime market is established in the agreement between the Bank of Albania and the Government of the Republic of Albania "On the issuance of the long-term government bonds in registration form" dated 25.09.2002, but it is not published.</p> <p>The methodology on the interest rate calculation of the treasury bills in the prime market is established in the agreement between the Bank of Albania and the Ministry of Finance "On the issuance of the treasury bills in registration form" dated 08. 07. 2002, but it is not published.</p> <p>Regarding the interest rates on the banking system deposits and credits, respective explanations along with the data are provided in the Bank of Albania web page.</p>	<p>X</p>
<p>The dissemination of component detail, reconciliations with related data, and statistical frameworks that support cross-checks and provide assurance of reasonableness:</p> <p>This element recommends the dissemination of component detail, emphasizing the release within a statistical framework, and/or the dissemination of the comparison and reconciliation with other related data.</p> <p>The component detail must be in a way so that it does not cause conflicts to other elements and the individual information reliability and confidentiality.</p>	<p>The data are disseminated in Reuters, in the "Monthly Statistical Report" through a series published the last 6 years and in the Bank of Albania web page.</p>	<p>✓</p>

ANNEX 2: EXTERNAL SECTOR

I) BALANCE OF PAYMENTS

Data: Coverage, Periodicity and Timeliness SDDS Requirements	Our Practice
<p>Characteristics of coverage:</p> <p>Regarding the current account, the SDDS recommends: goods and services imports and exports coverage, net income and net current transfers. With regard to the capital and financial account, the recommended key elements include the international reserve and other financial transactions. It is encouraged a sub-division of financial transactions in direct and portfolio investment. Classifications according to the IMF Manual, BPM5, and the one on the separate division of the financial derivatives are recommended.</p>	<p>In principle, the Balance of Payments of Albania covers all transactions between residents and non-residents, although some illegal activities remain uncovered. The balance of payments data are compiled in million usd and classified according to the table structure of the balance of payments and definitions of standard components listed in the IMF Balance of Payments Manual, BPM5. These components are classified in three main categories:</p> <ul style="list-style-type: none"> I – Current account, covering goods, services, income and current transfers: <ul style="list-style-type: none"> (a) Goods – cover moveable goods, whose ownership passes from residents to non-residents (exports) and vice-versa, from non-residents to residents (imports). (b) Services – cover services performed by residents to non-residents (loans) and by non-residents to residents (debit). Services are further divided into the following groups: <ul style="list-style-type: none"> transportation services; insurance services; travel; other services. (c) Income – cover the income that residents gain from non-residents (loans) or that non-residents gain from residents (debit). They are further divided into: <ul style="list-style-type: none"> 1. compensation of employees; 2. investments income. (d) – Current transfers are balance records applied in cases of real values (goods or services) ownership change from residents to non-residents (debit) or from non-residents to residents (loans), which are not followed with compensation from the other party. Current transfers in the balance of payments in Albania are classified into: <ul style="list-style-type: none"> 1. state assistance from abroad; 2. worker's remittances; 3. others. II – Capital account – capital transfers are divided into the following sub-components: (a) debt forgiveness; and (b) other transfers. Other capital transfers are mainly related to the assistance investments aiming at the supplement or the financing of the fixed capital formation of the beneficiary economy. III – Financial account, financial claims and liabilities of Albania to non-residents. The main division in the financial account is as follows: <ul style="list-style-type: none"> (a) International reserves – foreign financial assets which are controlled and available to be used by the Bank of Albania, for the financing of international payments unbalances, for interventions in the currency markets, etc. (b) Financial transactions which are classified in assets and liabilities according to these items: <ul style="list-style-type: none"> 1. direct investment; 2. portfolio investment; 3. other investment. <p>The current account balance is equalised by the net balance of the capital and financial account. The statistical chart of the balance of payments is based on the double entry principle and the remaining is included in the "Errors and Omissions" item. Main data sources are the customs statistics, data on the foreign exchange, reporting from the banks and enterprises collected by the Bank of Albania, and the information received by the government.</p>

Periodicity: Quarterly.		The Balance of Payments Statistics are produced in quarterly and annual basis.	✓
Timeliness: Three months.		The Balance of Payments Statistics are published nearly 2 months after the reference period.	✓
Access by the public			
SDDS Requirements		Our Practice	
Advance release of the publication calendar: At least a quarter in advance, the participating members must announce the publication date or its due date. An initial period up to 5 business days could be identified, during which the publication will be made.		Not any.	X
Simultaneous release of data to all parties: The standard recommends the simultaneous release of data to all parties. In this case, the publication does not refer to the ministries or governmental agencies. Simultaneous release refers to the first instance when the data is accessible by all users at any kind of format (hardcopy, floppy disc, electronically, etc.)		The first introduction of the public to the balance of payments data is the publication of the press quarterly statement (disseminated in a hardcopy), along with the summary table. The electronic dissemination and the publication in the Bank of Albania web site is made after no longer than three weeks, in the "Time Series" database and in the "Monthly Statistical Report", which is disseminated in hardcopy according to the user's list. Based on the user's requests (always after the statistics publication date), the published data according to the standard format can be disseminated electronically or in printed.	✓
Integrity of the data			
SDDS Requirements		Our Practice	
Publication of terms and conditions, under which the statistics are produced and disseminated, including the protection of individual information: Terms and conditions may refer to issues, such as, the relationship between the statistical unit and one department or ministry in which it takes part. For instance, they might refer to the dependency (in the budget or human resources aspect) of the agency producing the statistics on an external authority or to the independence in choosing the statistics methodology and decisions related to the publication of statistical results. Moreover, the terms and conditions may refer to the requirement to the agency to publish the data collected as a protection from the political pressure to hide certain results, and the revision of statistical programs by independent expert groups. Another issue concerning the conditions in which the statistical agencies operate refers to the procedures and processes related to the individual data confidentiality. These procedures cover various issues, varying from the computer security to the exchange of information between statistical agencies.	<p>The balance of payments data compilation is made pursuant to Article 27 of the Law "On the Bank of Albania", according to which the Bank of Albania compiles the balance of payments of Albania, as well as organizes and commands the statistics system of this balance of payments.</p> <p>The banks, institutions and other judicial and physical persons are obliged to send the required statistical data in accordance with the reporting system approved by the Bank of Albania, and use the assessment, evidence, designations and classifications criteria, presented in it.</p> <p>The data collection from the banking system is based on:</p> <ul style="list-style-type: none"> • Article 27 of the Law no. 8269 "On the Bank of Albania", dated 23.12.1997. • Article 40 of the Law no. 8365 "On Banks in the Republic of Albania", dated 02.07.1998. <p>The individual information confidentiality is provided by Article 58 of the Law no. 8269 "On the Bank of Albania", dated 23.12.1997, where it is clearly specified that the administrators, employees and agents are prohibited to disclose or hand to the third parties information provided during their employment with the Bank of Albania, as well as use or let this information be used for personal gains.</p> <p>The individual information confidentiality is also provided by the Regulation "On the Transparency and Confidentiality at the Bank of Albania", approved upon the decision of the Bank of Albania Supervisory Council no. 53, dated 21.06.2000 along with all the respective mentioned laws and regulations are published in the Bank of Albania web page.</p>	✓	

<p>Identification of the government access prior to data publication: In order to be protected by the influences of the authorities out of the agency publishing the data, the standard recommends the listing of persons or officials with certain positions in the government, but out of the data compilation agencies, which have access to the statistical data prior to the publication, and the reporting of an accessible calendar. This practice is recommended in order to grant full transparency to every prior access by the government, deemed as necessary.</p>	<p>✓</p> <p>The governmental units do not have prior access to the published data for the balance of payments statistics.</p>
<p>Identification of ministerial commentary related to the statistical data: Considering that the government may not objectively assess the statistical data, in particular in those cases when they are directly related to its responsibilities, the standard provides the identification of the commentary source over the data.</p>	<p>✓</p> <p>There are not any commentaries along with the published data.</p>
<p>The provision of information about revision and advance notice of major changes in methodology: Essential information regarding the data revision might be the one related to the observed policies and the extent of previous revisions. Revisions are made in order to reflect the amendments or changes concerning different aspects of the statistical methodology, such as: fundamental concepts and definitions; sources of information; evaluation methods. The revision policies referring to these changes must determine the frequencies of the respective procedures that these revisions have to observe. The revision policies must be made public. Notices on the above mentioned changes may vary from short press releases to public presentations and materials. The members are also encouraged to provide quicker information on the revisions after they have been made (for example, via telephone, fax or internet by a contact person who could answer questions related to the revisions).</p>	<p>X</p> <p>The balance of payments statistics are final once they are published. However, they are regularly revised due to changes regarding the preliminary evaluations, changes in methodology, and new additional sources of information and amendments of the existing ones. The revised tables are published, but not the documentation of the respective revisions. Moreover, there are not any real revision policies.</p>

Quality of the data	Our Practice
<p>SDDS Requirements</p> <p>The dissemination of documentation on methodology and sources used in preparing statistics:</p> <p>The dissemination of documentation on methodology and sources used is the key to the user's awareness on the advantages and shortfalls of statistics.</p> <p>The recommended documentation may take different forms, including the summary notes accompanying the data dissemination, special dissemination or prepared materials to be released upon request. The members are encouraged to include and highlight statements on the most essential characteristics of quality. These statements may clarify the type of error, subject to which might be the data, reasons of the data non-comparativeness in time or the selection errors in cases of research, etc.</p>	<p>X</p> <p>The balance of payments of Albania is compiled pursuant to the "Balance of payments methodology", which is based on the standards of the "Balance of Payments Statistics Manual, IMF, Fifth Edition". It contains technical details of the balance of payments statistics compilation, fundamental concepts and definitions of the balance of payments items as well as the sources of information used. This methodology is widely used by the Balance of Payment and Research Section, but it is neither official nor published. Moreover, the changes and amendments made in years need to be presented.</p>
<p>The dissemination of component detail, reconciliations with related data, and statistical frameworks that support cross-checks and provide assurance of reasonableness:</p> <p>This element recommends the dissemination of component detail, emphasizing the release within a statistical framework, and/or the dissemination of the comparison and reconciliation with other related data.</p> <p>The component detail must be in a way so that it does not cause conflicts to other elements and the individual information reliability and confidentiality.</p>	<p>✓</p> <p>In the Statistical Bulletin of the Balance of Payments and in the aggregated series published in the Bank of Albania web site, are included detailed data and time series for the last quarters and for at least the last 10 years.</p>

I) INTEREST RATES

Data: Coverage, Periodicity and Timeliness		
SDDS Requirements		
Characteristics of coverage:		✓
The SDDS requires the spot exchange rate dissemination of the national currency against the main foreign currency. The SDDS also requires the dissemination of 3 and 6-month term exchange dissemination when such a market exists.	Our Practice The Bank of Albania, the central bank, calculates the official exchange rate for 13 main currencies, precious metals and the currency of the International Monetary Fund, SDR as well as for 9 currencies of Central/Eastern European Countries and Asia. The exchange rates are calculated as arithmetical average of the quotations of 6 commercial banks and 4 exchange bureaus at 12.00. The official exchange rates are used for non-trade purposes and they are not obligatory for the foreign exchange market operators; meanwhile the Bank of Albania requires their use in the evaluation of the currency positions from the commercial banks. One of the main uses of these rates may be the evaluation of the customs liabilities by the customs administration, balances evaluation of companies by the tax authorities, as well as the evaluation of the foreign assets of the Bank of Albania itself. Every day, the exchange rates of 13 main currencies, where included are gold, silver and the SDR.	✓
Frequency: Daily.	The exchange rates of 9 currencies of Central and Eastern European countries are calculated once in two weeks. At 12.00 and it is effective for the day in which it is published.	✓
Timeliness: Not specified.		
Access by the public	Our Practice	
SDDS Requirements		
Advance release of the publication calendar: At least a quarter in advance, the participating members must announce the publication date or its due date. A period up to 5 business days could be identified, during which the publication may be made.	Not any.	X
Simultaneous release of data to all parties: The standard recommends the simultaneous release of the data to all interested parties. In this case the publication does not refer to the ministries or governmental agencies.		
Simultaneous release refers to the first instance when the data is accessible by all users at any kind of format (hard copy, floppy disc, electronically, etc.)	The exchange rate after the calculations is published in the Bank of Albania web page and in the Reuters (NBAL) web page of the institution, thus, being useful for the interested parties at the same time.	✓

Integrity of the data SDDS Requirements	Our Practice
<p>Publication of terms and conditions, under which the statistics are produced and disseminated, including the protection of individual information:</p> <p>Terms and conditions may refer to issues, such as, the relationship between the statistical unit and one department or ministry in which it takes part. For instance, they might refer to the dependency (in the budget or human resources aspect) of the agency producing the statistics from an external authority or to the independence in choosing the statistics methodology and decisions related to the publication of statistical results. Moreover, the terms and conditions may refer to the requirement to the agency to publish the data collected as a protection from the political pressure to hide certain results, and the revision of statistical programs by independent expert groups. Another issue concerning the conditions, in which the statistical agencies operate, refers to the procedures and processes related to the individual data confidentiality. These procedures cover various issues, varying from the computer security to the exchange of information between the statistical agencies.</p>	<p>✓</p> <p>The publication of the official exchange rate is made pursuant to Law no. 8269 "On the Bank of Albania", Article no. 59 and Article no. 60, which authorizes the Bank of Albania as the responsible institution for the calculation and the publication of the official exchange rate.</p>
<p>Identification of the government access prior to data publication: In order to be protected by the influences of the authorities out of the agency publishing the data, the standard recommends the listing of persons or officials with certain positions in the government, but out of the data compilation agencies, which have access to the statistical data prior the publication, and the reporting of an accessible calendar. This practice is recommended in order to grant full transparency to every prior access by the government, deemed as necessary.</p>	<p>✓</p> <p>The governmental units do not have prior access to the published data.</p>
<p>Identification of ministerial commentary related to the statistical data:</p> <p>Considering that the government may not objectively assess the statistical data, in particular in those cases when they are directly related to its responsibilities, the standard provides the identification of the commentary source over the data.</p>	<p>✓</p> <p>There are not any commentaries along with the published data.</p>

<p>The provision of information about revision and advance notice of major changes in methodology: Essential information regarding the data revision might be the one related to the observed policies and the extent of previous revisions. Revisions are made in order to reflect the amendments or changes concerning different aspects of the statistical methodology, such as: fundamental concepts and definitions; sources of information; evaluation methods. The revision policies referring to these changes must determine the frequencies of the respective procedures that these revisions have to observe. The revision policies must be made public. Notices on the above mentioned changes may vary from short press releases to public presentations and materials. The members are also encouraged to provide quicker information on the revisions after they have been made (for example, via telephone, fax or internet by a contact person who could answer questions related to the revisions).</p>	<p>The published data are final and they are not subject to revision.</p>	<p>✓</p>
<p>Quality of the data</p>		
<p>SDDS Requirements</p>		
<p>The dissemination of documentation on methodology and sources used in preparing statistics: The dissemination of documentation on methodology and sources used is the key to the user's awareness on the advantages and shortfalls of statistics. The recommended documentation may take different forms, including the summary notes accompanying the data dissemination, special disseminations or prepared materials to be released upon request. The members are requested to include and highlight statements on the most essential characteristics of quality. These statements may clarify the type of error, subject to which might be the data, reasons of the data non-comparativeness in time or the selection errors in cases of research, etc.</p>	<p>Our Practice</p> <p>The procedure of the official exchange rate calculation is made public in the Bank of Albania web page under the rates column.</p>	<p>✓</p>
<p>The dissemination of component detail, reconciliations with related data, and statistical frameworks that support cross-checks and provide assurance of reasonableness: This element recommends the dissemination of component detail, emphasizing the release within a statistical framework and/or the dissemination of the comparison and reconciliation with other related data. The component detail must be in a way so that it does not cause conflicts to other elements, as well as provide the individual information reliability and confidentiality.</p>	<p>The daily exchange rates series has been available in the Bank of Albania web page and after its reconfiguration there was the need of their re-entering. Any interested person may quickly and freely get the exchange rate of every day through a request sent to this electronic mail address: public@bankofalbania.org. The monthly average data of the exchange rate are published in the Monthly Statistical Report of the Bank of Albania. The series of average exchange rates is published in the "Monthly Statistical Report" and in the "Economic Bulletin".</p>	<p>✓</p>

II) FOREIGN TRADE

Data: Coverage, Periodicity and Timeliness SDDS Requirements

Characteristics of coverage:

The SDDS requires the data compilation for merchandise trade as an auxiliary and explanatory category, which provides more frequent and detailed information on developments of the current account in the balance of payments. The data regarding the total of imports and exports are recommended to be disseminated separately according to the most detailed categories, commodity groups and partner countries.

Our Practice

The data on the merchandise trade are compiled and disseminated by the Bank of Albania and the Statistics Institute (INSTAT) based on the information received from the Directorate of General Customs, which reports the total of the customs statements for the period. The data are entered at the moment of the customs statement acceptance. The Bank of Albania observes the balance of payments methodology, by publishing the imports and exports of goods in f.o.b. value, in million dollars. With regard to the type of goods to be included or excluded by the trade import and export, the Bank of Albania observes the methodological standards defined by Eurostat, UN and IMF. For the evaluation of imports in f.o.b. value, the imports in c.i.f. value are exempt from the insurance and transportation costs. The coefficients for the goods insurance and transportation costs are provided through the foreign trade research. Moreover, the Bank of Albania uses estimation for the contraband imports and the unregistered ones. The foreign trade statistics are not seasonally regulated.

✓

Periodicity: Monthly.

The foreign trade statistics are disseminated on monthly, quarterly and annual basis.

✓

Timeliness: Eight weeks (encouraged 4-6 weeks).

Access by the public

Not longer than two months after the reference period.

✓

SDDS Requirements

Our Practice

Advance release of the publication calendar:

At least a quarter in advance, the participating members must announce the publication date or its due date. An initial period up to 5 business days could be identified, during which the publication could be made.

Not any.

X

Simultaneous release of data to all parties: The standard recommends the simultaneous release of data to all interested parties. In this case, the publication does not refer to the ministries or governmental agencies.

The first introduction of the public to the foreign trade data is the publication of the quarterly press statement along with the summary table. This table contains the total of imports and exports and the trade deficit in dollars for the last three quarters. Within three weeks from the statement publication, there is the electronic dissemination and the publication in the Bank of Albania web page, in the "Time Series" database and in the Statistical Report, which is disseminated in hard copy according to the users' list. Based on the user's requests (always after the statistics publication date), published data according to the standard format can be disseminated electronically or in printed. Moreover, the foreign trade data statements, according to the respective breakdowns in commodity groups and partner countries, are published in the monthly and annual statistical reports of the Bank of Albania. Practically, the foreign trade data are disseminated to all users at the same time.

✓

Simultaneous release refers to the first instance when the data is accessible by all users, at any kind of format (hard copy, floppy disc, electronically, etc.).

<p>Integrity of the data SDDS Requirements</p> <p>Publication of terms and conditions, under which the statistics are produced and disseminated, including the protection of individual information: Terms and conditions may refer to issues, such as, the relationships between the statistical unit and one department or ministry in which it takes part. For instance, they might refer to the dependency (in the budget or human resources aspect) of the agency producing the statistics from an external authority or to the independence in choosing the statistics methodology and decisions related to the publication of statistical results. Moreover, the terms and conditions may refer to the requirements to the agency to publish the data collected as a protection from the political pressure to hide certain results, and the revision of statistical programs by independent expert groups. Another issue concerning the conditions, in which the statistical agencies operate, refers to the procedures and processes related to the individual data confidentiality. These procedures cover various issues, varying from the computer security to the exchange of information between statistical agencies.</p> <p>Identification of the government access prior to data publication: In order to be protected by the influences of the authorities out of the agency publishing the data, the standard recommends the listing of persons or officials with certain positions in the government, but out of the data compilation agencies, which have access to the statistical data prior the publication, and the reporting of an accessible calendar. This practice is recommended in order to grant full transparency to every prior access by the government, deemed as necessary.</p> <p>Identification of ministerial commentary related to the statistical data: Considering that the government may not objectively assess the statistical data, in particular in those cases when they are directly related to its responsibilities, the standard provides the identification of the commentary source over the data.</p> <p>The provision of information about revision and advance notice of major changes in methodology: Essential information regarding the data revision might be the one related to the observed policies and the extent of previous revisions. Revisions are made in order to reflect the amendments or changes concerning different aspects of the statistical methodology, such as: fundamental concepts and definitions; source of information; evaluation methods. The revision policies referring to these changes must determine the frequencies of the respective procedures that these revisions have to observe. These revisions must be made public. Notices on the above mentioned changes may vary from short press releases to public presentations and materials. The members are also encouraged to provide quicker information on the revisions after they have been made (for example, via telephone, fax or internet by a contact person who could answer questions related to the revisions).</p>	<p>Our Practice</p> <p>The compilation of foreign trade statistics by the Bank of Albania derives from its obligation of compiling the balance of payments of Albania, based on Article 27 of the Law "On the Bank of Albania".</p> <p>The individual information confidentiality is provided by Article 58 of the Law no. 8269, dated 23.12.1997, "On the Bank of Albania", and the Regulation "On the Transparency and Confidentiality at the Bank of Albania", approved upon the decision of the Bank of Albania Supervisory Council, no. 53, dated 21.06.2000 along with the respective amendments.</p> <p>The mentioned laws and regulations are published in the Bank of Albania web page.</p>	✓
<p>Identification of the government access prior to data publication: In order to be protected by the influences of the authorities out of the agency publishing the data, the standard recommends the listing of persons or officials with certain positions in the government, but out of the data compilation agencies, which have access to the statistical data prior the publication, and the reporting of an accessible calendar. This practice is recommended in order to grant full transparency to every prior access by the government, deemed as necessary.</p>	<p>The governmental units do not have prior access to foreign trade statistics.</p>	✓
<p>Identification of ministerial commentary related to the statistical data: Considering that the government may not objectively assess the statistical data, in particular in those cases when they are directly related to its responsibilities, the standard provides the identification of the commentary source over the data.</p>	<p>There are not any commentaries regarding the published data.</p>	✓
<p>The provision of information about revision and advance notice of major changes in methodology: Essential information regarding the data revision might be the one related to the observed policies and the extent of previous revisions. Revisions are made in order to reflect the amendments or changes concerning different aspects of the statistical methodology, such as: fundamental concepts and definitions; source of information; evaluation methods. The revision policies referring to these changes must determine the frequencies of the respective procedures that these revisions have to observe. These revisions must be made public. Notices on the above mentioned changes may vary from short press releases to public presentations and materials. The members are also encouraged to provide quicker information on the revisions after they have been made (for example, via telephone, fax or internet by a contact person who could answer questions related to the revisions).</p>	<p>With regard to the revisions in the foreign trade statistics, though considered final at the moment when they are published (that is, they are not labelled as operational data), they are regularly revised, due to changes in the preliminary evaluations, changes in methodology, new additional sources of information and amendments of the existing ones. The revised tables are published, but not the documentation of the respective revisions. Moreover, there are not any real revision policies to determine an accurate revision calendar, as well as the information of the foreign trade statistics users regarding these revisions.</p>	X

Quality of the data	Our Practice
<p>SDDS Requirements</p> <p>The dissemination of documentation on methodology and sources used in preparing statistics:</p> <p>The dissemination of documentation on methodology and sources used is the key to the user's awareness on the advantages and shortfalls of statistics.</p> <p>The recommended documentation may take different forms, including the summary notes accompanying the data dissemination, special disseminations or prepared materials to be released upon request. The members are requested to include and highlight statements on the most essential characteristics of quality. These statements may clarify the type of error, subject to which might be the data, reasons of the data non-comparativeness in time or the selection errors in cases of research, etc.</p> <p>The dissemination of component detail, reconciliations with related data, and statistical frameworks that support cross-checks and provide assurance of reasonableness:</p> <p>This element recommends the dissemination of component detail, emphasizing the release within a statistical framework and/or the dissemination of the comparison and reconciliation with other related data.</p> <p>The component detail must in a way so that it does not cause conflicts to other elements, as well as provide the individual information reliability and confidentiality.</p>	<p>The foreign trade statistics are compiled based on the recommendations presented in the "Balance of Payments Statistics Manual, IMF, Fifth Edition, 1993", as well as based on the details of the "Balance of Payments Compilation Guide, IMF, 1995".</p> <p>The data compilation observes the methodology defined in the "International Merchandise Trade Statistics: Concepts and Definitions" of the United Nations.</p> <p>In this context, in order to meet the SDDS standard requirements, the methodology has to be published, by presenting in it the changes and amendments made through the years, as well as providing room for changes in the future.</p>
	<p>X</p> <p>✓</p>

NOTES

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The views expressed in this paper are those of the authors and do not necessarily reflect those of the Bank of Albania.

¹ Data dissemination, in the context used in this material, includes all the chain of actions starting from the source data collection to their access by the public out of the agency producing these data.

² Allum and Agca (2001) indicate a “positive transition effect” in the data dissemination evaluation. It shows the serious engagement on the part of the authorities in enhancing the data dissemination quality, something which is related to their interest in participating in the international financial markets.

³ “Fifth Review of the Fund’s Data Standards Initiatives”, page 9.

⁴ The GDDS includes 83 member countries in total. The countries which are already members of the SDDS are Kazakhstan, Kyrgyzstan, Armenia, Bulgaria and Romania.

⁵ The ROSC mission has visited Albania twice, in May 2000 for the data dissemination and in July 2003 for the fiscal transparency. For more information please refer to <http://www.imf.org/external/np/rosc/rosc.asp>.

⁶ The term “timeliness” in this material shall mean the time period from the reference date of the statistical indicator to its release.

⁷ Here it refers to the media and private users, not to the governmental units.

⁸ IMF (1996), Guide to the data dissemination standards, page 39.

⁹ It refers to the governmental units out of the agency producing the data.

¹⁰ Manual on Monetary and Financial Statistics, IMF (2000).

¹¹ Balance of Payments Manual, Fifth Edition, 1993.

¹² Classification system of commodity groups according to the manual of international merchandise trade statistics “International Merchandise Trade Statistics: Concepts and Definitions”, United Nations, 1998.

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A SURVEY ON TIME SERIES OF DEPOSITS, LOANS AND NET FOREIGN ASSETS OF THE BANK OF ALBANIA

*Refika Fejzo**

Key words

- Time series - Monetary indicators - Deposits - Credit - Net foreign assets -

INTRODUCTION

This paper aims to inform the time series users of monetary indicators on some of their features, such as computing methodology and methodological changes over time, reclassifications, use of new instruments, special events having impacted on their performance, etc. The material deals with the indicators of residents' deposits, indicators of credit to the economy and net foreign assets of the Bank of Albania, as some of the most useful indicators for the policy makers of the Bank of Albania and for home and foreign scientific researchers.

Given that a complete analysis of these indicators goes beyond the purposes of this material, the provided information is based mainly on the analysis of time series tables and charts. Also, the Annual Reports of the Bank of Albania, analyses and surveys carried out by the Monetary Policy Department, Research Department, Supervision Department, and other analyses carried out by Bank of Albania specialists are taken into account. The computing methodology and its trend are described for each of the indicators and later on the breaking points are highlighted and explained. The obvious changes at the level of indicators within one or two periods of time, methodological changes,

and reclassifications with which the statistics specialists are acquainted and which may be less distinctive for the aggregated data, are taken as such.

The time series data disclosed at the Bank of Albania web site are used as the source of data. When the index data are not disclosed at this data base, the data published at the statistical reports and annual reports of the Bank of Albania are made use of. In each case, when the data are not obtained from the "Time Series" data base, the relevant source is cited.

The surveyed period is the period of December 1992 – June 2005. In cases when we have not ensured any relevant data, we have analyzed the period for which published data already exist.

1. DEPOSITS AND THEIR WEIGHT IN MONETARY AGGREGATES

1.1. OVERVIEW ON DEPOSITS PERFORMANCE AS OF DECEMBER 1992 – JUNE 2005

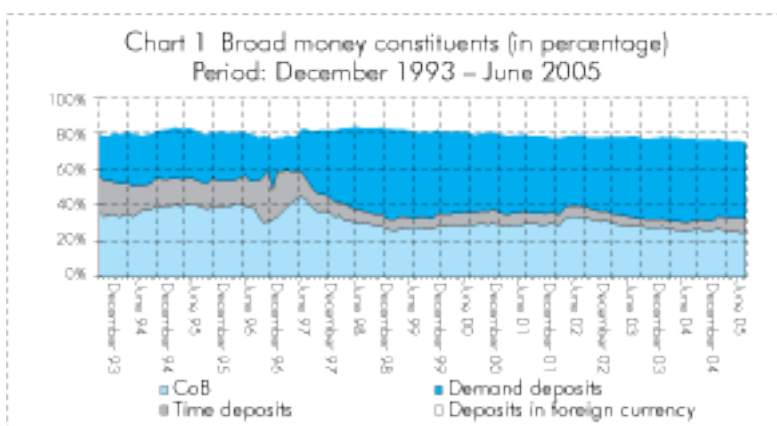
During the previous decade the banking system deposits structure underwent important changes due to country's economic development and banking system developments. The overall trend of the system deposits was positive and the time series charts and tables indicate their upward trend. However, the fragility and problems over the first decade of banking system establishment were reflected in crises and problems of the banking system deposit structure and level.

In 1993 – 1995, the Albanian economy had just entered into free economy, therefore most of the total of deposits was composed of public sector deposits. The privatization processes made the increase of the private sector and households' deposits level (respectively about 68 per cent, 62 per cent and 50 per cent) be the overall trend. The main contribution to the increased level of deposits is given by households' time deposits, due to lack of

investment alternatives and rise in the real interest rates and ALL stability in the domestic market¹.

During 1993 – 1995, time deposits in lek constituted on average 27.5 per cent of the broad money, while 37 per cent was constituted of currency outside banks, 16 per cent demand deposits in lek and 19.5 per cent deposits in foreign currency (chart 1). The increased number of trading or manufacturing small- and medium-sized enterprises, the relatively insignificant use of banking services, and the public awareness on fall of inflation, made the currency outside banks be the main constituent of the broad money. Also, a non-effective banking system of payments and services had a negative impact.

Year 1996 marked a change in the weight of the broad money constituents and in the growth rate of such constituents. The emerging and developing of pyramid schemes caused reduction in the growth rate of currency outside banks and of time deposits in the favour of the growth rate of demand deposits, taking into account that the public started to withdraw the savings from the time deposits and the pyramid schemes placed the money at demand deposits with banks. This became more obvious particularly during October – November, when the activity of pyramid schemes reached its climate. In September – December the broad money decreased on average 7 per cent, time deposits in lek fell by 14 per cent, while demand deposits



in lek grew by 104 per cent. This change in the banking system deposit structure reduced banks' costs, but on the other hand the liquidity management problem emerged. Having demand deposits as their main assets, the banks could not invest in long-term instruments.

The collapse of pyramid schemes in 1997 gravely damaged the public confidence in the banking system. This was accompanied by significant reduction of deposits in the favour of currency outside banks, which caused liquidity problems to the banking system. To stop the outflow of deposits from the banking system, the interest rates were raised. For example, the interest rates on three-month deposits were raised from 27 per cent in March of 1997 to 37 per cent in June of that year.

The positive interest rate rise and other measure taken to raise the public confidence in the banking system, made deposits over the second half of 1997 until 1998 (rather time deposits in lek) be increased positively and currency outside banks drop significantly (chart 1).

Kosovo crisis in 1999 caused rise of currency outside banks and of foreign currency deposits because of the mainly foreign currency inflows² from humanitarian and non-governmental bodies helping the Kosovo citizens who settled in our country.

Even during 2000 – 2001 the main contribution to broad money growth was given by foreign currency deposits and currency outside banks. During 2000, ALL deposits decreased in their volume or in the growth rate, due to deposit interest rate cut. The average weighted interest of three-month deposits for the banking system was reduced from 9.5 per cent (in December 1999) to 6.9 per cent at end of 2001. After October 2000, the level of ALL time deposits interest rate was not determined any longer administratively by the Bank of Albania. The repo interest rate was set as a reference to market interest rate.

Precisely when the financial situation of the banking system was assessed as the best over ten last years, another crisis hit

the banking system. In March – April 2002, the banking system was characterized by a massive withdrawal of households' time deposits, mainly from the two largest banks of the country, the Savings Bank (presently the Raiffeisen Bank) and the National Commercial Bank. In consequence, about ALL 21.4 billion was withdrawn from the banking system. The initiation of the Savings Bank's privatization procedures, the financial problems of the National Commercial Bank's owner, the misinterpretation of the deposits insurance law, etc., caused a shaking of the public confidence in the banking system³. Deposits withdrawal brought about liquidity problems in commercial banks. Responding to the situation created, the Bank of Albania changed its monetary policy stance and injected liquidity into the market.

The second semester of 2002 and year 2003 were characterized by money return into the system. This return reduced the level of currency outside banks (by about ALL 5.6 billion or 4.3 per cent in December 2003) and its ratio to money supply. The money was returned into the system in the form of ALL time deposits. The spread of the ALL and foreign currency interest rates and the ALL appreciation made the time deposits in lek be more favorable for the households. The same trend continued even during 2004.

The broad money has been increasing at higher rates during the first quarter of 2005. In June of 2005 the broad money grew by an annual rate of 18.3 per cent, compared to 13.1 per cent the annual growth was in December of 2004. The broad money growth in this period was mainly due to foreign currency deposits growth. Their annual growth rate in June of 2005 was 30.2 per cent, compared to 17.1 per cent it was in December of 2004. During this period, while the foreign currency deposits weight went upward, the weight of currency outside banks to broad money decreased. The raised confidence of the public in the banking system (reflected in increased household investments at banks, such as time deposits in ALL and in foreign currency) and the efficiency of the system of payments⁴ impacted on the reduction of currency outside banks. The depreciation of the lek exchange rate against the American dollar during January –

June 2005, and the more favourable interest rates in American dollar have also impacted on the increase of foreign currency deposits.

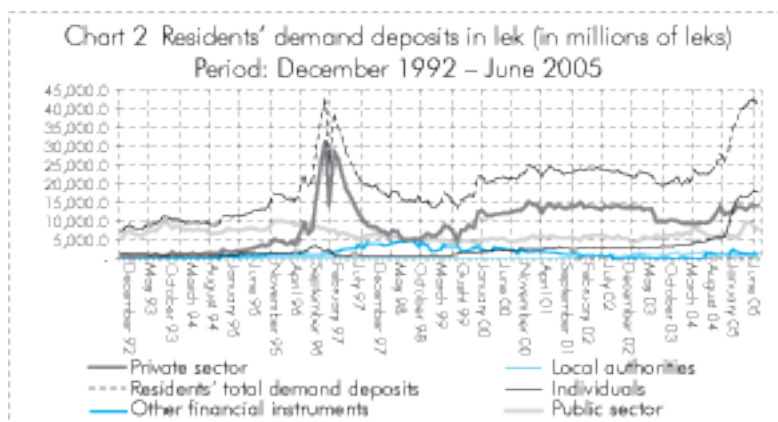
1.2. PROBLEMS RELATED TO DEPOSITS TIME SERIES ACCORDING TO THE "TIME SERIES" DATA BASE STRUCTURE

1.2.1 Residents' demand deposits in lek

Indicators:

Residents' demand deposits in lek

- Local authorities⁵
- Non-financial public enterprises
- Other financial enterprises
- Private sector
- Households



Demand deposits in lek represent current accounts and ALL demand deposits placed by local authorities, non-financial public enterprises, other financial institutions, private sector and households, with the deposit banks and with the Bank of Albania.

Excluding currency outside banks, the demand deposits in ALL are the most liquid instruments of the broad money. Along

with currency outside banks, the demand deposits in ALL form the narrow money or the M1 aggregate.

The indicator of ALL demand deposits includes:

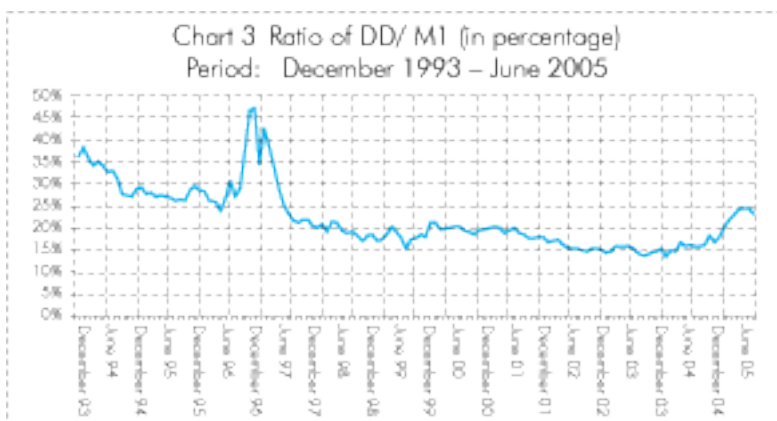
Current accounts in lek, which include accounts in lek that are exchangeable upon request, in nominal value, without any penalty or limitation, freely transferable with cheques, pay orders, largely used as means of payment.

Demand deposit accounts in ALL, which are exchangeable upon request, in nominal value, without any penalty or limitation, but which can not be used as means of payment.

The indicator of demand deposits in ALL also includes the collateral deposits in lek and frozen deposits in lek (as for example the deposits for covering cheques, letters of credit, etc.) which have limitations regarding their liquidities and transfer. Based on the new monetary statistics methodology, these accounts must not be included in the narrow money aggregate.

The general trend of the level of the demand deposits in ALL has been upward, but with frequent fluctuations. As the demand deposits in ALL are high liquidity means used for transactions, high jumps in their value at a certain moment do not necessary indicate a rise or fall of the economic agents' preference for these instruments.

The chart 3, displaying the ratio of demand deposits in ALL (DD^6) to narrow money (M1), has a downward trend for the period of December 1993 – December 2003, which indicates that during this period transactions in cash prevailed in the Albanian economy. During 2004 and the beginning of 2005 an upward trend of the ratio of DD/M1 is noticed, indicating positive accomplishments concerning the banking services efficiency and relations of businesses and households with banks. The efforts made to fight cash economy, for example through the "Beyond money" program ⁷, have given positive outcomes.



Problems and explanations

July 1996 – December 1996: ALL demand deposits go up.

It is the period when ALL demand deposits underwent the largest increase. This is the period during which the pyramid schemes were in full swing and the firms that collected money from the public, invested them back as ALL demand deposits with banks.

January 1997 – December 1997: Reduction of ALL demand deposits from month to month.

In this period, ALL demand deposits decreased from month to month. The pyramidal schemes went bankrupt and did not invest any more in demand deposits.

In January 1997 the ALL demand deposits decreased by 40 per cent, compared to December of 1996. The funds of pyramid schemes, invested in ALL demand deposits with the National Commercial Bank, were frozen and classified as ALL time deposits of the private sector. In February the frozen funds of pyramid schemes were posted to the Savings Bank and were reclassified by this bank again as ALL demand deposits of the private sector.

June 2003: Reclassification of demand deposits

In June 2003 the demand deposits of the private sector dropped by 27 per cent (approximately ALL 4 billion in absolute value) on annual basis. In this month, the Savings Bank, based on the suggestions of its auditors, reclassified a part of the frozen deposits of pyramid firms as time deposits of the public sector.

December 2004: Growth of demand deposits

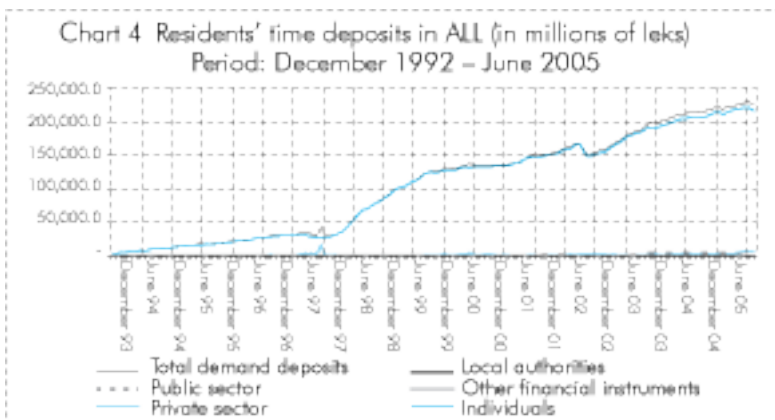
The demand deposits in December 2004 increased due to matured time deposits classification at a bank, expecting renovation of the contract as demand deposits. It's worth emphasizing that such a shifting of time deposits into demand deposits does not constitute a fundamental change, but only a temporary reclassification.

1.2.2 Residents' time deposits in ALL

Indicators:

Residents' time deposits in ALL

- Local authorities
- Public nonfinancial enterprises
- Other financial institutions
- Private sector
- Households



Time deposits in ALL represent time deposits held in lek from the local authorities, public nonfinancial enterprises, other financial institutions, private sector and households, with deposit banks and with the Bank of Albania.

Time deposits include deposits, which may be withdrawn only after a certain period of time, having restrictions which make them more appropriate for saving than for commercial transactions. Also, time deposits index includes even the deposits certificates, which represent a certain form of time deposits. Time deposits have had an upward trend (chart 4). This has been as a result of the lek stability in the domestic market, real positive interest rates and increased public confidence in the banking system. Most of time deposits in ALL are the households' deposits, who do not have many alternatives to invest their savings.

Problems and explanations

May 1996 – December 1996: Reduction of the level of households' time deposits

During this period a reduction of the level of households' time deposits took place month in month out. This is the period of the emerging of pyramid schemes, which absorbed households' money. The households withdrew deposits from banks to invest such funds in such firms. During this period, the time deposits in ALL of the private sector increased.

January 1997: There is a jump in the total of time deposits in ALL by 43 per cent on a monthly basis.

The total of time deposits in ALL was impacted by a growth of 432 per cent on monthly basis of the private sector's time deposits in ALL. This breaking point in the series of ALL time deposits of the private sector was due to temporary reclassification of demand deposits of the firms that went bankrupt, explained in the above paragraphs. In February these deposits were reclassified as demand deposits.

March – April 2002: There is a negative jump in the level of time deposits in ALL.

This period coincides with the shaking of the public confidence in the banking system. Households addressed to banks' windows (mainly at the Savings Bank and at the National Commercial Bank) and withdrew their deposits. Approximately ALL 21.4 billion was withdrawn from the banking system within two months.

June 2003: There is a jump in the level of ALL time deposits of the private sector

In June 2003 the time deposits of the private sector increased by about 400 per cent. This breaking point in the series of time deposits of the private sector was due to reclassification of pyramid schemes' funds explained above.

February – March 2005: Reclassification of ALL time deposits of the private sector took place.

During these two months a reduction of about ALL 4 billion of private sector's time deposits took place. Funds of pyramid schemes classified as the private sector's time deposits were reclassified as households' current accounts, with the intention to send them back to their creditors.

1.2.3 Residents' foreign currency deposits

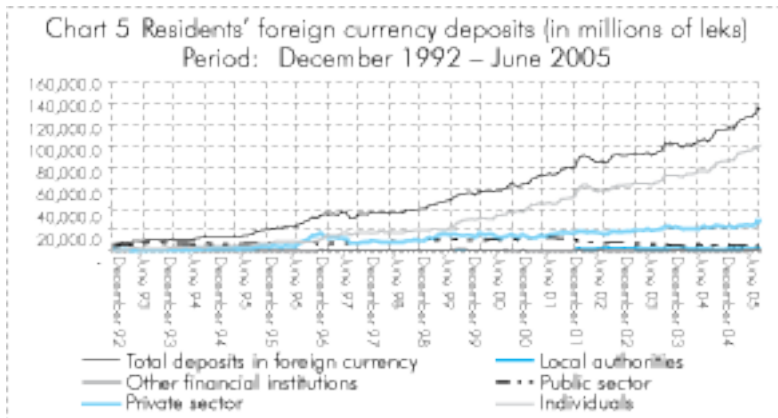
Indicators:

Residents' foreign currency deposits

- Local authorities
- Non-financial public enterprises
- Other financial institutions
- Private sector
- Households

Foreign currency deposits represent current accounts, demand deposits, time deposits, certificates of deposits, and

frozen deposits and guarantees held in foreign currency from local authorities, nonfinancial public enterprises, other financial institutions, households and private sector, with deposit banks and with the Bank of Albania.



Foreign currency deposits have had an upward trend along the period. Foreign currency deposits are the type of deposits that have had less jumping of value as compared to ALL deposits.

For example, the banking system 1997 crisis had a smaller impact on the total of households' foreign currency deposits as compared to fluctuations of households' ALL deposits, thus reflecting, inter alia, a greater confidence of the public in the foreign currency against the lek. Chart 1, which represents the constituents of the broad money, indicates that the weight of foreign currency deposits to broad money presents a more stable trend as compared to other constituents of the broad money.

After 1996, the households' deposits constitute the majority of foreign currency deposits. Remittances from emigrants have been the main source of foreign currency deposits⁸.

Problems and explanations

June 1996 – December 1996: Growth of private sector's foreign currency deposits

During June 1996 – December 1996 the foreign currency deposits increased by 280 per cent. This growth was due to foreign currency investment, collected from pyramid schemes, in foreign currency demand deposits with banks.

January 1999 – June 1999: Foreign currency demand deposits growth

Year 1999, which coincides with the period of Kosovo crisis was characterized by a steady trend in the foreign currency deposits growth. This growth was larger during the first semester of the year. The main inflows were foreign currency demand deposits (current accounts of nongovernmental organizations, aids for the persons coming from Kosovo, etc.).

March 2002 – April 2002: There is a negative threat in the level of foreign currency deposits.

The shaking of the public confidence in the banking system during March 2002 – April 2002 impacted even on the level of foreign currency deposits. The reduction in these indicators was due to reduction of households' foreign currency deposits.

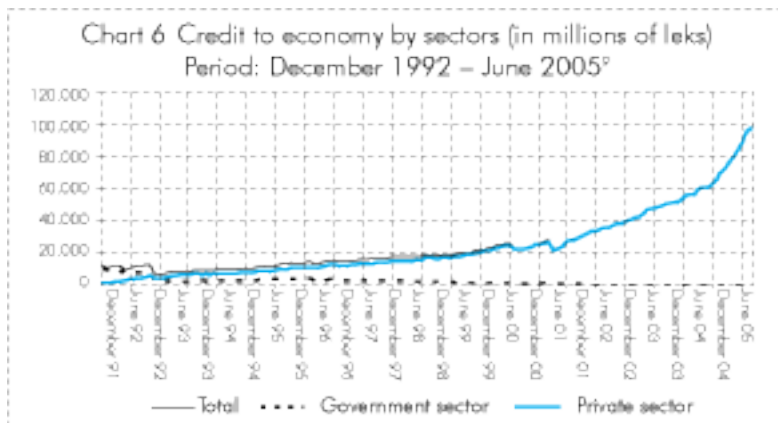
2. CREDIT TO THE ECONOMY

2.1 GENERAL VIEW ON CREDIT PERFORMANCE

Credit is an important instrument in supporting the country's development. It sustains new productive developments in the economy by impacting on the growth of production, trade, services, etc.

During twelve last years the credit activity in our country is estimated to carry over many risks, such as that of nonperforming loans, that of order and security in the country, etc. This made banks be prudential in lending for a long time. This may be noticed even in chart 6, which displays the performance of the

total of credit to the economy and lending to the government and private sectors. However, the overall credit trend along the years has always been growing, but until 1999 it has been growing at low paces.



Years 1992 – 1996 were the first years of coming out from the socialist system. In this period, due to low expertise in the banking system, the banks did not manage to apply lending conditions rigorously. This made the number of non-performing loans go up¹⁰. To reduce the high number of non-performing loans, the Bank of Albania applied a tightening refinancing policy, using the credit ceiling as the main monetary policy instrument. Also, lending was prohibited even to banks with completely state-owned capital. In November 1999 the Bank of Albania decided to omit the credit ceiling, which influenced the increase of lending at faster rates. So, only in 2000 lending was increased by about 3 times as compared to 1999.

A survey¹¹ made in 2000 indicated that the low lending to the Albanian business was due to the fact that, besides the credit ceiling provided by banks, the businesses themselves were reluctant to address themselves to the banking system for meeting their capital needs. Banking credit was estimate to be used at very low level by only 10.5 per cent of businesses. It was so due to high lending interest rates and lack of tradition and culture in bank-business relations.

To increase lending, the Bank of Albania has followed an easing policy, reducing the key interest rate time and again. At the beginning of 2005 this rate was cut to 5 per cent, whereas in December 1999, that was the first moment the credit ceiling was omitted, the key interest rate was 18.5 per cent.

As concerns to sectors supported by loans (chart 6), during the whole this period, on average 95 per cent of the credit was extended to private sector (70 per cent to enterprises and 25 per cent to households) and only 5 per cent of credit was extended to public sector. Credit to public sector has a negative tendency and has been disappearing almost completely from the balance sheets of banks. This may be understood even by the fact that credit to private sector has supported the privatization of state-owned enterprises, bringing about reduction in the number of state-owned enterprises and in the loans extended for them.

Most of credit extended by the Albanian banking system is credit in foreign currency. Just like with deposits, the lending level is characterized by the domination of one or two banks in the market, either for credit in lek or for credit in foreign currency¹². However, it is worth mentioning the fact that after 1999, these banks do not continue any more to hold dominant positions in the lending activity. Dynamic developments in the Albanian banking system, such as the increased number of banks operating in the market, extension of banking network in various areas of the country, full transfer of the Savings Bank's capital to Raiffeissen Zentral Bank, have increased competition among banks and have made possible that the percentage of extended credit be more diversified among banks.

Table 1 indicates the total of new credit extended during each year. Even though most of the new credit extended until now is short-term credit, the data indicate that banks are oriented to investments of longer maturity. During the first semester of 2005 the banks were more committed, about 60 per cent, to loans of more than 1 year maturity, reducing significantly the economy financing with short-term loans¹³.

Table 1 New credit¹⁴ (in billions of lek)

Year	2000	2001	2002	2003	2004	2005 I Semester
Total of Loans	24.2	40.6	94.3	183.0	88.1	57.5
Leks	4.4	10.0	18.1	27.6	30.9	17.4
Foreign currency	19.8	30.6	76.2	155.4	57.2	40.1
Short-term	12.9	27.6	80.7	157.8	54.4	27.0
Mid-term	10.0	10.7	7.1	7.9	13.0	12.2
Long-term	1.3	2.6	6.5	17.3	20.7	18.3

A highly important aspect regarding credit is the credit portfolio quality. Chart 7 indicates the percentage of nonperforming loans to total loans extended, while the chart 8 displays the value of the total nonperforming loans.

Though the weight of nonperforming loans has a downward trend, the total of nonperforming loans has increased. High credit growth rates dictate the need to be more prudential concerning the portfolio¹⁵ quality. The credit risk reflects various problems in terms of rules and practices that relate to protection of the creditors' rights. The solution of these problems in the future will be a key factor that will support the rapid growth of credit to the economy.

2.2 PROBLEMS RELATED TO CREDIT TIME SERIES BY THE "TIME SERIES" DATA BASE STRUCTURE

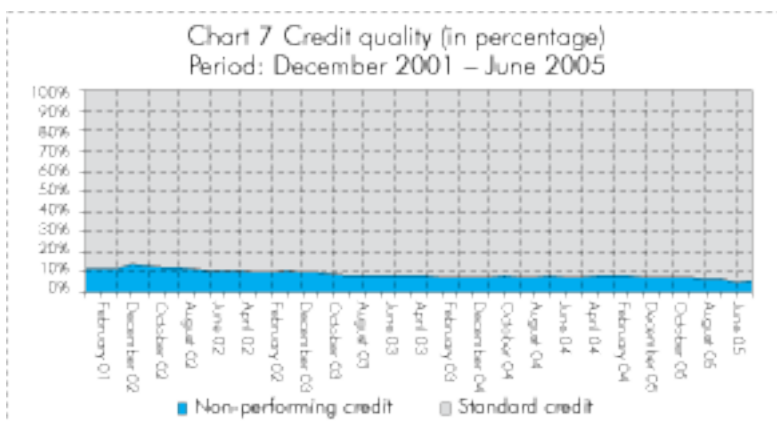
2.2.1 Credit to economy

Indicators:

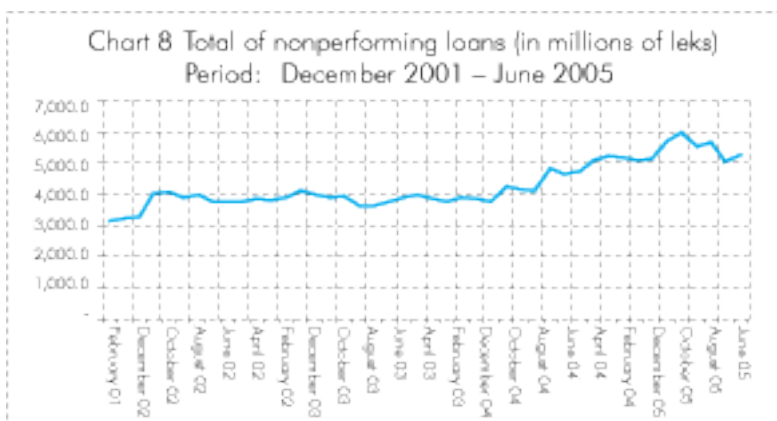
Total of credit

- Claims on public sector
- Claims on private sector
- Private enterprises
- Households
- Claims on other financial institutions

Credit to economy includes all claims of banks on the public sector, private enterprises, households and other financial institutions. These claims are expressed in the form of short-term,

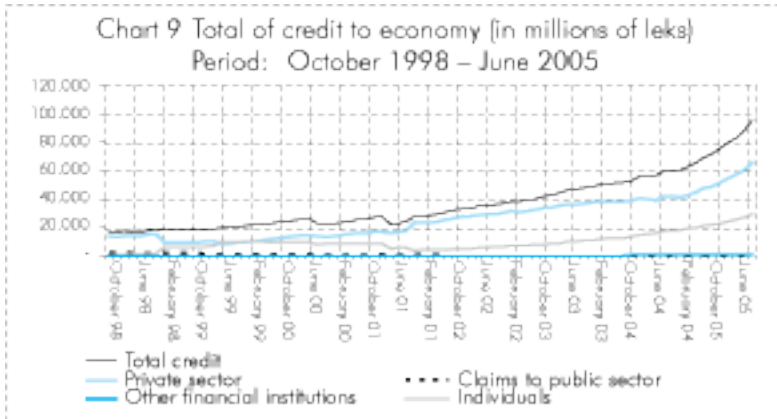


mid-term and long-term loans, mortgage loans, financial leasing contracts and crediting through current debit accounts.



This indicator represents the total lending in leks and in foreign currency of the economy by deposit banks. This indicator has included standard loans, overdue loans, special mention loans, substandard loans, doubtful loans, and loss loans.

As chart 9 displays, the total of loans has an upward positive trend. In the period following 1999, credit to economy increased at high rates. The new banks' licensing, interest rate policy liberalization, credit ceiling prevention and political environment stabilization have made banks be more aggressive in their policy



to increase lending. The chart displays the increase of lending at higher paces even for 2004 and for the beginning of 2005. This period was positively influenced by the Savings Bank's privatization (presently Raiffesisen Bank) and prevention of the lending activity restriction of this bank in December 2004.

Problems and explanations:

May 1993: Credit to economy had a negative jump by - 21.5 per cent.

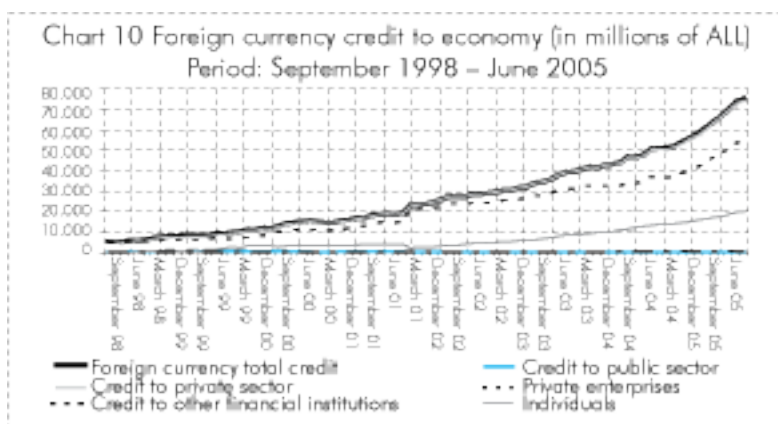
This reduction in the total of loans was due to a reduction of 30 per cent in the credit extended to state-owned enterprises. The government's decision to release them of the overdue loans they had received from the Agricultural Development Bank, an amount of ALL 2.9 billion not repaid until December 31, 1992, caused such reduction.

December 1993: Credit to economy had a negative jump by - 47 per cent.

At end of 1993 the Government accepted to release the state-owned companies of the debt they had received earlier than 1992 at the National Commercial Bank, for a value of ALL 4.3 billion. The Ministry of Finances issued bonds to replace overdue loans that were released of debt.

August 2001 – September 2001: Credit to economy had a negative jump of -19 per cent.

In September 2001 the Bank of Albania transferred substandard, doubtful, loss loans, to the Bank Assessment Resolution Trust. Credit to private and public sectors was significantly reduced, respectively by -17 per cent and -55 per cent monthly change.



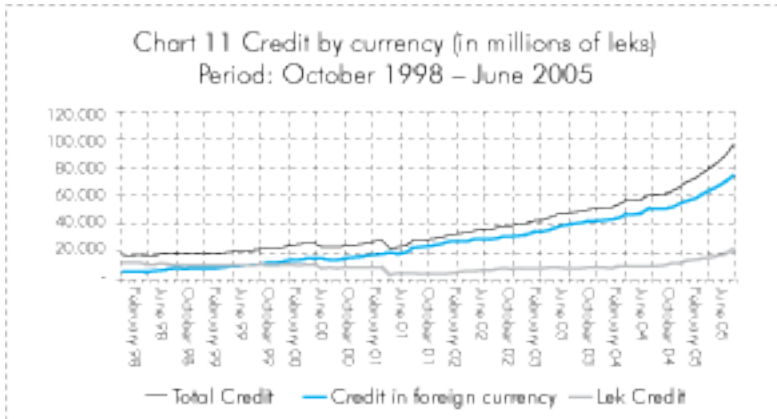
2.2.2 Foreign currency credit to economy

Indicators:

Total of credit

- Claims on public sector
- Claims on private sector
- Private enterprises
- Households
- Claims on other financial institutions

Foreign currency credit to economy includes all foreign currency claims of banks on the public sector, private enterprises, households and other financial institutions. Such claims are expressed in the form of short-term, mid-term, and long-term loans, mortgage loans, financial leasing contracts, and crediting through debit current accounts.



The “Foreign currency credit” indicator has reflected an upward trend along the period (Chart 10). The performance of this indicator was influenced by foreign currency credit extended to private sector and mainly to private enterprises, because most of foreign currency credit was extended to this sector.

Foreign currency credit to public sector has been constantly decreasing until it became zero on January 2001, even though it appeared again in 2004, but at rather small values. Credit to other financial institutions is an indicator appearing in 2003 and still constitutes an item of rather small weight to total of loans.

Foreign currency credit is the credit occupying most of the weight to total of credit. Starting from March of 2000 and onwards, foreign currency credit has always been higher than ALL credit (chart 10). Foreign currency credit was encouraged by the more favourable foreign currency credit interest rates. For example, in December 2003, the interest rate for ALL credit of a 1 – 3 year maturity was 20.33 per cent, whereas for Euro credit it was 11.04 per cent and for American dollar credit it was 9.34 per cent.

Table 2 Credit to economy

	Dec. 1998	Dec. 1999	Dec. 2000	Dec. 2001	Dec. 2002	Dec. 2003	Dec. 2004	June 2005
Total of credit (in millions of Lek)	17745	19890	23242	27941	38652	50683	69973	95892
Foreign currency credit	5627	9277	14827	22829	30519	41537	56312	73872
ALL credit	12065	10613	8415	5112	8132	9146	13661	22020
In percentage to the total								
Foreign currency credit	32%	47%	64%	82%	79%	82%	80%	77%
ALL credit	68%	53%	36%	18%	21%	18%	20%	23%

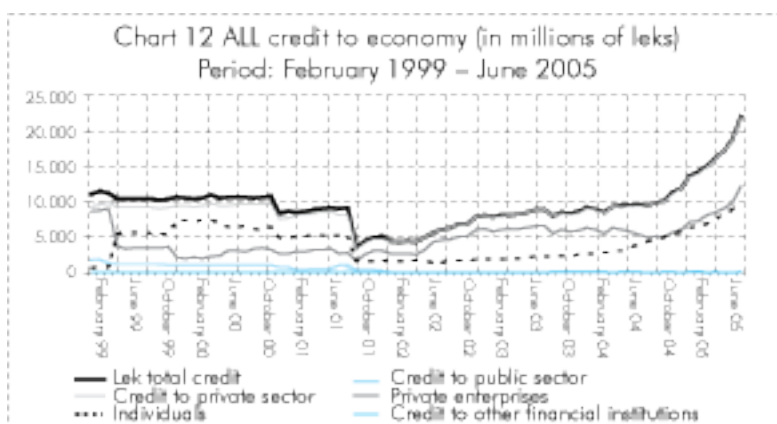
Other reasons for the foreign currency credit may be the problems of exchange rate risk management, existence of banks' foreign currency liabilities (deposits and capital) and the fact that our economy is based mainly on high imports from other countries. We mention here the import of machinery and raw materials.

2.2.3 ALL credit to economy

Indicators:

Total of credit

- Claims on public sector
- Claims on private sector
- Private enterprises
- Households
- Claims on other financial institutions



ALL credit to economy includes all ALL claims of banks on the public sector, private enterprises and households.

Such claims are expressed in the form of short-term, mid-term, and long-term loans, mortgage loans, financial leasing contracts, and crediting through debit current accounts.

ALL credit had a downward trend, with frequent oscillations during 1999, 2000 and 2001 and only after 2001 it had a more regular upward trend, indicating that after that moment the banking system was increasing the role of ALL lending as a way of financing. The ALL credit growth rate was increased particularly following 2004. Such positive rates are mostly due to increasing commitments of banks to provide services for meeting the households' applications for credit.

Problems and explanations:

May 1999: Reclassification of ALL credit among sectors took place.

In May 1999 there was an overturn of values on credit to private enterprises with the one to households, which continued even during the following months until year 2000. In this month, credit to private enterprises was reduced by ALL 5033 million and credit to households was increased by ALL 4601 million, but the change of credit to private sector to the total was insignificant. This change took place at the Savings banks' reporting, and given that this was a period during which that bank was not allowed to extend new credit, this change was derived from possible reclassifications at the balance sheet.

December 2000: ALL credit had a negative jump by -22 per cent.

In December 2000 the National Commercial Bank transferred the substandard, doubtful, loss loans to the Bank Assessment Resolution Trust. During this month, the credit either to private sector or to public one underwent a significant reduction.

September 2001: ALL credit had a negative jump by -61 per cent.

ALL credit decreased because in this month the Savings Bank posted the non-performing loans extended to private and public sectors for administration to the Bank Assessment Resolution Trust.

3. NET FOREIGN ASSETS OF THE BANK OF ALBANIA

3.1 NET FOREIGN ASSETS OF THE BANK OF ALBANIA

Indicators:

Net foreign assets (NFA)

- Foreign Assets (FA)
- Foreign Liabilities (FL)

The indicator “Net foreign assets of the Bank of Albania” presents all the claims of the Bank of Albania on nonresidents¹⁶ minus the monetary authority liabilities on the same sector.

The indicator “Net foreign assets” is calculated as the difference between “Foreign assets” and “Foreign liabilities”. As a result, its performance is influenced by the specific performance and events occurring to the latter ones.

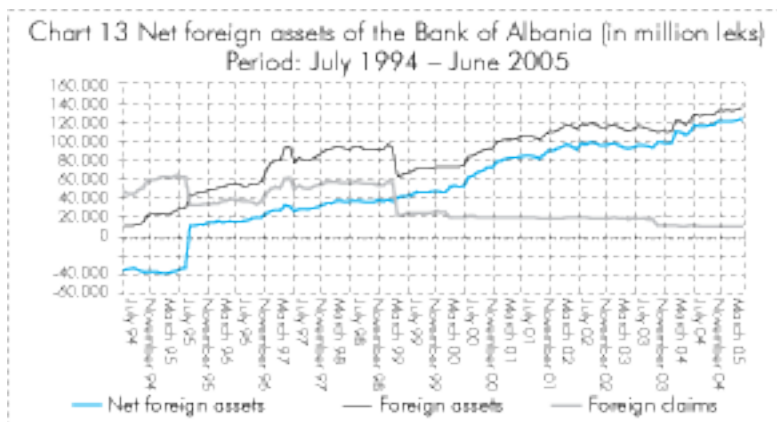
Claims on non-residents include:

- The gold the Bank of Albania holds as deposit with foreign banks;
- Time and demand deposits with foreign banks;
- Securities investments of nonresidents;
- Coins and banknotes in foreign currency;
- SDR holdings;
- Reserve positions with the Fund;
- Quotas of the World Bank and Islamic Development Bank.

Liabilities to non-residents include:

- Various loans from non-residents (such as Greek loan for covering the balance of payments, loan from the European Investment Bank, loan for the development of agriculture, industry and services as well as other loans received by commercial banks for their needs);
- Foreign banks' deposits with the Bank of Albania;
- ESAF programs of the IMF;
- ALL accounts of the World Bank and Islamic Development Bank with the Bank of Albania.

The table of foreign assets is compiled with values denominated in ALL and in American dollar. The difference between NFA in American dollar and NFA in ALL rests on the fact that the NFA in dollars include only those claims and liabilities of the Bank of Albania that are in foreign currency, excluding the ALL accounts of the World Bank and of the Islamic Development Bank. NFA of the Bank of Albania in ALL include all claims and liabilities on nonresidents, in ALL and in foreign currency.



Net foreign assets of the Bank of Albania have had an upward trend, due to the influence of three groups of factors:

1. Transactions performed

This group includes all factors impacting on the increase or decrease of foreign assets through inflow and outflow of funds of donators, international financial institutions, foundations, foreign governments, various projects, etc.

2. Factors impacting on revaluation of net foreign assets

We highlight here the impact of the exchange rate change at various moments, according to situations, in international and domestic markets.

3. Changes occurred due to methodology alteration and reclassifications.

Increase or decrease of net foreign assets of the Bank of Albania may derive even due to changed methodology or adjustments in items classified under this indicator. For example, until December 2002, the gold held at the Bank of Albania's safe was classified as one of the constituent items of Net Foreign Assets. According to the methodology on compiling monetary statistics¹⁷, the nonstandard gold must not be included in foreign assets. After the clarifications on the characteristics of such gold and instructions provided by the methodology, the gold at the Bank of Albania's safe was not included at Foreign Assets of the Bank of Albania. However, the nonstandard gold held at the Bank of England continues to be presented as part of foreign assets.

Problems and explanations:

July 1994 – August 1995: Net foreign assets of the Bank of Albania had a negative value.

In the period of 1990 – 1994 until mid of 1995, the “Monetary authority net foreign assets” index had a negative value. This is so because during all this period, the foreign liabilities of the Bank of Albania were rather high in comparison to foreign assets (see the Chart in figure 13). The Bank of Albania had inherited a relatively high foreign debt and small foreign currency reserves

in its balance sheet, which made the “Net foreign assets” index have negative values.

September 1995: Monetary authority net foreign assets had the highest positive jump by +136.36 per cent.

This immediate growth of net foreign assets was due to reduction of foreign liabilities of the Bank of Albania. In September of 1995 the overdue short term obligations¹⁸ decreased, due to restructuring of Albania’s debt to foreign credit banks. This debt was settled by the investment in purchasing zero coupon bonds of the American treasury, of a maturity of 30 years. So, in this month, the item “US – TB collateral is added and on the liability side the item “30 - year bonds for FX claims” is added for the same value.

July 1997: Net foreign assets had the highest negative jump by –18.1 per cent.

In July 1997 the “Net foreign assets – NFA” in ALL had the highest monthly reduction. This worsening of the level of NFA is related mainly to performance of the American dollar in the international forex market and of the lek in the domestic market. During the said period, the American dollar was appreciated against the German mark and all other foreign currencies that composed the Bank of Albania foreign reserve. That appreciation had a negative impact, reducing significantly the “Foreign Assets” in American dollar. Also, we bring to mind the fact that this period coincided with a grave period in the country’s economic and political area. Lack of stability of 1997 was also reflected in the lek’s price against foreign currencies in the forex market, associated with the loss of confidence people had in the domestic currency, and with various speculations which brought about the lek’s depreciation. Therefore, the Bank of Albania intervened some times in the market, by selling dollars and by purchasing leks, which instantly revaluated the lek. For example, while in June 1997 the lek/usd exchange rate was 178.74, in July of that year it reached to 145.17. The appreciation of the lek against the dollar caused a reduction of the value of “Net foreign assets” evaluated in leks.

December 2003: There is a reduction of 38 per cent in the foreign liabilities.

Credit to Government, extended by German Government for the KFW program (a loan for the development of agriculture, industry, services, etc) was prevented from the Bank of Albania's balance sheet. On the decision of the Supervisory Council, the follow-up of this loan was passed to the government, therefore it was not entered any more at the Bank of Albania's balance sheet.

4. Conclusion

This paper aimed to assist the Bank of Albania analysts and other analysts of institutions within the country and abroad. Given that such a summarized information on time series of monetary indicators disclosed by the Bank of Albania is made for the first time, we tried to select the statistical indicators that are more useful for the economic decision-making and for other analysts.

Also, describing the time series methodology and the main changes over time, this material constitutes even a fulfillment of the methodological documentation of the time series, comprising one of important steps in terms of raising the standards of data dissemination at the Bank of Albania. So, the associating of the disclosed data with their detailed methodological description in the IMF's SDDS program, where Albania aims to become a member, constitutes the main element of the degree of data quality¹⁹. On the other hand, the description of the main methodological changes constitutes one of the elements of the degree of data integrity. This material comprises a first step made in this direction and it will be fulfilled in the future.

NOTES

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This material provides general information on the performance of the time series of deposits, credits and net foreign assets of the Bank of Albania, the breaking points in respective series and causes of such breakings. The provided information is based mainly on the analysis of time series tables and charts. The data disclosed at the "Time Series" data base of the Bank of Albania web site are used as a data source. The surveyed period is December 1992 – June 2005.

¹ See: Bank of Albania, Annual Report 1994, pages 17 – 18.

² See: Bank of Albania, Annual Report 1999

³ See: Cani, Sh., and Vika, I., (2002), Confidence Crisis, Causes behind Banking Deposits Hemorrhage, Monitor, No.4.

⁴ See: Bank of Albania, Monetary Policy Statement on the First Semester of 2005, page 27.

⁵ Starting from December 2001, the deposits of local authorities are presented as a separate sector. Prior to that they were presented together with those of non-financial public enterprises.

⁶ DD stands for the Demand Deposits in ALL.

⁷ "Beyond money" is a program of the Bank of Albania in cooperation with the government and the banking system for reducing cash transactions in economy. Some of accomplishments of this program on the anticash combat are the realization of the Real Time Gross Settlements (RTGS) system, the Albanian Interbank Payment System, the channelling of public system employees' salaries through commercial banks, etc.

⁸ See: Bank of Albania, Annual Report 2004, page 53.

⁹ Data source: December 1992 – December 1997, Monthly Statistical Report, January 1999 – June 2005, "Time Series" data base at the Bank of Albania web site.

¹⁰ See: Çeliku, E., and Luçi, E., (2003), Impact of macroeconomic stability on non-performing loans.

¹¹ See: Cani Sh., Muço M., and Baleta T., (2000), Albanian banking system, its development problems.

¹² See: Baleta T., (2000), Domination of Albanian Banking market.

¹³ See: Bank of Albania, Monetary Policy Statement on the First Semester of 2005, pages 32 – 33.

¹⁴ Data source: Year 2000 and 2001, Annual report 2002. Years 2002, 2003, 2004 and the first semester of 2005, "Time series" data base at the Bank of Albania web site.

¹⁵ See: Fullani A., (2005), Greeting speech at the Inter-Balkan Forum of the

Bankers' Association, Economic Bulletin, Volume 8, No.2.

¹⁶ The concept of nonresidents is based on the "Methodology of monetary and financial statistics, Bank of Albania, July 2003".

¹⁷ IMF, Guide to international monetary and financial statistics, 1997

¹⁸ See: Taçi, S., (2004), Albania's foreign debt and its service.

¹⁹ SDDS – Special Data Dissemination Standards. These standards are based on best international practices in disseminating the statistical data and are mandatory to countries, which will become members of the SDDS. The monitoring degree of these standards relates to data characteristics (data covering, periodicity, publication time), access to data, data integrity and data quality. For more details, see reference 20. Other references: 18., 19., 21., 22., 23., 24., 25..

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IMPORTANT ELEMENTS OF THE INTERNATIONAL FINANCIAL REPORTING STANDARDS

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Key words

- Accounting Standards - Financial statement - GAAP - Conceptual framework -

INTRODUCTION

Economic developments, particularly globalization of the economy, have made the economic-financial decisions take an ever larger importance internationally. The main international factors have already converged in the same attitude as concerns to the “common language” of financial information, the economic enterprises of different countries of the world publish via financial statements. This language will be that of international accounting standards, whose application has been stated as an obligation at least for publicly-traded companies in national and international financial markets.

In this framework, many countries, separately or grouped in certain bodies, such as the European Union, have undertaken reforming initiatives in their regulatory accounting disposition. This process has already started even in the so-called transition countries or in countries that have entered lately in the market economy, such as Poland, Czech, Russia, Bulgaria, etc.

The reforming process in accounting is neither easy nor without problems to any state that has not developed its regulatory disposition according to Anglo-Saxon practices and

concepts and particularly to states that have lately entered into the market economy. Naturally, our country is also involved into this process, intending its accession to the European Union, a process also embodied in the Law No. 9228, dated 29.04.2004 "On Accounting and Financial Statements".

We deemed that the preparation of this paper would be necessary and useful for presenting the nature and scope of this process as properly as possible, by exhibiting first of all a history of the arising and development of the international accounting standards.

1. HISTORY OF INTERNATIONAL ACCOUNTING STANDARDS (IAS)

1.1 DEVELOPMENTS DURING 1973-1998

1973: Creation of IASC

IASs have their start in the need to harmonize the rules for preparing financial statements presentation in international level. The demand for such a harmonization derived naturally, because of the internationalization of markets and enterprises, and capital markets in particular. The initiative to achieve this harmonization was announced in July 1973, when the International Accounting Standards Committee (IASC) was established. The initiators were the accountancy bodies of 9 countries (England, France, Germany, the Netherlands, Japan, Canada, Mexico, Australia and the USA).

IASC announced the following objectives in its constitution:

- a. To compile and disclose in the public interest accounting standards enforceable in preparing financial statements and to promote their acceptance and application.
- b. To work generally for the improvement and harmonization of rules, standards and procedures on financial statements presentation.

Once established, the objectives of the IASC were in compliance with capital markets internationalization, since these markets require financial statements that can be easily understood and compared, despite the origin country of the enterprise disclosing these statements. The IASC, as a private organization, could not have an enforceable authority on any country; therefore, it would work for achieving the harmonization objectives, mainly through developing and promoting its standards. This was really an ambitious and difficult task, which would need a long time, as the reality showed. In November 1974 IAS 1 (IAS1) titled "Disclosure of Accounting Standards" was published and until 1989 the number of published standards amounted to 31.

In 1987, due to critics made to IASs and the resistance made to the adjustment of these standards by the developed countries, the IASC undertook a program for revising the standards. The objective set for this revising was the qualitative improvement and reduced number of options.

In June 1989 the IASC produced the Framework for the Preparation and Presentation of Financial statements, referred to as the conceptual framework.

1987: IOSCO joins Consultative Group

The IOSCO (the International Organization of Securities Exchange Commissions) indicated to the IASC that among the existing standards, most of them were acceptable with some reservations on non-essential points (14 standards), some had to be revised (6 standards) and some others were acceptable (4 standards).

In December 1998, the IASC received a letter on behalf of the Ministers of Finances of the G7 and central banks' Governors, which encouraged the IASC in its work on the financial information and expressed the confidence that this body would manage to timely carry out its program. The letter expressed the willingness of G.7 to promote "principles, standards and codes of good conduct, accepted internationally, more rigorous and understandable, as well as the goal for a closer supervision of

their effective application". Besides the G.7, the continuation of the work of the IASC was encouraged also by the IOSCO, the European Commission, the World Bank, etc.

Countries such as Germany, Belgium, Italy, and France adopted some laws or decisions that allowed some or all national enterprises to adopt IAS and/or American standards for the consolidated financial statements. Other countries such as Austria, Australia, Sweden, Switzerland, etc., also took domestic measures to encourage the international accounting harmonization, authorizing their enterprises to unify their accounting standards with the international standards. Most of European Stock Exchanges had accepted the IAS and the number of enterprises having decided to use these standards all over the world had increased.

Summarizing the developments over 25 years (1973-1998), we state that:

- During the first 25 years, the role of the IASC has been mainly in harmonizing the accounting standards of the main countries that had worked out a national accounting reference;
- Despite the progress marked in adopting or accepting the IASs by other countries, they did not manage to officially gain the status of an international accounting reference;
- The IASC and the American FASB remain only two claimants for becoming international accounting standardization bodies.

1.2 RECENT DEVELOPMENTS

At their beginning, the IASs frequently constituted options dictated by the goal of finding an as good compromise as possible. The existence of these options allowed enterprises find a proper solution according to their insights. On the other hand, the existence of options did not go in the same direction with

the harmonization objective. Under the pressure of regulatory stock-exchange bodies, the IASC undertook the revising of many standards with the purpose to reduce the options.

Passing from the objective of harmonization to the objective of standardization, dictated by further complexity of trading and financial transactions (financial instruments and derivatives), and the goal to be accepted as the only body of international accounting standardization, were the reason why the IASC was reorganised in 2000. So on May 24, 2000, the members of the IASC approved the new constitution in Edinburgh (Scotland).

According to this constitution, the objectives of the Committee are:

- To develop, in the public interest, a single set of high quality, understandable and enforceable global accounting standards that require high quality, transparent and comparable information in financial statements and other financial reporting to help participants in the world's capital markets and other users make economic decisions;
- To promote the use and rigorous application of those standards; and
- To bring about convergence of national accounting standards and International Accounting Standards to high quality solutions.

The accomplishment of these objectives, already oriented to international accounting standardization (and not harmonization), dictated the need to the IASC to closely work with national accounting bodies.

Without analyzing the new constitution, however, it is worth mentioning some names and bodies of this committee:

International Accounting Standards Committee (IASC)

International Accounting Standards Board (IASB). IASB is the body charged with the preparation and adjustment of

standards. The new standards, starting from 2002, will be referred to International Financial Reporting Statement (IFRS), whereas the existing, non-modified standards are referred to as IAS. On May 2002, the IASB published an exposure draft titled "Improvements to International Accounting Standards". It has to do with a proposal to change 12 standards out of 34 existing ones. This is the first proposal in the framework of the "Improvement" project of the IASB, intended to increase the quality and coherence of financial information. These standards are: IAS 1, IAS 2, IAS 8, IAS 10, IAS 16, IAS 17, IAS 21, IAS 23, IAS 27, IAS 28, and IAS 33. Other proposals may be made in the future for revising the IASs.

Standards Advisory Council International, SAC) has the role to advise the IASB on the work program and advantages of discussions in meetings and consultations.

1.3 EUROPEAN UNION ON ADOPTING AND APPLYING THE IASS

The countries of the European Union estimated as necessary the speeding up of the international harmonization process of accounting standards, mainly due to high pressure the international capital markets exercised and the increasing needs of the European multi-national organisations to address to these financing markets to promote their development. On the other hand, the debates and particularly those after 1990 highlighted the difficulties in reaching this international harmonization and presented the process as a long-term one.

Among these difficulties we can mention:

- In most of member states of the European Union, accounting traditions are not expressed or are wrongly expressed at the IAS. The latter ones are openly expressed in the favour of a preference given to investors' interests, on the way the financial information is compiled. The creditors' interests are shifted to the second level and the importance of financial statements comes out

somewhat indirectly in the framework of administrators' accountability.

- IASs do not have to do with the linkage that exists between accounting and taxation, at a time when this issue is of primary importance to most member states.
- IASs do not differentiate between individual financial statements (FS) and consolidated ones. Two separate directives exist in the European Union level and companies are obliged to disclose both types of statements.
- Some of the IASs go beyond the needs of small and medium-sized enterprises. The great deal of information to be presented at the appendix exceeds the information really necessary.

Along with difficulties mentioned earlier, the general assumption was that the European Directives were not any longer sufficient for financial statements of big European enterprises that required acquiring capitals in international markets, particularly in American markets, and the issue on the European accounting directives should not have been left to go so far as to hinder any future development. Given these assumptions and pursuing prudentially the steps undertaken by the IASC itself, under the support and the incentive of interested international bodies, the European Commission took measures that led to the new European strategy for the application of international accounting standards. The new European strategy was initiated on March 2000, but the legal process was completed in the middle of 2002, with the adoption of the "Regulation of the European Union on the Application of International Accounting Standards". The regulation was voted by the European Parliament on 27 May 2002.

Article 1 of the European Regulation defines two main objectives:

- To ensure a high degree of transparency and comparability of financial statements;
- To ensure an efficient functioning of the Community capitals market and of the internal market.

Article 4 of the European Regulation requires that “for each financial year starting on or after 1 January 2005, publicly traded companies of a Member State shall prepare their consolidated accounts in conformity with the international accounting standards (IAS)”.

Concerning other financial statements, the Regulation (Article 5) leaves to the option of each member state to provide the application of the IAS/IFRS, differentiating between:

- The case of individual financial statements of publicly traded companies (companies that are in the area of applying the IAS/IFRS for consolidated financial statements);
- The case of consolidated financial statements and individual financial statements of other non publicly-traded companies.

1.4 ALBANIA ON APPLICATION OF ACCOUNTING STANDARDS

The Law No. 9228, dated 29.04.2004 “On Accounting and Financial Statements”, Article 4 stipulates the accounting standards on compiling financial statements, as follows:

- a. Economic units applying this law, excluding the cases provided in Points 2 and 3 of this Article apply the national accounting standards on financial statement compilation and disclosure. The accounting standards are compiled by the National Council of Accounting and within one month the Ministry of Finances announces them as enforceable.
- b. The Minister of Finance, after considering the opinion of the National Council of Accounting, announces the accounting standards as enforceable to the public economic units that do not have profitable intentions.
- c. Standards compiled by the International Accounting Standards Board translated into Albanian under the responsibility of the National Committee of Accounting,

without changing from the original English version, are made public by the Minister of Finances and their application is mandatory:

- To companies listed in any securities exchange and their subsidiaries, subject to account consolidation;
- To commercial banks, financial institutions similar to banks, insurance and re-insurance companies, securities funds, and all entities licensed to perform investment activity in securities, even when they are not listed in an official securities exchange;
- To other large economic units, not listed in an official securities exchange, when they exceed the limits determined by the Council of Ministers on the annual income and number of employees.

2. CONCEPTUAL FRAMEWORK

2.1 CONCEPTUAL FRAMEWORK AND ITS NEED

Accounting Conceptual framework is a statement of theoretical principles generally accepted, which form a referring financial reporting framework.

These theoretical principles are important because they ensure the bases for the development of new accounting standards and for assessing the existing ones. The financial reporting process is related to the providing of the information useful to the economic decision-making process. Though it has a theoretical nature, a conceptual framework for financial reporting has definitive intentions valuable in practice.

The need to compile a conceptual framework for the preparation of financial statements is evidenced by the risks that may arise if not using it for drafting the accounting regulation. The absence of a conceptual framework would imply that core principles may be repeated more than once in various accounting standards, thus bringing about contradictions and instability in

the core principles, such as those of prudence and compliance. This leads to lack of security and affects the financial reporting concept of “real and accurate”.

2.2 GENERALLY ACCEPTED ACCOUNTING PRINCIPLES (GAAP) AND CONCEPTUAL FRAMEWORK

Definition: GAAP means all the rules, irrespective of their source, which guide the accounting. It may be stated that for a certain country they are composed mainly of:

- National law of companies;
- National accounting standards;
- Domestic stock-exchange requirements.

Without neglecting the three above sources, the GAAP basis for each certain country is larger and also includes other sources, such as:

- International accounting standards;
- Statutory requirements of other countries.

In Great Britain, GAAP refers to accounting practices that are regarded as acceptable by the accounting experts’ profession. Each accounting practice legitimated to circumstances it is applied, should be treated as a GAAP. The decision whether an accounting practice is accepted / legitimated or not would depend on one or more of the following factors:

- Does the practice take into account the accounting standards, the constitution or other official pronouncements?
- Is the practice unchangeable in terms of the users’ needs and the financial reporting objectives?
- Is the practice sufficiently based on accounting literature?
Is the practice applied similarly in other companies?
- Is the practice in compliance with the “real and accurate” core concept”¹

In the USA, the generally accepted accounting (GAAP) principles are defined as the principles that have “important authoritative support”. Therefore, annual accounts and financial statements (FS) prepared in compliance with accounting principles for which no such important authoritative support exists, are assumed to be inappropriate for users’ decision-making. The effect here is that the accounting “new” or “various” principles are not acceptable unless adjusted by the accounting professional conduct, and usually by the drafting bodies of standards and/or by professional accounting bodies. This viewpoint is much stricter than the viewpoint of the Great Britain.

2.3 CONCEPTUAL FRAMEWORK FOR THE PREPARATION OF FINANCIAL STATEMENTS

IASC is charged with the identification of various differences existing in producing the financial statements (FS) and with the harmonization of accounting standards, regulation and procedures on the preparation and disclosure of FS. The conceptual framework of the IASs drafted by the IASC was adopted by the IASCB in April 1989 and was published in June 1989. This framework presents a set of basic accounting concepts and rules, other agreements and core principles, which are intended to assist in the process of compiling and reviewing the accounting standards for the preparation and presentation of financial statements.

Purpose, status, objective, scope

Purpose:

The conceptual framework serves to set out the concepts that underline the preparation and presentation of financial statements for external users. So, it takes into account only the financial statements published and does not regulate or provide concepts and rules for other financial statements, produced by the accounting system for management or other needs.

According to definitions made by the IASC, the purpose of this framework is to:

- Assist the Board of the IASC in reviewing the existing IAS and in developing new IFRSs;
- Assist the Board of IASC in promoting harmonisation of regulations, accounting standards and procedures relating to the presentation of financial statements by providing a basis for reducing the number of alternative accounting treatments permitted by IASs;
- Assist preparers of financial statements in applying IAS;
- Assist auditors in forming an opinion as to whether financial statements conform with IAS;
- Assist users of financial statements in interpreting the information contained in financial statements prepared in conformity with IAS.

Status:

The conceptual framework elaborated and issued by the IASC, though presented and published along with IAS, is not an IAS; therefore it is not a standard to any specific problem on assessment or presentation of elements of disclosed financial statements. Nothing from the treatments of this framework is above any separate IAS. This should be understood in such a way that, in the cases when any conflict arises between the treatment of a problem in IAS with the treatment of the same problem in the conceptual framework, then the requirement and the regulation defined in the IAS shall prevail.

Objective of financial statements:

Financial statements should provide information about the financial position, performance, changes in financial position of an enterprise that is useful to a wide range of users in making economic decisions.

Extension and restructuring:

The conceptual framework deals with:

- The objectives and constituents of financial statements;
- The qualitative characteristics of financial statements;
- The definitions, criteria of recognition and measurement of the elements of financial statements;
- Concepts of capital and capital maintenance.

2.3.1 Objectives and constituents of financial statements

Financial statements (FS) should provide information to meet their users' needs in economic decision-making. The financial statements should provide this information via informing a:

- Financial position;
- Financial performance; and
- Changes in financial position.

According to the conceptual framework, all the constituent parts of financial statements displayed above should be seen interwoven among them, because they reflect various aspects of similar transactions or events. Though each statement provides information which is different from others, none of them should serve as a single purpose or ensure all the necessary information for separate needs of users.

Information on financial position is provided in a balance sheet. A balance sheet statement provides information on the financial position of an entity, which is impacted by:

- Economic assets it controls;
- Its financial structure;
- Liquidity and solvency;
- Its ability to adjust to changes of the environment where it operates.

Financial performance is presented in the Income Statement. Information about the performance of an entity, and particularly its abilities for profits are required with the intention to estimate possible changes in economic reserves it is able to control in the future.

Changes in financial position are presented in the Cash Flow Statement. Information on the changes in financial position of an enterprise is useful with the purpose to evaluate its investing, financing and operational activity during the reporting period.

2.3.2 Underlying assumptions and qualitative characteristics of financial statements

Underlying assumptions

In the conceptual framework, the rules to be taken into account for producing financial statements to meet the requirements and needs of their users are presented in the form of two underlying assumptions for producing financial statements and four essential qualities the information obtained from annual financial statements should meet. The two following underlying assumptions are frequently referred to as core principles:

a. Accrual basis

According to this assumption, the effects of transactions and other events are simply recognized at the point when they occur (and not when money or its equivalent is paid) and are matched to the period in the financial statements to which they relate.

So the conceptual framework does not cover the rules and principles of building the financial statements, set up on monetary basis, but only those set up on accrual basis.

b. Going concern

According to the conceptual framework, financial statements are normally prepared on the assumption that the enterprise is a going concern and is likely to operate for the foreseeable future. The framework does not define the duration of the period of "foreseeable income". It is defined in the IAS 1, according to which the optimal period is 12 months following the date of compiling the financial statement.

According to this assumption, the enterprise has neither the intention nor the need to liquidate or curtail materially the scale of its operations.

Qualitative characteristics of financial statements

In the conceptual framework of IAS, four fundamental qualitative characteristics are defined: Understandability, relevance, reliability, and comparability.

A brief description of these characteristics is given below:

- a. **Understandability:** According to this quality, the financial information should be readily understandable by user. This depends not only on the simple and understandable presentation of information but also on the user's abilities, knowledge of business and economic activities and accounting and a willingness to study the information with reasonable diligence. However, information about complex matters that should be included in the financial statements because of its relevance to the economic decision-making needs of users should not be excluded merely on the grounds that it may be too difficult for certain users to understand.
- b. **Relevance:** Information possesses the attribute of relevance when it influences the economic decisions of users by helping them evaluate past, present and future events. The relevance of information is affected by its nature. For example, exposure of new segments of production may affect the assessment of risks. But relevance of information frequently depends not only on its nature but also on the degree of its materiality. According to the conceptual framework, information is material if its omissions or misstatement could influence the economic decisions of users taken on the basis of the financial statements.
- c. **Reliability:** The financial information is reliable when it is free from error and bias of the preparers. Information reliability, as its qualitative characteristic, depends on the application of the following principles:
 - Faithful Representation;
 - Substance over form;

- Neutrality (free from bias);
- Prudence;
- Completeness.

Without underestimating the above principles, prudence is very important. According to the conceptual framework, the application of prudence in compiling the financial statements does not allow the creation of hidden reserves or excessive provisions, understatement of assets or income, or overstatement of liabilities or expenses.

- d. **Comparability:** Information of financial statements should provide to the users the ability to compare it through time. This serves them to identify trends in its financial position and performance. The comparability is related to the sustainability of the employment of accounting methods and policies in compiling the financial statements from period to period and by different enterprises, provided it gives appropriate explanations in relation to new policies and approaches used and to the effect they have caused on financial statements. For ensuring the comparability of information, it is necessary for an entity to include in the annexes of the financial statements, the accounting policies employed in the preparation of the financial statements.

2.3.3 Definitions, recognition criteria and estimation of elements of the financial statements

Recognition criteria and definitions

Definitions	Recognition criteria
Assets	
An asset is: <ul style="list-style-type: none"> • a resource controlled by the entity; • as a result of past events; • from which future economic benefits are expected to flow to the enterprise. 	An asset is recognised in the balance sheet when it satisfies the criteria: <ul style="list-style-type: none"> • when the future economic benefit will flow to the enterprise; • when the asset has a cost or value that can be measured reliably.
Liabilities	

<p>A liability is:</p> <ul style="list-style-type: none"> • a present obligation of the enterprise; • as a result of past events; • the settlement of which is expected to result in an outflow from the enterprise of the resources embodying economic benefits. 	<p>A liability is recognised in the balance sheet when it satisfies the criteria:</p> <ul style="list-style-type: none"> • when the outflow of resources embodying economic benefits will result from the settlement of a present obligation; • the amount at which the settlement will take place can be measured reliably.
<p>Equity</p> <p>Equity is the residual interest in the assets of the entity after deducting all its liabilities.</p>	
<p>Assets - Liabilities</p>	
<p>Revenues</p>	
<p>Income is:</p> <ul style="list-style-type: none"> • increases in economic benefits during the accounting period in the form of: • inflows; • enhancement of assets; or • decreases of liabilities. 	<p>Income is recognised in the income statement when:</p> <ul style="list-style-type: none"> • an increase in future economic benefits related to an increase in an asset or decrease of a liability has arisen; • This increase in the economic benefit can be measured reliably.
<p>Expenses</p>	
<p>Expenses are:</p> <ul style="list-style-type: none"> • decreases in economic benefits during the accounting period in the form of: • outflows; • depletion of assets; or • incurrence of liabilities. 	<p>Expenses are recognised in the expenditure statement when:</p> <ul style="list-style-type: none"> • a decrease in future economic benefits related to a decrease in an asset or an increase of a liability has arisen; • This decrease in the economic benefits can be measured reliably.

Measurement of the elements of financial statements

The conceptual framework has defined that measurement is the process of determining the monetary amounts at which the elements of the financial statements are to be recognised and carried in the balance sheet and income statement.

Measurement bases defined in the conceptual framework are:

- a. Historical cost. Assets are recorded at the amount of cash or cash equivalents paid or the fair value of the consideration given to acquire them at the time of their acquisition. Liabilities are recorded at the amount of proceeds received in exchange for the obligation, or in some circumstances (for example, income taxes), at the amounts of cash or cash equivalents expected to be paid to satisfy the liability in the normal course of business.
- b. Current cost. Assets are carried in the balance sheet at the amount of cash or cash equivalents that would have

to be paid if the same or an equivalent asset was acquired currently. Liabilities are carried in the balance sheet at the undiscounted amount of cash or cash equivalents that would be required to settle the obligation currently.

- c. Realisable (settlement value). This method requires that assets are carried at the amount of cash or cash equivalents that could currently be obtained by selling the asset in an orderly disposal. Liabilities are carried at their settlement values; that is, the undiscounted amounts of cash or cash equivalents expected to be paid to satisfy the liabilities in the normal course of business.
- d. Present value. According to this method, assets are carried at the present discounted value of the future net cash inflows that the item is expected to generate in the normal course of business. Liabilities are carried at the present discounted value of the future net cash outflows that are expected to be required to settle the liabilities in the normal course of business.

2.3.4 Concepts of capital and capital maintenance

The framework focuses on two concepts of capital:

- Financial concept of capital,
- Physical concept of capital.

Financial concept of capital, such as invested money or invested purchasing power is synonymous with the net assets or equity of the enterprise. This concept is used by most of entities in the process of preparation of financial statements.

Physical concept of capital, such as operating capability is regarded as the productive capacity of the enterprise based on, for example, units of output per day.

Physical capital maintenance is concerned with how an enterprise defines the capital that it seeks to maintain. It provides the linkage between the concepts of capital and the concepts of profit because it provides the point of reference by which profit is measured; it is

a prerequisite for distinguishing between an enterprise's return on capital and its return of capital; only inflows of assets in excess of amounts needed to maintain capital may be regarded as profit and therefore as a return on capital. Hence, profit is the residual amount that remains after expenses have been deducted from income.

Capital maintenance concept requires the adoption of the current cost basis of measurement. The financial capital maintenance concept, however, does not require the use of a particular basis of measurement.

Under the concept of financial capital maintenance where capital is defined in terms of nominal monetary units, profit represents the increase in nominal money capital over the period. Thus, increases in the prices of assets held over the period, conventionally referred to as holding gains, are, conceptually, profits. They may not be recognised as such, however, until the assets are disposed of in an exchange transaction.

Under the concept of physical capital maintenance when capital is defined in terms of the physical productive capacity, profit represents the increase in that capital over the period. All price changes affecting the assets and liabilities of the enterprise are viewed as changes in the measurement of the physical productive capacity of the enterprise; hence, they are treated as capital maintenance adjustments that are part of equity and not as profit. The selection of the measurement bases and concept of capital maintenance will determine the accounting model used in the preparation of the financial statements. Different accounting models exhibit different degrees of relevance and reliability and, as in other areas, management must seek a balance between relevance and reliability.

3. IFRS 1: "FIRST TIME ADOPTION OF INTERNATIONAL FINANCIAL REPORTING STANDARDS"

Objective

IFRS 1, First-time Adoption of International Financial Reporting

Standards, sets out the procedures that an entity must follow when it adopts IFRSs for the first time as the basis for preparing financial statements.

Definition of first-time adoption

A first-time adopter is an entity that, for the first time, makes an explicit and unreserved statement that financial statements comply with IFRSs.

An entity may be a first-time adopter if, in the preceding year, it prepared IFRS financial statements for internal management use, as long as those IFRS financial statements were not given to owners or external parties such as investors or creditors. If a set of IFRS financial statements was, for any reason, given to an external party in the preceding year, then the entity will already be considered to be on IFRSs, and IFRS 1 does not apply.

An entity can also be a first-time adopter if, in the preceding year, its published financial statements asserted:

- Compliance with some but not all IFRSs.
- Included only a reconciliation of selected figures from previous GAAP to IFRSs. (Previous GAAP means the GAAP that an entity followed immediately before adopting to IFRSs.)

However, an entity is not a first-time adopter if, in the preceding year, its published financial statements asserted:

- Compliance with IFRSs even if the auditor's report contained a qualification with respect to conformity with IFRSs.
- Compliance with both previous GAAP and IFRSs.

Effective date of IFRS 1

IFRS 1 applies if an entity's first IFRS financial statements are for a period beginning on or after 1 January 2004. Earlier application is also recommended.

Overview for an entity that adopts IFRSs for the first time in its annual financial statements for the year ended 31 December 2005.

1. Accounting policies. Select its accounting policies based on IFRSs in force at 31 December 2005. (The draft that preceded IFRS 1 had proposed that an entity could use the IFRSs that were in force during prior periods, as if the entity had always used IFRS. That option is not included in the final standard.)
2. IFRS reporting periods. Prepare at least 2005 and 2004 financial statements and restate retrospectively the opening balance sheet (beginning of the first period for which full comparative financial statements are presented) by applying the IFRSs in force at 31 December 2005.
 - a. Since IAS 1 requires that at least one year of comparative prior period financial information be presented, the opening balance sheet will be 1 January 2004 if not earlier.
 - b. If a 31 December 2005 adopter reports selected financial data (but not full financial statements) on an IFRS basis for periods prior to 2004, in addition to full financial statements for 2004 and 2005, that does not change the fact that its opening IFRS balance sheet is as of 1 January 2004.

Adjustments required to move from previous GAAP to IFRSs at the time of first-time adoption

1. Derecognition of some old assets and liabilities. The entity should eliminate previous-GAAP assets and liabilities from the opening balance sheet if they do not qualify for recognition under IFRSs. For example:
 - a. IAS 38 does not permit recognition of expenditure on any of the following as an intangible asset:
 - research
 - start-up, pre-operating, and pre-opening costs
 - training

- advertising and promotion
- moving and relocation

If the entity's previous GAAP had recognised these as assets, they are eliminated in the opening IFRS balance sheet.

- b. If the entity's previous GAAP had allowed accrual of liabilities for "general reserves", restructurings, future operating losses, or major overhauls that do not meet the conditions for recognition as a provision under IAS 37, these are eliminated in the opening IFRS balance sheet.
 - c. If the entity's previous GAAP had allowed recognition of reimbursements and contingent assets that are not certain, these are eliminated in the opening IFRS balance sheet.
2. Recognition of some new assets and liabilities. Conversely, the entity should recognise all assets and liabilities that are required to be recognised by IFRS even if they were never recognised under previous GAAP. For example:
 - a. IAS 39 requires recognition of all derivative financial assets and liabilities, including embedded derivatives. These were not recognised under many local GAAPs.
 - b. IAS 19 requires an employer to recognise its liabilities under defined benefit plans. These are not just pension liabilities but also obligations for medical and life insurance, vacations, termination benefits, and deferred compensation. In the case of "over-funded" plans, this would be a defined benefit asset.
 - c. IAS 37 requires recognition of provisions as liabilities. Examples could include an entity's obligations for restructurings, onerous contracts, decommissioning, remediation, site restoration, warranties, guarantees, and litigation.
 - d. Deferred tax assets and liabilities would be recognised in conformity with IAS 12.
 3. Reclassification. The entity should reclassify previous-

GAAP opening balance sheet items into the appropriate IFRS classification. Examples:

- a. IAS 10 does not permit classifying dividends declared or proposed after the balance sheet date as a liability at the balance sheet date. In the opening IFRS balance sheet these would be reclassified as a component of retained earnings.
 - b. If the entity's previous GAAP had allowed treasury stock (an entity's own shares that it had purchased) to be reported as an asset, it would be reclassified as a component of equity under IFRS.
 - c. Items classified as intangible assets in a business combination accounted for under the previous GAAP may be required to be classified as goodwill under IAS 22 because they do not meet the definition of an intangible asset under IAS 38. The converse may also be true in some cases. These items must be reclassified.
 - d. IAS 32 has principles for classifying items as financial liabilities or equity. Thus mandatory redeemable preferred shares and puttable shares that may have been classified as equity under previous GAAP would be reclassified as liabilities in the opening IFRS balance sheet.
- Note that IFRS 1 makes an exception from the "split-accounting" provisions of IAS 32. If the liability component of a compound financial instrument is no longer outstanding at the date of the opening IFRS balance sheet, the entity is not required to reclassify out of retained earnings and into other equity the original equity component of the compound instrument.
- e. The reclassification principle would apply for the purpose of defining reportable segments under IAS 14.
 - f. The scope of consolidation might change depending on the consistency of the previous-GAAP requirements to those in IAS 27. In some cases, IFRS will require consolidated financial statements where they were not required before.
 - g. Some offsetting (netting) of assets and liabilities or of

income and expense items that had been acceptable under previous GAAP may no longer be acceptable under IFRS.

4. Measurement. The general measurement principle – there are several significant exceptions noted below – is to apply IFRS in measuring all recognised assets and liabilities. Therefore, if an entity adopts IFRS for the first time in its annual financial statements for the year ended 31 December 2005, in general it would use the measurement principles in IFRSs in force at 31 December 2005.
5. Adjustments required to move from previous GAAP to IFRS at the time of first-time adoption. These should be recognised directly in retained earnings or other appropriate category of equity at the date of transition to IFRSs.

How to recognise adjustments required to move from previous GAAP to IFRSs?

Adjustments required to move from previous GAAP to IFRSs at the time of first-time adoption should be recognised directly in retained earnings or, if appropriate, another category of equity at the date of transition to IFRSs.

Exceptions to the basic measurement principle in IFRS 1

1. Optional exceptions. There are some important exceptions to the general restatement and measurement principles set out above. The following exceptions are individually optional, not mandatory:

Business combinations that occurred before opening balance sheet date

- a. An entity may keep the original previous-GAAP accounting, that is, not restate:
 - previous mergers or goodwill written-off from reserves;
 - the carrying amounts of assets and liabilities recognised

- at the date of acquisition or merger;
 - how goodwill was initially determined.
- b. IFRS 1 includes an appendix explaining how a first-time adopter should account for business combinations that occurred prior to transition to IFRS.
 - c. However, should it wish to do so, an entity can elect to restate all business combinations starting from a date it selects prior to the opening balance sheet date.
 - d. In all cases, the entity must make an initial IAS 36 impairment test of any remaining goodwill in the opening IFRS balance sheet, after reclassifying, as appropriate, previous GAAP intangibles to goodwill.

Property, plant, and equipment, intangible assets, and investment property carried under the cost model

- a. These assets may be measured at their fair value at the opening IFRS balance sheet date (this option applies to intangible assets only if an active market exists). Fair value becomes the “deemed cost” going forward under the IFRS cost model. (Deemed cost is an amount used as a surrogate for cost or depreciated cost at a given date.)
- b. If, before the date of its first IFRS balance sheet, the entity had revalued any of these assets under its previous GAAP either to fair value or to a price-index-adjusted cost, that previous-GAAP revalued amount at the date of the revaluation can become the deemed cost of the asset under IFRS.
- c. If, before the date of its first IFRS balance sheet, the entity had made a one-time revaluation of assets or liabilities to fair value because of a privatisation or initial public offering, and the revalued amount became deemed cost under the previous GAAP, that amount (adjusted for any subsequent depreciation, amortisation, and impairment) would continue to be deemed cost after the initial adoption of IFRS.

IAS 19 - Employee benefits: actuarial gains and losses

An entity may elect to recognise all cumulative actuarial gains and losses for all defined benefit plans at the opening IFRS balance sheet date (that is, reset any corridor recognised under previous GAAP to zero), even if it elects to use the IAS 19 corridor approach for actuarial gains and losses that arise after first-time adoption of IFRS. If an entity does not elect to apply this exemption, it must restate all defined benefit plans under IAS 19 since the inception of those plans (which may differ from the effective date of IAS 19).

IAS 21 - Accumulated translation reserves

An entity may elect to recognise all translation adjustments arising on the translation of the financial statements of foreign entities in accumulated profits or losses at the opening IFRS balance sheet date (that is, reset the translation reserve included in equity under previous GAAP to zero). If the entity elects this exemption, the gain or loss on subsequent disposal of the foreign entity will be adjusted only by those accumulated translation adjustments arising after the opening IFRS balance sheet date. If the entity does not elect to apply this exemption, it must restate the translation reserve for all foreign entities since they were acquired or created.

2. Mandatory exceptions. There are also three important exceptions to the general restatement and measurement principles set out above that are mandatory, not optional. These are:

IAS 39 - Derecognition of financial instruments

A first-time adopter is not permitted to recognise financial assets or financial liabilities that had been derecognised under its previous GAAP in a financial year beginning before 1 January 2001 (the effective date of IAS 39). This is consistent with the transition provision in IAS 39.172(a).

IAS 39 - Hedge accounting

The conditions in IAS 39.122-152 for a hedging relationship that qualifies for hedge accounting are applied as of the opening IFRS balance sheet date. The hedge accounting practices, if any, that were used in periods prior to the opening IFRS balance sheet may not be retrospectively changed. This is consistent with the transition provision in IAS 39.172(b). Some adjustments may be needed to take account of the existing hedging relationships under previous GAAP at the opening balance sheet date.

Information to be used in preparing IFRS estimates retrospectively

In preparing IFRS estimates retrospectively, the entity must use the inputs and assumptions that had been used to determine previous GAAP estimates in periods before the date of transition to IFRS, provided that those inputs and assumptions are consistent with IFRS. The entity is not permitted to use information that became available only after the previous-GAAP estimates were made except to correct an error.

Changes to disclosures

For many entities, new areas of disclosure will be added that were not requirements under the previous GAAP (perhaps segment information, earnings per share, discontinuing operations, contingencies, and fair values of all financial instruments) and disclosures that had been required under previous GAAP will be broadened (perhaps related party disclosures).

Disclosure of selected financial data for periods before the first IFRS balance sheet

IAS 1 only requires one year of full comparative financial statements. If a first-time adopter wants to disclose selected financial information for periods before the date of the opening IFRS balance sheet, it is not required to conform that information to IFRS. Conforming that earlier selected financial information to IFRSs is optional.

If the entity elects to present the earlier selected financial information based on its previous GAAP rather than IFRS, it must prominently label that earlier information as not complying with IFRS and, further, it must disclose the nature of the main adjustments that would make that information comply with IFRS. This latter disclosure is narrative and not necessarily quantified.

Of course, if the entity elects to present more than one year of full comparative prior period financial statements at the time of its transition to IFRSs, that will change the date of the opening IFRS balance sheet.

Disclosures in the financial statements of a first-time adopter

IFRS 1 requires disclosures that explain how the transition from previous GAAP to IFRS affected the entity's reported financial position, financial performance, and cash flows. This includes:

1. Reconciliations of equity reported under previous GAAP to equity under IFRS both (a) at the date of the opening IFRS balance sheet and (b) the end of the last annual period reported under the previous GAAP. For an entity adopting IFRSs for the first time in its 31 December 2005 financial statements, the reconciliations would be as of 1 January 2004 and 31 December 2004.
2. Reconciliations of profit or loss for the last annual period reported under the previous GAAP to profit or loss under IFRSs for the same period.
3. Explanation of material adjustments that were made, in adopting IFRSs for the first time, to the balance sheet, income statement, and cash flow statement.
4. If errors in previous-GAAP financial statements were discovered in the course of transition to IFRSs, those must be separately disclosed.

Disclosure of an impending change to IFRS

If an entity is going to adopt IFRS for the first time in its annual financial statements for the year ended 31 December

2005, certain disclosures are required in its interim financial statements prior to the 31 December 2005 statements, but only those interim financial statements purport to comply with IAS 34. Explanatory information and a reconciliation are required in the interim report that immediately precedes the first set of IFRS annual financial statements. The information includes changes in accounting policies compared to those under previous GAAP.

Compliance in interim reports in the year of first-time adoption of IFRS

If an entity that adopts IFRS for the first time in its annual financial statements for the year ended 31 December 2005, it is required to apply IFRS 1 in its interim financial reports for periods within the year ended 31 December 2005 if those interim reports are described as conforming to International Financial Reporting Standards. It would not be required to apply IFRS 1 if those interim reports are described as conforming to previous GAAP.

Different IFRS adoption dates of investor and investee

A parent or investor may become a first-time adopter earlier than or later than its subsidiary, associate, or joint venture investee. In these cases, IFRS 1 is applied as follows:

1. If the subsidiary has adopted IFRSs in its entity-only financial statements before the group to which it belongs adopts IFRS for the consolidated financial statements, then the subsidiary's first-time adoption date is still the date at which it adopted IFRS for the first-time, not that of the group. However, the group must use the IFRS measurements of assets and liabilities.
2. If the group adopts IFRSs before the subsidiary adopts IFRSs in its financial statements, then the subsidiary has an option either (a) to elect that the group date of IFRS adoption is its transition date or (b) to first-time adopt in its IFRS financial statements.
3. If the group adopts IFRSs before the parent adopts IFRSs in its financial statements, then the parent's first-time

adoption date is the date at which the group adopted IFRSs for the first time.

4. If the group adopts IFRSs before its associate or joint venture adopts IFRSs in its financial statements, then the associate or joint venture should have the option to elect that either the group date of IFRS adoption is its transition date or to first-time adopt in its entity-only financial statements.

The application of international financial reporting standards (referred to as IAS/IFRS) in the banking system dictate the need that banks should set up, adopt and apply certain policies which will orient them to adjustments to these changes. These policies should be associated with written procedures on how the bank and its personnel will be acquainted with these developments, which structures will evidence the necessary changes to be carried out, how will such changes be effected, at what time frame and which are the problems that may come out, which structures will monitor this process, etc. We consider of importance the fact that banks should pass to the application of these standards, only after having assessed and made the best of advantages offered by these developments and after having taken necessary measures for minimising possible disadvantages.

It is important that together with banks and other financial institutions, all other institutions of the country, which play a role in practical application of standards mentioned earlier, have an explicit strategy on how they are going to carry out this role and their objectives. Besides the Bank of Albania, the Ministry of Finance, National Council of Accounting, Institute of Chartered Accountants, and most important companies in these area, are also included in these institutions. In this framework, it is necessary to institutionalise a joint negotiating process, where institutions can discuss about their problems while applying these standards, so that problems are understood and the attitude for sorting them out is harmonised and steady over the course of time.

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¹ Taken from UK GAAP, Davies, Paterson & Wilson, Ernst & Young.

Foreign Direct Investment. Methodological notes

Argita Frashëri
Anjeza Hobdari
March 2006

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developing countries: The case of Albania

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FOREIGN DIRECT INVESTMENT. METHODOLOGICAL NOTES

*Argita Frashëri**
Anjeza Hobdari

Key words

- Foreign Direct Investment - Transaction - International Investment Position -

ABSTRACT

The perception of the importance of Foreign Direct Investment (FDI) as a mean for the promotion of investments highlights the need for accurate measurement and detailed statistics of the FDI for the assessment of their relation to the economic growth and their impact over various economic sectors. Through a comprehensive theoretical framework, this paper provides the concepts and definitions of the FDI, the components, the forms it is introduced with, and the sources and methods of collecting information.

This paper shall also consider the institutional mechanisms with regard to the reporting of data, which are essential to guaranteeing the quality of data. A few issues in the measurement have also been summarized.

The measurement and record of FDI in our country have been and still remain a challenge in attaining the contemporary levels of the developed countries for the provision of qualitative and comparable statistics.

LIST OF ACRONYMS AND ABBREVIATIONS

<i>FDI</i>	<i>Foreign Direct Investment</i>
<i>OECD</i>	<i>Organisation for Economic Cooperation and Development</i>
<i>IMF</i>	<i>International Monetary Fund</i>
<i>IIP</i>	<i>International Investment Position</i>
<i>BOP</i>	<i>Balance of Payments</i>
<i>FCS</i>	<i>Fully Consolidated System</i>
<i>M&A</i>	<i>Mergers and Acquisitions</i>
<i>SPE</i>	<i>Special Purpose Entities</i>
<i>ITRS</i>	<i>International Transactions Reporting System</i>
<i>BoA</i>	<i>Bank of Albania</i>

1 INTRODUCTION

The role of Foreign Direct Investment (FDI) in the economic development of a country has been debated at length and accompanied by pros and cons opinions. Several countries have welcomed the FDI as a fundamental contribution to the development processes and the facilitation of accessing the world economy, assessing it in a wide context of strategic reforms for economic restructuring and growth.

Empirical studies acknowledge the role of the FDI in the economic growth and development of host countries, in particular of developing countries. During the last decade, the flow of foreign direct investment has played a significant role in increasing the productivity, employment and exports of transition economies.

Foreign Direct Investments have been considered to the advantage of the economy in general even in the context of transition economies towards a market economy, economic integration and globalization, enlargement of capital international flows, free movement of individuals, goods, services and technologies.

Many positive effects are ascribed to these particular capital transfers that apparently set them apart from other types of

private capital flows. The import of improved management techniques and of more advanced technologies as well as the related easier access to international financial markets are among the commonly cited advantages associated with foreign direct investments. FDI is also inclined to be relatively a stable long-term engagement to the benefit of the foreign company. All these together have significant benefits for the recipient countries in terms of economic growth and reduced external vulnerability. Under these conditions, the high current deficits are more sustainable when mostly financed by FDI instead of bank borrowing or portfolio investments, considered as highly volatile.

FDI is also a crucial indicator for Albania's integration into the global division of labour and the general growth level. However, the analyses of the integration process require harmonized procedures to compile and disseminate FDI data.

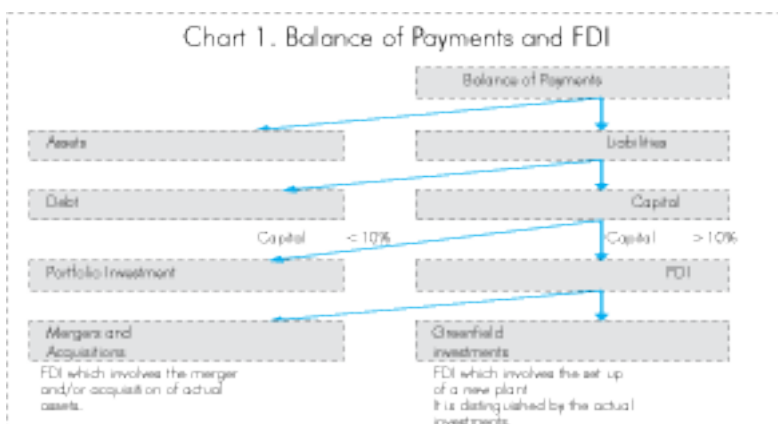
Apart from the advantage of compiling an institutional framework for the promotion of foreign investments in Albania, their accurate measurement is a necessity of time.

According to international standards, FDI is estimated for the stock and capital flows they bring to the economy. While the stock provides information on the degree of the presence of a company or a country in a foreign company, FDI flow is used for the assessment of the balance of payments sustainability.

Foreign Direct Investment from the viewpoint of the Balance of Payments and the International Investment Position share the same conceptual framework given by the International Monetary Fund. In this context, the Balance of Payments is a statistical statement, which systematically summarises, for a specific time span, the economic transactions of an economy with the rest of the world (transactions between residents and non-residents) and the International Investment Position compiles for a specific date, such as the end of a year, the value of the stock of each financial asset and liability as defined in the standard components of the Balance of Payments.

Below, there is an overview of the balance of payments in a macroeconomic level. FDI is under the category of liabilities, since it represents the foreign ownership in the company control, in a given country. FDI is generally more stable compared to the bank borrowing or portfolio investments abroad.

This paper has been organised as follows: sections 2, 3 and 4 provide an overview of definitions, concepts and recommendations adopted by the IMF (Balance of Payments Manual – Fifth Edition) and by the OECD – “Benchmark Definition of Foreign Direct Investment (1996)” on Foreign Direct Investment. They both provide an operational guidance and detailed international standards for recording flows and stocks related to the FDI. Section 5 treats and describes the forms of direct investment, which are encountered more frequently and specific cases, which require the meeting of some conditions in order to be classified as FDI. The identification and recognition of FDI forms are important for the compilation of statistics of foreign direct investments in accordance with the standards. Section 6 describes different modes of data collection for the FDI statistics. The selection of different modes for the provision of information is critical for the degree of accuracy of FDI statistics and the application of international standards.



2 WHAT IS FOREIGN DIRECT INVESTMENT?

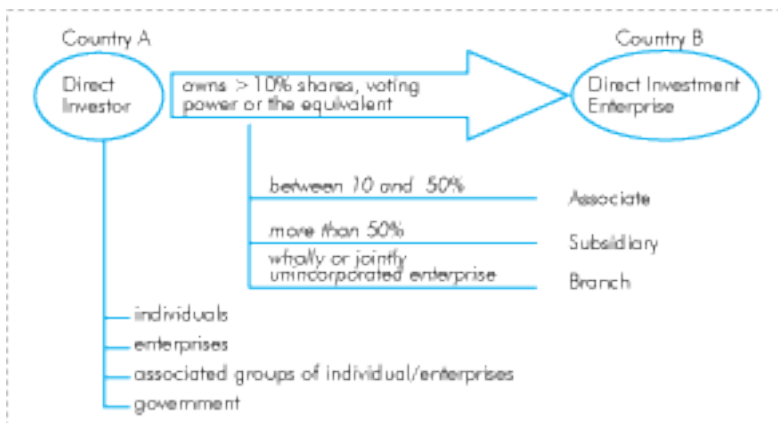
FDI concept has undergone changes through the years. Historically, a threshold in equity and the idea that the investor plans to display control influence on the company have been closely related to the concept of the FDI.

In order to harmonise the distinctions in the FDI concepts, the OECD and the IMF have developed a common definition: "... foreign direct investment reflects the aim of obtaining a lasting interest by a resident entity of one economy (direct investor) in an enterprise that is resident in another economy (the direct investment enterprise)". The "lasting interest" implies the existence of a long-term relationship between the direct investor and the direct investment enterprise and a significant degree of influence on the management of the latter (OECD 1999, appendix IV, pg 88).

The above definition does not specify what a lasting interest really constitutes in itself. However, the latter is pointed out in the application of the OECD recommendations. The OECD recommends "...an effective voice in the management, as evidenced by an ownership of at least 10%, implies that the direct investor is able to influence or participate in the management of an enterprise; it does not require absolute control by the foreign investor¹..." Pursuant to this, the settlements which do not bear an ownership of at least 10%, but which permit the exercise of control (such as, sub-contracts, licences and exclusiveness) are not included in the definition developed by the OECD and the IMF.

Direct investment involves both the initial transaction establishing the relationship between the investor and the enterprise, and all subsequent capital transactions between them and among affiliated enterprises, despite the legal form they have been enrolled in – as juridical persons or natural persons. It should be noted that capital transactions which do not give rise to any settlement, for example an interchange of shares among affiliated companies, may also be recorded in the BOP and in the IIP.

The Fifth Edition of the IMF’s Balance of Payments Manual defines the owner of 10% or more of a company’s capital as a direct investor. The IMF recommends using this percentage as the basic dividing line between direct investment and portfolio investment in the form of shareholdings. Thus, when a non-resident who previously had no equity in a resident enterprise purchases 10% or more of the shares of that enterprise from a resident, the price of equity holdings acquired should be recorded as direct investment. From this moment, any further capital transactions between these two companies should be recorded as a direct investment. When a non-resident holds less than 10% of the shares of an enterprise as portfolio investment, and subsequently acquires additional shares resulting in a direct investment (10% or more), only the purchase of additional shares is recorded as direct investment in the Balance of Payments. The holdings that were acquired previously should not be reclassified from portfolio to direct investment in the Balance of Payments but the total holdings should be reclassified in the International Investment Position.



Concerning the terms “direct investor” and “direct investment enterprise”, the IMF and the OECD define them as follows: A direct investor may be an individual, juridical person², natural person³, a public enterprise, a government, a group of related individuals, or a group of juridical persons and/or natural persons, that have a direct investment enterprise, operating in a country other than the country of residence of the direct investor.

A direct investment enterprise is a juridical person or natural person in which a foreign investor owns 10% or more of the ordinary shares or voting power of an incorporated enterprise or the equivalent of an unincorporated enterprise.

Direct investment enterprises may be subsidiaries⁴, associates or branches. A subsidiary is an incorporated enterprise in which the foreign investor controls directly or indirectly (through another subsidiary), more than 50% of the shareholders' voting power. An associate is an enterprise where the direct investor and its subsidiaries control between 10-50% of the voting shares. A branch (controlled associations) is a wholly or jointly owned unincorporated enterprise.

It should be noted that the choice between setting up either a subsidiary/associate or a branch in a foreign country is dependent, among other factors, upon the existing regulations in the host country (and sometimes in the home country, too).

Box 1. Foreign Direct Investment in the Albanian legislation

Based on the Albanian legal framework, direct investment enterprises may be the juridical persons (Law no. 7638, date 19.11.1992 "On Commercial Companies") and the natural persons (Article 2 of the Law no. 7632, date 4.11.1992 "On provisions which regulate the first part of the commercial code").

Juridical persons are in the form as defined in Article 2 of the Law no. 7638, date 19.11.1992 "On Commercial Companies": collective companies, commandite companies, limited liability companies and anonymous companies, which have a juridical personality upon their registration in the court.

The simple company may be considered another form of these enterprises, as defined by Article 1074 and on of the Civil Code. According to Article 1075 of the Civil Code, a company is simple when it does not have the distinctive characteristics of the commercial company, regulated in the aforementioned Law no. 7638. The principal distinction between them is that despite its denomination as "company", it does

not constitute a juridical personality since there is a contract upon which two or more people agree to exercise an economic activity, aiming at sharing profit deriving from such an activity.

The forms of holding the shares in the case of commercial companies are the subsidiaries (Article 217), associates (Article 218) and controlled companies.

According to the Law "On Commercial Companies", Foreign Direct Investment in these companies may be carried out:

- by participation in the equity capital upon the creation of the company;*
- by transfer of shares of the equity capital pursuant to the requirements of this Law in the case of each form of commercial companies (for example, Articles 23, 33, 45, 47 etc.);*
- by the increase in capital;*
- in cases of merger or demerger (Article 243 and on).*

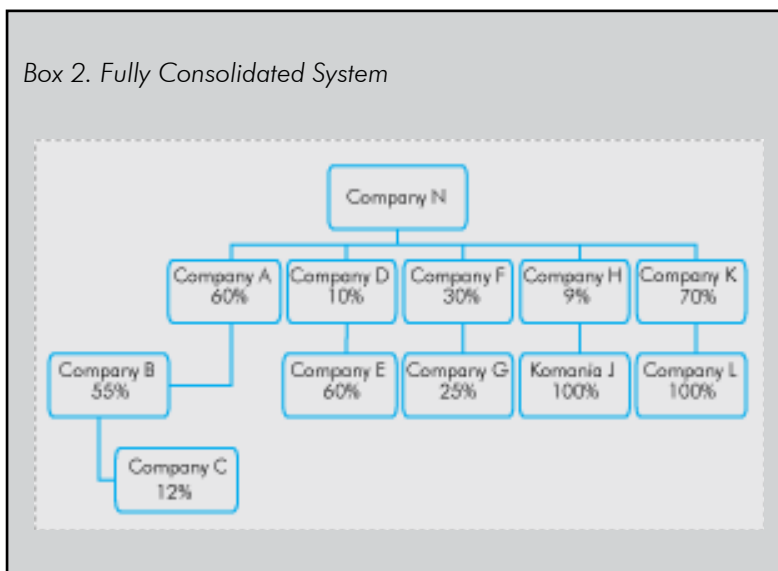
Base on Article 1076, in the case of simple companies, direct investment may be carried out when the contract provides that its members shall contribute unequally with money, objects or services (Article 1074).

In the case of the purchase and sale of land by Albanian residents, according to the Albanian legislation and in the context of the abovementioned direct investment, foreign natural or juridical persons who carry or have carried investment in the territory of the Republic of Albania, pursuant to the Law no. 7764, date 2.11.1993 "On foreign investment", have the right to purchase land for investment, state-owned or private-owned property, or the land of carried or in process investment. Foreign natural or juridical persons have the right to purchase land after they have carried the investment according to the construction permit, in a value not less than three times the land value, as defined by the Council of Ministers (Article 5 of the Law no. 7980 date 27.07.1995 "On the Purchase and Sale of Land").

After becoming land owners according to the above terms, there is the ownership transfer to a notional resident unit. As a result, the foreign (non-resident) natural or juridical person has a financial investment in this resident unit (except for the investment carried on the land), which is assumed to be a direct investment enterprise.

It should be mentioned that in the case of affiliated banks (depository institutions) and affiliated financial intermediaries, such as security dealers, transactions recorded under direct investment are those associated with permanent debt (loan capital representing a permanent interest) and equity (share capital) investment or, in the case of branches, fixed assets. Deposits, loans and other claims and liabilities related to usual banking transactions of depository institutions and of other financial intermediaries are classified, as appropriate, under “portfolio investment” or “other investment”, but never as direct investment. The stock of foreign assets and liabilities of banks and other financial liabilities should be treated in a parallel manner.

The OECD recommends that for the existence of a direct investment relationship the “fully consolidated system” should be applied (see the box below). In other words, it implies the establishment of relationships in the case of cascade participation. Thus, direct investment enterprises, which are in a direct investment relationship with a direct investor, also enjoy such a relationship with each other (box 2). This criterion does not correspond with the consolidation concept in the accounting statement.



Fully Consolidated System (FCS) includes the following:

- Branches.
- Subsidiaries (more than 50% directly owned by the direct investor) for example, A and K.
- Associates (10% - 50% directly owned by the direct investor) for example, D and F.
- Subsidiaries of subsidiaries, for example, B and L.
- Subsidiaries of associates, for example E.
- Associates of subsidiaries, for example C.

In the above scheme, enterprises A, B, C, D, E, F, K and L are all involved in a direct investment relationship with enterprise N – even though, for example, company N owns indirectly only 4% of company C.

FCS excludes the following:

- Enterprises in which the direct investor owns less than 10%, for example H.
- Subsidiaries of those enterprises in which the direct investor owns less than 10%, for example J.
- Associates of associates of the direct investor, for example G.

In the following example:

- Enterprises H and J are not in a direct investment relationship with enterprise N, because enterprise N owns less than 10% of enterprise H.
- Enterprise G is not in a direct investment relationship with enterprise N, because enterprise G is an associate of an associate of enterprise N.

Remember that once an enterprise is determined to be in a direct investment relationship with N, it is also in a direct investment relationship with all the other enterprises that are in a direct investment relationship with N. For example, C is in direct relationship with A, B, D, E, F, K, and L, as well as with N.

An important consequence of this rule is that the FDI data should include all transactions/positions made/held directly between enterprises in different economies, that are in direct investment relationship – including enterprises that share a common direct investor but have no ownership in each other.

3. DIRECT INVESTMENT CLASSIFICATION, COMPONENTS AND SECTOR BREAKDOWN

The classification of direct investment is based firstly on the direction of investment both for assets or liabilities; secondly, on the investment instruments used (shares, loans etc.); and thirdly, on the sector breakdown.

As for the direction, it can be looked at it from the home and the host country perspectives. From the home country, financing of any type extended by the resident parent company to its non-resident affiliated would be included as direct investment abroad. By contrast, financing of any type by non-resident subsidiaries, associates or branches to their resident parent company is classified as a decrease in direct investment abroad, rather than as a foreign direct investment. From the host country, the financing by non-resident parent companies to their resident subsidiaries, associates or branches would be recorded, in the country of residence of the affiliated companies, under foreign direct investment, and the financing extended by resident subsidiaries, associates and branches to their non-resident parent company would be classified as a decrease in foreign direct investment rather than as a direct investment abroad.

As for the instruments, direct investment equity comprises the capital provided (either directly or through other related enterprises) by a direct investor to a direct investment enterprise and the capital received by a direct investor from a direct investment enterprise. Direct investment equity transactions are made up of three basic components: (i) Equity capital: comprising equity in branches, all shares in subsidiaries and associates, and other capital contributions, such as provisions of machinery, etc. (ii) Reinvested earnings: consisting of the direct investor's share (in proportion to direct equity participation) of earnings not distributed as dividends by subsidiaries or associates and earnings of branches not remitted to the direct investor. If such profits are not identified, they are considered to be distributed. (iii) Other direct investment capital (or inter-company debt transactions): covering the borrowing and lending of funds,

including debt securities and trade credits, between direct investors and direct investment enterprises and between two direct investment enterprises that share the same direct investor. As mentioned above, deposits and loans between affiliated deposit institutions are recorded as other investment rather than as direct investment.

The following box (box 3) provides a more specific explanation of the definition and measurement of FDI flows for the balance of payments and the stock for the IIP.

Box 3. Definition and measurement of FDI flows and stocks

In defining the foreign direct investment flows, for reporting period in the balance of payments, are included:

- *for subsidiaries and associates:*
 - (i) the direct investor's share of the company's - reinvested earnings (retained earnings for the subsequent year and the fiscal year earnings – which are not distributed as dividends). This share is determined proportionally based on the respective shares of direct individual shareholders in the subscribed capital (nominal capital);*
 - (ii) plus the direct investor's net purchases of the company's share, debt securities and loans (including non-monetary ones, machineries, production rights etc.);*
 - (iii) less the company's net purchases of the direct investor's, debt securities and loans;*
 - (iv) plus the net increase in trade and other short-term credits given by the direct investor to the company.*

- *for branches:*
 - (i) the increase in the reinvested earnings;*
 - (ii) plus the net increase in funds received from the direct investor;*
 - (iii) plus inter-company flows, excluding some flows between affiliated banks, affiliated intermediaries (for example, securities dealers) and Special Purpose Entities (SPE), whose sole purpose is serving as financial intermediaries.*

International investment positions are defined as follows:

- *for subsidiaries and associates:*
 - (i) *market or (balance sheet) value of shares and reserves attributable to direct investor;*
 - (ii) *plus loans, trade credits and debt securities issued by the direct investor (including determined but not yet paid dividends);*
 - (iii) *less reverse loans, trade credits and debt securities;*
- *for branches:*
 - (i) *market or book value of fixed assets, investments and current assets, excluding the amounts to be paid by the direct investor;*
 - (ii) *less liabilities of branches to third parties.*

According to IMF recommendations, positions should be recorded under the directional principle (respectively as an asset/liability), which takes into account the status of the enterprise. In this context, the direct investors country records all capital transactions with direct investment enterprises under “direct investment abroad”, while the country of direct investment enterprise records all capital transactions with foreign investors under “direct investment in the reporting economy”.

Moreover, the IMF recommends that the positions should be calculated based on the market price of the respective reporting period. Positions derived from balance sheets of direct investors and direct investment enterprises (book values) represent a satisfactory approximation to the market values. Thus, in most cases these two data groups (book values and market values) may be adequate.

Finally, there are several sector breakdowns of Foreign Direct Investment and International Investment Position flows. The IMF has chosen a breakdown by four institutional sectors (see table 1 below), defined according to the sector to which the resident party belongs. However, reporting on this sector breakdown is not compulsory in the Fifth IMF Manual.

By contrast to the classification according to the institutional sector, the OECD favours an “industrial” breakdown (see table 1 below), which includes nine economic sectors. The OECD specifically recommends, for the purpose of this classification, that FDI carried out via a resident holding company be classified

according to the industrial sector to which the parent company belongs. Under this criterion, when the parent company is a bank, FDI transactions carried out by a non-banking holding company would be attributed to the banks.

Table 1 Sector breakdown of FDI according to the IMF and the OECD

Classification according to the IMF	Classification according to the OECD
1. Monetary Authority 2. Banks 3. General Government 4. Other Sectors	1. Agriculture, hunting, forestry and fishing 2. Mining and quarrying 3. Manufacturing 4. Electricity, gas and water 5. Construction 6. Wholesale and retail trade, restaurants and hotels 7. Transportation, storage and communication 8. Financing, real estate and business services 9. Community, social and personal services

4 VALUATION OF FDI FLOWS AND STOCKS AND RELATIONS BETWEEN THEM

The Balance of Payments and the International Investment Position are compiled under the same framework of methodological rules defined in the Fifth Edition of the IMF Balance of Payments Manual. According to this, FDI transactions should be recorded in the Balance of Payments at the accrued value, i.e. "...transactions are recorded when economic value is created, transformed, exchanged, transferred or extinguished..." In practice, it is very difficult to apply the accrued principle to all transactions and many of them are therefore recorded at the time when the proceeds or payments are generated.

Moreover, the IMF recommends the use of market value as the basis for the valuation of flows and stocks, although this implies different approaches for both types of data: (i) for flows, the market value refers to the actual price agreed upon by transactors on the date of transaction and it should not reflect changes induced by fluctuations in exchange rates or in the market value of the financial assets and liabilities in question; (ii) for stocks, the market value at the time of the compilation

of the stocks is recommended. Nevertheless, it is recognized that in practice, book values from the balance sheets of direct investment enterprises are often used as a proxy of the market value of the stock of direct investments, when the company has no market value. The balance sheets values, if recorded on current market value, shall be considered to be in conformity with this principle. If based on historical cost or on an interim but not current revaluation, such balance sheet values would not conform to the principle. However, it should be noted that the balance sheet values represent the only possible source of valuation of assets and liabilities readily available in most countries.

The difference between the stock at the beginning of the year and its value at year-end must be equal to the flow recorded in the Balance of Payments, which reflects the transactions on these assets and liabilities that actually took place during the year; plus the change in the value of the stock induced by swings in the exchange rate; plus the change caused by alterations in the price of the related assets and liabilities; and plus other changes in the volume of financial assets and liabilities. In a more summarized way:

Position at the end of the period = position at the beginning of the period + FDI flows + price changes + exchange rate changes + other adjustments.

With regard to the "other adjustments", although some of them may be explained by the use of different sources to compile both statistics, the main conceptual ones are reclassifications in the International Investment Position (but not in the Balance of Payments) e.g. portfolio to direct investment as previously explained in the second section.

As for the international comparison of data, despite a common international methodological framework, discrepancies between countries are considerable. In fact, the worldwide discrepancy between outward and inward direct investment flows should be zero, if both sides recorded all flows fully and consistently.

Nevertheless, according to Lipsey (2001) “the asymmetries have been no higher than 8% in any year from 1993, as contrasted with 40 or 50 per cent for portfolio investment”.

Discrepancies are mainly due to the use of different criteria for the valuation or the geographical distribution of transactions.

The most frequent deviations are caused by the lack of information on reinvested earnings. The latter, unlike the partial capital flows or distribution of dividends, do not initiate any currency transactions, which may be channelled through the banking system. Consequently, the countries using the banking information as the main source, rather than direct reporting from direct investment companies and their affiliate enterprises, do not have available data on reinvested earning.

Box 4 Recording reinvested earnings in the balance of payments

The importance of identifying the reinvested earning is emphasized by the fact that it constitutes the sole opportunity for the recording of earning of companies in the balance of payments and the respective items in the IIP. From the economic viewpoint, the accounting of the reinvested earnings does not affect actual developments in the external equilibrium of the national economy. However, it provides a more accurate picture of the role that FDIs play in the economy, the size of the resulting income and how that income is distributed.

International standards define two distinct approaches, depending on how corporate income is measured: income may (i) incorporate all the components of profits, such as exchange rates gains and losses or loss related to the deduction of claims; (ii) exclude such and rely solely on ordinary profits. International methodologies recommend the latter approach.

Recording income on equity as part of direct investment in the balance of payments statistics requires the following information:

- year and the after-tax profit (or loss) of the enterprise with foreign direct investment;*
- the timing and size of dividends declared payable by the*

investors;

- the dividend tax payable;
- the timing of the actual dividend payment.

The responses given to questions on “timing” help to identify the accounting period, for example the period in which the transaction in question is to be disclosed in the balance of payments.

Consequently:

-Direct investors’ after-tax profit (or loss) must be recorded as reinvested earning in the balance of payments of the year in which it was actually earned.

-Dividends must be recorded as an income component in the case when they are declared payable. When taken together, an important distinction is made between profit as a benefit of the company’ operation and dividend emerging as a result of the owner’s decision. Dividends declared payable reduce the reinvested earnings for the given year in the current account and financial account. The distributed dividends, but still unpaid also represent a short-term liability vis-à-vis the investor; therefore, in the financial account of the balance of payments they are recorded in the “other capital” item within direct investments.

- After investors have distributed after-tax profits, they must pay dividend tax on the dividend declared payable. Later, general government’s claim (item in the balance of payments) –vis-à-vis the investor is replaced by the enterprise’s claim -vis-à-vis the investor in the financial account, as opposed to (tax) revenue recorded as a current transfer.

- Once the dividends are paid, the actual amount transferred equals the dividend declared payable net of dividend tax. Thus, both the liability (arising as a result of the distributed, but unpaid dividend) and the claim vis-à-vis the investor (for example, dividend tax paid to general government) are liquidated. In other words, at the payment stage, no components of the current account exist; the two legs of the transfer only affect the financial account.

The recording of corporate net profits as reinvested earning shows how direct investment affects the current account balance through the income account. However, the owners’ decision concerning distribution of income (except for the indirect effect of dividend tax) and the payment of dividends, has no effect over the current account

balance; that is, it does not affect the savings – investment relationship in the national economy.

Statistics based on the international methodological recommendations may be compiled on a yearly basis, following assessment of the questionnaires, filled in using corporate balance sheets and the financial statements of the profit – loss. In these statistics, the data on reinvested earnings, dividends and other distributed earning on the capital are estimations.

5 FORMS OF DIRECT INVESTMENT

The acquisition by the direct investor of the part of control in a company established in an economic territory, other than the home country, may take different forms.

There is a distinction between the provision of a lasting interest in an existing enterprise in the form of merger and acquisition, known as Mergers & Acquisitions – (M&A) and the establishment of a new production unit (Greenfield investment).

In reality, FDI is a heterogeneous flow of financial assets, which includes new investments (Greenfield investments) that represent a net increase of capital stock in the host country, and direct investment in the form of acquisition or mergers, which represent a change in the ownership of the existing capacities of production in the host economy.

It is believed that Greenfield investment is more beneficial for an economy as it results in asset creation. However, in certain countries, such as in transition economies, M&A may be more desirable. A reason could be that M&A flows in these economies are associated with the privatisation programme.

Reinvested earnings, made by existing investors in the area out of their profit are another form of direct investment. While not constituting a fresh capital inflow from abroad, this form of

investment adds to the host country's capital stock, assets, and productive capacity.

Intra-company loans are another form of FDI in one economy. They usually constitute a capital flow from parent company (abroad) to the subsidiary. Since this "debt" is repaid by the latter along with the interest, it constitutes a larger outflow than the inflow. This form of investment is not of interest for different countries, although it helps in financing the business of the direct investor, as such enabling the continuity of their contribution to the domestic economy.

Non-equity forms of FDI which include licences, exclusive agreements etc, are also known. Such forms do not necessarily contain capital outflows; however, their contribution to the economic development is significant.

Besides these forms of investment, there are other special cases, which require the meeting of some specific conditions to be classified as foreign direct investments. Their identification and acknowledgement is very important for the compilation of foreign direct investment statistics according to the standards.

Box 5. Special cases of Foreign Direct Investment

-Offshore – These are enterprises which are engaged in the assembly of components manufactured outside the country. They generally process export goods, engage in trade and financial operations.

These companies locate in "special trade zones", "free-trade zones" or tax-havens (with a very low level of taxes; there is even no tax for some businesses).

In the FDI data, the residency of offshore enterprises is attributed to the economies in which they are located without regard to the special treatment they may receive by the local authorities, such as exemptions from taxes, tariffs or duties.

- Quasi-corporations are enterprises which produce goods and services in an economy other than their own, but do not establish separate legal corporations in the host country. These enterprises, which are in a direct investment relationship with the parent enterprise, shall be deemed as FDI if:

1. Production is maintained for one year or more.
2. A separate set of accounts is maintained for the local activities.
3. Income tax is paid in the host country, not in the country of origin.

Examples of this kind of enterprises are those involved in construction¹ or mobile equipment².

- Special Purpose Entities (SPEs)³, are generally organized or established in economies other than those in which the parent companies are resident. They engage primarily in international transactions, but in few or no local operations. Special Purpose Entities are those legal structures, which have little or no working power, activities or physical presence in the juridical system of the country they have been established. They are generally used as mechanisms to own assets and liabilities and they are not producing companies in themselves. As legal mechanisms, SPEs do not have a high establishment cost and they use financially the regulatory liabilities and confidential privileges. Their establishment is often accompanied by offshore financial centres or according to specific legal rules of the economy they are in.

SPEs are defined by structure (for example base companies, central regional offices etc.) and by their purpose (for example, sales administration, foreign risk administration, assistance in the investment financing, etc.).

SPEs are treated as direct investment enterprises and they are included in the FDI data, if they complete the 10% ownership criterium.

- Financial intermediaries are defined as: other deposit institutions (commercial banks); other financial intermediaries, other than insurance companies and pension funds; other financial institutions (for example, insurance agents); SPE for financial intermediation and/or auxiliary services purposes.

Transactions between financial intermediaries (for example, financial intermediaries which are in direct investment relationship) should be excluded from FDI data, other than capital or lasting debt transactions.

- Purchase and sale of land by residents⁴. Under an agreement, in the Balance of Payments, all land within the territory of one economy, other than that owned by foreign governments (such as embassies) is considered to be property of residents.

If the current owner of land is a non-resident, the ownership is supposed to be transferred to a notional resident institutional unit, which owns this land and/or building.

As a consequence, the non-resident has a financial investment in this notional resident unit, which is assumed to be a foreign direct enterprise.

The purchase and sale of land (or of a building on this land) by non-residents should be included in the FDI as equity capital.

- Natural resources exploration⁵. Expenditures on discoveries or explorations of natural resources (oil for instance) by non-residents should be recorded in the FDI as equity capital. The payments of one direct investor for the exploration natural resources of one economy should be recorded in the FDI as equity capital, if the intention of establishing a direct investment enterprise in this economy is obvious.

If natural resources explorations result unsuccessful (a dry oil well etc., for instance) and there is termination of the enterprise activities:

-no further entries in the FDI data of BOP should be recorded;
-negative adjustments (with opposite sign) should be made in the data of International Investment Position (IIP) and FDI for both countries.

¹ Paragraphs 545 – 548 of BOP Textbook and 712 – 717 of BOP Compilation Guide provide examples on construction enterprises. Paragraph 545: Work undertaken in one economy by a construction enterprise may be treated (i) as work performed by a notional enterprise

that is resident in the host economy and engaged in a direct investment relationship with the parent enterprise or; (ii) as a service imported by the host economy. The important issue is determination of the economy to which production is attributed. If an enterprise maintains, or expects to maintain, a presence in the host economy for more than a year, and if separate and appropriate records are kept in respect of the enterprise's work in the host economy, production should be attributed to the host economy. In such a case, a new company with foreign direct investment is established in this economy. On the contrary, we are not dealing with a direct investment enterprise and in the balance of payments of the economy in question, the company's transactions shall be shown in the imports item in the current account.

² Paragraphs 552 – 554 in BOP Textbook provide examples on the treatment of mobile equipment in the balance of payments.

³ Paragraphs 542 – 544 in BOP Textbook provide examples on the treatment of SPEs in the balance of payments.

⁴ Paragraphs 550-551 from BOP Textbook and 718-722 from BOP Compilation Guide provide examples on the treatment of these cases in the balance of payments.

⁵ See <http://www.imf.org/external/np/sta/bop/biblio.htm>

6 MODES OF COLLECTING THE DATA ON FOREIGN DIRECT INVESTMENT

The accurate measurement of foreign direct investments is very important in determining the FDI flow and stock. There are three modes for the collection of data: enterprise surveys, international transactions reporting system (which includes transactions through the banking system) and administrative data. The choice between different modes of collecting information can be decisive for the accuracy of FDI statistics and the ability of the compilers to implement the international standards. Each type of information source has its specific advantages and disadvantages.

Table 2 Advantages and disadvantages of main sources of information on FDI

Advantages	Disadvantages
International Transactions Reporting System (ITRS)	
<p>ITRS is normally used in the collection of information for different BOP items, such as import/export etc. The use of an ITRS avoids the expense of developing alternative FDI data collection system.</p>	<p>In general, only cash transactions are measured. This implies that part of FDI components (such as reinvested earnings or inter-company indebtedness) are not involved without a specific agreement, therefore supplementary sources will be required.</p> <p>The concepts of FDI are difficult to be explained on a generalised banking report system, in particular concepts, which relate to the classification.</p> <p>Transactions in domestic currency or through accounts with non-resident banks are difficult to measure.</p> <p>The provision of data on the international investment position may be difficult.</p>
Enterprise Surveys	
<p>Enterprise survey is designed based on specific requirements of FDI statistics. It provides for complete recording of transactions and FDI position for each enterprise surveyed, including reinvested earnings. It provides the opportunity to explain to data providers the concept and treatment of FDI. It may include information on other influencing economic factors, such as the number of employees, exports, etc.</p>	<p>It may be difficult to maintain a comprehensive list of enterprises with foreign direct investment transactions/stock positions.</p> <p>Countries that do not normally use enterprise surveys for BOP measurement will incur costs in developing and implementing specialised direct investment surveys.</p> <p>In cases of alternative survey, extrapolation may lead to unreal results.</p>
"Administrative" Data	
<p>Information is often readily available as a by-product of the approval process.</p>	<p>This information is rarely compiled to meet the BOP requirements.</p> <p>There could be significant time lags between approval and actual investment (approved investment may never actually take place).</p> <p>Information on reinvested earnings and dis-investments may not be available.</p> <p>Information on stocks of investments valued at market price is typically not available.</p> <p>Information may relate only to investments in particular industries.</p> <p>Generally, information relates only to incoming and not to outgoing FDI.</p>

Source: IMF (1995); OECD (1999), Bertrand (1999)

Many countries base on the ITRS data for the creation of FDI database. The Bank of Albania provides very limited information from bank reporting. There are many reasons for this, but the main one is the high use of cash in economy.

Currently, enterprise survey is the most useful mode. Such a survey has been undertaken by the Bank of Albania as an initiator for the creation of the complete register of foreign capital enterprises. The creation of this register shall be the basis for the establishment of time series, useful for the Balance of Payments and the International Investment Position. So far, there have been two FDI surveys, respectively in 2003 and 2004, which have aimed at interviewing all companies directly investing in Albania. The Bank of Albania has planned annual surveys, aiming at surveying the foreign capital companies in Albania.

Although considered a very good source of information, the carrying out of statistical surveys is a very difficult and complicated process. It requires the clear definition of objectives, well-compiled questionnaires, selection of the representatives taking the survey, well-defined classification and structure of statistical data, assessment of the results and effective aggregate procedures etc. As a result, one of the main tasks for the balance of payments compilers is the improvement of the relevant methodologies and the ongoing study for the finding of adequate statistical and econometric methods for the processing of the relevant data, paying attention to other sources of information, as well.

The creation of data history with regard to the foreign capital in Albania in the form of direct investment and the study analysis of survey results shall provide a clear framework of its origin, the sectors of economy, which have absorbed it more, and its influence on the economy. The analysis of foreign direct investment market characteristics and their efficiency may serve as a promoting factor in the opening of new foreign capital companies in the country.

NOTES

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¹ OECD (1996)

² Juridical person implies the commercial companies registered in the commercial register at the court as commercial companies, in one of the forms recognized by the law (commandite, simple, limited liability or anonymous). They have a statute and a founding act.

³ A natural person is a partnership unregistered in the commercial register as commercial companies or in any other forms recognized by the law. That is, they are simply a form of cooperation between traders, but not a form recognized by the law; they are not presented in the juridical relationships as a party on their own. They do not have a statute and a founding act.

⁴ A subsidiary is a commercial company in itself, considered a subsidiary of the parent commercial company.

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THE EVALUATION OF FOREIGN DIRECT INVESTMENT IN EASTERN EUROPE DEVELOPING COUNTRIES: THE CASE OF ALBANIA

*Endrita Xhaferaj**

Key words

- Foreign Direct Investment - Developing countries - Economic growth - Business Environment -

ABSTRACT

The global foreign investments experienced a sharp increase during 1995-2000, and have been falling from 2000, almost with the same speed. This trend is determined by the falling investment into developed countries, while developing countries continue attracting more flows of foreign capital. Within the developing countries the distribution of foreign investment is uneven, and some of them find more difficulties in attracting foreign investors, than others.

The paper analyses the evolution and distribution of foreign direct investment in the South Eastern European countries compared to the Central Eastern European ones, focusing particularly on Albania. Foreign investment is considered to play a very important role in the economies' reconstruction of these countries during their transition from central planned to market economies.

In this paper, Albania's resources and potentials, as well as its weak points are analysed, in order to define their impact on the current situation of inward foreign investment, and provide with possible future strategies to improve it.

I INTRODUCTION

During the last decades, there have been increasing levels of Foreign Direct Investments (FDI) going to developing economies, and since 1989, also to countries in Central and Eastern Europe. FDI in the transition economies of Central and Eastern Europe has been studied frequently lately because of the relative newness of these markets and the importance of FDI for the region's growth and development. It has long been recognized that the benefits of FDI for these countries can be significant, including knowledge and technology transfer to domestic firms and the labour force, productivity spillovers, enhanced competition, and improved access for exports abroad. Moreover, they are a preferred method of financing external current account deficits (which is quite high for countries in transition), since FDI flows are non-debt-creating. Therefore, despite some negative effects that FDI might have in the host countries, for the Central and Eastern Europe countries, FDI is considered a very important resource to help their reconstruction and their transition into market economies.

In Albania, foreign direct investment has been an important driver of the economic growth, and it has changed during years in forms and figures. However, Albania belongs among the least developed countries of the region, and the ones that have attracted proportionately less FDI during these years of transition.

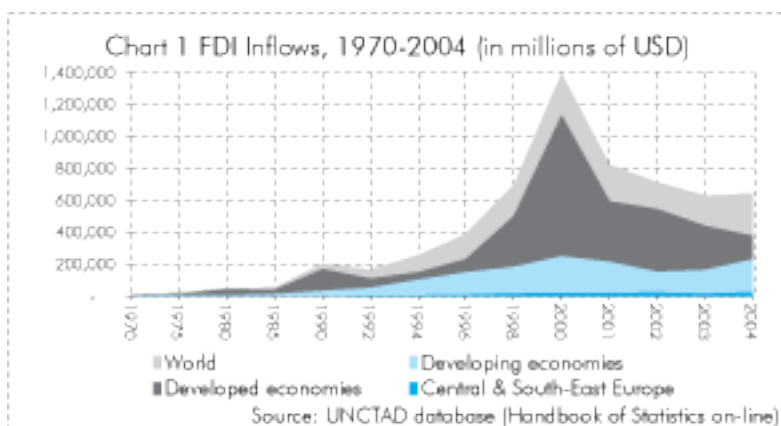
The main objective of this research is to investigate and answer the following questions:

- How has the change in the market conditions in the post-communist countries of Eastern Europe influenced the foreign direct investments there?
- What has been the empirical evidence of FDI trends and developments in these countries?
- What is the case in Albania concerning foreign direct investment compared to the other countries in the region?
- What conditions does Albania's investment climate present? Which are its competitive advantages to drive foreign investments?

- How can these advantages be used and what else is needed for Albania to become more attractive to foreign investors?

II GLOBAL TRENDS IN FDI

According to the World Investment Report 2004, (UNCTAD, 2004a), from a global point of view, inflows of foreign direct investment (FDI) declined in 2003 for the third year in a row.



However, this was prompted again by a fall by 25% in the FDI flows to developed countries. Meanwhile flows to developing countries rose in 2003 by 9%. Not only are developing countries attracting a bigger share of inward FDI flows, at the same time they are starting to act in the international market as sources of outward foreign investment. Multinationals from developing countries are becoming a force in the world FDI market (UNCTAD, 2004a).

The overview of The World Investment Report 2005 (UNCTAD, 2005) shows that the share of global inflows of foreign direct investment (FDI) going to developing countries continued to increase by 40% in 2004, whereas FDI to developed countries dropped by 14%. This meant the highest share of FDI (36%) going to the developing part of the world since 1997. The

“Prospect for Foreign Direct Investment” prepared by UNCTAD (2004b) foresees that the global FDI flows are likely to increase during the period 2005-2007. Even concerning the Central and Eastern European, the survey results also indicate bright prospects for the medium term (2006-2007).

III FDI AND EASTERN EUROPE: THEORETICAL FRAMEWORK

There is considerable literature on foreign direct investment in transition economies in general, and those of Central and Eastern Europe in particular. The two main focal points of the researchers have been the analysis of the determinants of foreign direct investment, including studies of the relation between investment climate and FDI, and analysis of the impact of FDI on the economy.

III.1 THE IMPACT OF FDI IN EASTERN EUROPE

The inflows of foreign capital in general have been, and still are, crucial for the reconstruction of the Central and Eastern Europe region (especially for the South Eastern Europe), and its reintegration into the world economy. “Without massive inflows of foreign capital, successful transition [from planned to market economies] in Central and Eastern Europe is unlikely” (Schmidt, 1995). In an economic survey of Europe in 2005, it is argued that of the various types of capital flows, foreign direct investment is generally considered to be the most desirable. A country may gain the benefits from FDI without also being dependent on net capital inflows or increasing its net external debt. (UNECE, 2005)

The belief that foreign direct investment has a positive impact on economic performance is relatively well established. FDI is reported to affect key macroeconomic indicators, such as the gross domestic product, the balance of payments and employment.

III.2 THE DETERMINANTS OF FDI IN CENTRAL AND EASTERN EUROPE

There is a general agreement on the main determinants of foreign direct investment in central and east European transition countries (Lankes and Venables, 1996; Resmini, 2000). These factors include mainly: low cost but qualified labour, natural resources endowment, the long-term market potential, progress in transition reforms, host market size, gravity factors and economic and political stability. Clearly, the absence or bad performance of such indicators would be a deterrent for FDI in the respective country.

London and Ross (1995) adopt a theory of global capitalism, which contends that developed countries' investors seek more vulnerable and less costly Third World labour. The authors argue that labour control and labour cost are key determinants of FDI, net of level of development.

The studies published by OECD (1994) and EBRD (1994) have challenged the 'low wage-assumption' considerably. The general conclusion of EBRD (1994) was straightforward: "Most striking perhaps is the predominance of market access among factors of importance to investor decisions [...] Factor cost advantages are clearly rated as less important than the market access in all surveys...." The results of the OECD (1994) study, that evaluated the investment climate in the Central and Eastern European countries and the New Independent States of the former Soviet Union, are very similar. The key motive for FDI was to gain market access (44%) and labour cost was of secondary importance (only 9%).

The investment climate has a significant impact on foreign direct investment inflows and is particularly highlighted in the literature when comparing the good performance of advanced central European transition countries and the weak performance of Balkan states, which are less advanced in transition reforms. Foreign investment policies may also facilitate or deter investment inflows. Those Central and East European transition countries with active national policies on FDI provide incentives to foreign investment through tax breaks, establishment of free economic

zones, and prevention of double taxation. In countries with passive policies, FDI is discouraged through the requirement of extra investment permits or registration, restrictions and barriers. However, Dunning (1994) argues that it is not simply a question of liberalization of investment policies or of offering foreign investors generous fiscal incentives, but equally, if not more important, there is a need for governments to both create and sustain an economic and social environment, in which both domestic and foreign firms can compete effectively.

IV THE COUNTRIES AND THE BACKGROUND

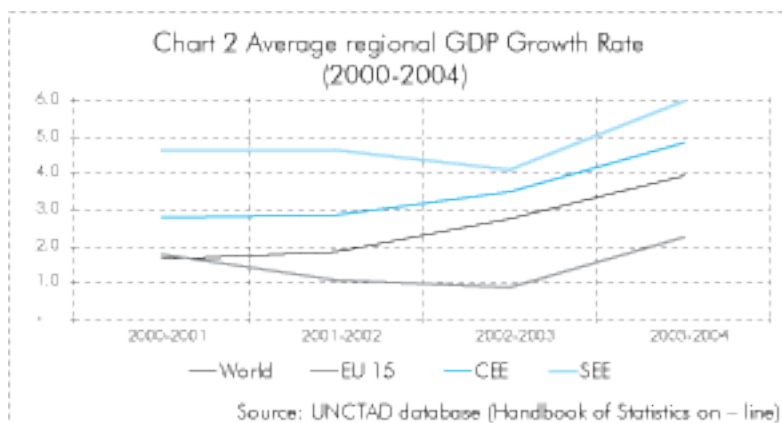
According to the dictionary of modern politics (Robertson, 1993), Eastern Europe was until the collapse of Soviet power, defined politically rather than geographically. Broadly, it consisted of those countries, which fell under communist rule in the aftermath of the Second World War (Albania, Bulgaria, Czechoslovakia, East Germany, Hungary, Poland, Romania and Yugoslavia). Even fifteen years after the downfall of communism, Europe is still described in papers and studies with the same geographical partitions that were used during the Cold War. Often the countries in economic transition of the Eastern part of the Europe are divided into two groups: Central Eastern European countries (CEEC), which (not including the Baltic states) consist of: the Czech Republic, Hungary, Poland, the Slovak Republic and Slovenia; and South Eastern European countries (SEEC), which include: Albania, Bosnia-Herzegovina, Bulgaria, Croatia, FYR Macedonia, Romania and Serbia and Montenegro. This research refers to the latter classification.

The communist inheritance has had two important dimensions for Eastern Europe. First, the socialist ownership structure placed industry, services, and agriculture mainly in the hands of state. Second, after forty years the communist economic system failed to sustain itself, leaving utter industrial collapse, financial distress and chaos, and very low living standards.

The transformation of the former centrally planned economies began in Poland and Hungary, which were the first countries in

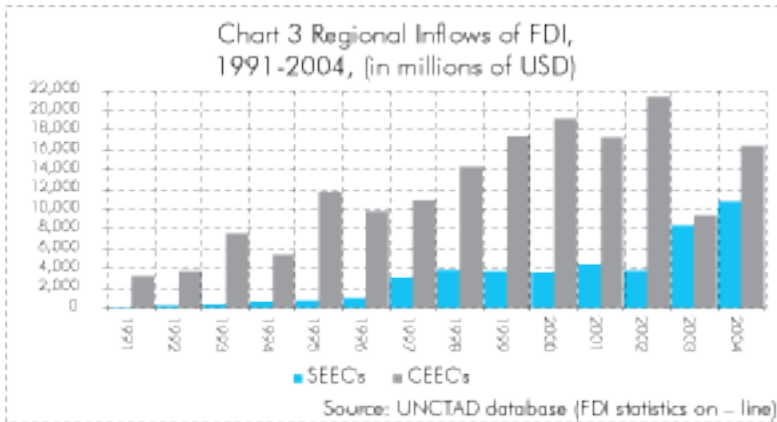
transition to democracy and also the first ones to benefit from the international community's involvement in their process of transition through assistance and advice (Lavigne, 1995). Southeast Europe has been the least developed region of Europe. The economies in the region started the transition from very weak positions; political uncertainty was high, institutions were weak and civil societies were fragmented. Macroeconomic performance has been erratic, heavily influenced by civil strife and war during much of the transition period. These countries have weaker relationships with the EU and are lagging behind the CEE countries in terms of progress in transition.

However, the Balkans are narrowing the gap. The region of Southeast Europe accounts for slightly above 2% of the world's gross domestic product in purchasing power parity terms, and a similar share of the world's population. Yet, despite the global slowdown, it remains one of the most dynamically growing regions with a respectable GDP growth, which has outpaced growth in both global and EU from 1999 to 2004.



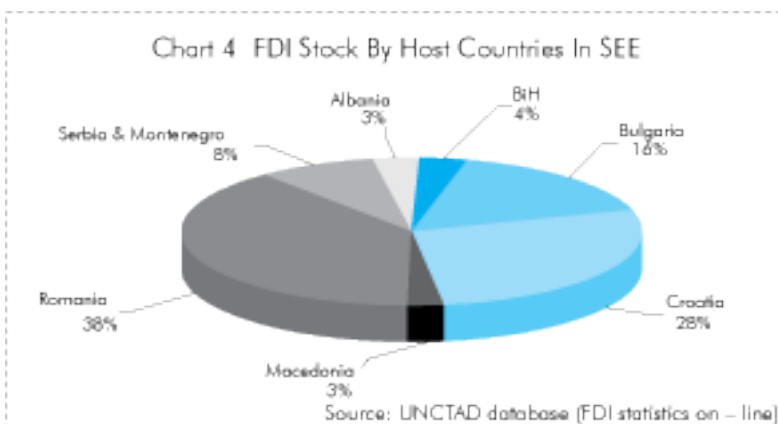
V THE FDI DEVELOPMENT IN THE REGION

The South Eastern European countries as a group have attracted far less FDI than the countries in transition of Central Europe during the year 1990 to 2004.



Nonetheless, it seems that the SEE countries are catching up with their neighbours. In terms of flows, in South-East Europe, FDI inflows started to grow after 2002. Led by large privatization deals, these inflows nearly tripled, to \$11 billion in 2004.

Within the SEE group, Romania, Croatia and Bulgaria remain the main actors in attracting FDI flows. At the end of 2004, they had the biggest proportion of the total FDI stock in the Balkans, leaving the less developed countries: Albania, Bosnia and Herzegovina, Macedonia and Serbia and Montenegro with a total of almost 20 percent of FDI stock to split between them. However, even in these countries, there is a growing tendency of FDI flows in the last 4 years.



Hunya (2004) explains the different FDI trends by the different types of FDI the two regions receive. In Central Europe, privatisation-related FDI is basically over and the local market is controlled by foreign investors that invest mainly in export-oriented projects in existing companies or in greenfield establishments. The main export market, the EU-15, did not expand in the past few years and the overall investment activity of the multinational enterprises was low. Meanwhile, the FDI in SEE has had a different pattern. The progress achieved over the past couple of years in terms of economic transformation has translated into lower investment risk and increasing interest from foreign investors. Increased volumes of FDI have been brought in the region by the governments' increased efforts to privatise large companies, utilities and banks but they have rarely gone into export-oriented projects.

V.1 SECTORS, SOURCE COUNTRIES, AND INCENTIVES FOR FDI IN THE REGION

As to the distribution of FDI by sectors of economy, most of the FDI in SEE countries concentrates in manufacturing, financial services, telecommunications and trade.

The data analysis from EBRD (2004) show that the FDI in SEE is concentrated in the manufacturing sector and especially in the steel production. (Bevan and Estrin, 2000; Hunya, 2004)

The financial sector is another important sector in the SEE where foreign involvement has been increasing during the 1990s. The privatisation of the banking sector was carried out in all these countries in recent years.

The tourism sector has attracted some foreign investment in Croatia and Bulgaria. Lack of restructuring, uncertainty over the property rights on land and poor quality infrastructure are among the key deterrents to foreign investment in this sector. (EBRD, 2004)

In terms of source countries for FDI, both the CEE and the SEE countries have attracted mostly their western European neighbours. The main source of FDI in the region has been the OECD countries, which account for over 90 per cent of FDI inflows in Bulgaria, Croatia, and Romania. (Broadman et al, 2004). The geographical and sectoral analysis made by EBRD (2004), also shows that most FDI comes from EU countries, such as Italy, Germany, Austria and Greece, especially in the western Balkan region.

In relation to the policy environment to support FDI, the countries of SEE have a certain degree of trade liberalisation. Albania, Croatia and the FYR of Macedonia are already members of the WTO, while Bosnia and Herzegovina and Serbia and Montenegro are in the process of acceding. Moreover, as explained by the European Commission (2004), the five above mentioned countries enjoy duty-free access to the EU market, thanks to the asymmetric Trade Measures granted since the end of 2000.

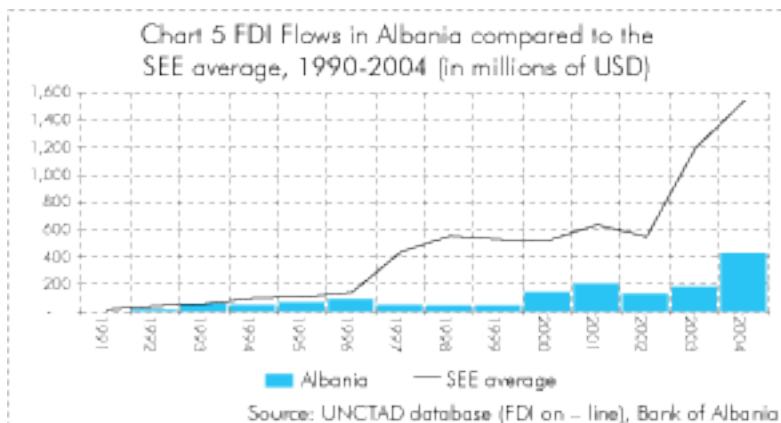
As far as the regulatory framework is concerned, all countries of the region have an appropriate FDI legislation. Foreign Investment Promotion Agencies exist in Albania, Bosnia and Herzegovina and Croatia, while internal Free Trade Zones have proliferated in all countries and offer many potential incentives to foreign investors. Restrictions on foreign ownership exist and concern sensitive sectors such as land property (e.g. the FYR of Macedonia) or agricultural land (e.g. Albania, Croatia). (European Commission, 2004)

VI ALBANIA

VI.1 FDI DEVELOPMENT IN ALBANIA

FDI flows continue to be an important component of private sector development and a prerequisite for the economic development of Albania. In the past years, FDI flows have been an important source of foreign capital to finance the current

deficit of Albania as compared to other sources like the external debt.



Albania's economy has become considerably more hospitable to foreign investment in recent years. The foreign investment levels in Albania have fluctuated in the past few years; however, they are generally low by regional standards, especially when compared to the SEE countries, that also started from level zero of FDI in 1990 and almost under the same political and economic conditions.

Looking at the figures of the FDI flows during these years of transition, it is evident that there was a growing tendency of foreign capital in Albania, since the beginning of transition up to 1996.

It should be emphasized that during 1995-1996, the pyramidal schemes were flourishing, and that might have strongly affected foreign investments. Immediately after the crisis of 1997, foreign investments dropped by 50% compared to the best years 1995-1996. The image of Albania after the institutional and social chaos had much to regain. The Kosovo crisis was another factor during 1999 (although, a regional factor that caused a drop in flows of FDI throughout the region) that had an impact in discouraging the foreign investments.

This simple analysis shows that Albania's difficulties in keeping alive the image of a stable political area have been a huge impediment for many foreign investors (for whom political stability, which means primarily institutional stability, is a key premise for investing) from investing in Albania. It seems that the instability and the lack of rule of law, internal or regional, has been the main barrier to foreign direct investment in Albania, because as for the level of liberalization of economy and appropriate legal framework, Albania has made quite an impressive progress. But this proved not to be enough when institutions are weak and unclear about their role.

The privatisations have had the main role in the FDI flows during these years. A significant example was the privatisation of the largest commercial bank, the Savings Bank of Albania. In mid-April 2004, the Austrian Raiffeisen Zentralbank (RZB) took over 100% of the shares for the price of USD 126 million, which was 37 percent of the total annual flow of FDI for 2004.

By the end of 2004, almost all state owned small and medium enterprises were privatised. The Government is now working on the privatisation of other strategic objects, such as the AlbTelekom (the only landline phone provider in Albania), and KESH (the Albanian Energy Corporation).

VI.2. INVESTMENT CLIMATE

VI.2.1 Opportunities and incentives for foreign investors

In a study undertaken by OECD (2003), based on questionnaires, individual meetings, dialogue and peer review in the SEE countries, the review 'Motivations of foreign investors for investing in Albania' states:

"... almost all of the interviewed answered that they try to have a dynamic evaluation of the country's advantages and disadvantages. They think that the advantages of the country are becoming stronger. They believe that the process of stabilisation

and association with Europe and implementation of free trade agreements will improve the situation considerably.” (OECD, 2003, page 51)

Despite the difficulties and challenges, Albania is a country that does offer opportunities to foreign investors:

- Tourism

Albania is a country rich in tourism resources, including mountains, valleys, forests, rivers and lakes. Being a Mediterranean country, it has special geographical and geological features, with varying landscapes mixed with one another. Landscapes range from typical Mediterranean in West and South West, to mixed ones in the central areas, to steep mountains in the inner part of country. Its Adriatic and Ionian coastlines are endowed with beautiful beaches. There are many inland lakes, natural lagoons, reserves, hunting grounds and SPAs. Also, Albania has an ancient history and culture. In the long run, tourism could be one of the main attractions for foreign investors, but currently Albania lacks the proper infrastructure to facilitate significant investments.

- Oil and minerals

Albania is endowed with natural resources including chrome ores, coal, nickel, copper, oil and gas. It is the only country in Europe with substantial reserves of chromium and before 1990 it was the world’s third largest producer of chrome ore. Both the oil and mining industries are export oriented.

According to INOGATE (Interstate Oil and Gas Transport to Europe Programme, funded by the EU), Albania has estimated recoverable oil reserves of about 550 million tonnes, offering large export capacity. According to the Albanian Foreign Investment Promotion Agency (2004) Albania’s proven natural gas reserves are estimated at 3.316 billion cubic meters. The country has gas industry centres on 11 fields with an annual capacity of 69 million cubic metres. However, output is much lower and imports are required to meet domestic needs. Albania is the only country in Europe, which is not connected

to an international gas pipeline. Options are under discussion to remedy this, including links to Italy, Greece or FYR of Macedonia.

- Manufacturing

The manufacturing sector has attracted a large number of small joint ventures in food processing, textiles, shoe making and wood processing, mainly with Greek and Italian companies. The textile industry offers plenty of opportunities for foreign investors and accounts for some 38 per cent of exports, with shoes accounting for a further 21 per cent (as of 2001). Forestry is a traditionally important industry, with local wood processing industries throughout the country supplied by relatively cheap local inputs of raw materials. The sector offers opportunities in saw milling, plywood and reconstituted panel making, parquet, joinery and furniture making. (EBRD, 2001)

- Agriculture

Albania enjoys natural factors that support agriculture, such as its climate and geography. Primary products include vegetables, livestock forages, corn, fruit, vineyards and olives. Albania has the potential for a competitive agro processing industry. Albania's agricultural commodities include: horticulture (mainly tomatoes), olives, grapes (used primarily in the production of a local alcohol, raki), dairy products, livestock, and herbs (particularly sage, of which Albania is a significant global producer).

- Low cost skilled labour

The education system in Albania is well consolidated throughout the country. Recently, there have been implemented well-known postgraduate programmes such as MBA, IFG, and Magistracy. Statistical data about students that have finished their studies abroad (especially in European and North American universities) show a very good preparation of them as well. Albanians are distinguished for their ability to speak different foreign languages, such as English, Italian, Greek, French, German, and Spanish. One of the advantages that Albania offers for attracting foreign direct investments is the low labour cost for this highly skilled workforce. Different studies

have shown that wages in Albania are one tenth of those in Italy. The average monthly salary in Albania for 2004 was just over EUR 114 per month. (KPMG, 2005)

VI.2.2 Deterrents of FDI

In almost all the business surveys or research work related to constraints to business development, find as the most critical factors the issues related to the legal and regulatory framework and infrastructure. (Xhepa and Agolli, 2004)

- Infrastructure

Poor physical infrastructure, including transportation and communication create a barrier to business and economic development. Although recent steps have been taken to improve the transportation infrastructure, Albania has a limited network of roads, generally in poor conditions, very few railway lines, and no reliable public transportation. Though there is no regular commercial air service between domestic destinations, it is possible to charter a small plane or helicopter.

- Corruption and non - transparency

Corruption and a general lack of transparency are persistent challenges to democracy in Albania and to multinational enterprises that might invest there. Although it is not as problematic today as it was in previous years, corruption continues to obstruct economic and social development. It can make obtaining licenses a very long, and/or costly process. Bribery is a common practice. Based upon public perception, the most corrupted institutions in Albania are the customs, the police and the public health system. Transparency is further inhibited by the fact that much commercial activity in Albania remains outside the formal economy.

According to TI 2004 index (which ranks countries in terms of the degree to which corruption is perceived to exist among public officials and politicians), Albania scores 2.5 out of 10 (10 means highly clean and 0 means highly corrupted). It is one of the 60 countries (out of 146 countries) that scores less than 3 out of 10, indicating rampant corruption. (Transparency International, 2004)

- Informal economy

In a report prepared by the OECD - Investment Compact for the Ministry of Economy of Albania, it is argued that "The informal economy is an important contributor to employment and production in Albania but also fiscal and regulatory evasion and, as such, is a hotly debated issue." (OECD, 2004, pg.9) However, this 'contribution' comes with significant costs in terms of lost tax revenues, lack of employee protection and unfair competition among enterprises. There are optimistic estimates that suggest that one-third of total economic activity is informal, while higher estimates range from 50 to 60 per cent of the economy. The estimation of the OECD in the above-mentioned report was that informal production over the last 5 years contributed between 24 - 28% of total gross value-added.

VI.3 EXTERNAL POLICIES AND GOVERNMENT'S INVOLVEMENT

Albania benefits from one of the most open trade regimes among transition countries. Import tariffs are among the lowest in the region, coupled with very limited non - tariff barriers, and several regional free-trade agreements are in effect. (IMF, 2005)

FDI promotion is a strategic objective of the Government. In this regard, the Government has pursued:

- The establishment of a legal and regulatory framework with incentives for foreign investors (some of the legal incentives include: equal treatment of foreign and domestic investors; full profit and dividend repatriation (after taxation); funds from the liquidation of a company may be repatriated.) The use of arbitration as a means to resolve international commercial disputes is well articulated in the Albanian law and Albania is party to the International Court for Settlement of Investment Disputes (ICSID).
- The minimization of investment risk: Foreign investments in Albania are fully protected by law. They cannot be nationalised, expropriated or subject to any other measure,

except in special cases provided by law, such as public interest, etc. Albania has also signed the Convention of Multilateral Investment Guarantees Agency (MIGA), the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards and the Geneva Convention on Execution of Foreign Arbitral Awards.

- The improvement and enhancement of Albania's image as a credible FDI destination;
- The establishment of an independent and credible institution to appeal tax issues and cases with.

Albania has signed several bilateral agreements on the promotion and protection of reciprocal investments. It also has double taxation treaties with many countries and participates in several international economic organizations. Moreover, to help Albania provide financial security for private sector entities investing in the country, the World Bank has established a Political Risk Guarantee Facility (PRGF). The PRGF is administered by the Albanian Guarantee Agency (AGA) and enterprises involved in production are eligible to apply for guarantees (excluding tobacco products, alcohol and armaments).

An Albanian Economic Development Agency (AEDA) was established by the Government in August 1998 to promote investment and exports. In 2002 the Albanian Government established another agency, the Albanian Foreign Investment Promotion Agency (ANIH) with the mission to promote and increase foreign direct investment in Albania and create a more favourable business environment.

VII CONCLUSIONS AND RECOMMENDATIONS

VII.1 SUMMARY OF FINDINGS

The figures analysed show that during 1992-2004, the South East Europe countries have benefited only sporadically and in limited ways from the flow of foreign capital and know-how. The main flows of FDI in these countries have been linked to privatizations. Foreign capital has been invested mainly in

manufacturing, financial services, telecommunications and trade, and has come mostly from EU countries. The whole region offers rich resources in tourism, however the FDI in these field is very limited (main exception being Croatia).

Regarding Albania, these 15 years of transition have been characterized by a series of crises that have affected the economy sharply. However, over these last years, Albania has experienced considerable GDP growth, low inflation and exchange rate stability.

The country has great potential to attract FDI in various sectors (manufacturing and agro-processing, tourism and other services, agriculture, etc). Nevertheless, it ranks among the countries that have attracted less foreign capital within the region, recording levels of FDI far lower than its real potential. The foreign investment in these years has mostly come as a result of privatisation on small, medium and big state-owned enterprises, and has focused on intensive labour industries. The main source countries of investment have been the closest neighbours, Greece and Italy.

The low level of FDI inflows and stock in the country points to the fact that there exist serious barriers to investment that relate to the overall political and security developments in the country; the instability and the insufficient progress made in the transition process and structural reforms; corruption and unfair practices; poor condition of the physical infrastructure; frequent changes of regulatory framework; administrative barriers; the existence of a significant informal economy.

VII.2 POSSIBLE RECOMMENDATIONS AND POLICY IMPLICATIONS

To reach the country's potential of inward FDI flows, the Albanian authorities should pursue their efforts to improve the business environment. One of the most important actions that the government can take to promote the foreign investment is that against the FDI barriers, in order to improve Albania's investment climate and the foreign investor's perceptions of it.

To start with corruption, a main problem affecting not only FDI, - in terms of facilitating the foreign investments, unnecessary regulation (that can be a basis for bribing or corruption) can be eliminated, and the ones that remain should be more transparent and accountable for.

The legal framework needs strengthening, and not much in terms of legislation itself rather than in terms of application of the law and of transparency related to it, to regulation and procedures.

Reducing the size of the informal economy would not only help improving the economy in the macro view, but it would eliminate an obstacle faced by legitimate businesses, that is the unfair competition.

Infrastructure (including energy and water) needs a solution if foreign investment in all areas of Albania is to be promoted. Increase of public investments in infrastructure is not the only solution; attempts can be made to attract foreign projects in this area by offering special incentives.

In terms of tax regulations, Albania has already double taxation treaties with many countries. However, were there more foreign investments to be attracted, these treaties should expand with other countries, which are big players in the international markets, such as the Western Europe (e.g. U.K.), and USA.

Finally, the Albanian Government might encourage the development of particular geographical zones within the country that represent investing opportunities, instead of trying to make the whole country more attractive. Such zones can be industrial, or tourism ones (like the coastal areas, for example). Developing such zones might require significant investment and resources; however pilot projects can be taken in consideration, and then be adopted if they work out.

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BANK OF ALBANIA'S ROLE IN EUROPEAN INTEGRATION

*Elvis Çibuku**

Key words

- SAA - European integration - Copenhagen Criteria - Internal Market - Acquis Communautaire -

I INTRODUCTION

On June 12 2006 the Republic of Albania signed the Stabilisation and Association Agreement with the European Union, which will enter into force following its ratification by the Albanian Parliament, the parliaments of the EU Member States and the approval by the European Parliament. The agreement aims at drawing Albania closer to the EU by providing reciprocal rights and obligations and creating mechanisms for working closer together in the areas of common interest, having as final goal, the full integration of Albania into the European Union.

The Stabilisation and Association Agreement provides the main political, economic and institutional requirements needed for full integration of an applicant country into the European Union, as already enshrined in the "Copenhagen Criteria"¹:

- Stability of institutions guaranteeing democracy, the rule of law, human rights and respect for and, protection of minorities.
- The existence of a functioning market economy, as well as the ability to cope with competitive pressures and market forces within the Union.
- The ability to take on the obligations of membership, which

include the adoption of the *acquis communautaire* within the domestic legal system and its proper implementation and enforcement by the administrative and judicial bodies.

During the implementation of the SAA, the Republic of Albania has to demonstrate not only that it shares the same values of the European Union, but that it also has sufficient capacity to make a reality of the obligations agreed-upon in the Agreement.

The Bank of Albania's obligations under the SAA include the areas of macroeconomic stability, the freedom to provide services (financial services), movement of capital and the approximation of Albania's legislation to that of the EU.

II MACROECONOMIC STABILITY

The European Commission has set out its methodology to assess the progress of associated countries towards meeting the Copenhagen economic criteria in its Annual Reports². The criterion for the existence of a functioning market economy has to be met at the latest by the time of signing the accession treaty. Meanwhile, the second element of this criterion - the capacity to withstand competitive pressures and market forces within the EU – can be met after the accession.

The existence of a functioning market economy, as set out in the Copenhagen Criteria, requires that³:

- macroeconomic stability is achieved, including adequate price stability, sustainable public finances and external balance of payments;
- equilibrium between demand and supply is established by the free interplay of market forces; prices as well as trade are liberalised;
- there are no significant market barriers to market entry (establishment of new firms) and exit (bankruptcies);
- the legal system, including the regulation of property rights, is in place; laws and contracts can be enforced;

- broad consensus exists about the essentials of economic policy;
- the financial sector is sufficiently well developed to channel savings towards productive investment.

The association between the European Community and Albania, set out in the Agreement, provides for the establishment of close cooperation in the economic and monetary areas, which aim at facilitating the reforms and the economic integration of Albania into the EU.

III THE OBLIGATIONS DERIVING FROM THE SAA IN THE AREA OF FINANCIAL SERVICES

One of the aims of the Stabilisation and Association Agreement is to develop gradually a free trade area between the European Community and Albania⁴. It is for this reason that the Agreement reflects the four freedoms of the Internal Market, a frontier-free area in which, the free movement of goods, persons, services and capital is ensured.

The establishment of the Internal Market in the area of financial services intends the removal of any discriminatory treatment with regard to the establishment and to the provision of services by credit and other financial institutions, within the territory of the Community. The removal of barriers between Member States aims at increasing competition among national markets in financial services and reducing the price of these services to the consumers. Based on the relevant provisions of the SAA, banking and financial institutions⁵ can pursue their business in the territory of Albania or that of the Community, through the right of establishment and the freedom to provide services.

III.1 ESTABLISHMENT

Under the SAA, establishment is understood as the right of Community banks and other financial institutions to take up

economic activities by means of the setting up of subsidiaries and branches in Albania.

Pursuant to Article 50 of the SAA: “Albania shall facilitate the setting-up of operations on its territory by Community companies and nationals. To that end, it shall grant, upon entry into force of this Agreement: as regards the establishment of Community companies treatment no less favourable than that accorded to its own companies or to any third country company, whichever is the better, and; as regards the operation of subsidiaries and branches of Community companies in Albania, once established, treatment no less favourable than that accorded to its own companies and branches or to any subsidiary and branch of any third country company, whichever is the better”.

Thus, the Community companies established in Albania will be granted either “national treatment” or “most-favoured-nation treatment”, whichever is the most favourable. Granting national treatment to Community banks and other financial institutions means the prohibition of discrimination based on nationality (place of formation) and the creation of a level playing field for Community and domestic institutions within the national market⁶. It follows that, Community banks and other financial institutions will be subject to the same laws, rules, and administrative practices as their Albanian counterparts.

At the same time, the Parties to the Agreement shall not adopt any new regulations or measures which introduce discrimination as regards the establishment of Community or Albanian companies on their territory or in respect of their operation, once established, by comparison with their own companies.

III.2 SUPPLY OF SERVICES

The Stabilisation and Association Agreement guarantees the right of Community banks and other financial institutions to pursue their business in Albania, without having to be established. Pursuant to Article 57 of the SAA: “The Parties undertake to take the necessary steps to allow progressively the supply of services

by Community or Albanian companies or nationals which are established in a Party other than that of the person for whom the services are intended”.

In contrast to the right of establishment, which will be effective upon the entry into force of the Agreement, the liberalisation of trade in services is envisaged as a gradual process. In this regard, 5 years after the entry into force of the SAA, the Stabilisation and Association Council⁷ shall take the measures necessary to implement progressively the liberalisation process, while taking in account the progress achieved in the approximation of their laws.

The Agreement also provides for the establishment of cooperation between Albania and the European Community, focused on priority areas related to the *acquis communautaire* in the fields of banking and financial services. The Parties will cooperate with the aim of establishing and developing a suitable framework for the encouragement of the above-mentioned sectors in Albania. This cooperation will focus on the operational aspects of improving the financial sector, as well as on improving the supervisory framework and will include the offering of technical assistance and training.

The provisions of the Agreement relating to the establishment and the supply of services are fully addressed in the draft banking law, prepared recently by the Bank of Albania. Pursuant to the provisions of the draft law, the Community banks may provide banking services in Albania only through a branch, for which licensing will be applied in the same rules as for the Albanian banks. As far as Community banks’ subsidiaries are concerned, they are considered as Albanian banks in all aspects, therefore there is no limitation regarding to their establishment and provision of services.

III.3 THE PREVENTION OF MONEY LAUNDERING AND TERRORISM FINANCING

Pursuant to Article 82 of the SAA: “The Parties shall co-operate closely in order to prevent the use of their financial systems for

laundering of proceeds from criminal activities in general and drug offences in particular, as well as for the purpose of terrorist financing”.

In this regard, the role of the Bank of Albania, as the regulatory and supervisory body of the banking system in Albania, is to strengthen the supervision of banks’ international activities as well as the cooperation with the Community supervisory authorities in monitoring the activities of EU branches and subsidiaries established in Albania. A precondition to the effective functioning of this cooperation is the establishment of a comprehensive regulatory framework for the exchange of data between the Albanian and the foreign supervisory authorities as regards the supervision of banking activities, in their own jurisdiction.

The regulations governing banking secrecy may become an obstacle to the exchange of information across national borders between the branches of foreign banks established in the territory of Albania or of the Community, the Bank of Albania and the supervisory institutions in the Member States. For this reason, it is necessary that banking secrecy regulations facilitate the cross-border flow of information, while guaranteeing at the same time the confidentiality of the information transmitted.

IV MOVEMENT OF CAPITAL AND CURRENT PAYMENTS

The free movement of capital in the European Community, besides economic goals, serves as a precondition for ensuring the functioning of the free movement of goods, services and people, while achieving the efficient functioning of the Internal Market.

In the Commission’s view, there are three categories of operation concerned by the progressive liberalisation of capital movements⁸:

- capital operations: operations, such as commercial credits or direct investments are linked to the exercise of

- the other fundamental freedoms of the Internal Market;
- operations in financial market securities: the liberalisation of financial securities, such as bonds or shares, requires a single financial market at European level;
- operations involving financial credits: the liberalisation of operations involving financial credits and operations relating to money market instruments is necessary for the establishment of a unified financial system.

The Stabilisation and Association Agreement, in Article 61, provides only for the liberalisation of capital operations, which constitute the first phase for achieving the total freedom of capital movements between the European Community and Albania. On the other hand, the liberalisation provided for by the SAA includes only two of the aforementioned categories, more specifically the liberalisation of capital operations⁹ and of the operations involving financial credits¹⁰.

In contrast to the Treaty Establishing the European Community, where capital and payments are treated in the same way, the Stabilisation and Association Agreement provides for the full liberalisation of current payments and the progressive liberalisation on capital movements¹¹. This means that all restrictions on current payments between the European Community and Albania shall be prohibited.

This distinction is supported by the European Court of Justice, according to which: "...it is not necessarily the case that every physical transfer of financial assets constitute a movement of capital". After examining the relevant Treaty provisions, the ECJ concluded that current payments are transfers of foreign exchange which constitute the consideration within the context of an underlying transaction, whilst movements of capital are financial operations essentially connected with the investment of the funds in question rather than remuneration for a service¹².

It should be mentioned that the *acquis* in the field of movement of capital does not take in account such a distinction, by treating the movement capital and current payments in the same way.

For this reason, the full adoption of the *acquis* in this field would make the distinction provided by the SAA irrelevant.

In conclusion, we may say that implementing the obligations of the Agreement on the movement of capital and current payments means the abolishment of present administrative barriers for control and authorisation of capital movements. In this regard, the Bank of Albania, in cooperation with the Council of Ministers, is the responsible body for the establishment of a legal and administrative framework for the implementation of the Community legislation in this field, especially regarding the safeguard clauses in the case of serious economic and monetary difficulties.

V APPROXIMATION OF LAWS AND LAW ENFORCEMENT

The adoption and proper implementation of the *acquis communautaire* in the domestic legal system is perhaps the most important criterion for the European integration of the associated and candidate countries. Pursuant to Article 70 of the Agreement, "Albania shall endeavour to ensure that its existing laws and future legislation will be gradually made compatible with the Community *acquis*. Albania will ensure that existing and future legislation will be properly implemented and enforced".

The *acquis communautaire*, which will be adopted in the domestic legal system, includes the primary EU legislation (the founding Treaties and the international agreements to which the Union is a party), the secondary legislation (regulations, directives, decisions, and recommendations), the decisions of the European Court of Justice and of the Court of the First Instance, the Community policies and the general principles of justice in the European Union.

This approximation started on the date of signing of the Agreement, and will gradually extend to all the elements of the Community *acquis*. During the first stage (5 years from the entry into force of the SAA), approximation will focus on fundamental

elements of the Internal Market *acquis* as well as on other important areas, i.e. financial services. During the second stage, Albania will focus of the remaining parts of the *acquis*.

V.1 THE APPROXIMATION OF LAWS IN THE AREA OF FINANCIAL SERVICES

As mentioned above, the functioning of the Internal Market in the area of financial services includes the freedom of cross-border provision of services and the abolishment of all legal and administrative barriers to the establishment of branches of credit and other financial institutions within the territory of the Community.

The Internal Market in the banking is based on these fundamental principles¹³:

- essential harmonisation in all Member States of the laws and practices governing access to banking activity;
- home-country control, which means that a bank operating in other Member States will be supervised by the authorities in the country of origin; i.e. the country which has issued the single licence and in which its registered office is located;
- mutual recognition by the national supervisory authorities of the laws and regulations in the countries of origin of the banks operating on their territory.

On the other hand, the provisions of the Stabilisation and Association Agreement seem more restrictive in this regard, by providing only for the granting of “national treatment” (non-discrimination) to the Community individuals and companies, a concept which constitutes just one of the types of restrictions to the freedom of establishment or the freedom to provide services. The reason for such a regulation is that the SAA does not aim at unifying the Albanian and the Community market into a single market, but only the creation of a free trade area between these two parties.

For this reason, the harmonisation of the domestic legislation to the EU *acquis*, in the sector of financial services, will be focused on the adoption of the first banking Directive (consolidated in the Directive 2000/12/EC), which lays down the essential requirements for the authorisation of credit institutions, the principles of the right of establishment and the freedom to provide services, and the establishment of a supervisory authority.

Full harmonisation with the *acquis* in the sector of financial services includes the adoption, from the Bank of Albania, of the technical instruments of prudential supervision, in particular:

- Own funds: The Directive 2000/12/EC puts forward a definition of own funds comprising two elements (original own funds and additional own funds). The amount of additional own funds included in own funds must not exceed the original own funds.
- Solvency ratio (in Albania referred to as the capital adequacy ratio): The own funds of each credit institution are defined as a proportion of the risk-adjusted value of its assets and off-balance-sheet items. That essentially concerns the credit risks incurred in the event of non-payment by a borrower and draws a distinction between the degrees of risk associated with individual assets and off-balance-sheet items, and with certain specific categories of borrower. The prescribed minimum ratio is 8%.
- Large exposures: The Directive 2000/12/EC limits the credit institution's exposure to one single person to a maximum equal to 25% of its own funds. Credit institutions must report every large exposure (more than 10% of own funds) to the competent authorities. A credit institution must not incur large exposures which, in aggregate, exceed 800% of own funds.
- Supervision on a consolidated basis of credit institutions applies to all banking groups, including those the parent undertaking of which are not credit institutions. The Directive 2000/12/EC has provisions on the competent authority or authorities responsible for consolidated

supervision and how the authorities shall cooperate. The competent authorities must require full consolidation of all the credit and financial institutions which are subsidiaries of a parent undertaking.

In conclusion, we can say that under the Stabilisation and Association Agreement, the Republic of Albania is committed to adopting all of the European legislation in the area of financial services, but without creating the conditions for the Community financial institutions to be established within the territory of the Republic of Albania, without having to be licensed. At the same time, the activity of these institutions within the Republic of Albania will be subject to regulation and supervision by the Bank of Albania.

V.2 THE APPROXIMATION OF LAWS IN THE AREA OF PAYMENTS AND MOVEMENT OF CAPITAL

The free movement of capital is a key element to the Internal Market and the associated country can benefit from this freedom, in accordance with its economic development. Just like in the case of financial services, for the movement of capital the Agreement provides liberalisation to be achieved in two phases. During the first phase the necessary improvements for market entry will be realised, which aim at creating the conditions for the further gradual application of Community rules on the movement of capital.

The EU legislation, in the field of free movement of capital is based on some general principles¹⁴:

- The effective removal of controls on capital and payments not only compromises respective foreign exchange restrictions, but any kind of administrative regulation which effectively discriminates on the basis of the source or destination of the capital.
- The rights to such free transactions are conferred on residents rather than nationals.

- Not only are the general prohibitions ruled out by this freedom, but equally any, explicit or implicit, authorisation procedures.
- Some general restrictions to this freedom continue to be applied. These exceptions include national security and public policy, but do not extend to broader economic interests, i.e. monetary policy¹⁵.

During the second phase, the Parties shall engage in full implementation of the Community rules in this area¹⁶. The adoption of the European legislation includes the full liberalisation of capital movement. Pursuant to Article 56 of the Treaty Establishing the European Community, “all restrictions on the movement of capital and payments between Member States and between Member States and third countries shall be prohibited”. This principle is enshrined in the Directive 88/361/EEC for implementation of Article 67 of the Treaty, which abolishes the general arrangements for restrictions on movement of capital between persons resident in Member States¹⁷.

The experience of the European Union shows that there is no particular legal or administrative precondition for the liberalisation of capital movements. The most significant impact of removing capital controls is not on administrative structures, but on policy management. In the absence of controls, large outflows and inflows of capital may occur which complicate monetary and exchange rate policy. Thus, legislative approximation in this field presupposes an overall stable macroeconomic environment¹⁸.

The liberalisation of capital movements has facilitated cross-border transfers within the European Union, but there are still some differences between the legislations of Member States regarding payments, differences that may become an obstacle to the functioning of the Internal Market in this area. For this reason, the legal harmonisation in the European Union in the area of payments, aims at standardising the technical methods and applying the equal rules for the internal and cross-border transactions and payments, which will promote and facilitate the free movement of capital.

In order to create the necessary conditions for the gradual application of Community rules on the free movement of capital (an obligation that derives from Article 62 of the SAA), the legislative activity of the Bank of Albania should be focused on the adoption of the following EU *acquis*:

Directive 97/5/EC on cross-border credit transfers, which establishes minimum information that should be provided to the clients as well as the performance requirements so as to ensure that credits (up to EUR 50,000) can be transferred from one part of the Community to another rapidly, reliably and inexpensively. The Directive 97/5/EC is further supplemented by the Regulation 2560/2001/EC on cross-border payments in euro, which extends the effects of the Directive to all types of payments.

Directive 98/26/EC on settlement finality in payment and securities settlement systems seeks to contribute to the efficient and cost effective operation of cross-border payment and securities settlement arrangements in the Community, while facilitating in this way the free movement of capital.

Commission Recommendation 97/489/EC concerning transactions by electronic payment instruments and in particular the relationship between issuer and holder establishes the minimum information that should be provided to the consumers during transactions with electronic payment instruments (information on charges, exchange rates and interest rates) as well as the minimum obligations and liabilities of the parties concerned.

It is worth mentioning that the approximation of the Albania's legislation to that of the Community is a nonnegotiable requirement for European integration. Since the final goal of the Republic of Albania is its accession to the European Union, the only negotiable element in the process of approximation of laws is the timetable for its finalisation, and the possible transitional periods.

VI CONCLUSIONS

The implementation of the obligations deriving from the Stabilisation and Association Agreement and the efforts to adopt the *acquis communautaire* in the domestic legal system should not be considered as goal in itself, but rather as a mean for achieving broader economic goals. The European standards in the areas of financial services and movement of capital, on their side, reflect the international principles adopted in the framework of the World Trade Organisation and the Basel Committee for Banking Supervision.

By adopting the European Union law, Albania not only will facilitate its future membership in the EU, but also adjust its legal and administrative framework to the international standards, while promoting its integration in the international banking community.

The incorporation of the *acquis communautaire* in the domestic legal system should not be considered as formal and abstract process of transplanting the Community regulations in Albania. This, since introducing economic law, and banking legislation in particular, should be adjusted to the economic context and the market structure in which they have to operate¹⁹. As defined by the European Commission in the White Paper, the three elements needed in order to develop a correctly functioning financial sector are: a) trained and reputable personnel; b) appropriate legislation; and c) effective supervisory bodies to ensure that the financial institutions are respecting the laws and regulations under which they operate.

NOTES

* Elvis Çibuku: Specialist, Foreign Relations, European Integration and Communication Department. Tirana, 11 July 2006

¹ See: Presidency conclusions of the Copenhagen European Council of 21/22 June 1993, page 13.

² Albania 2005 Progress Report; Brussels, 9 November 2005 {COM (2005) 561 final}.

³ See: Progress towards meeting the economic criteria for accession; No. 26; European Commission, November 2005.

⁴ Pursuant to Article 1, par. 2, of the SAA: "The aims of this association are...to support the efforts of Albania to complete the transition into a functioning market economy, to promote harmonious economic relations and develop gradually a free trade area between the Community and Albania".

⁵ In the EU these institutions are called by the common name "credit institutions", which means an undertaking whose business is to receive deposits or other repayable funds from the public and to grant credits for its own account as well as electronic money institutions (Article 1 of Directive 2000/12/EC).

⁶ OECD National Treatment Instrument (2000).

⁷ The Stabilisation and Association Council, which will be established under the Article 116 of the Agreement, shall supervise the application and implementation of the SAA. It shall consist of the members of the Council of the European Union and members of the Commission of the European Communities, on the one hand, and of members of the Government of Albania, on the other.

⁸ Communication from the Commission to the Council of 23 May 1986 on the programme for the liberalisation of capital movements in the Community {COM(1986) 292 final}.

⁹ Pursuant to Article 61, par. 1, of the SAA: "With regard to transactions on the capital and financial account of balance of payments, from the entry into force of the Agreement, the Parties shall ensure the free movement of capital relating to direct investments made in companies formed in accordance with the laws of the host country and investments made in accordance with the provisions of Chapter II of Title V, and the liquidation or repatriation of these investments and of any profit stemming therefrom".

¹⁰ Pursuant to Article 61, par. 2, of the SAA: "With regard to transactions on the capital and financial account of balance of payments, from the entry into force of this Agreement, the Parties shall ensure the free movement of capital relating to credits related to commercial transactions or to the provision of services in which a resident of one of the Parties is participating, and to financial loans and credits, with maturity longer than a year".

¹¹ Pursuant to Article 60 of the SAA: "The Parties undertake to authorise, in freely convertible currency, in accordance with the provisions of Article VIII of the Articles of the Agreement of the International Monetary Fund, any payments and transfers on the current account of balance of payments between the Community and Albania".

¹² Joint Cases 286/82 and 26/83 Lusi and Carbone v. Ministero del Tesoro (1984); ECR 377.

¹³ These principles are set out in the second banking Directive (consolidated in the Directive 2000/12/EC), which is the main instrument for completing the Internal Market in banking. The Directive introduces the principle of a single banking licence or authorisation, which grants banks the right to establish branches in other Member States or to provide cross-border services without a new authorisation (but after notification of the host authorities).

¹⁴ Annex to White Paper for the preparation of the associated countries of Central and Eastern Europe for integration into the Internal Market of the Union; COM (95) 163, Brussels, 10.05.1995.

¹⁵ A similar regulation may be found in the Article 61 of the SAA, according to which: "...where, in exceptional circumstances, movements of capital between the Community and Albania cause, or threaten to cause, serious difficulties for the operation of exchange rate policy or monetary policy in the Community or Albania, the Community and Albania, respectively, may take safeguard measures with regard to movements of capital between the Community and Albania for a period not exceeding one year if such measures are strictly necessary".

¹⁶ Pursuant to Article 62 of the SAA: "During the first three years following the date of entry into force of this Agreement, the Parties shall take measures permitting the creation of the necessary conditions for the further gradual application of Community rules on the free movement of capital".

¹⁷ "Capital movements", as set out in the Directive, are understood to be all the operations necessary for the purposes of capital movements carried out by a natural or legal person. This includes direct investments, investments in real estate, operations in securities and in current and deposit accounts, and financial loans and credits.

¹⁸ Annex to White Paper, pg. 3.

¹⁹ Michel Tison; Harmonisation and Legal Transplantation of EU Banking Supervisory Rules to Transitional Economies. A Legal Approach; Financial Law Institute, Universiteit Gent, 1999

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FOREIGN DIRECT INVESTMENT IN ALBANIA (FISCAL YEAR 2004)

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Key words

- Foreign direct investment - Foreign capital - Enterprise -

INTRODUCTION

Foreign direct investments (FDI) stand in an important position in the economic background of the developing countries. They provide necessary investments for the economic growth and for the technological development, when domestic savings cannot. Moreover, capital flows serve as a signal for the change of one's country economic conditions, compared to the foreign ones. These flows influence a set of economic variables of a country, such as: current account deficit, exchange rate, domestic savings and investments, employment, etc..

Many countries have benefited from capital flows in the form of FDI. Fighting the lack of capital that the closed markets used to suffer, they have helped the effective use of these sources and they have created a competitive environment, which provides the investors with ever-growing outputs.

A long-lasting, positive effect of the FDI is the transfer of the production technology and of the most effective manners of industrial set up, from the countries of origin to the host ones. In this track, FDI also have a positive effect on the output of domestic companies. In general, the bilateral causative relationship

between the FDI and the economic and political stability has been positive¹, which means that the latter has induced higher levels of FDI. On the other hand, the great concentration of FDI in a country has helped its general stability. Another positive aspect is that, regardless of the cyclic trends, the capital in the form of FDI is not easily transferable within a short period of time, so it presents fewer risks to the monetary stability of a country than the other forms of financial capital.

Apart from the priority of drafting an institutional framework to encourage the foreign investment in Albania, their accurate measurement is a necessity of time. For this reason, the Bank of Albania, in collaboration with the Institute of Statistics conducts annual surveys in the enterprises with foreign capital participation. The purpose of these surveys stands in evidencing the foreign investment in Albania, through national surveys of the foreign and joint - venture enterprises operating in Albania.

The survey we are analysing is the second one conducted by the Bank of Albania. In monitoring this database, the Bank of Albania has planned the conduct of annual surveys. These surveys will be conducted among the population living by foreign direct investment enterprises in the country. Meanwhile, the all-inclusive FDI survey in Albania will be conducted every 3 years.

The success of this initiative is really important for the Bank of Albania, not only for the accurate measurement of foreign investment flow in Albania, but also for the calculation of the stock of these investments, which will serve as a basis for defining the International Investment Position (IIP) of Albania.

The legal framework and the informal economy do not allow complete and real statistics on foreign direct investment in Albania.

The development of a database for the foreign capital in the form of direct investment and the research analyses on the results of the surveys, provide us with a clear setting of the origin of foreign capital in Albania, the sectors of economy that have

absorbed most of the foreign capital and their effects on the domestic economy.

The analysis of the FDI market characteristics in Albania and of their productivity, may act as a promoting element in the opening of new foreign capital enterprises in Albania.

The study proceeds with definitions and methodologies related to the concept of the FDI. This section describes the approach used to estimate the foreign capital stock. The analysis of the survey results is divided into two main sections. Section 2 analyzes the numerical characteristics of foreign and joint venture enterprises operating in Albania (such as, the sectoral distribution of enterprises, their origin, the regional distribution of foreign capital enterprises in the country, the concentration of labour force, etc.).

Section 3 analyzes the quantitative characteristics of the FDI, mainly related to the evaluation of the capital stock by country of origin and its distribution by sectors of economy.

I DEFINITIONS AND METHODOLOGIES

Even though the definition of the foreign direct investment has changed over the years, historically a certain limit of capital participation and the idea that the investor plans to show control influence in the enterprise, have been closely related to the meaning of the FDI. IMF and OECD, attempting to harmonize the definition, have developed a common definition: "... the foreign direct investment reflects the aim of obtaining a lasting interest by a resident entity of one economy (direct investor) in an enterprise that is resident in another economy (the direct investment enterprise).

Foreign direct investment involves both the initial transaction establishing the relationship between the investor and the enterprise and all subsequent capital transactions between them and among affiliated enterprises, regardless of the legal form of their registration – as incorporated or unincorporated.

The fifth Edition of the IMF Balance of Payment Manual (BPM5) defines the owner of 10% or more of a company's capital as a direct investor. This percentage is used as the basic dividing line between direct investment and portfolio investment in the form of shareholdings. Thus, when a non-resident who previously had no equity in a resident enterprise purchases 10% or more of the shares of that enterprise from a resident, the price of equity holdings acquired should be recorded as direct investment. From this moment, any further capital transactions between these two companies should be recorded as a direct investment.

A direct investor may be an individual, an incorporated or unincorporated private or public enterprise, a government, a group of related individuals, or a group of related incorporated and/or unincorporated enterprises.

Direct investment capital comprises (i) the capital provided (either directly or through other related enterprises) by a direct investor to a direct investment enterprise and (ii) the capital received by a direct investor from a direct investment enterprise.

Direct investment capital transactions are made up of the equity capital, the reinvested earnings and any other direct investment capital (or inter company debt transactions).

- Equity capital comprises equity in branches, all shares in subsidiaries and associates and other capital contributions.
- Reinvested earnings consist of the direct investor's share (in proportion to direct equity participation) of earnings not distributed, as dividends and earnings of branches not remitted to the direct investor.

I.1 CALCULATION OF THE STOCK OF FOREIGN DIRECT INVESTMENT

In presenting the direct investment statistics is taken into account the fact that the direct investments consist in the relations of the

foreign direct capital, derived from the participating interests of the non-resident units in the domestic enterprises. The FDI stock comprises:

1. the shares in the nominal capital held directly by shareholders (subscribed capital);

plus

2. the shares in the capital reserves and revenue reserves, as well as in the profits brought forward and in the profits for the year, to be attributed to the direct shareholders. These shares are determined based on the respective proportion shares of the individual direct shareholders in the nominal capital;

less

3. the shares in the losses brought forward and in the losses for the year to be attributed to the direct shareholders.

Aggregation of the items 1 to 3 above yields the direct investment capital.

The direct investment capital also comprises:

4. direct lending by direct or indirect shareholders in Albania or abroad.

plus

5. direct lending by other associated enterprises, namely – direct investment abroad – lending by affiliated enterprises in the country, and – in the case of foreign direct investment in the country – lending by affiliated enterprises domiciled outside the country.

Due to the lack of statistical information, in the calculation of the FDI stock are included only the three above mentioned items.

II NUMERICAL CHARACTERISTICS OF THE FDI ENTERPRISES IN ALBANIA

II.1 FOREIGN DIRECT INVESTMENTS (FDI) BY INVESTING COUNTRY

According to the origin of the investing country, Italy and Greece have a dominant position in foreign direct investment in Albania. 51 per cent of direct investment enterprises have participation of Italian foreign capital and 24 per cent of Greek foreign capital. The nearest followers are the Turkish capital (4 per cent) and the American one (3 per cent) (table 1). Meanwhile, we notice an opening toward China and the Middle East, accompanied by increasing flows of capital from these countries.

Table 1 Foreign direct investment by investing country

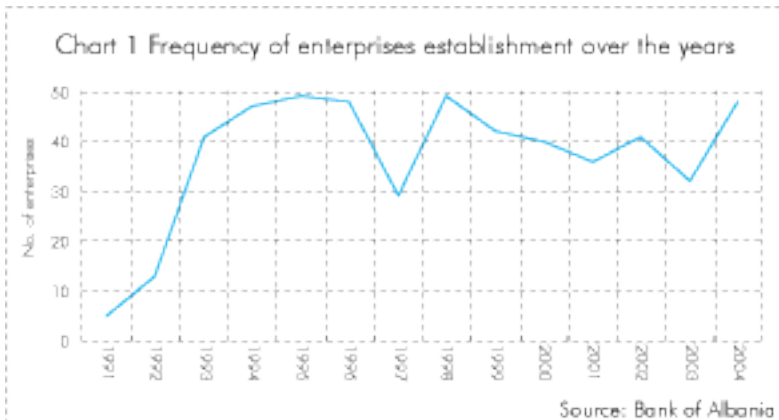
Investing Country	No. of enterprises	Percentage
European Union	434	82.5%
England	3	0.6%
Austria	3	0.6%
Belgium	1	0.2%
Bulgaria	2	0.4%
France	4	0.8%
Greece	128	24.3%
Germany	9	1.7%
Holland	2	0.4%
Hungary	7	1.3%
Italy	269	51.1%
Malta	1	0.2%
Cyprus	2	0.4%
Slovenia	2	0.4%
Sweden	1	0.2%
Regional countries	40	7.6%
Croatia	4	0.8%
Kosovo	6	1.1%
Macedonia	8	1.5%
Serbia and Montenegro	2	0.4%
Turkey	20	3.8%
Middle East & North Africa	15	2.9%
Saudi Arabia	3	0.6%
Egypt	3	0.6%
Kuwait	1	0.2%
Lebanon	6	1.1%
Israel	1	0.2%
Syria	1	0.2%
Far East	10	1.9%

China	10	1.9%
Australia	1	0.2%
United States of America	14	2.7%
Canada	2	0.4%
International Institutions	2	0.4%
Switzerland	2	0.4%
Other	6	1.1%
Total	526	100.0%

Source: Bank of Albania

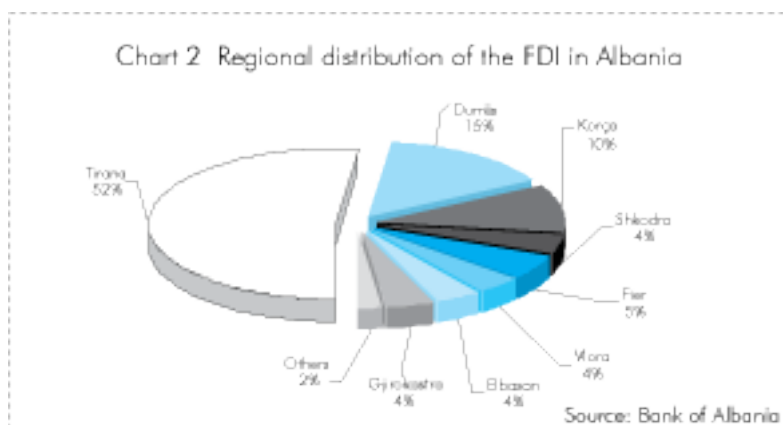
II.2 DYNAMICS OF THE ESTABLISHMENT OF NEW ENTERPRISES WITH FOREIGN CAPITAL

The frequency of FDI enterprises establishment in Albania, as expected, has followed the trends of the domestic economic development, since its opening to the foreign capital. The United Nations² cite the year 1990, as the year when the Albanian legislation first permitted the opening of the country toward foreign direct investment. The establishment of new enterprises with foreign capital participation in the country has increased over the first years of transition, having a recession during the socio-economic crisis of the year 1997 (chart 1). After this period, this trend has been moderated, also effected by the general problematic situation in the Balkans. The year 2004 seems to have had a positive trend.



II.3 GEOGRAPHICAL DISTRIBUTION OF FOREIGN DIRECT INVESTMENT

Regarding the geographical distribution of the FDI in Albania, it is noticed that they are mostly concentrated in Tirana and in the west part of the country (chart 2 and table 1 in the attached annex). The areas with the most concentration of the FDI are the ones with the highest income and the most developed infrastructure. The central internal zone and the northeast part of the country are the least favourite areas for the foreign investors. Apart from the undeveloped infrastructure of these areas and the lack of marketing, the internal and external migration, which makes it difficult to find qualified labour force, is considered to have played a role in this. However, there is a considerable percentage of the FDI in the borderline with Greece, like in Korça and in Gjirokastra.



II.4 CONCENTRATION OF THE LABOUR FORCE

Regarding the employment, there is a disproportion between the size of the enterprises and the labour force. Upon this, 46 per cent of the enterprises (table 2) have 1-9 employees, accounting for only 4 per cent of total employment. On the other hand, enterprises employing more than 100 employees represent only 12 per cent of FDI enterprises in Albania, employing about 61 per cent of the labour force. This means that there is a higher concentration

of FDI enterprises in Albania, in labour-intensive sectors, clearly observed in the concentration of the FDI by sectors.

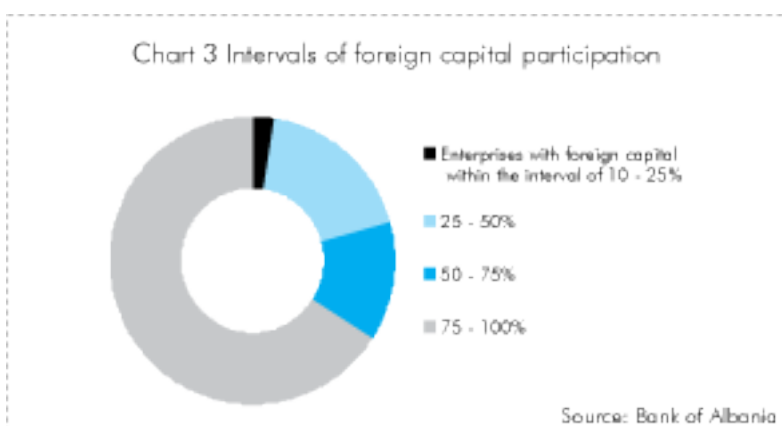
Table 2 Concentration of the labour force

No. of employed in enterprises:	Number of enterprises	%	Number of employed	%
1-9	238	46	901	4
10-50	171	33	4274	19
51-100	50	10	3777	17
over 100	62	12	13723	61
Total	521	100	22675	100

Source: Bank of Albania

II.5 FOREIGN CAPITAL PARTICIPATION

The participation of the foreign capital in around 66 per cent of the enterprises is within the interval of 75-100 per cent of the subscribed capital (chart 3). What stands out is the relatively high presence of the foreign capital in the enterprises with most employed people. Enterprises totally owned by foreign investors account for 56 per cent of the surveyed ones.



II.6 FOREIGN DIRECT INVESTMENT BY SECTORS OF ECONOMY

The sectoral distribution of foreign direct investment in Albania shows a high level of concentration in the manufacturing industry and the wholesale trade (table 3).

This means that there have been more investments in sectors with high returns on investment. These investments may be considered unstable, because of the quick change of their geographic location and the sector they are operating.

Meanwhile, investments in the manufacturing industry, represented by textiles and footwear, aim at labour-intensive sectors rather than capital or technological intensive ones. Hence, the role of these investments in improving the technology of the domestic production has fewer positive effects on other sectors of production. The last one may be also explained by the higher domestic demand for short-term consumer goods.

Combining these results with those on employment, we conclude that investment in industry have aimed at labour-intensive sectors rather than capital or technological intensive ones. This leaves little space to the role of foreign investment in the transfer of technology and in the enhancement of the technological capacity of domestic production, minimizing the positive side effects of these investments in other sectors of production.

(The analytical distribution of enterprises by economic activity is provided in table 2 of the attached annex.)

Table 3 Distribution of enterprises by sectors (NACE Rev. 1.1)

Section	Description	Number of enterprises	%
A	Agriculture, hunting and forestry	3	1
B	Fishing	3	1
C	Extraction industry	12	2
D	Manufacturing industry	234	45
E	Electricity, gas and water supply	2	0
F	Construction	41	8
G	Wholesale and retail trade; repair of motor vehicles, motorcycles and personal and household goods	142	27
H	Hotels and restaurants	7	1
I	Transportation, storage and communication	24	5
J	Monetary and financial intermediation	4	1
K	Real estate, renting, information technology, research and business activities	24	5
L	Public administration and defence; compulsory social security	0	0
M	Education	4	1
N	Health and social work	5	1
O	Other community, social and personal service activities	15	3

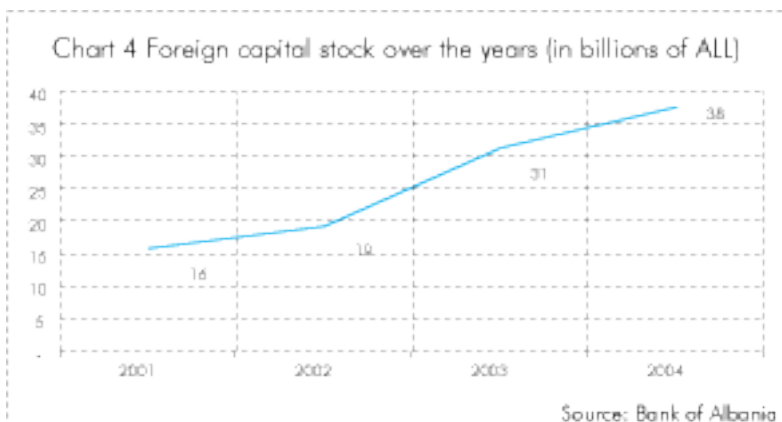
P	Activities of households	0	0
Q	Extra-territorial organizations and bodies	0	0
	n.a	1	0
	TOTAL	521	100

Source: Bank of Albania

III QUANTITATIVE CHARACTERISTICS OF FOREIGN DIRECT INVESTMENT

III.1 FOREIGN CAPITAL STOCK

Starting from the available information and basing on the above explained methodology, the foreign capital stock, in the form of direct investment, is estimated at the level of ALL 38 billion for year 2004.



48 new direct investment enterprises were established over 2004 in Albania, bringing in a new flow of foreign capital of ALL 28.6 million. This flow of capital has been mainly absorbed by textiles, wholesale trade of foodstuffs, etc.

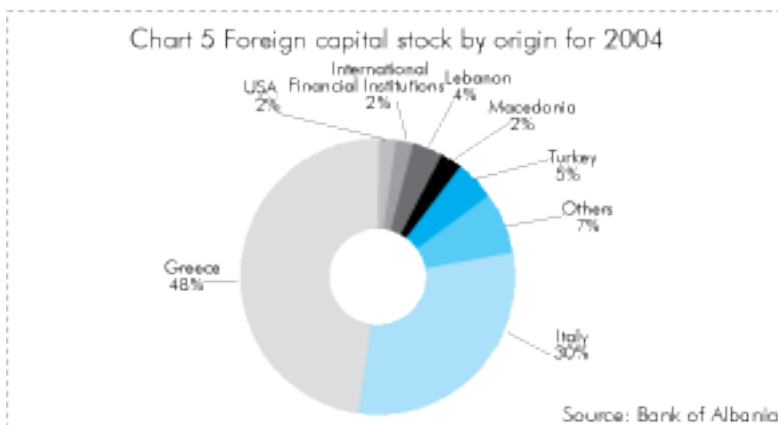
In addition, over 2004, in more than 12 per cent of the interviewed enterprises, the boards of shareholders have made decisions on increasing the subscribed capital, increasing the foreign capital in Albania by about ALL 5 billion. It seems that the foreign investors are evaluating the investment environment

of our country. Reinvested earnings for 2004 were estimated at ALL 10 billion, considerably higher compared to the previous year, and it maintains the highest level for the period being analyzed.

III.2. FOREIGN CAPITAL ORIGIN

Investors from EU countries dominate FDI in Albania. At year end 2004, no less than 82 per cent of total FDI stock was accounted for EU countries, the major investors among them being Greece (with 48 per cent of total foreign equity stock at year end 2004) and Italy (with 30 per cent). (chart 4 and table 3 in the attached annex). Of non-EU countries, only Turkey and Lebanon are considered to be significant investors.

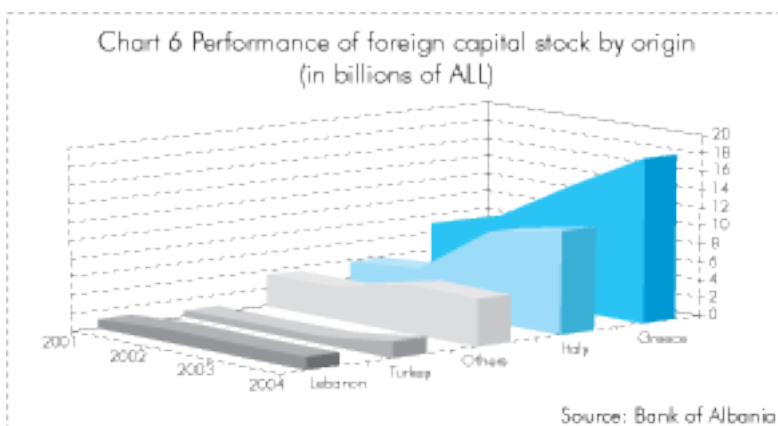
Greece and Italy have considerably increased their presence in the foreign equity stock in Albania. Albania's geographical proximity to these countries and its strong economic collaboration with the EU, are the main reasons for the domination of foreign investors from these countries.



The growth of the foreign capital stock over the years seems to have been more significant for the Greek capital. By the end of 2004, the latter was estimated at about ALL 18 billion, from ALL 7 billion at year ended 2001 (chart 5). Greek capital is

mainly concentrated in the communication sector (68 per cent), due to its participation in the privatization process over 2000-2001, and to the wholesale trade (13 per cent). Its presence in textiles has become weaker over the recent years.

Italian capital, for the surveyed period (2001-2004), has maintained its representation with investment in the manufacturing industry between the intervals of 60-65 per cent. By the end of 2004, the Italian capital stock was estimated at about ALL 11.3 billion from ALL 3.8 billion in 2001.



III.3. DISTRIBUTION BY ECONOMIC ACTIVITY

Accounting for 36 per cent of total FDI stock at the end of 2004 and 45 per cent of the total foreign enterprises, manufacturing industry is by far the most attractive sector of FDI in Albania (table 5). Within the manufacturing sector, foreign capital, accounting for more than 65 per cent, is concentrated in textile and clothes industry, food processing and furniture. Manufacturing industries using technology (such as, medical and pharmaceutical, electrical machinery and equipment and electronics) and using the capital (such as, refined petroleum products and chemical products) almost share the remaining part. This indicates that a strong motivation for the foreign companies has been the competitive advantage of the cheap labour force.

The communication sector, being represented by only 5 enterprises, shares about 33 per cent of the foreign capital stock, by the end of 2004. The wave of privatizations over 2000-2001 attracted potential investors in this industry. Foreign capital invested in this sector has shown an increasing trend in the last years, by raising their share in nominal capital as well as the rate of reinvested earnings and investment over the fiscal year.

The rapid developments in the construction sector over the last years, are calling the attention of foreign investors. The presence of foreign capital in this sector has increased considerably over the last two years, bringing new flows of foreign capital even in other supporting fields, such as in architectonic and engineering activities (classified under section K, table 5).

Table 4 Distribution of foreign capital stock by sectors (NACE Rev 1.1) (in percentage)

Section	Description	2001	2002	2003	2004
					%
A	Agriculture, hunting and forestry	0.8	0.6	0.4	0.5
B	Fishing	0.0	0.0	0.0	0.0
C	Extraction industry	3.0	1.9	1.2	1.2
D	Manufacturing industry	33.1	31.7	37.8	36.3
E	Electricity, gas and water supply	0.0	0.5	0.3	0.2
F	Construction	4.8	4.7	5.6	5.6
G	Wholesale and retail trade; repair of motor vehicles, motorcycles and personal and household goods	10.4	6.8	5.6	9.6
H	Hotels and restaurants	6.7	5.5	3.4	3.0
I	Transportation, storage and communication	35.8	43.0	38.9	36.9
J	Monetary and financial intermediation	4.4	3.8	2.7	2.4
K	Real estate, renting, information technology, research and business activities	0.2	1.0	2.7	3.3
L	Public administration and defence; compulsory social security	0.0	0.0	0.0	0.0
M	Education	0.0	0.0	0.1	0.1
N	Health and social work	0.0	0.0	0.0	0.1
O	Other community, social and personal service activities	0.5	0.4	1.1	0.9
P	Activities of households	0.0	0.0	0.0	0.0
Q	Extra-territorial organizations and bodies	0.0	0.0	0.0	0.0
	n.a.	0.3	0.2	0.1	0.1
	TOTAL	100.0	100.0	100.0	100.0

Source: Bank of Albania

(The analytical distribution of foreign capital stock by sectors of economy is provided in table 4 of the attached annex.)

III.4 INVESTMENT OVER THE FISCAL YEAR 2004

Rate of responses for this section is 56 per cent.

According to the available information from enterprises, about 100 per cent of investment flow over 2004 was used for fixed assets.

The total investment amounted to ALL 15 billion, out of which ALL 14 billion relate to foreign investors' quota.

More than half of total investment was used for technical installations, machinery and equipment.

Table 5 Structure of investment over the fiscal year 2003

Total Investments (I+II)	100.0
I. Intangibles	0.1
II. Tangibles	99.9
Out of which	
1. Land	1.7
2. Buildings	3.7
3. Construction and general installations	22.6
4. Technical installations, machinery, equipment, tools	51.6
5. Transportation means	3.2
6. Office and information technology equipment	2.5
7. Other	14.7

Source: Bank of Albania

The manufacturing industry results to be the sector with the major flow of investment over the fiscal year 2004, accounting for about 42 per cent, followed by the communication sector with about 39 per cent.

Table 6 Structural distribution of investment over the fiscal year 2004 by sectors of economy

Section	Description	%
A	Agriculture, hunting and forestry	0.2
B	Fishing	0.0
C	Extraction industry	2.0
D	Manufacturing industry	42.2
E	Electricity, gas and water supply	0.5
F	Construction	1.3
G	Wholesale and retail trade; repair of motor vehicles, motorcycles and personal and household goods	10.4
H	Hotels and restaurants	0.5
I	Transportation, storage and communication	38.5
J	Monetary and financial intermediation	0.0
K	Real estate, renting, information technology, research and business activities	2.9

L	Public administration and defence; compulsory social security	0.0
M	Education	1.0
N	Health and social work	0.2
O	Other community, social and personal service activities	0.3
P	Activities of households	0.0
Q	Extra-territorial organizations and bodies	0.0
	TOTAL	100.0

Source: Bank of Albania

ANNEX

Table 1 Foreign investment in Albania - by statistical region

No.	County	No.	Districts	No. of enterprises
1	Berat	1	Berat	7
		2	Kuçovë	7
		3	Skrapar	8
2	Dibër	4	Dibër	0
		5	Mat	
		6	Bulqizë	
3	Durrës	7	Durrës	76
		8	Krujë	68
4	Elbasan	9	Elbasan	8
		10	Peqin	21
		11	Gramsh	20
		12	Librazhd	1
5	Fier	13	Fier	24
		14	Mallakastër	20
		15	Lushnjë	4
6	Gjirokastrë	16	Gjirokastrë	19
		17	Tepelenë	18
		18	Përmet	1
7	Korçë	19	Korçë	52
		20	Devoll	48
		21	Kolonjë	1
		22	Pogradec	1
8	Kukës	23	Pogradec	2
		24	Kukës	0
		25	Has	
9	Lezhë	26	Tropojë	5
		27	Lezhë	5
		28	Kurbin	
10	Shkodër	29	Mirditë	
		30	Shkodër	23
		31	Malësi e Madhe	23
11	Tirana	32	Pukë	
		33	Tirana	273
		34	Kavajë	271
12	Vlorë	35		2
		36	Vlorë	21
		37	Sarandë	17
		38	Delvinë	2
	Total	36		521

Table 2 No. of Albanian enterprises with foreign direct investment (direct affiliation) - by activity, end-year 2004

NACE	DESCRIPTION	No	%
A	Agriculture, hunting and forestry	3	1
'01	Agriculture, hunting and related service activities	2	0
'02	Forestry, logging and related service activities	1	0
B	Fishing	3	1
'05	Fishing, fish farming and related service activities	3	1
C	Mining and quarrying	12	2
CA	Mining and quarrying of energy producing materials	3	1
'10	Mining of coal and lignite; extraction of peat	0	-
'11	Extraction of crude petroleum and natural gas; service activities incidental to oil and gas extraction, excluding surveying	3	1
'12	Mining of uranium and thorium ores	0	-
CB	Mining and quarrying, except of energy producing materials	9	2
'13	Mining of metal ores	0	-
'14	Other mining and quarrying	9	2
D	Manufacturing	234	45
DA	Manufacture of food products, beverages and tobacco	14	3
'15	Manufacture of food products and beverages	12	2
'16	Manufacture of tobacco products	2	0
DB	Manufacture of textiles and textile products	92	18
'17	Manufacture of textiles	3	1
'18	Manufacture of wearing apparel; dressing and dyeing of fur	89	17
DC	Manufacture of leather and leather products	29	6
'19	Tanning and dressing of leather; manufacture of luggage, handbags, saddlery, harness and footwear	29	6
DD	Manufacture of wood and wood products	8	2
'20	Manufacture of wood and of products of wood and cork, except furniture; manufacture of articles of straw and plaiting materials	8	2
DE	Manufacture of pulp, paper and paper products; publishing and printing	10	2
'21	Manufacture of pulp, paper and paper products	4	1
'22	Publishing, printing and reproduction of recorded media	6	1
DF	Manufacture of coke, refined petroleum products and nuclear fuel	0	-
'23	Manufacture of coke, refined petroleum products and nuclear fuel	0	-
DG	Manufacture of chemicals, chemical products and man-made fibres	7	1
'24	Manufacture of chemicals and chemical products	7	1

DH	Manufacture of rubber and plastic products	12	2
'25	Manufacture of rubber and plastic products	12	2
DJ	Manufacture of other non-metallic mineral products	20	4
'26	Manufacture of other non-metallic mineral products	20	4
DJ	Manufacture of basic metals and fabricated metal products	14	3
'27	Manufacture of basic metals	2	0
'28	Manufacture of fabricated metal products, except machinery and equipment	12	2
DK	Manufacture of machinery and equipment n.e.c.	1	0
29	Manufacture of machinery and equipment n.e.c.	1	0
DL	Manufacture of electrical and optical equipment	10	2
30	Manufacture of office machinery and computers	0	-
31	Manufacture of electrical machinery and apparatus n.e.c.	7	1
32	Manufacture of radio, television and communication equipment and apparatus	1	0
33	Manufacture of medical, precision and optical instruments, watches and clocks	2	0
DM	Manufacture of transport equipment	1	0
34	Manufacture of motor vehicles, trailers and semi-trailers	0	-
35	Manufacture of other transport equipment	1	0
DN	Manufacturing n.e.c.	16	3
36	Manufacture of furniture; manufacturing n.e.c.	16	3
37	Recycling	0	-
E	Electricity, gas and water supply	2	0
40	Electricity, gas, steam and hot water supply	1	0
41	Collection, purification and distribution of water	1	0
F	Construction	41	8
45	Construction	41	8
G	Wholesale and retail trade; repair of motor vehicles, motorcycles and personal and household goods	142	27
50	Sale, maintenance and repair of motor vehicles and motorcycles; retail sale of automotive fuel	8	2
51	Wholesale trade and commission trade, except of motor vehicles and motorcycles	108	21
52	Retail trade, except of motor vehicles and motorcycles; repair of personal and household goods	26	5
H	Hotels and restaurants	7	1
55	Hotels and restaurants	7	1
I	Transport, storage and communication	24	5
60	Land transport; transport via pipelines	4	1
61	Water transport	2	0

62	Air transport		3	1
63	Supporting and auxiliary transport activities; activities of travel agencies		10	2
64	Post and telecommunications		5	1
J	Financial intermediation		4	1
65	Financial intermediation, except insurance and pension funding		2	0
66	Insurance and pension funding, except compulsory social security		2	0
67	Activities auxiliary to financial intermediation		-	-
K	Real estate, renting and business activities		24	5
70	Real estate activities		9	2
71	Renting of machinery and equipment without operator and of personal and household goods		2	0
72	Computer and related activities		2	0
73	Research and development		0	-
74	Other business activities		11	2
L	Public administration and defence; compulsory social security		0	-
75	Public administration and defence; compulsory social security		0	-
M	Education		4	1
80	Education		4	1
N	Health and social work		5	1
85	Health and social work		5	1
O	Other community, social and personal service activities		15	3
90	Sewage and refuse disposal, sanitation and similar activities		2	0
91	Activities of membership organizations n.e.c.		6	1
92	Recreational, cultural and sporting activities		6	1
93	Other service activities		1	0
P	Activities of households		0	-
95	Activities of households as employers of domestic staff		0	-
96	Unaffiliated goods producing activities of private households for own use		0	-
97	Unaffiliated services producing activities of private households for own use		0	-
Q	Extra-territorial organizations and bodies		0	-
99	Extra-territorial organizations and bodies		0	-
	n.a.		1	
Total			521	100

Table 3 Foreign direct investment in Albania by investing country 2001 - 2004. end-year stock in 000 Lekë

	2001	%	2002	%	2003	%	2004	%
European Union	12,197,774	77	15,119,893	79	25,641,738	82	31,085,736	82
of that								
Austria	873,285	5	873,390	5	874,102	3	874,117	2
Greece	6,973,210	44	9,205,083	48	13,906,849	45	18,139,697	48
Germany	290,252	2	388,130	2	382,921	1	369,613	1
Italy	3,760,558	24	4,410,597	23	9,896,521	32	11,314,441	30
Other countries	300,469	2	242,693	1	581,346	2	387,868	1
Europe & Central Asia	1,210,619	8	1,251,390	6	2,048,256	7	3,152,459	8
of that								
Croatia	178,110	1	178,110	1	281,907	1	325,792	1
Kosovo	51,243	0	77,060	0	92,608	0	115,890	0
Macedonia, Former Yugoslav Republic	278,968	2	247,644	1	849,865	3	898,669	2
Turkey	702,246	4	748,523	4	816,074	3	1,803,815	5
Other countries	53	0	53	0	7,801	0	8,292	0
Middle East & North Africa	1,521,447	10	1,932,085	10	1,882,647	6	1,972,923	5
of that								
Egypt	527,980	3	528,674	3	529,955	2	543,731	1
Lebanon	991,429	6	1,401,013	7	1,350,110	4	1,354,149	4
Other countries	2,039	0	2,398	0	2,582	0	75,043	0
East Asia & Pacific	777	0	777	0	38,306	0	13,515	0
China	777	0	777	0	38,306	0	13,515	0
United States	278,441	2	327,376	2	890,437	3	757,264	2
International Organisations	696,269	4	696,269	4	696,269	2	696,269	2
Other countries	13,146	0	-72,784	0	12,804	0	29,994	0
Total	15,918,473	100	19,255,005	100	31,210,458	100	37,708,160	100

Table 4 Foreign direct investment in Albania - by activity 2001 - 2004. end-year stock in 000 Lekë

NACE	DESCRIPTION	2001	2002	2003	2004
A	Agriculture, hunting and forestry	122,599	123,642	122,187	177,435
'01	Agriculture, hunting and related service activities	122,450	123,493	122,038	177,285
'02	Forestry, logging and related service activities	150	150	150	150
B	Fishing	3,871	5,400	5,301	5,157
'05	Fishing, fish farming and related service activities	3,871	5,400	5,301	5,157
C	Mining and quarrying	478,818	367,904	369,849	446,866
CA	Mining and quarrying of energy producing materials	3,051	-78,139	-15,339	-3,072
'10	Mining of coal and lignite; extraction of peat				
'11	Extraction of crude petroleum and natural gas; service activities incidental to oil and gas extraction, excluding surveying	3,051	-78,139	-15,339	-3,072
'12	Mining of uranium and thorium ores				
CB	Mining and quarrying, except of energy producing materials	475,767	446,042	385,188	449,938
'13	Mining of metal ores				
'14	Other mining and quarrying	475,767	446,042	385,188	449,938
D	Manufacturing	5,276,885	6,097,960	11,805,036.97	13,701,582
DA	Manufacture of food products, beverages and tobacco	1,087,117	1,122,912	4,890,497	4,071,129
'15	Manufacture of food products and beverages	898,688	928,740	4,704,788	3,884,379
'16	Manufacture of tobacco products	188,430	194,172	185,708	186,749
DB	Manufacture of textiles and textile products	1,016,115	1,193,020	1,325,668	1,440,979
'17	Manufacture of textiles	26,442	26,303	22,946	23,705
'18	Manufacture of wearing apparel; dressing and dyeing of fur	989,673	1,166,717	1,302,722	1,417,274
DC	Manufacture of leather and leather products	281,515	302,533	442,715	450,686
'19	Tanning and dressing of leather; manufacture of luggage, handbags, saddlery, harness and footwear	281,515	302,533	442,715	450,686
DD	Manufacture of wood and wood products	183,867	184,927	306,678	280,800
'20	Manufacture of wood and of products of wood and cork, except furniture; manufacture of articles of straw and plaiting materials	183,867	184,927	306,678	280,800
DE	Manufacture of pulp, paper and paper products; publishing and printing	10,673	7,491	16,082	53,428
'21	Manufacture of pulp, paper and paper products	210	222	690	34,711
'22	Publishing, printing and reproduction of recorded media	10,463	7,269	15,392	18,717

DF	Manufacture of coke, refined petroleum products and nuclear fuel	0	0	0	0	0
'23	Manufacture of coke, refined petroleum products and nuclear fuel					
DG	Manufacture of chemicals, chemical products and man-made fibres	68,158	70,855	73,613	73,613	85,881
'24	Manufacture of chemicals and chemical products	68,158	70,855	73,613	73,613	85,881
DH	Manufacture of rubber and plastic products	136,086	139,851	289,950	278,368	278,368
'25	Manufacture of rubber and plastic products	136,086	139,851	289,950	278,368	278,368
DI	Manufacture of other non-metallic mineral products	1,447,380	1,940,798	2,804,110	3,678,295	3,678,295
'26	Manufacture of other non-metallic mineral products	1,447,380	1,940,798	2,804,110	3,678,295	3,678,295
DJ	Manufacture of basic metals and fabricated metal products	588,372	497,227	598,430	1,739,017	1,739,017
'27	Manufacture of basic metals	415,200	282,455	294,411	913,092	913,092
'28	Manufacture of fabricated metal products, except machinery and equipment	173,172	214,772	304,019	825,925	825,925
DK	Manufacture of machinery and equipment n.e.c.	105	371	105	1,266	1,266
29	Manufacture of machinery and equipment n.e.c.	105	371	105	1,266	1,266
DL	Manufacture of electrical and optical equipment	8,143	8,008	382,507	913,872	913,872
30	Manufacture of office machinery and computers					
31	Manufacture of electrical machinery and apparatus n.e.c.	7,985	7,735	381,700	913,143	913,143
32	Manufacture of radio, television and communication equipment and apparatus	105	105	105	105	105
33	Manufacture of medical, precision and optical instruments, watches and clocks	53	168	702	624	624
DM	Manufacture of transport equipment	372,795	548,024	586,110	610,119	610,119
34	Manufacture of motor vehicles, trailers and semi-trailers					
35	Manufacture of other transport equipment	372,795	548,024	586,110	610,119	610,119
DN	Manufacturing n.e.c.	76,560	81,944	88,572	97,743	97,743
36	Manufacture of furniture; manufacturing n.e.c.	76,560	81,944	88,572	97,743	97,743
37	Recycling					
E	Electricity, gas and water supply	105	87,204	87,204	87,204	87,204
40	Electricity, gas, steam and hot water supply	0	54	54	54	54
41	Collection, purification and distribution of water	105	87,150	87,150	87,150	87,150
F	Construction	762,983	900,195	1,749,458	2,093,426	2,093,426
45	Construction	762,983	900,195	1,749,458	2,093,426	2,093,426
G	Wholesale and retail trade; repair of motor vehicles, motorcycles and personal and household goods	1,659,806	1,300,980	1,743,499	3,609,569	3,609,569

50	Sale, maintenance and repair of motor vehicles and motorcycles; retail sale of automotive fuel	83,675	70,782	85,795	95,081
51	Wholesale trade and commission trade, except of motor vehicles and motorcycles	1,549,288	1,202,486	1,567,595	3,409,868
52	Retail trade, except of motor vehicles and motorcycles; repair of personal and household goods	26,843	27,712	90,109	104,621
H	Hotels and restaurants	1,062,455	1,062,730	1,066,422	1,130,254
55	Hotels and restaurants	1,062,455	1,062,730	1,066,422	1,130,254
I	Transport, storage and communication	5,692,778	8,278,967	121,529,680	13,896,890
60	Land transport; transport via pipelines	16,362	18,678	21,981	259,975
61	Water transport	5,167	-14,078	5,357	-125,036
62	Air transport	929,905	976,537	984,347	1,343,694
63	Supporting and auxiliary transport activities; activities of travel agencies	11,692	12,309	21,778	16,181
64	Post and telecommunications	4,729,653	7,285,521	11,119,534	12,402,076
J	Financial intermediation	705,069	726,789	848,860	893,634
65	Financial intermediation, except insurance and pension funding	1,155	1,155	104,952	148,836
66	Insurance and pension funding, except compulsory social security	703,914	725,634	743,908	744,797
67	Activities auxiliary to financial intermediation				
K	Real estate, renting and business activities	28,650	186,855	848,618	1,226,813
70	Real estate activities	21,567	42,678	678,499	713,149
71	Renting of machinery and equipment without operator and of personal and household goods	2,100	137,795	139,761	142,835
72	Computer and related activities	0	0	0	210
73	Research and development				
74	Other business activities	4,982	6,382	30,358	370,620
L	Public administration and defence; compulsory social security	0	0	0	0
M	Public administration and defence; compulsory social security				
80	Education	210	289	21,253	23,598
81	Education	210	289	21,253	23,598
N	Health and social work	2,132	2,132	14,821	20,819
85	Health and social work	2,132	2,132	14,821	20,819
O	Other community, social and personal service activities	78,012	69,860	330,851	350,812
90	Sewage and refuse disposal, sanitation and similar activities	200	1,318	200	1,834

91	Activities of membership organizations n.e.c.		70,792	59,397	59,039	71,982
92	Recreational, cultural and sporting activities		6,756	8,965	271,433	276,646
93	Other service activities		266	180	180	351
P	Activities of households		0	0	0	0
95	Activities of households as employers of domestic staff					
96	Undifferentiated goods producing activities of private households for own use					
97	Undifferentiated services producing activities of private households for own use					
Q	Extra-territorial organizations and bodies		0	0	0	0
99	Extra-territorial organizations and bodies		44,100	44,100	44,100	44,100
	n.a.		15918472.668058	19,255,005	31210457.555887	37,708,160
Total						

NOTES

* Argita Frashëri, Head of Balance of Payments Division, Statistics Department.

¹ Razin, A.: FDI flows, a critical look, NBER Reporter Spring 2002.

² United Nation, World Investment Report, 1992.

HOW DOES THE EMU, AS WELL AS THE STABILITY AND GROWTH PACT, INFLUENCE MEMBER STATES' ABILITY TO CONDUCT EFFICIENT ECONOMIC POLICY?

Bledar Hoda*

Key words

- European Monetary Union - Stability and Growth Pact - Euro - European Central Bank -

ABSTRACT

The essay makes a review of the existing literature of the assessment of EMU policies, particularly SGP measures. The objective of setting a framework for coordinating economic policy in Euro area is not wrong by any standard, though there are different views as to how optimal that framework is. The stance towards its feasibility in terms of regulatory lay out and of political compromise among member states is not covered. The essay is outlined as follows; first, it introduces the rationale for a common currency. It summarizes some of lasting positive effects while putting down the costs in terms of short-term negative impacts of the common monetary policy in Euro area. In the third section, it explains SGP neglecting two important macroeconomic indicators of member states, growth potential and debt level, with a view to support the idea that it needs to be a function of these two variables. The essay closes with some general remarks.

I INTRODUCTION

The euro zone has moved through different stages of cooperation and reconciliation during the second half of the

last century. Status quo of the continent has been defined by the course through which it has moved as well as the speed of accomplishments of necessary steps. The latter, that is the speed with which it has progressed, has been paved by specific national interests of member states, and Europe has a well documented pool of examples of opposite attitudes. Yet, the path of co-movement has been laid down well in advance by futurists who have seen the solution of political and cultural disputes in terms of joint economic objectives. Many of them have argued that sharing a common economic future as a long term perspective will override the short-term disputes. I join to this argument and further argue that it removes off the table the implementation of the zero-sum game strategy of fulfilling the objective of improving economic welfare, by not obeying to the Pareto-optimality condition¹.

II UNIFIED MONETARY POLICY

One of the most influential supporters of the idea of a single Europe, Jean Monet, has argued that sharing the very basic mean of measuring economic welfare, the money, would leave the European people and their leaders with no other option but to cooperate. It turns out that besides avoiding conflicts, economic cooperation has positive spill over effects in terms of productivity and welfare for its citizens. Europe has spent half a century to reconcile from the last dispute to implement such a cooperative strategy in terms of a common currency, the euro. The implementation of a common currency calls for a common monetary policy among member states, which has been well set through the set up of a central bank for the whole euro area. The single monetary policy is part of a more general framework of cooperation in terms of economic policy of the Economic and Monetary Union (EMU). A unified monetary policy and the EMU itself have been considered as the single most important event in post-war monetary history (Danthine et. al., 2000).

Member states tend to benefit from the positive impacts of a unified monetary policy. First, it introduces stable and low

long-term inflationary expectations for all member states due to absence of political influence, as such ensuring low inflation economic environment as ECB enjoys supranational power. Second, it gives new impetus to financial integration in EU area with positive spill over effects in terms of financial intermediation of the financial sector in the economy. Also, it opens the way for focusing member states policies exclusively on economic growth, leading to higher economic welfare for the community.

Some of the negative aspects of the common monetary policy stand on the monetary policy itself, while the others are more related to the lack of sufficient coordination with other economic policies in the EMU. The asymmetries in the Euro Area, in presence of low labor mobility, lead to disparities in regional economic stability. Also, the inflation target of close but below 2 may not be optimal for new entries in EU as it may not fit to growth potential of some regions. Yet, Mongelli argues that signs of increased divergence in growth rates that have emerged so far are limited, and the dispersion of real GDP growth rates in the euro area has remained very close to its historical average (Mongelli et.al., 2006).

Furthermore, the common monetary policy favors larger countries in the Euro area, since their inflation rates are more highly correlated with aggregate (Euro area) inflation. The welfare cost of wage and price stickiness in an average small country is four times greater than that in a large country (Canzoneri, 2004). By and large, the effects of the ECB's single monetary policy do, implicitly, enhance the implementation of structural reforms that are strongly recommended by economists. Canzoneri et. al., argues that euro area countries, as a group, have undertaken more structural reforms than they are normally given credit for after the birth of ECB, as such reforms take time to display their positive effects.

Yet, there has been more of that criticism why a single monetary policy may not be yet optimal for the euro area. A centralized monetary policy may not release its potential of positive effects under decentralized fiscal and economic policies. As the SGP

disregards that countries are different, it limits necessary flexibility to conduct country-, inflation- and growth-specific fiscal policies. While this was problematic already in the EU-15, it is even more so in the EU-25, given that the new Member States' economic variables such as real GDP growth, inflation and public debt differ significantly from those of the old members, due to their transition process and catching-up endeavors (Wenzel, 2004).

III COORDINATING FISCAL AND OTHER ECONOMIC POLICIES

Economic policies have largely remained the responsibility of the member states. EU institutions, constituting of representatives of member states, have set out main outlines to be followed by each member state in order to coordinate individual economic policies with each other, as well as with the common monetary policy of EU. These outlines have been formally set under the Stability and Growth Pact which has been adopted at Amsterdam European Council in June '97. The Stability and Growth Pact (SGP) sets a framework for coordinating Economic and Monetary Union policies, mainly focusing on monetary and fiscal policy objectives. The framework as set in 1997 covers four principles, two of which are particularly relevant.

- *Price stability.* Under this pact, EU through its policies and institutions would set price stability as an objective in the medium term. Sustainable price stability is defined as a 12-month average inflation of less than 1.5 basis points more than that of, at most, the three best performing member states. With the set-up of ECB in 1999, inflation objective of the whole euro area is defined as close but less than 2 per cent.
- *Public finance.* Sustainable financial position defined as:
 1. general government deficit of less than or equal to 3 per cent of GDP,
 2. gross debt total of less than or equal to 60 per cent of GDP or approach it at a satisfactory pace.

The SGP of 1997 required also interest rate stability defined as an average 12-month long-term Government Bond yields be at most less than or equal to 2 percent higher than that of the three member countries with the lowest inflation. It also conditioned on member countries exchange rate policy. Also, each country was expected to respect the normal fluctuation margins of the Exchange Rate Mechanism for at least 2 years with no devaluation of currency against any other member's currency on its own initiative. With the introduction of Euro as a currency in January 1, 1999 these conditions did not apply any further.

The first principle of price stability is resolved by a common monetary policy. The second issue, regarding fiscal policy, but relevant for other economic policies, sets a constraint for all member countries' fiscal policies. Such a flat boundary penalizes most countries on the developing phase, while it rewards inefficiently other countries through moral hazard related implications of this boundary or ceiling. It turns out that it may only fit for a very small number of member states. SGP disregards that countries are different, and limits necessary flexibility to conduct country-, inflation- and growth-specific fiscal policies (Wenzel et. al 2004).

The issues of penalization and rewarding could be set in a more theoretical background without a specific model applying to a specific country. From an economic textbook perspective, the higher is a country's potential for economic growth, the larger the fiscal deficit it can afford without risking debt default or financial costs in terms of financial credibility in the markets. Also, unsustainable fiscal deficits in one country have spill over effects to other member states as well. Calmfors (1998) highlights that the international transmission of fiscal policy between countries takes place not via the government deficit, but via the country's net exports. Assuming a linear relationship of the two variables, it can be represented in a textbook type of graph (see Appendix).

It has been rightly argued in vast literature that high nominal GDP growth rates (through real GDP catch-up and Balassa-

Samuelson effects with a fixed exchange rate or a common currency) make, other things being equal, higher deficit-GDP ratios sustainable in accession countries. Higher real GDP growth rates and lower risk-free real interest rates (through financial market integration and Balassa- Samuelson effects) also enhance the fiscal authorities' ability to sustain debt and deficits (Buiter et al, 2002).

It simply makes the SGP rule of 3 per cent penalize countries with high growth potential. This becomes a self fulfilling result since limiting public expenditure of a country with high growth potential, cuts off the capital expenditure required to achieve the higher growth that this country can potentially achieve. The need to catch up in the areas of infrastructure and environmental standards also justifies increased, albeit strictly limited, recourse to borrowing. As a result these countries' growth rates remain below their potential, slowing down the catch up process in terms of per capita income of its citizens. It happens that countries with high growth potential are countries that have low per capita income, mostly the newly accessing countries of EU.

The second macroeconomic variable which SGP disregards is debt to GDP ratio. Countries with low debt to GDP ratios can afford higher fiscal deficits for many years. Such countries that have to fulfill the criteria of 3 per cent fiscal deficit may find their economies missing growth opportunities. The reason for this bias is that the existence of a single currency for the entire Eurozone means that excessive fiscal deficits in any individual country do not cause the rise in that nation's interest rates or the change in its exchange rate that would occur in a country with its own currency. In short, there is no market feedback to discipline large budget deficits. Also, a country that increases its own budget deficit contributes to this Eurozone problem but does not bear any proportionate share of the adverse effect. This free rider problem becomes increasingly important as the number of countries in the European Economic and Monetary Union (the EMU) increases. It is this fiscal externality that justifies an agreement among the countries to limit their deficits (Feldstein 2005).

Chart 1 Positive relationship between growth potential and sustainable fiscal deficit (left), and a negative relationship between debt stock (% of GDP) and its affordable fiscal deficit

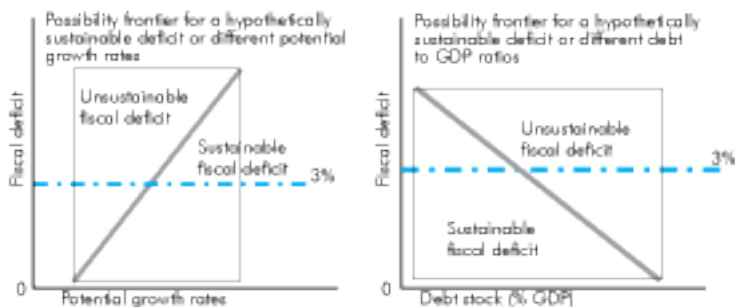


Chart 2 Inverse relationship between per capita GDP and potential economic growth



All said, deficits are more sensitive to interest rates in high debt countries, due to the burden of debt service. In addition, high debt countries tend to have higher tax rates, increasing tax distortions, and making tax revenues more sensitive to changes in the tax base. These factors lead to welfare costs. Collignon (2003) calculates that a typical household in a high debt country would be willing to give up 1.3 per cent percent of its consumption each period to live in an average country, implying a country without debt related problems. Other analysts of SGP argue against any fiscal constraint unless central bank enjoys independence (Cari et. al., 2004). The desirability of fiscal constraints in monetary unions depends critically on whether the

monetary authority can commit to follow its policies. This type of issue arises because of a time inconsistency problem.

If it can commit, then debt constraints can only impose costs. If it cannot commit, then fiscal policy has a free-rider problem, and debt constraints may be desirable.

IV FINAL REMARKS

The launch of the euro is part of a long process of macroeconomic convergence, and yet efforts should be inputted in terms of economic policy coordination in order to building a robust monetary union.

In short, the combination of a centralized monetary policy and a decentralized fiscal structure in Europe increases the need for and the effectiveness of countercyclical fiscal policy. The problems will arise when the worsened budget deficits become irreversible in a relatively short time due to downturns in business cycles.

A static model like SGP may not be optimal for all of the member states of EU and that economic policy under such a model should incorporate country-specific measures on basis of regions and development stages.

NOTES

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¹ This would be my own definition of an armed conflict, called “war” in the very traditional sense, from a basic economic point of view.

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ON THE FINDINGS OF THE ROSC MISSION ON THE STATISTICAL DATA DISSEMINATION MARCH - APRIL 2006

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Kliti Ceca

Key words

- Data dissemination - ROSC Mission - Macroeconomic statistics - DQAF -

ACRONYMS:

BPM5 – Balance of Payments Statistics Manual, fifth edition
COICOP – Classification of Individual Consumption by Purpose
CPI – Consumer Price Index
DMFAS – Debt Management and Financial Analysis System. In use by the Ministry of Finance
DMFAS – Debt Management and Financial Analysis System. In use by the Ministry of Finance
DQAF – Data Quality Assessment Framework
FSAP – Financial Sector Assessment Program
GDDS – General Data Dissemination System
GDP – Gross Domestic Product
GFS 1986 – Government Finance Statistics, 1986
GFSM 2001 – Government Finance Statistics Manual, IMF, 2001
HBS – Households Budget Survey
IIP – International Investment Position
IMF – International Monetary Fund
ISWGNA – Intersecretariat Working Group on National Accounts
ITRS – International Transaction Reporting System
MFSM 2000 – Monetary and Financial Statistics Manual, IMF, 2000
NACE Rev. 1 – Statistical Classification of Economic Activities in the European Communities, Revision 1
PPI – Producer Price Index
ROSC – Report on the Observance of Standards and Codes

SBS – Structural Business Survey
SDDS – Special Data Dissemination Standard
SNA 93 – System of National Accounts, 1993
WB – World Bank

ABSTRACT

This paper summarizes the findings of the ROSC Mission on the statistical data dissemination, which visited Albania over March – April 2006. The Mission made a positive assessment of the progress achieved in producing and disseminating the national statistics since 2000. The Mission’s findings and the recommendations left in order to improve the Albanian statistical framework constitute the core of the future developing plans of the three main national statistical agencies: INSTAT, the Bank of Albania and the Ministry of Finance.

INTRODUCTION

ROSC Mission on data dissemination visited Albania for the second time over March – April 2006. The assessment of the statistical processes development in Albania, the identification of problems and the taking of measures timely precedes one of the most important projects of national statistics: membership to the SDDS project. This paper summarizes the findings and recommendations of the Mission on the five main macroeconomic statistics categories: external sector statistics, national accounts, prices statistics, monetary statistics and fiscal statistics of the Government.

The first part of the paper provides some information on ROSC and its importance in the development of one’s country financial market, focusing on ROSC for the data dissemination. Moreover, it provides an explanation of the method of assessment (Data Quality Assessment Framework - DQAF) and of the criteria considered in the assessment. The second part of the paper gives the findings of the Mission on each of the data categories

according to the DQAF framework. The third part provides the measures taken by the three statistical agencies in the country (INSTAT, Ministry of Finance and the Bank of Albania) in order to observe the Mission's recommendations.

ROSC AND ITS IMPORTANCE

The role of the international standards in consolidating the financial structure is perceived by the international community as an ever-increasing need. In an environment where there are integrated capital markets, the financial crisis can be spread quickly and jeopardize the international financial stability. As a consequence, the establishment of a minimum of international standards is considered as a public "good", from which both international and national systems would benefit. At an international level, these standards enhance transparency and enable the multilateral supervision of the national systems; they provide the opportunity of identifying the weaknesses that may potentially lead to an economic and financial destabilization, as well as enhance market efficiency. At a national level, the international standards provide a criterion for identifying problems and orienting the reforms. In order to reach these goals, the observance of standards must be assessed in the context of the general strategy of the country's development and in accordance to its terms. In this context, the IMF and the WB have, since 1999, been undertaking an initiative to evaluate the whole number of rules where given countries' economic policies are implemented, comparing them with the best international practices. These rules and practices named codes and standards are being assessed as important for the development and stability of the financial and private sector and are summarized in some modules called ROSC - Report on the Observance of Standards and Codes -, under the responsibility of the IMF, the WB or in their common projects. The IMF is in charge of assessing the standards in data dissemination and transparency. The modules for the financial sector (transparency of monetary and fiscal policy, banking supervision, regulation of securities markets, payment system and deposit security) are

undertaken under the joint responsibility of the WB and the IMF in the Financial Sector Assessment Program (FSAP). The WB is also in charge of three other fields covered by ROSC, corporate management, auditing and accounting and creditors' rights.

Through the promotion of the adoption of the international standards, this initiative aims to achieve three intermediate goals: first, help countries to enforce their economic institutions; second, support the IMF and the WB to better assess the needs and risks of a country; and third, to inform the market members and enhance market efficiency.

The assessment of ROSC missions has been generally applied in developing financial market countries and in developed ones, while the participation of developing countries has been lower. Around 90 percent of developed countries and of developing financial markets countries have, at least, had one assessment from the ROSC missions. Empirical tests indicate that participating countries are mostly those countries that aim to be more transparent and to reinforce their institutions. Around 75 percent of the ROSC assessments have been released, while the developed countries mainly are the ones to publish this assessment.

There have been several empirical studies, mainly of the Fund experts, in order to assess the ROSC efficiency. They all pose the hypothesis that the ROSC assessment, ROSC publication and the membership to the data standards projects (GDDS and SDDS) bring advantages in borrowing costs reduction, strengthening the country's rating and increasing the market efficiency. Despite the limits that these studies have, due to the small volume of choices, to the short time series, etc., they generally show that the participation in these projects brings some advantages to the countries. Four of these studies point out that the identification of issues and the follow-up of the proposed reforms, in particular in banking supervision and in policies transparency, improve the market performance rating and indices.

Both the IMF and the WB have developed detailed methodologies for the assessment of standards, which are under

a continuous process of review. For instance, the IMF uses DQAF¹ in the data dissemination, which is essentially a methodology for assessing the statistical data that covers their entire production cycle and is straight related to their accessibility, assurance of data integrity and their quality. These methodologies can be even used by the countries themselves in order to assess the observance of standards in certain areas. In general, the countries' self-assessment using the ROSC methodologies among developing financial market countries has had a greater impact on policies transparency, financial infrastructure and on the rules and practices that assure the market integrity. Such an assessment has been made on the Bank of Albania statistics dissemination in 2005 by the Statistics Department² and has enabled the improvement of some practices prior to the ROSC assessment.

Further in this paper, we will briefly explain the assessment methodology used by the ROSC for the data dissemination – DQAF. The second part of the paper summarises the assessment of the ROSC mission for the statistical data in Albania.

DQAF is a methodology for data quality assessment which joins the best international practices and methodologies including the “United Nations Fundamental Principles of Official Statistics” and SDDS and GDDS projects. Since 1997, this methodology has been constantly being reviewed, following the consultations with different countries statisticians, experts from international organizations, IMF experts and statistical data users outside the IMF. In order to develop the quality assessment methodology, it was first necessary to clarify the dimensions of the statistical data related to the quality. Even though the quality of statistical data often implies their accuracy, today there is a general consensus that the quality of data is a multidimensional concept. According to DQAF, there are five dimensions which define data quality: assurance of data integrity, adequate methodology, accuracy and reliability, data serviceability and data accessibility. For each of these five dimensions, DQAF is detailed in monitorable characteristics that can be used to assess quality. Moreover, DQAF specifies that there should be some prerequisites of

quality – a supporting environment for the statistics, accordance of sources with the statistical programs requirements and the orientation to quality in statistics. DQAF includes a normative affirmation, which describes the international standards and the assessment is made comparing the latter with the country's practices. DQAF assesses the practices according to a four-point rating scale:

- Practice observed,
- Practice largely observed,
- Practice largely not observed, and
- Practice not observed.

This system makes the assessment easily understandable even from a non-technical auditor, highlights the priorities for improvement more clearly, and it also enables the comparison of the practices among different countries.

The component dimensions and characteristics are summarized in table 1. Section 2 of the paper presents the assessments for each characteristic of the official statistics assessed by the ROSC mission. The first column of the table presents the five dimensions of data quality along with the prerequisites of quality (in the table, listed from 0 to 5). The second column of the table presents the components of each dimension and the third one the criteria used to assess their observance. We will refer to the second column elements in section 2, which are grouped according to the respective dimensions.

Table 1 DQAF dimensions and component elements

Dimensions	Dimensions' elements	Indicators
0. Prerequisites of quality	0.1. The legal and institutional environment is supportive of statistics	The responsibility for collecting, processing, and disseminating the statistics is clearly specified.
		Data sharing and coordination among data-producing agencies are adequate. Individual reporters' data are to be kept confidential and used for statistical purposes only.
	0.2. The resources must be adequate to meet statistical programs' needs.	Statistical reporting is supported through legal mandate or other measures to encourage response.
		Human resources must be at an adequate level, in order to carry out the duties in accordance to the statistical programs. The level of technology must be adequate to carry out the duties in accordance to the statistical programs. Financing for the compilation of statistics must be adequate to carry out the duties in accordance to the statistical programs.
1. Assurance of data integrity	0.3. Monitoring of the serviceability of statistical data 0.4. Statistical information quality on the basis of the process.	There should be mechanisms to ensure the most efficient use of resources.
		The statistical agency is entitled to comment on erroneous interpretation and misuse of statistics.
	1.1. Professionalism	Statistics are produced on an impartial basis. Choices of sources and statistical techniques should be based solely on statistical considerations. The statistical agency is entitled to comment on erroneous interpretation and misuse of statistics.
		The terms and conditions under which statistics are collected, processed, and disseminated are available to the public. Internal governmental access to statistics prior to their release is publicly identified. Products of statistical agencies/units are clearly identified as such. Advance notice is given of major changes in methodology, source data, and statistical techniques.
1.2. Transparency of statistical processes	There are ethical standards in the statistical agency, whose observance is continuously monitored.	
1.3. Ethical standards – policies and practices are guided by ethical standards	The ethical standards are well known to managers and staff of the statistical agency.	

2. Methodology	<p>2.1. Concepts and definitions</p> <p>2.2. Scope</p> <p>2.3. Classification/sectorization</p> <p>2.4. Basis for recording</p>	<p>For each data category, the IMF has a reference standard, such as the MSMF, 2000 for monetary and financial statistics, etc. The methodology elements are assessed by comparing the existing practices with the reference manuals.</p>
3. Accuracy and reliability	<p>3.1. Source data</p> <p>3.2. Assessment of source</p> <p>3.3. Statistical techniques</p> <p>3.4. Assessment of intermediate data and statistical outputs</p> <p>3.5. Data revision studies</p>	<p>Source data are chosen based on all-inclusive programs, which take into account country-specific conditions.</p> <p>Source data enable the compilation of statistics to meet the methodological requests for scope, classification, sectorization and valuation of assets and liabilities.</p> <p>The information required as an input for the statistics are reported timely, in order to allow the timely compilation of the statistical indices.</p> <p>The data reported from the reporting units are continuously controlled and the results of this control serve to identify and solve the problems.</p>
4. Serviceability	<p>4.1. Periodicity and timeliness</p> <p>4.2. Integrity</p> <p>4.3. Existence of a data revision policy and its publication</p>	<p>Periodicity (different for different types of data).</p> <p>The delay in statistics release (different for different types of data).</p> <p>Statistics are consistent within the dataset.</p> <p>Statistics are consistent with the time series (with a minimum duration of five years).</p> <p>Statistics are presented in a way that facilitates proper interpretation and meaningful comparisons.</p>
5. Accessibility	<p>5.1. Data accessibility</p> <p>5.2. Metadata accessibility</p> <p>5.3. Assistance to users</p>	<p>Dissemination media and format are adequate (hard copy, webpage etc).</p> <p>Statistics are released on a pre-announced schedule.</p> <p>Statistics are made available to all users at the same time.</p> <p>Documentation on concepts, scope, classifications, basis of recording, data sources, and statistical techniques is available, and differences from internationally accepted levels of detail are adapted to the needs of the intended audience.</p> <p>Contact points for each subject field are publicized, and there should be catalogues of publications, documents, and other services.</p>

THE FINDINGS OF THE ROSC MISSION MARCH-APRIL 2006 ON THE ALBANIAN STATISTICS

The ROSC Mission on the data quality that visited Albania in 1999, published by the Fund in 2000, apart from the positive assessments, left a number of recommendations including the establishment of a national accounts system, the improvement of the legal framework and the coverage of economic activities, in particular of the real and external sector statistics, as well as the efficient use of the information sources. During March – April 2006, another ROSC Mission on the data quality visited Albania to reassess the progress achieved in these data categories: national accounts, consumer price index, producer price index, government fiscal statistics, monetary statistics and external sector statistics³. The statistical agencies responsible for the dissemination of these types of data – the Institute of Statistics (INSTAT), the Ministry of Finance and the Bank of Albania, were also assessed for the prerequisites of quality and assurance of data integrity. Further in this paper, there is a summary of the Mission’s assessments for each of the data dimensions.

0. PREREQUISITES OF DATA QUALITY

0.1. The institutional responsibility for the compilation and dissemination of the data categories covered by ROSC is clearly specified in the legal framework and in the day-to-day work practices of INSTAT, Ministry of Finance and Bank of Albania.

- The new Law “On Official Statistics”, No. 9180, which stands at the basis of the functioning of the INSTAT, defines INSTAT as an independent governmental unit under the supervision of the Statistics Council, which before 2004 had only consulting functions. This Law clearly gives the INSTAT the responsibility for the collection, processing, and dissemination of official statistics. Moreover, the Law explicitly states the reporting confidentiality and the responsibilities of respondents to submit data to INSTAT.
- The Macroeconomic Department in the Ministry of

Finance is specifically designated to compile government fiscal statistics and to produce monthly and quarterly bulletins on fiscal statistics. The Organic Budget Law No. 8379 of July 29, 1998 authorizes the Ministry of Finance to specify reporting requirements for budgetary institutions, budgetary and extra-budgetary funds, and local government.

- The Bank of Albania is, by tradition, responsible for compiling and disseminating monetary statistics, although the BoA Law does not specifically spell out this statistical mandate. The BoA is the only statistical agency carrying out this function and the Law gives to the Bank of Albania the right to formulate the reporting requirements for commercial banks, juridical and natural persons. However, the Law is not clear on the cases of misreporting. Reported data confidentiality is rigorously observed in practice by the work procedures, however, the Law states that these data may be disclosed to tax authorities. The Mission suggests that the existence of such a possibility in the Law may potentially decrease the reporting entities' confidence on the usability of reports by the Bank of Albania. Moreover, the perception of such a possibility provided by Law reduces the confidence of the public in the official statistics.

The Mission assesses that the information sharing among agencies and the conditions, under which the entities report, need improvement. The information sharing is done through Memorandums of Understanding among the institutions, a part of which actually is in the process of drafting. Regarding the regulation of the flow of information, the Mission suggested the implementation of an electronic reporting system for banks and other financial institutions to enhance the efficiency of monetary and balance of payments statistics compilation processes and to allow a more efficient use of the resources. Another recommendation is the introduction of a database for keeping and compiling the statistical information for monetary, financial and balance of payments statistics.

0.2. The sources of the statistical agencies are insufficient to carry out the existing processes adequately and to realize the plans of these agencies related to their projects⁴.

- The Mission assesses that INSTAT's human resources, work conditions, information technology and financial resources are inadequate to fulfil this institution's targets.
- At the Ministry of Finance, the human resources are inadequate to put the current and planned statistical programs into function, required to monitor the fiscal policy.
- At the Bank of Albania, human resources in the Balance of Payments are not adequate, while resources for monetary statistics are adequate for current responsibilities only. The Mission suggests that additional statistics staff resources are needed to compile other financial statistics, such as the funds flow account, the compilation of financial flows for monetary statistics and for other short- and mid-term plans of the division. In addition to the increase of the statistics staff, the Mission recommends more information technology support and integrated database development to further enhance the efficiency of statistical processes at the BoA.

0.3. Monitoring of the data relevance:

The three institutions monitor regularly users' needs through seminars, surveys and periodical meetings among statistical agencies and international organizations. Particular users' needs are another information source that serves to extend or modify the published statistical indices.

4.4. Statistical information quality

The three institutions show interest for the statistics quality. There are regular practices to monitor quality including self assessment (DQAF prepared by the Statistics Department of the Bank of Albania), monitoring of the working programs related to the statistics, as well as periodical meetings with the reporting subjects in order to clarify the reporting requirements.

1. ASSURANCE OF DATA INTEGRITY

1.1. Professionalism

- At the INSTAT, professionalism and impartiality of official statistics are guaranteed by the Law “On official statistics”, which specifies that there should be no interferences from the government or any other institution. The Law also stipulates that the roles and tasks of the Statistics Council and of INSTAT’s General Director. The Statistics Council proposes the appointment of the General Director, who is approved by the Prime Minister and the Council of Ministers. INSTAT staff has the Civil Servant status and is appointed based on qualifications. INSTAT promotes staff participation in seminars and research activities which enhance professional capacity. The selection of data sources, statistical techniques and data dissemination practices are based only on statistical considerations. Governmental bodies have no right to preliminarily access the statistical data prior to their publication. INSTAT staff is obliged to respond to erroneous interpretation and misuse of statistics and organizes and encourages the correct use of statistics through seminars with the users and through explanations of the indices.
- The Organic Budget Law provides the independence of the Ministry of Finance staff in executing the accounting and statistics functions. This Law gives the MoF the independence to choose sources and reporting methods, which are released on its website. The MoF regularly monitors the coverage of its data in the media. The Spokesperson for the Minister comments on erroneous interpretations of official statistics when deemed necessary.
- The Law “On Bank of Albania” ensures the independence of the BoA. The BoA defines its own methodologies and procedures for compiling and disseminating monetary and balance of payments statistics, taking into account international standards. Recruitment and promotion of BoA staff are based on professional competence and training and professional development opportunities are

provided. Choices of statistical methodology are based solely on statistical considerations. The BoA comments on public use of statistics and is active in developing a culture of statistics through a training program for the media.

1.2. Transparency

The terms and conditions under which statistics are compiled are available to the users by all the three institutions. The major changes in methodology are released in advance and are available to the public on the websites of each of the statistical agencies. All users have simultaneous rights to use all data categories.

1.3. Ethical standards

Staff behaviour in all the three statistical agencies is guided by the Law "On the Status of Civil Servants" (INSTAT and Ministry of Finance), the related Ethical Code of each agency. Staff is trained on the institution's ethical standards and during periodical performance reviews, ethics observance is one of the assessment items.

2. METHODOLOGY

2.1. Concepts and definitions

The elements for assessing the statistical indices for each data category are assessed based on SNA 93, NACE Rev. 1, COICOP and the relative IMF's manuals: MFSM 2000, GFSM 2001, and BPM5. For all the statistical categories except for Government Finance Statistics, the concepts and definitions used are evaluated to be in line with the best international practices. Regarding the fiscal statistics, the concepts and definitions follow GFS 1986 and it is not yet realized the transition to the new methodology.

2.2. Scope

The Mission assessed that the scope is in line with the international standards on production price index, fiscal, monetary and balance of payments statistics.

Regarding the national accounts, INSTAT does not produce all the accounts needed to meet the minimum requirement of the Intersecretariat Working Group on National Accounts⁵. Actually, the national accounts include only the annual value added and GDP at current and constant prices by 25 major activity groups and the annual expenditure components of GDP at current and constant prices.

Regarding the consumer price index, the scope was assessed to be broadly in line with the standards. However, the existing HBS (Household Budget Survey) covers only urban households, accounting for 45 percent of all households. The new HBS, currently in preparation by INSTAT will cover rural households as well.

2.3. Classification/sectorization

The Mission assesses that classification and sectorization practices used are consistent with internationally accepted standards (respective manuals for every data category).

2.4. Basis for recording

The basis for statistics recording are assessed to be broadly consistent with the standards, however the Mission remarks that there are some discrepancies in the consumer price index, national accounts, monetary and balance of payments statistics.

- In the national accounts, this discrepancy is mainly related to the treatment of the non-deductible VAT in the intermediate consumption and to the government accounts recorded on a cash basis⁶.
- In the consumer price index, the deviation from the standard is related to the non-inclusion of resold goods prices and their respective shares.
- In the monetary statistics, the deviation relates to the accounting of the savings and credit associations' accounts on cash basis (while required on accrual basis) and the treatment of long term securities held by the banks. In the current reporting requirements these instruments are reported at their purchase price

in accordance with the banking accounting manual, while for monetary statistics purposes their recording is required at the market value.

- In the balance of payments statistics, the discrepancy relates to the recording of public debt interests on accrual basis.

3. ACCURACY AND RELIABILITY

This dimension is related to the source data and to their periodical assessment. Among all the other dimensions, the Mission assesses the lack of sources as the most problematic issue for the Albanian statistics compared to the other dimensions.

3.1. Source data

The Mission assesses the source data for the monetary statistics as completely in line with the standards, the source data for CPI, PPI and fiscal statistics as largely in line with the standards, and the source data for the balance of payments statistics as largely not in line with the standards.

- Regarding the national accounts, the source data have some limitations, among which can be listed improper design of the questionnaires (SBS), partial coverage of the Albanian territory (HBS), the low frequency of the surveys, the exclusion of the informal economy and the delays in reporting.
- On CPI, the Mission assesses that the methodology used by the HBS is in line with the best international practices, but the non respondents to the questionnaire are not replaced. This causes a reducing deviation of the CPI, due to the fact that generally the entities that avoid reporting are those with the higher income.
- On PPI, source data do not provide the information reported on time. Prices are collected for each month but only once every quarter, causing delays in PPI dissemination for the first months of the quarter. Moreover, the weights used derive from the 1998 SBS and the enterprises that have ceased business are not replaced.

- The problem in source data for the fiscal statistics is in the availability of data on certain external donor financed (grants) projects that do not pass through the Bank of Albania and the commercial banks.
- According to the balance of payments statistics, the source data, even if in due time, are based on infrequent and/or incomplete surveys, including those on freight, insurance, and smuggling adjustments for imports; travellers' expenditures domestically and abroad; workers' remittances; direct and portfolio investment; and trade credit. Grants from abroad to regional and local governments are underreported.

3.2. Assessment of source data

The assessment of source data is related to surveys routinely assessed, sample error, coverage, misreporting, etc., and the use of this information to further guide the statistical processes. The Mission evaluates the national accounts, fiscal and balance of payments statistics as fully consistent with the standards, while the CPI, PPI and monetary statistics as largely in line. Actually, the identified problems are:

- Regarding CPI, the prices collected, even if checked for the very different values from the others, but the information obtained from the surveyor is not checked.
- Regarding the PPI, the remarks are the same with CPI.
- Concerning the monetary statistics, there are checking processes on the source data, such as the reporting control based on the "Manual of Control Procedures", however they are time-consuming and cause delays in the whole statistics production process, since they are mostly manual.

3.3. Statistical techniques

In compiling the statistical indices, statistical techniques should adapt to data sources. Moreover, the statistical processes such as the data adjustments and transformations and the statistical analysis should be based on suitable techniques. In relation with this element, the Mission assesses the fiscal statistics as the only consistent with the standard, while assesses CPI, PPI,

balance of payments and monetary statistics as largely in line with the standards. The statistical techniques used in the national accounts are evaluated as largely not consistent with the standards. More precisely, the identified problems are:

- In the national accounts, the estimates of the value added from the non-observed activities, especially for construction activity, is limited due to the very limited labour input data in production. Estimates of expenditure components rely also on weak assumptions and the results are not crosschecked against other data sources.
- Regarding CPI, the current weights derive from 2000 and considering the major changes in the real household consumption, the weights used are far from reality.
- The same issue is worthy even for PPI, where the weights derive from 1998. The Mission recommends changing the weights for 2005 and introducing a regular program for rebasing the index at least every six years.
- For the monetary statistics, the Mission recommends to change the practice of delayed reporting. In the previous practice, if there were delays in reporting by a commercial bank, the statistical indices were not compiled until the arrival of this report. The Mission recommends the dissemination of the elementary indices that are calculated using the existing reports and those of the previous period of the entity that has not reported. The elementary indices are identified as such in the publications of the Bank of Albania.
- For the balance of payments statistics, the current compilation system is based on distinct Excel spreadsheets and is prone to error. Remittances are calculated as part of the unidentified transactions in the balance of payments. The Mission recommends also that the split of “total remittances” between remittances from seasonal work and remittances from workers residing in another economy should be re-estimated.

3.4. Assessment of intermediate data and statistical outputs

This element implies the evaluation of intermediate results, considering additional information, apart from those used in the

compilation process and the study of possible discrepancies. As a result, it is needed a statistical analysis of the intermediate results and of the output in order to see if there are any discrepancies in findings and findings from statistical analysis of the other indices. The Mission evaluates this process consistent with the standards for CPI, fiscal and monetary statistics, while national accounts, PPI and balance of payments statistics are evaluated to be largely in line with the standards.

- Regarding the national accounts, the adjustments to remove discrepancies are not sufficiently detailed (used at a high level of aggregation). This is a result of the too limited resources they rely on, as well as of inefficient use of the existing resources.
- Regarding PPI, the Mission recommends to validate the PPI results with CPI and all the other available price indices.

3.5. Data revision studies

According to the best international practices, revised data should be accompanied by analysis on the effects due to changes in methodology that take place on the data, in order to aid users in understanding the functions in time. These studies should be carried out routinely with the statistical work. The Mission evaluates that this practice is fully followed in the CPI, PPI, fiscal, monetary and balance of payments statistics. Concerning the national accounts, revision studies are done on an *ad hoc* basis and not according to a definite program. As this data category is the most sensitive regarding revisions made even within a relatively long period of time, the existing practice is estimated as largely in line with the standards.

4. SERVICEABILITY

In order for the statistical data to be serviceable for the users, they should minimally fulfil these criteria: being available at the right time and periodicity, being consistent on time or within the series and among each-other and follow a predetermined review policy.

4.1. Periodicity and timeliness

As Albania is part of the GDDS project, the Mission evaluated the practices related to the delay from the reference date and the periodicity related to this standard. As shown in Table 2, the practices for national accounts and PPI are not consistent with the standards. Since Albania aims to adhere to SDDS by the end of 2007, in the table are shown even the requirements of this standard. The current practices do not meet the SDDS requirements on national accounts, PPI and monetary statistics.

Table 2 Timeliness and periodicity practices compared to the SDDS and GDDS standards

Data Category	Practice		GDDS Standard		SDDS Standard	
	Periodicity	Timeliness	Periodicity	Timeliness	Periodicity	Timeliness
National accounts	Annual	11 months	Annual	9 months	1 Quarter	3 months
CPI	Monthly	8 days	Monthly	1-2 months	Monthly	1 month
PPI	Monthly	4 months	Monthly	1-2 months	Monthly	1 month
Government Finance Statistics	Monthly	1 month	Annual	6-9 months	Annual	6 months
Monetary Statistics	Monthly	6 weeks	Monthly	2-3 months	Monthly	1 month
Balance of payment statistics	1 Quarter	10 weeks	Annual	6-9 months	1 Quarter	60 days

4.2. Consistency

This element is related to the procedures that check statistical data for consistency within a dataset (with other statistical indices), as well as consistency as a time series. The Mission evaluated as consistent with standards all the other data categories except for national accounts that are evaluated as largely in line with the standards. This is due to the fact that the estimation of GDP with the expenditure approach is not independent from the production approach and consistency is ensured through balancing items on the expenditure side. The Mission recommends independently estimating the components of GDP with the expenditure approach, and checking the indices consistency.

4.3. Data revision policy

According to the standards, data revisions should follow a predetermined released calendar, in order for the users to know if the data are final or not and also to know when they can

have the final data. Revision studies and analysis should be publicized together with the data. Except for national accounts and fiscal statistics, the current practices are consistent with the standards.

- Regarding the national accounts, not all the publications indicate clearly the data status (preliminary, revised, or final).
- Regarding the fiscal statistics, the revisions are indicated only at the data publication moment and not before.

5. ACCESSIBILITY

The accessibility is related to the facility of the users to understand and use the data. The elements evaluated by DQAF related to this dimension are data accessibility, metadata accessibility (information on data), and assistance to users from the statistical agency.

5.1. Data accessibility

Data accessibility means data dissemination in a format and in a manner that is easy to use (such as through tables, charts, etc). Moreover, it implies statistical indices dissemination according to a calendar released in advance by the agency. The Mission evaluated the practices followed by all data categories, except for national accounts, in line with the standards. For this data category, the Mission remarks that statistical indices dissemination does not follow the predetermined calendar published by INSTAT.

5.2. Metadata accessibility

The standards recommend the release of the concepts, scope, basis for recording, source data and deviation from the international standards. The levels of detail of the metadata should match the needs of the targeted audience, so there should be different media to disseminate this information. The Mission evaluates the national accounts, fiscal, monetary and balance of payments statistics as in line with the standards, while recommends the release of CPI and PPI statistical methodologies.

5.3. Assistance to users

The assistance to users according to the standards implies providing contact points for each data category in order to answer specific questions or requests of the users. Moreover, this element implies the existence of catalogs of publications on the indices, documents related and statistical services offered. The Mission assesses all data categories, except for national accounts, as consistent with the standards. This is due to the fact that the INSTAT website is not always updated with the latest information on the indices, even if this information is available on other formats (hard copy).

MEASURES ADOPTED BY THE STATISTICAL AGENCIES TO IMPLEMENT THE MISSION'S RECOMMENDATIONS

In response to the recommendations left by the Mission, all the three statistical agencies have taken measures to improve those practices that deviate from the standards. Together with the ROSC assessment has been published the response by the Albanian authorities to the ROSC assessment, which delineates the institutions' plans and manner to improve their practices and measures already taken.

THE RESPONSE TO THE GENERAL ROSC RECOMMENDATIONS

- Hire new staff and increase the information technology support in the statistical agencies, in order to fulfil the current or planned statistical programs.

The structure of the Statistics Department at the Bank of Albania will be reviewed by the first quarter of 2007. Apart from the commitments in providing information for internal purposes of Bank of Albania, in its position as a distributor of statistical data, the staff increase in the Statistics Department, will enable the

compilation of flows data (financial sector), IIP and External Debt statistics.

- Maintain a professional staff in the statistical agencies and upgrading the status of INSTAT staff in the hierarchy of the government civil service and upgrading office facilities in all the data-producing agencies. Continue emphasizing staff training and development.

The statistical agencies are continuing their work in order to enhance the competence level of the statistics staff. Therefore, the development of human resources in INSTAT has recently benefited from a raise in salaries of its staff. At the Bank of Albania's commitment to meet the monetary policy needs for real and fiscal sector data, in the view of launching Inflation Targeting, the staff working in the Statistics Department, has been trained to comprehend and assess the statistical information produced by the other institutions.

- Increase financial resources for improving source data. Attach priority to improving source data to adequately capture the non observed economy and remittances, which are particularly important in the Albanian economy.

INSTAT and Bank of Albania are working on estimating the informal economy in Albania. A better understanding of the structure and type of the transactions will enable a better estimation of remittances.

- Sign Memorandums of Understanding between data producing agencies and define the modalities of data sharing (e.g., data details, timetable, responsibility on these data, etc.)

INSTAT and Bank of Albania are in the process of drafting a Memorandum of Understanding, which is in the final stage of completion. Moreover, with the establishment of a centralized database at the Bank of Albania, that shall contain a great number of statistical data, from the major data producing

institutions, the Statistics Department at Bank of Albania is working to define the required modalities that will be included in the memorandums of understanding with these institutions.

- Implement an electronic (online) reporting system for banks and other financial institutions to enhance the efficiency of monetary and balance of payments statistics compilation processes. Introduce an automatic compilation system for monetary and balance of payments statistics.

The implementation of this recommendation is included in the BoA strategy plan as a medium-term plan, to be accomplished by 2007.

RESPONSE TO SECTORAL RECOMMENDATIONS

NATIONAL ACCOUNTS

- Expand and improve surveys, such as, labour force survey and country-wide HBS.
By the beginning of 2007, INSTAT will conduct a labour force survey, while the preparations for HBS, that will be presented by 2007 have already started. Improving labour data should be a matter of priority in the context of using these data so as to ensure the reliability of the national accounts estimates.
- Expand the scope of annual national accounts to include the income account, the capital account, and the rest of the world accounts as intended in INSTST strategic plan.
In the framework of the EU funded Twinning project is created a strategic plan to define the possibilities to include these accounts in the INSTAT produced statistics. INSTAT is currently developing a methodology to estimate the generation of income account starting from the estimate of wages and salaries.

- Rationalize statistical techniques to maximize the use of existing source data, used for the expenditure approach. The introduction of a single balancing item combining household final consumption, changes in inventories, and the statistical discrepancies for years when household final consumption cannot be separately estimated.

INSTAT is working to improve the methodology of calculation of GDP from expenditures side.

- Use of more data sources to cross-check the accuracy of intermediate data.
Basing on the Mission's recommendations, INSTAT will review the methodology that estimates household consumption for 2003-2004, on LSMS basis. In the same time, there are possibilities for a better use of the business structural survey to reevaluate the construction sector activity.
- Apply the revision policy consistently. Identify status of disseminated GDP (e.g., preliminary, revised, and final) in all releases.
The recommendation is implemented already.
- Update the advance release calendar.
The recommendation is implemented already.
- Improve the timeliness of the data for the national accounts releases through a better use of the INSTAT website.
The recommendation is implemented already.

CONSUMER AND PRODUCER PRICE INDICES

- Update the weights.
Update of CPI weights will be enabled by the HBS conduction. The current version of PPI uses a fix base index and INSTAT is working to replace this approach with the chain index one. This type of index enables the use of different weights, if felt necessary.

The revision of product list was done using the Business Structural Survey of 2004. Moreover, INSTAT is preparing a new questionnaire for PPI data compilation. Creation of authentic data entry, in collaboration with IT staff, is in process.

- Publish the PPI every month.
The publishing of PPI every month requests the collection of the data on monthly basis. So far, because of usage of enumerators, INSTAT collects the data on the enterprises on monthly basis. The recommendation will take place on medium term.
- Check on the prices reported by the enumerators.
With the renovation of CPI and PPI the new data entry system will have an automatic check of price reported.
- Replacement of the non-respondents to the HBS with similar households (CPI) and replacement of the enterprises that go out of business.
In the methodology of the HBS it is not foreseen the replacement of the non-respondents with the similar household. In the new PPI index the replacement of enterprises will be once a year, in December.
- Validate the PPI results against all other available price indices.
INSTAT is working to find comparison methods between PPI and export – import prices, CPI etc.
- Update the methodology used and publish it in both languages (English and Albanian).
The drafting of the relative methodologies is in process.

GOVERNMENT FINANCE STATISTICS

- Accelerate work aimed at adopting the GFSM 2001 methodology for monthly and quarterly reporting.

The Albanian Ministry of Finance Treasury System (AMoFTS) is on the phase of testing and training, until the end of 2006. MoF plans to go-live with the system on the beginning of 2007. This system is going to ensure the passage from a cash basis reporting to an accrual basis one as required by the standards.

- Construct a national chart of accounts for the government sub sectors aligned with GFSM 2001 classifications.

Ministry of Finance will implement and publish a detailed (7 digits) chart of accounts for the general government, in 2007.

MONETARY STATISTICS

- Strengthen the BoA law to provide full legal assurances that individual reporters' data may be used only for statistical purposes.
The BoA's Legal Department is drafting a new law on the Bank of Albania. Thus, it has been planned that the amended Law will pass to the Parliament by end 2009. This Law will also strengthen the legal support for the dissemination of monetary and financial statistics by including an explicit role for the Bank of Albania to disseminate these statistics. It will also ensure confidentiality of individual data and use of these for statistical purposes only.
- Implement an electronic (online) reporting system for commercial banks and other financial institutions to enhance efficiency of monetary statistics compilation.
The implementation of this recommendation has been included in the BoA's strategy plan as a medium-term plan. This duty is expected to be fulfilled by the end of 2007.
- Increase of the Information Technology Department staff, involved in the statistical processes to (1) design

the SARS database for a better performance including the automatic generation of monetary data and (2) implement an electronic (online) reporting system for commercial banks. More human resources are needed in the SD to expand monetary statistics to cover other financial corporations and to compile flow data for the financial sector, as recommended by the Fund's methodology (MFSM-2000).

The structure of the Department of Statistics will be reviewed until the first quarter of 2007, and will be expanded to include among other things, the compilation of flows data on the financial sector. The Sector of Financial Statistics is currently working on a draft structure.

The compilation of flows data together with the stock would require additional information from bank's reporting in order to separately identify the transactions from the changes in value due to changes in the market value of the securities holdings of the banks portfolios. The SD is currently considering the possibility of taking this information from the commercial banks.

- Revalue long-term securities for investment held by the commercial banks and use estimated fair value.

The SD will consider obtaining this information by the commercial banks, while the information required for this change is already available from the Accounting and Payments Department.

- Adopt accrual accounting for SLAs so as to apply fully the MFSM guidelines.
For the moment the SD considers that the SLA's accrual assets and liabilities are not enough materially significant such as to justify an increase in the reporting burden. The total assets of such institutions represent only 0.4 percent of the total assets of Other Depository Corporations.
- Implement measures to minimize errors in commercial banks' reporting and speed up processes that check and correct reports.

The time lag for reporting by banks has been already shortened, on October of the current year, from 20 days to 15 days, from the end of the referred month. It will be further shortened to 10 days starting from March 2007. This measure allows more time for the reports to be checked for errors, before they are used for the compilation process.

- When delayed reporting by commercial banks occurs, carry forward the balance sheet for the previous month of the late reporting bank and make users aware of this technique. The data should be denoted as provisional.

The recommendation is implemented already.

BALANCE OF PAYMENTS STATISTICS

- Conduct more frequent surveys: on quarterly basis for remittances, redo the foreign trade survey in order to revalue freight, smuggle and trade credit coefficients.

Particularly because remittances are a predominant item in the Albanian balance of payments, in 2007 several surveys in quarterly basis will be conducted to the households who receive money from their family abroad.

Later, it will be analyzed whether new coefficients need to be applied on freight and smuggled goods, that it will be conducted on the big importing companies.

- Strengthen the Bank of Albania law to provide sanctions for the entities that do not fulfil the legal obligation of reporting to the Bank of Albania for statistical purposes, include the right of the Bank to inspect the financial accounts of firms, and to prohibit the provision of these reports to tax authorities.
The legal status of the Bank regarding to the statistics and the right to reporting will be reviewed on medium term.

- Obtain the public debt service schedule from the MoF and record interest on an accrual basis.
The DMFAS system actually used by MoF for monitoring of external debt (suspended debt) does not calculate the accrued interest. With the implementation of the new version of this system it will be provided the necessary information for this change.
- Obtain quarterly reporting in direct investment equity, debt, and reinvested earnings; in portfolio equity and debt; and in trade credit.
The annual survey of Bank of Albania in cooperation with INSTAT is not supported by the legal requirement of Bank of Albania to have direct reporting from the firms. This recommendation will be applied in line with the improvement of the Bank of Albania legal framework.
- Estimate purchases of land and construction financed by unidentified foreign exchange inflows.
Bank of Albania is actually conducting a survey on construction companies and real estate agencies to find what portion of the constructions is being financed by unreported transactions between residents and non-residents. This is the very first survey of this kind in Albania. The results will be analyzed in order to understand the structure and the type of transactions necessary to develop estimation methods of the BoP statistics.
- Improve the coordination with INSTAT with respect to survey design, execution, and follow-up to non-response.
Bank of Albania's Statistics Department and INSTAT, are both working to further improve the quality of the surveys starting with the designation of the questionnaire and the improvement of the response rate.
- IT support to set up an automated compilation system that would preclude the need for manual data entry, could include electronic reporting by banks, and possibly ITRS.

The implementation of this recommendation is included in the Bank of Albania strategy plan as a medium-term plan.

SUMMARY

The ROSC Mission on data dissemination finds considerable improvements in the national statistical framework since 2000. These achievements are mainly due to the implementation of the new Fund's methodologies, to the improvements of the legal basis that supports statistics, to the increase of the staff involved in statistics compilation and dissemination, etc. From the assessment, it results that in the major part of the quality dimensions and component elements, the national practices are consistent with internationally accepted standards, as presented in table 3. The Mission recommends the enhancement of the support that implies support with financial resources, qualified staff, information technology and improvement of the working facilities. Among all the data categories, the most problematic ones are the national accounts statistics, whose quality is doubtful because of the insufficiency of sources, inappropriate techniques, etc. Their improvement through the measures given in section 3 of this paper is one of the main challenges for Albania's membership in the SDDS project by the end of 2007. In addition to these improvements, this standard requires the compilation of some other categories, such as quarterly national accounts, data on wages and salaries, industrial production index, IIP, Albania's external debt (including all its sectors and instruments), module of international reserve and foreign currency liquidity, etc. Monetary and fiscal statistics are presented much better than the other categories. In the meantime, the improvements in the national accounts structure are the most significant ones expected in the improvement of the statistical standards.

Table 3 Data Quality Assessment Framework—Summary Results

Datasets		National Accounts	Consumer Price Index	Producer Price Index	Government Finance Statistics	Monetary Statistics	Balance of Payments Statistics
Dimensions/Elements							
0. Prerequisites of quality							
0.1	Legal and institutional environment	LO	O	O	O	LO	LO
0.2	Resources	LNO	LNO	LNO	LNO	LO	LNO
0.3	Relevance	O	O	O	O	O	O
0.4	Other quality management	O	O	O	O	O	O
1. Assurance of integrity							
1.1	Professionalism	O	O	O	O	O	O
1.2	Transparency	O	O	O	O	O	O
1.3	Ethical standards	O	O	O	O	O	O
2. Methodology							
2.1	Concepts and definitions	O	O	O	LO	O	O
2.2	Scope	LNO	LO	O	O	O	O
2.3	Classification/Sectorization	O	O	O	O	O	O
2.4	Basis for recording	LO	LO	O	O	LO	LO
3. Accuracy and reliability							
3.1	Source data	LNO	LO	LO	LO	O	LNO
3.2	Assessment of source data	O	LO	LO	O	LO	O
3.3	Statistical techniques	LNO	LO	LO	O	LO	LO
3.4	Assessment and validation of intermediate data and statistical outputs	LO	O	LO	O	O	LO
3.5	Revision studies	LO	O	O	O	O	O
4. Serviceability							
4.1	Periodicity and timeliness	LO	O	LO	O	O	O
4.2	Consistency	O	O	O	O	O	O
4.3	Revision policy and practice	LO	O	O	LO	O	O
5. Accessibility							
5.1	Data accessibility	LO	O	O	O	O	O
5.2	Metadata accessibility	O	LO	LO	O	O	O
5.3	Assistance to users	LO	O	O	O	O	O

NOTES

* This paper was prepared by Hilda Shijaku, Head of Financial Statistics Division and Kliti Ceca, Director of Statistics Department. Special thanks to Evis Ruçi, Head of Balance of Payments Division, for her collaboration.

¹ Data Quality Assessment Framework.

² Published in the Economic Bulletin, volume 8, number 1, June 2005.

³ The report has been already published on IMF website, at the following link: <http://www.imf.org/external/pubs/cat/longres.cfm?sk=20059.0>

⁴ Among the long-term projects are included the membership to the SDDS project, the provision of information needed by the decision-makers in terms of an inflation targeting regime and practices converging to the European standards.

⁵ ISWGNA recommends these accounts as minimum: annual value added and GDP at current and constant prices by activity; annual expenditures of GDP at current and constant prices; annual value added components at current prices by activity; sequence of accounts for the total economy up to financial accounts with an annual frequency; and rest of the world accounts.

⁶ The transaction is recognized when the cash accounts are affected.

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TRANSITION COUNTRIES AND ALBANIA

*Elvana Troqe**

Key words

- Transition countries - Economic development - Structural reforms -

INTRODUCTION

Economic development in the transition countries has been considerable over the past years. Positive performance, frequently higher than that of the developed countries, has helped in narrowing the gap of the economic development between transition and developed countries. Albania, like the other transition countries, has had significant economic growth in these last years. Maintenance of the macroeconomic stability is reflected in low inflation rate, in increased confidence of the public in the domestic currency and the banking system. Macroeconomic stability on the other hand, reflects a good coordination of the fiscal and monetary policies and the progress in structural reforms. But the economic development, like in many other countries could face risks caused by domestic and foreign factors. To better manage risky situations, structural reforms take a specific important role that could serve as a construction in building a healthy and robust economy. This paper analyzes the Albanian position as opposed to more developed countries in the region, which have made the greatest progress in the context of reforms. It also raises some key challenges the country faces to maintain and enhance economic development.

I. AN OVERVIEW OF THE TRANSITION COUNTRIES

The transition¹ countries have displayed considerable economic growth rates over these last years. Economic growth in these countries has been mainly driven by a high domestic demand, which has been spurred by credit and wage growth. On the other side, strong domestic demand and high energy prices are exerting inflationary pressures throughout the region. Moreover, domestic savings are insufficient to cover investments, resulting in large current account deficits especially in countries that are not rich in natural resources. Foreign direct investments are projected to reduce slightly from the levels recorded in 2004-2005. In 2006, several countries' currencies have come under pressure in the foreign exchange market. This reflects a more critical valuation by foreign investors on the vulnerabilities of the economies of this region. Furthermore, central banks in the United States, Euro area and Japan lately raised their interest rates, making investments in these countries become more attractive.

Central banks in transition countries have been trying to deal with the problems arising from the rapid development of the financial sector combined with a rising inflation rate. Many central banks have decided to raise the interest rates, to introduce stricter regulations on the minimum reserves or to take other measures against inflation. Against this background, fiscal policy has generally been too loose to stem domestic demand effectively. The case of more restrictive fiscal policies is becoming more necessary in view of long term implications of aging population that will cause significant pressures on the fiscal budget in the future.

Economies of transition countries are gradually catching up with European economies and other matured markets. Thus, the economic growth of 5.7 per cent in 2005 and around 6.2 per cent in 2006 is several percentage points higher than that of the Euro area. Anyhow, further economic development faces risks coming from global imbalances and from the increase of

the interest rates in the OECD countries, which influence on diminishing the interest in investing in these countries.

Over the medium term, transition countries are projected to continue to have considerable growth rates, although slightly slower for 2007. These developments are expected to reflect progress in structural reforms and increasing integration with the world economy. Performance in Central-Eastern Europe and the Baltic² states is closely related to the performance in the Euro area, while South-Eastern Europe³ and Commonwealth of Independent States and Mongolia⁴ countries still face substantial hurdles in reforms.

Transition countries according to the European Bank for Reconstruction and Development are grouped in:

1- Central-Eastern Europe and the Baltic States. Countries of this region had the best start for transition. Many of these countries had welcomed the concept of private property, market based prices and had strong popular support for rapid economic and political changes that would accelerate integration into the European and transatlantic institutions. During the first 10 years of transition much was achieved in these countries. This was partly prompted by the need to harmonize their legislation with that of European Union countries before becoming member states. Over the last years, these countries have concentrated on completing the reforms that will allow them to compete effectively in the European and global market. Despite the successful accomplishment of the initial phase reforms, some of the second phase reforms in areas, such as governance and enterprise restructuring, competition policy and infrastructure have dropped behind. These reforms are often difficult to design and require more time to be implemented. Among these countries, Estonia is assessed to have made the greatest progress.

2- South-Eastern Europe. Many countries of this region started the transition process with some basic elements of a market economy. Over the last years, there has been a remarkable

revival of the market forces all over the region. A very important factor was the relative stability after the turmoil of 1999. Institutions such as the Stability Pact for South-Eastern Europe have assisted in creating a climate of cooperation in all the countries of the region. The prospective of this region is the continuity of the reform progress. The countries of this region are divided into two main groups, SEE3 including Bulgaria, Rumania and Croatia and SEE5, including the other countries, such as Albania, Bosnia Herzegovina, Macedonia, Montenegro and Serbia. Bulgaria and Romania have had the most rapid progress, in the context of joining the EU. The success of Bulgaria and Romania in achieving the objective of EU membership in January 2007 is a factor of motivation for the other countries of the region. Therefore, the Association and Stabilization Process in the EU plays an important role in encouraging main reforms in areas, such as trade policies and food and safety standards. Consequently, countries of this region have begun to narrow the differences with the countries of Central-Eastern Europe and Baltic states and have come before CIS countries in terms of progress.

3- Commonwealth of Independent States and Mongolia (CIS). The countries of this region started the transition process with the most unfavourable conditions among the transition countries, including here the geographic isolation from the Central European countries, lack of experience in market economy and democratic institutions and the long time under the communist regime. Anyhow, they made significant progress during 1995-2000. Meanwhile, progress in reforms decreased significantly after 2000, in particular in oil and gas producing countries. Since 1992, non-energy producing countries have outpaced the energy producing countries in the two phase reforms. There is a strong link between the rise in oil prices and the slowdown in reforms in the energy producing CIS countries. The majority or reforms in these countries took place during 1992-1997, when oil prices fluctuated between 5 and 20 US \$ per barrel. From 1999, when oil prices started to rise quickly, reforms have slowed down and in some years have gone into reverse in a few countries. Furthermore, the investment climate has become worse in energy producing countries in CIS as oil prices have

increased. Similarly, the majority of corruption indices suggest that this phenomenon is a more disturbing problem in energy producing countries than in non energy producing one in this region. In this region, Russia, Ukraine and Kazakhstan have made the greatest advances.

II. THE POSITION OF ALBANIAN BETWEEN MORE DEVELOPED TRANSITION COUNTRIES

In the table below, is given a comparative development of some of the countries of the three transition regions that have made the greatest progress in reforms and Albania. This information is based on the evaluations of EBRD about progress in reforms for these countries. EBRD follows the development in reforms in transition countries throughout 9 indicators of transition. These cover four main elements of a market economy:

- Markets and trade reform is measured by the liberalization of prices, the liberalization of traded and access to foreign exchange and the effectiveness of the competition policy.
- Enterprise reform includes indicators for small-scale and large-scale privatizations and a measure of governance and enterprise restructuring.
- Financial institutions reform is measured by the development of the banking sector, including the quality of financial regulations and the creation and development of securities markets and non-bank financial institutions.
- Infrastructure reform is measured by the progress in five sectors, electricity, railways, roads, telecommunication and water and water waste.

The chosen indicators cover issues like: commercialisation, reform in tariffs, quality of the regulator framework and involvement of the private sector. The scale of measurement of the indicators ranges from 1 to 4+, where 1 stands for little or no change from a centrally planned economy and 4+ stands for standards of an industrialized market economy.

Table 1 Progress in reforms

Countries	Enterprises			Markets and trade			Financial institutions		infrastructure
	Large scale privatisation	Small scale privatisation	Governance and enterprise restructuring	Price liberalisation	Trade and foreign exchange system	Competition policy	Banking reform and interest rate liberalisation	Securities markets and non-bank financial institutions	Infrastructure reform
Albania	3	4	2+	4+	4+	2	3-	2-	2
Estonia	4	4+	4-	4+	4+	4-	4	4-	3+
Hungary	4	4+	4-	4+	4+	3+	4	4	4-
Bulgaria	4	4	3-	4+	4+	3-	4-	3-	3
Romania	4-	4-	3-	4+	4+	3-	3	2	3+
Russia	3	4	2+	4	3+	2+	3-	3	3-
Ukraine	3	4	2	4	4-	2+	3	2+	2+

Source: EBRD

From the comparison of the evaluations presented in the above table, it seems that Albania is positioned after the more developed transition countries of Central and South-eastern Europe countries and almost in the same level with the most developed CIS countries.

To better understand the Albanian position between these transition countries, we need to take into account the conditions of the country when the transition process started. Albania started transition with a lack of experience in the market economy, democratic institutions and coming from a hard communist system. As such, the transition process of the country started from significant worse conditions in comparison with the Central-eastern and South-eastern European countries and in more similar conditions with CIS countries. Economic performance, as a result of the measures taken by fiscal and monetary policy and structural reforms during these years, has been successful and is reflected in strong economic growth, low inflation rate and stable exchange rate. On the other side, the maintenance of the good macroeconomic performance over these last years, faces risks like instability from high credit growth and the continuing reliance on remittances from abroad to cover the trade deficit.

From the analyses⁵ of the stage of the economic development of Albania, it results that a lot is to be done. Among the most important challenges that Albania faces to induce and maintain the macroeconomic performance and to approximate standards with the most developed transition countries of our region like Romania, Bulgaria and Croatia and later on with the Central eastern European countries are:

- Taking systematic and effective decisions against corruption and organised crime. Taking measures to increase the efficiency and impartiality of the public administration and the juridical system are needed to improve the business confidence in the public sector.
- Improvement of the transport infrastructure, road network and the progress in restructuring and privatisation of the electricity system are needed to promote more reliable services, enhance standards and robust economic growth. Improvement of the energy supply system is one of the most immediate problems in the country. Reliability of energy supply is noticeably under the international standards and electricity blackouts are a continuous problem in the country, especially in dry periods. Improvement in the investment in the electricity sector is endangered by the low tariff collection rates.
- Improvement in the quality of the domestic production through increase in investments and labour training would increase the competitiveness of the exports. These measurements would help to lower trade deficit and to reduce the dependency created from remittances of the Albanians working abroad.

Concluding, we can say that Albania like many other transition countries has a lot to do to reach the best macroeconomic parameters. But, despite the so-far developments, the further development of the country seems to be a derivate of the willingness for further progress in structural reforms.

NOTES

* This paper was prepared by Ms. Elvana Troqe, Specialist of Monetary Issues Office, Monetary Policy Department.

¹ Transition countries are usually called the countries that have moved or are moving from a system of state planning to a system of market economy with private ownership of assets and market supporting institutions.

² Include: Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovak Republic, and Slovenia.

³ Include: Bulgaria, Croatia, Romania, Albania, Bosnia Herzegovina, Republic of Macedonia, Montenegro, and Serbia.

⁴ Include: Russia, Armenia, Azerbaijan, Belarus, Georgia, Moldova, Ukraine, Kazakhstan, Kyrgyz Republic, Mongolia, Tajikistan, Turkmenistan, and Uzbekistan.

⁵ Also by EBRD.

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INFORMATION ON INTERNATIONAL RESERVES AND FOREIGN CURRENCY LIQUIDITY TEMPLATE

*Hilda Shijaku**

Key words

- International Reserves - Foreign Currency Liquidity - Standards - Template Reporting -

ABSTRACT

The following paper provides some information on the compilation of international reserves and foreign currency liquidity template as an important macroeconomic statistics, mandatory to be reported as one of the standards of the SDDS Project Albania aims to subscribe in by the end of 2007. The compilation of this statistics is in line with the "International Reserves and Foreign Currency Liquidity Guidelines for a Data Template, IMF, 2001", and for the first time, it is being compiled in Albania.

PREFACE

The international reserves and foreign currency liquidity template establishes the standards for the provision of information to the public on the amount and composition of reserve assets, held by the central authorities: the central bank and the government.

This template also specifies the way of reporting the short-term foreign currency liabilities and related activities, such as, financial derivatives positions and guarantees extended by the government for public and private borrowing, which may potentially bring

about the withdrawal of reserve assets. Since 23 March 1999, this standard has been included in the SDDS Project requirements and it has been made mandatory to all countries subscribed to this project. On 29 March 2000, the International Monetary Fund approved the establishment of a database showing countries' template data of all SDDS subscribed countries, on the IMF's website. This is the first time for Albania to compile this statistical indicator. Apart from its usefulness in analyzing the country's liquidity risk, the subscription of Albania to the SDDS Project is another reason for meeting this standard.

The following paper provides an overview of the concepts of this template and it aims to present its linkages to other related statistics, such as "Net foreign assets", "International reserves" etc. The first section outlines the content of the template and its importance. The second section provides some explanations of key template concepts: definitions of "International reserves" and "Foreign currency liquidity" and how they are linked; it also provides the main statistical characteristics for their compilation. These characteristics relate to the institutional coverage, financial activities covered in the template, valuation principles, time horizon and other template reporting considerations. The third section contains four compiled tables of the template, using the data for Albania and providing a few explanatory notes.

1. OVERVIEW OF THE INTERNATIONAL RESERVES AND FOREIGN CURRENCY LIQUIDITY TEMPLATE AND THE IMPORTANCE OF ITS REPORTING

Financial crises in the late 1990s underscored the importance of disseminating comprehensive information on countries' international reserves and foreign currency liquidity on a timely basis. Deficiencies in such information have made it difficult to anticipate and respond to crises by obscuring financial weaknesses and imbalances. Moreover, the importance of such information has increased as a result of the ongoing globalization of financial markets and development of financial instruments.

The international financial activities that countries' central banks and government entities undertake now occur in myriad forms, involve multiple domestic and foreign entities, and span locations around the globe. To assess countries' foreign currency liquidity requires supplementing traditional data on international reserves that cover largely cross-border and balance-sheet activities with those on foreign currency positions and off-balance-sheet activities.

Timely disclosure of such information serves a number of purposes. First, it can strengthen the accountability of the authorities by better apprising the public of the authorities' policy actions and risk exposure in foreign currency. Second, it can spur a more timely correction of unsustainable policies and possibly limit the adverse effects of contagion in times of financial turbulence. Third, it can allow market participants to form a more accurate view of the condition of individual countries, of the vulnerability of regions, and of possible international consequences, thereby limiting uncertainty and the associated volatility in financial markets. Last, enhanced data transparency also can assist multilateral organizations to better anticipate emerging needs of countries for foreign currency liquidity.

Information on international reserves and foreign currency liquidity will best inform public and private decision-making if countries disclose it in a coherent common framework. As part of the effort to strengthen the architecture of the international financial system, the IMF and a working group of the Committee on the Global Financial System of the Group of Ten central banks in 1999 developed such a framework in the form of a data disclosure template. The template was devised in consultation with country authorities, statistical compilers, international organizations, market participants, and users. It reflects the efforts of all concerned to balance the anticipated benefits of increased data transparency and potential costs of adding to the authorities' reporting burden.

The template is intended to be comprehensive and innovative, compared to the so-far reporting of international reserves. It

integrates the concepts of international reserves and foreign currency liquidity in a single framework. In addition to covering the traditional balance-sheet information on international reserves and other selected external assets and liabilities of the authorities, the template takes account of their off-balance-sheet activities, such as in forwards, futures and other financial derivatives, undrawn credit lines, and loan guarantees. It also notes future and potential inflows and outflows of foreign exchange associated with balance-sheet and off-balance-sheet positions. Moreover, it includes data intended to illustrate how liquid a country's international reserves are, such as the identification of assets pledged, and to reveal a country's risk exposure to exchange rate fluctuations.

The template covers not only the authorities' foreign currency resources on a reference date but also inflows and outflows of foreign exchange over a future one-year period. The one-year horizon is consistent with the convention of defining "short-term" to cover a 12-month period, used in other economic statistics' international standards.

2. CONCEPTS OF INTERNATIONAL RESERVES AND FOREIGN CURRENCY LIQUIDITY

The underlying framework of the template is built on two related concepts, international reserves and foreign currency liquidity. The two concepts and their linkages are explained below.

2.1 INTERNATIONAL RESERVES

The fifth edition of the IMF Balance of Payments Manual sets forth the underlying concept of international reserves. "A country's international reserves refer to those external assets that are readily available to and controlled by monetary authorities for direct financing of payments imbalances, for indirectly regulating the

magnitudes of such imbalances through intervention in exchange markets to affect the currency exchange rate, and/or for other purposes.” (BPM5, paragraph 424). As defined, the concept of international reserves is based on the balance-sheet framework, with “reserve assets” being a gross concept. It does not include external liabilities of the monetary authorities. Underlying the concept of international reserves is the distinction between residents and non-residents, with reserve assets representing the monetary authorities’ claims on non-residents.

Also integral to the concept of international reserves are the provisos “readily available to” and “controlled by” the monetary authorities. That is, only assets that meet these criteria can be considered reserve assets. Types of reserve assets cover foreign exchange assets, consisting of foreign currencies and foreign currency deposits and securities, gold, special drawing rights (SDRs), reserve position in the IMF, and other claims.

2.2 FOREIGN CURRENCY LIQUIDITY

Foreign currency liquidity is a broader concept than that of international reserves. In the data template, foreign currency liquidity refers to (1) the foreign currency resources; (2) both predetermined (known, or scheduled) and contingent demands on foreign currency resources resulting from the short-term foreign currency liabilities and off-balance-sheet activities of the authorities.

That is, the authorities’ foreign currency liquidity position refers to the amount of foreign exchange resources that is readily available, taking into account both predetermined and potential net drains on such resources. Underlying the liquidity concept is the notion that prudent management of this position requires managing foreign currency assets along with foreign currency obligations to minimize the vulnerability to external shocks. The concept of foreign currency liquidity is broader than that of international reserves in at least three respects:

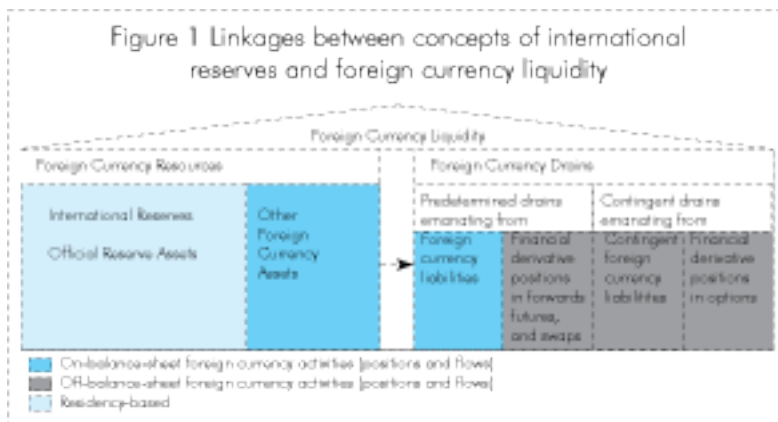
- While reserve assets refer to external assets of the monetary authorities, foreign currency liquidity concerns foreign currency resources and drains on such resources of the monetary authorities and the central government, referred to hereafter as “the authorities”, as opposed to “monetary authorities”.
- While reserve assets represent the monetary authorities’ claims on non-residents, foreign currency liquidity relates to the authorities’ foreign currency claims on and obligations to residents and non-residents.
- While the concept of reserve assets is based on the balance-sheet framework, the concept of foreign currency liquidity encompasses inflows and outflows of foreign currency that result from both on- and off-balance-sheet activities of the authorities.

The concept of foreign currency liquidity is also broader than the notion of net international reserves. Net international reserves refer to reserve assets net of outstanding reserves-related liabilities at a point in time. Foreign currency liquidity takes account of foreign currency drains on existing foreign currency resources arising from the authorities’ financial activities vis-à-vis residents and non-residents in the coming 12-month period. Information on whether a country’s short-term foreign currency drains exceed its foreign currency resources could be used, among other data, to analyze the country’s external vulnerability.

To enhance the transparency of data on countries’ international reserves and their foreign currency liquidity, the template calls for comprehensive disclosure of the authorities, according to this structure:

1. Official reserve assets.
2. Other foreign currency assets.
3. Predetermined short-term net drains on foreign currency assets.
4. Contingent short-term net drains on foreign currency assets.
5. Other related information.

A schematic presentation of the framework of the template, showing the linkages between the concepts of international reserves and foreign currency liquidity, is provided in Figure 1.



2.3 KEY FEATURES OF THE DATA TEMPLATE

The data template sets forth the institutions that are to be covered and their financial activities over a certain time horizon in order to facilitate analysis of the authorities' foreign liquidity and risk exposure.

2.3.1 Institutions Covered

The template is intended to apply to all public-sector entities responsible for, or involved in, responding to currency crises. In practice, this coverage includes the monetary authorities, which manage or hold the international reserves, and the central government (excluding social security funds), which, together with the monetary authorities, accounts for most of the official foreign currency obligations. Demands on the authorities' foreign currency resources also could arise from elsewhere in the public sector. These other public entities generally are not covered in the template because of the difficulties of obtaining the data from these entities on a timely basis. Nonetheless, the standard recommends the inclusion of these other public-sector entities

if their foreign currency activities are of material significance. In such a case, the data should be clearly indicated in country notes accompanying them.

Consistent with the BPM5 (paragraph 514), the template defines monetary authorities as “a functional concept, encompassing the central bank and other institutional units, such as the currency board, and certain operations usually attributed to the central bank but sometimes carried out by other government institutions or commercial banks. Such operations include the issuance of currency; maintenance and management of international reserves, including those resulting from transactions with the International Monetary Fund”.

In conformity with existing international guidelines of other macroeconomic statistics, the template defines the central government to include “all government departments, offices, establishments and other bodies that are agencies or instruments of the central authority of a country (Manual on Government Finance Statistics, page 12)”. “The central government excludes state governments, local governments, and social security funds operating at all levels of government” (System of National Accounts, paragraph 4.114), due to the timely non-collection of information.

2.3.2 Financial Activities Covered

For the purpose of foreign currency liquidity analysis, the template specifies that only instruments settled in foreign currency are to be included in resources and drains as covered in the template. The rationale is that, as concerns future inflows and outflows of foreign currency arising from the authorities’ contractual obligations, only instruments settled in foreign currency can directly add to or subtract from liquid foreign currency resources. Other instruments, including those denominated in foreign currency, but settled in domestic currency, will not directly affect liquid resources in foreign exchange. Instruments denominated in foreign currency or indexed to foreign currency but settled in domestic currency, are to be reported as memorandum (memo)

items in the last section of the template. These instruments can exert substantial indirect pressure on reserves during a crisis, particularly when expectations of a sharp depreciation of the domestic currency lead holders to exchange the indexed liabilities for foreign currency. Among such instruments are domestic currency debt indexed to foreign currency and nondeliverable forwards settled in domestic currency.

2.3.3 Valuation Principles

In the template, the values of foreign currency resources are to reflect what could be obtained for them in the market if they were liquidated; that is, at market prices on the reference date. In cases where determining market values on a frequent basis is impractical, approximate market values can be substituted. Drains on foreign exchange resources, including predetermined and contingent drains, are to be valued in nominal terms; that is, the cash-flow value when the currency flows are due to take place. Generally, this means the principal repayments reflect the “face value” of the instrument and the interest payments reflect contractual amounts due to be paid.

Inflows and outflows of foreign currency related to financial derivatives are also to be reported in nominal terms.

2.3.4 Time Horizon

Consistent with the focus on liquidity, the horizon covered in the template is short term. For practical purposes, “short-term” is defined as “up to one year.” Finer breakdowns of time horizon of “up to one month”, “more than one month and up to three months”, and “up to one year” are included to assess the authorities’ liquidity positions within the one-year time frame.

The term “residual maturity” is used in the template to indicate the types of “short-term” foreign currency flows to be reported for the various subperiods of the one-year time horizon. Residual maturity is commonly referred to as the time remaining until the final repayment of the outstanding obligations.

Accordingly, applying the “residual maturity” concept, one should include:

- Flows emanating from short-term instruments with original maturities of one year or less and;
- Flows arising from instruments with longer original maturities whose residual maturity is one year or less.
- In addition, in the template, this concept also includes principal and interest payments falling due within one year on instruments with original maturities of more than one year.

2.3.5 Other Reporting Considerations

The template does not specify the currencies (national, U.S. dollar, euro, or others) in which the data are to be reported. It is recommended, however, that compilers report data in the template in the same currency they normally use to disseminate data on official reserve assets, to promote reconciliations among different data sets. Moreover, to facilitate data comparability over time and among countries, it is preferable that the reporting currency be a reserve currency or, at a minimum, a stable one. The reference date in the template is the end date of the reporting period.

For position data, data to be reported refer to outstanding stocks of assets and liabilities on that date. For flow data, data to be reported refer to the anticipated amount on the reference date of future outflows and inflows of foreign currency, associated with known predetermined or contingent positions outstanding on the reference date. Where appropriate, the convention of applying a plus (+) sign to denote assets and inflows of foreign currency and a minus sign. In determining outstanding foreign currency resources and flows, it is recommended that transaction dates (not settlement dates) be used. Transaction dates are the preferred basis of recording because the time lags for countries’ settlement practices differ. Since the template is designed for use in diverse economies, it is important that items not applicable be left blank in the template. Where the value of an item is zero, an entry denoting zero should be shown. To

enhance the analytical usefulness of the data and to minimize the prospect that users will misinterpret information reported in the template, it is recommended that country-specific exchange rate arrangements, such as the operation of a currency board or the implementation of dollarization, be disclosed in country notes accompanying the data. Moreover, the practices differing from the standards related to sectorization, the valuation and time of recording are to be explained.

3 STRUCTURE OF THE DATA TEMPLATE

The data template has four sections: Tables 1 – 4 include the data on Albania with a reference date 29 September 2006. Section 1 covers information on the authorities' foreign currency resources, including official reserve assets and other foreign currency assets.

1. Official reserve assets and other foreign currency assets

Indicator	Period
I. Official reserve assets and other foreign currency assets	September 2006 In millions of USD
A. Official reserve assets	1,672.73
(1) Foreign currency reserves (in convertible foreign currencies)	1,603.21
(a) Securities	1,379.03
of which: issuer headquartered in reporting country but located abroad	
(b) total currency and deposits with:	224.18
(i) other national central banks, BIS and IMF	224.18
(ii) banks headquartered in the reporting country	
of which: located abroad	
(iii) banks headquartered outside the reporting country	
of which: located in the reporting country	
(2) IMF reserve position	4.96
(3) SDRs	11.72
(4) gold (including gold deposits)	52.83
volume in fine troy ounces	0.878
(5) other reserve assets (specify)	
—financial derivatives	
—loans to nonbank nonresidents	
—other	
B. Other foreign currency assets (specify)	
—securities not included in official reserve assets	
—deposits not included in official reserve assets	
—loans not included in official reserve assets	
—financial derivatives not included in official reserve assets	
—gold not included in official reserve assets	
—other	0

Official reserve assets are presented in part A of the table. According to the Balance of Payments Manual, Fifth Edition, they cover foreign currency, monetary gold, SDR, and reserve position in the Fund, which are marked-to-market values. The accounting balance data of the Bank of Albania and other additional data on securities have been used as a source of information, since the practice of their accounting recording does not meet the requirements of this template. The items included are the same with the ones included in measuring the NFAs¹, but the way of their recording differs. As explained above, these instruments are presented in the template in their market value, while in the existing NFAs, the purchase price of these instruments is presented.

Foreign currency assets, presented in section B of the table, are liquid assets issued in foreign currency (that meet the criteria of being available for use by the central government in times of a crisis). Pledged assets that are clearly not readily available should be excluded. These assets must be in convertible currencies, which may be claims on residents or nonresidents.

In this item of the template should be reported central government assets (excluding social security funds).

Examples of assets included in this item are:

- The authorities' foreign currency deposits in resident (domestic) banks, divided into deposits in resident banks and deposits in foreign banks' branches.
- The government's current accounts in foreign currency, readily available in non-resident banks.

Sub-loans extended by the government are not included in this item, since they are not liquid.

The accounting recording of the Ministry of Finance is used as a source of information. Currently, the Ministry of Finance reports that there are not any instruments, which meet these criteria.

II. Predetermined short-term net drains on foreign currency assets

Predetermined short-term net drains on foreign currency assets are the known or scheduled contractual obligations in foreign currencies. Short-term drains refer to contractual foreign currency obligations scheduled to come due during the 12 months ahead. Net drains are measured as a difference between outflows and inflows.

		II. Predetermined short-term net drains on foreign currency assets (nominal value)			
		Total	September 2006 Maturity breakdown (residual maturity)		
			Up to 1 month	1 month - 3 months	3 months - 1 year
1. Foreign currency loans, securities and deposits		293.40	50.18	63.68	179.55
—outflows (-)	Principal	-38.98	-1.52	-13.60	-23.86
	Interest	-26.05	-1.59	-6.80	-17.66
—inflows (+)	Principal	299.92	51.92	70.85	177.14
	Interest	70.53	1.36	14.89	54.28
2. Aggregate short and long positions in forwards and futures in foreign currencies vis-à-vis the domestic currency					
(a) Short positions (-)					
(b) Long positions (+)					
3. Other (specify)		0	0	0	0
—outflows related to repos (-)					
—inflows related to reverse repos (+)					
—trade credit (-)		0	0	0	0
—trade credit (+)		0	0	0	0
—other accounts payable (-)		0	0	0	0
—other accounts receivable (+)		0	0	0	0

Outflows consist of scheduled amortizations of foreign currency obligations and associated interest payments within 12 months. Inflows comprise obligations due to the authorities in the 12 month period ahead. Only inflows that are expected to be received should be reported. Interest payments should be reported separately from principal.

Whether an obligation is short term is defined on the basis of its remaining maturity. "Short term" refers to a period up to and including one year. In the template, they also include any amortization and interest payments falling due during the coming year. The time horizon in the table is broken into the

three subperiods: “up to one month”, “more than one month and up to three months” and “more than three months and up to one year”. The “total” column in Section II of the template is to reflect the sum of the three subperiods. The flows value is their nominal flow converted in the USD at the exchange rate applicable at the reference date.

Loans (Section II.1) comprise liabilities resulting from the direct provision of funds from creditors, such as loans to finance trade, mortgage loans, use of IMF credit and loans, etc.

Sections II.3 includes accounts payable that are materially significant, including scheduled payments for goods and services previously purchased, payments of interest or loans in arrears, and wages and salaries outstanding (outflows of foreign currency).

Debt and other payments schedules of the Ministry of Finance and the Bank of Albania, as well as inflows data related to the securities and deposits held with non-resident banks are to be used as information source for this table.

III. Contingent short-term net drains on foreign currency assets

III. Contingent short-term net drains on foreign currency assets (nominal value)	Total	September 2006 Maturity breakdown (residual maturity)		
		Up to 1 month	1 - 3 months	3 months - 1 year
1. Contingent liabilities in foreign currency	-296.09	-220.25	-18.28	-57.57
(a) Collateral guarantees on debt falling due within 1 year				
(b) Other contingent liabilities	-296.09	-220.25	-18.28	-57.57
2. Foreign currency securities issued with embedded options				
3. Undrawn, unconditional credit lines provided by:	256.48	43.62	46.89	165.97
(a) other national monetary authorities, BIS, IMF and other international organizations				
—other national monetary authorities (+)				
—BIS (+)				
—IMF (+)				
(b) banks and other financial institutions headquartered in the reporting country (+)				

(c) banks and other financial institutions headquartered outside the reporting country (+)	256.48	43.62	46.89	165.97
Undrawn, unconditional credit lines provided to:				
(a) other national monetary authorities, BIS, IMF and other international organizations				
—other national monetary authorities (-)				
—BIS (-)				
—IMF (-)				
(b) banks and other financial institutions headquartered in the reporting country (-)				
(c) banks and other financial institutions headquartered outside the reporting country (-)				
4. Aggregate short and long positions of options in foreign currencies vis-à-vis the domestic currency				
(a) Short positions				
(b) Long positions				
PRO MEMORIA: In-the-money options				
(1) At current exchange rates				
(a) Short position				
(b) Long position				
(2) + 5% (depreciation of 5%)				
(a) Short position				
(b) Long position				
(3) – 5% (appreciation of 5%)				
(a) Short position				
(b) Long position				
(4) + 10% (depreciation of 10%)				
(a) Short position				
(b) Long position				
(5) – 10% (appreciation of 10%)				
(a) Short position				
(b) Long position				
(6) Other (specify)				

This table covers only contingent short-term net drains on foreign currency resources. Contingent flows simply refer to contractual obligations that give rise to potential or possible future additions or depletions of foreign currency assets. These flows may derive from assets and liabilities arising in the 12 months following the reference period. Section III of the template differs from Section II because contingent flows relate only to off-balance-sheet activities and they are contingent upon exogenous events.

Section III.1 of the template is used to report flows related to collateral guarantees and other contingent liabilities, which refer

to guarantees provided by the authorities, backed by collateral. The recorded value in this item is the pledge of repayment by the authorities in the event of default by another entity. Data to be reported are foreign currency flows associated with the guarantees when they are exercised, and not the value of the collateral backing the guarantees.

Section III.1.(b) includes letters of credit and foreign currency loan commitments of the authorities. Also included are foreign currency deposits held at the monetary authorities by commercial banks in respect of the regulatory reserves/liquidity requirements.

Section III.3 is used for reporting undrawn, unconditional credit lines, which represent potential sources of foreign currency liquidity. Unconditional credit lines refer to those readily available to the authorities, that is, the ones that do not have material conditionalities attached. IMF arrangements are conditional lines of credit and thus should not be included in Section III of the template. However, where a country has not drawn amounts that have become available, these amounts can be shown in Section III as available over the period up to the next “test date” (a date at which end-of-period performance criteria have to be observed). These amounts are to be also reported separately in an explanatory note following the table.

IV. MEMO items

Section IV of the template provides supplementary information covering:

1. flows and positions not disclosed in Sections I-III, but deemed relevant for assessing the authorities’ reserves and foreign currency liquidity positions and risk exposure in foreign exchange;
2. Additional details on positions and flows disclosed in Sections I-III; and positions and flows according to a breakdown or valuation criteria different from those found in Sections I-III.

IV. Memo items	September 2006
(1) To be reported with standard periodicity and timeliness:	
(a) short-term domestic currency debt indexed to the exchange rate	
(b) financial instruments denominated in foreign currency and settled by other means (e.g., in domestic currency)	
(c) pledged assets	
—included in reserve assets	
—included in other foreign currency assets	
(d) securities lent and on repo	
—lent or repoed and included in Section 1	
—lent or repoed but not included in Section 1	
—borrowed and included in Section 1	
—borrowed but not included in Section 1	
(e) financial derivative assets	
(f) financial derivatives that have a residual maturity greater than one year	
(2) To be disclosed less frequently:	
(a) currency composition of reserves (by groups of currencies)	
—currencies in SDR basket	96.8%
—currencies not in SDR basket	3.2%
—by individual currencies (optional)	

* This paper was prepared by Hilda Shijaku, Head of Financial Statistics Division.

¹ Net Foreign Assets

ALBANIAN PRICE DEVELOPMENTS IN COMPARISON WITH GREECE AND ITALY. WHAT ABOUT CONVERGENCE?

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Valentina Semi

Key words

- Price developments - Convergence - Stability - Consumer Price Index -

ABSTRACT

One of the main criterions to become member of the European Union and then of the Monetary Union, is that of price stability. According to this criterion, the inflation rate must not exceed by more than 1.5 percentage points than that of the three best performing Member States in terms of price stability during the year preceding the examination of the situation in that state. Since one of the objectives of Albania is that of becoming a European member, in the following paper we have investigated price tendencies in comparison with that of Greece and Italy. These countries are taken in consideration because they are EU member states and Albania's main trading partners.

To compare price developments between Albania on one side and Italy and Greece on the other, in absence of absolute price data, we are based in series of the consumer price indices. These indices have the same division into 12 main groups for the three countries, but they have differences in the weights of these groups, in the division of groups into subgroups and in their respective weights.

Despite these differences we think that the methodology applied in this paper enables us to distinguish if the series of the 12 groups of the consumer price indices, have converged, are converging or diverge in relative prices or in inflation rates. The main conclusion in this paper is

that in all cases we do not find divergence in inflation rates for the 12 groups of the consumer price indices between Albania and the two other states, Italy and Greece.

INTRODUCTION

One of the most important goals of the transition economies in South Eastern European countries is to join the European Economic and Monetary Union. In order to join the Monetary Union and adopt the euro as its currency, a country must meet certain economic and legislative requirements. These economic requirements are known as convergence criteria and entail, in brief: low inflation, stable exchange rate, sound government finances and low interest rates. In addition, the country's national central bank legislation must satisfy certain requirements. As an approximation for integration, it is expected that more integrated and competitive markets have lower price differences. To investigate this issue we view the developments of the Albanian consumer price index (CPI) in comparison with those of Italy and Greece. These countries are EU members and Albania's main trading partners¹ and convergence or divergence in prices can be a good point to analyze, considering that the future of Albania is the accession in the EU.

The data used are the monthly series of the consumer price indices published by ISTAT for Italy, by General Secretariat of National Statistical Service of Greece for Greece (GSNSSG) and INSTAT for Albania. Although there are 12 groups of goods and services in the CPI basket of the three countries, there are differences in the classification of subgroups of goods and services and in their respective weights. In this analysis, we are conscious that these differences may distort the conclusions of this exercise.

It is not possible to use the CPI data to compare absolute price levels between different countries. CPIs do not tell us anything about the differences in the level of prices between the countries. An individual country index measures price level over a specific time period in that particular country and not absolute price levels.

Furthermore, convergence in the rate of change of prices does not imply convergence in price levels. If we compare index numbers for two different countries, we can say that prices in one country are rising or falling, faster or slower, than in the other. We cannot tell from the index numbers whether prices or living costs are higher or lower in that country in comparison with another.

In the first part we give a general view on the inflation developments in the three countries and the main factors that have played an important role in these developments. Afterwards, we have analyzed developments in the 12 groups of the CPI and have tried to identify the main reasons which have led to these developments. The CPI data have been indexed using year 1999 as a base period.

In the second part of this paper, our focus is on finding the main tendencies in prices and inflation rates of these countries. We search for convergence of prices and inflation rates. Unit root and stationarity tests in levels and first differences have been used to investigate whether series are converging or have already converged. These tests are applied to the same monthly series of CPI data but, taking March of 2006 as the base month. The series have been seasonally adjusted and transformed by the exchange rate. Then, we have calculated the series of the differences –or contrast- between the log of price indexes and the series of differences in the inflation between countries and the tests are applied on these series.

I CPI DEVELOPMENTS IN ALBANIA, GREECE AND ITALY

Table 1 Annual changes in percentage for GDP and annual inflation average

Annual changes in percentage for GDP and annual inflation average		1999	2000	2001	2002	2003	2004	2005	2006
Italy	Inflation	1.7	2.6	2.3	2.6	2.8	2.3	2.3	2.4
	GDP	1.9	3.6	1.8	0.3	0.0	1.1	0.0	1.5
Greece	Inflation	2.1	2.9	3.7	3.9	3.4	3	3.5	3.6
	GDP	3.4	4.5	5.1	3.8	4.8	4.7	3.7	3.7
Albania	Inflation	0.4	0.0	3.1	5.2	2.3	2.9	2.4	2.2
	GDP	10.1	7.3	7	2.9	5.7	5.9	5.5	5

Source: International Monetary Fund

Inflation in Albania has generally fluctuated between 2 and 4 per cent during these last six years. The main factors that have contributed to keeping inflation low are²:

- The gradual increase of the domestic agricultural production,
- The increase of the competition in supplying the domestic market with clothing, footwear products and household equipment.
- Stability oriented macroeconomic policies, with fiscal policy geared towards fiscal consolidation and monetary policy keeping positive levels of real interest rates have helped in keeping positive interest rate differences between lek and other foreign currencies.
- The appreciation of lek against Euro and USD. The appreciation might be explained by the increase in the productivity of the tradable goods³ (good macroeconomic conditions helped developments in SME), remittances and income from tourism that justify the appreciation of lek especially in summer and in the last months of the year. The appreciation of our currency has played an important role in the amortization of the imported inflation in our country.
- The modest effects of oil price increases on the CPI, probably is in part due to the structure of our economy, characterized by low-energy activities, such as agriculture and services⁴ (22.8 and 45.2 percent of GDP, respectively for the year 2005).



Greece has succeeded in bringing inflation down from around 16%, where it was for most of the first half of the 1990s, to an average just above 3% since 2000⁵. Regardless of these developments, Greece has been one of the EU member state with high inflation rate. This may in principal be attributed to macroeconomic factors associated with:

- The faster growth rate of domestic demand compared with supply. This growth is reflected in the positive “output gap” and is in part due to the generally expansionary fiscal policy pursued in Greece in recent years⁶.
- The rise of unit labour cost in Greece, which is higher than the euro average.
- Unsatisfactory competitive conditions in certain markets which do not operate efficiently (electricity, telecommunication, postal services).
- The developments of the world oil prices. Greece is more exposed to oil price changes than the European economy; the domestic energy consumption expressed in oil equivalent per GDP units is 36% higher in Greece than in EU-15 average. The developments in the exchange rate (appreciation of euro against usd during these last years) market has influenced on the impact of the increased oil prices in Greece.

Italy, in recent years, experienced a slower increase of GDP in comparison with other Euro area countries⁷; due to the decrease in the domestic demand.

- Household consumption decreased because of the weakening in the expectations about the economic growth. This is reflected in the increase of the household savings.
- Inflation was influenced by the developments in oil prices. The fluctuations in the euro/usd exchange rate contributed to the weight that the increase of the oil prices pursues against inflation.
- The main specific factors hindering more frequent price adjustments, in Italy, are the existence of explicit contracts with the buyers, the reluctance of individual firms to reprice

for fear of provoking reaction from competitors, and the perceived temporary nature of shocks⁸. On the other hand, with the exception of firms in the retail sector, menu costs are not considered an especially important impediment to more frequent price adjustments. The reaction of firm prices to shocks is asymmetrical. Positive changes in costs have a greater impact than negative ones; increases in demand give rise to larger price changes than decreases in demand.

1.1 PRICE TRENDS OF THE 12 GROUPS OF THE CPI

Group 1 – Food and non alcoholic beverages

Economic theory suggests that the improvement in a population’s standard of living leads to a fall of the share of its expenditure accounted for primary goods (food, housing, etc.) and to a raise in the share of the luxury goods. Consequently, relatively poor population groups spend a larger share of their income on primary goods and a smaller share on recreation, health, education etc. This theory holds when we compare the weights that the group “Food and non alcoholic beverages” has on the CPI basket for the three countries. The weight of this group for Albania is higher than for Greece and Italy.

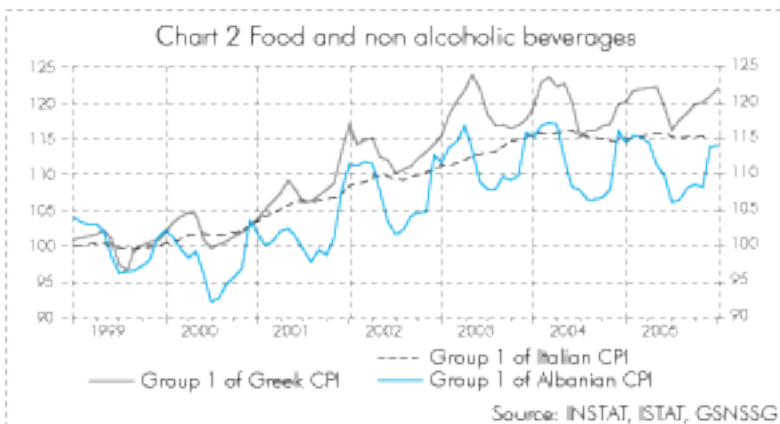


Table 2 CPI group weights in the three countries

CPI group weights in the three countries ⁹			
CPI Groups	Albania	Greece	Italy
Food and non alcoholic beverages	0.426	0.185	0.154
Alcoholic beverages and tobacco	0.031	0.039	0.027
Clothing and footwear	0.038	0.099	0.098
Housing	0.244	0.117	0.095
Household equipment	0.046	0.086	0.099
Health	0.021	0.069	0.077
Transport	0.048	0.130	0.138
Communication	0.013	0.038	0.032
Recreation and culture	0.026	0.049	0.080
Education	0.010	0.027	0.011
Hotels/catering	0.073	0.097	0.106
Miscellaneous	0.024	0.064	0.083

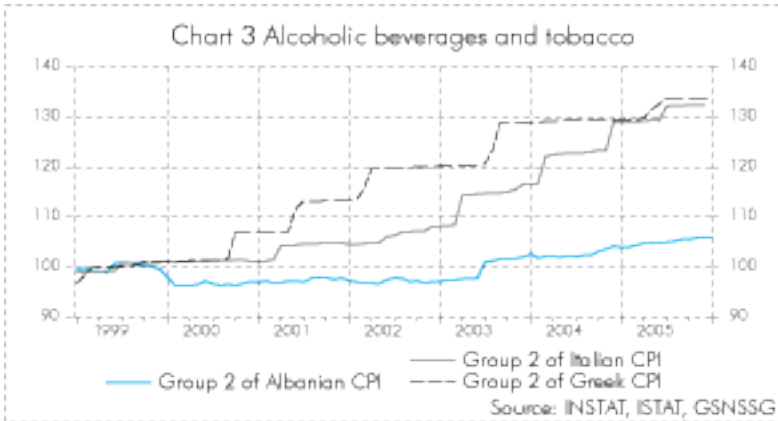
Source: INSTAT, ISTAT, GSNSSG

From chart 2, we notice that Albanian and Greece CPI experienced nearly the same fluctuations, while the Italian CPI is much smoother. The main explanations for these developments could be: the importance of the agricultural sector and the same climate conditions in Albania and Greece and the presence of a more industrialized economy, in comparison with the above countries, in the Italian case.

The relatively high inflation recorded in Greece could be easily imported in Albania, given that food imports from Greece, construct a large share of Albanian's total food imports¹⁰. However, we believe that the appreciation of lek has worked as a buffer against the rising import prices.

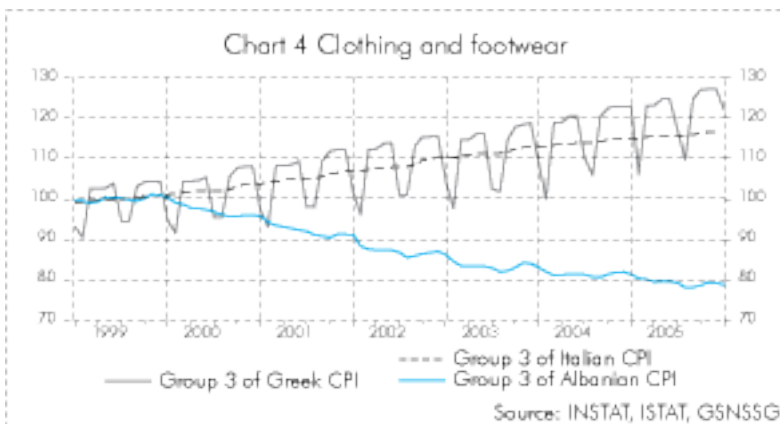
Group 2 – Alcoholic beverages and tobacco

The weights of this group in the CPI basket are higher in Greece and Albania and lower in Italy. Prices of this group in Greece seem to be growing up faster with prices of Italy following while Albanian prices seem to have a slower growth rate. This could be explained by the fact that the goods of this group are more luxury goods than primary ones and because Albanians consume a lot of home made alcoholic products. The jumps in the CPIs of Italy and Greece are the result of changes in the indirect taxes on tobacco and alcohol in these countries. EU membership can explain the visible convergence in charts of these countries with the passing of time.



Group 3 – Clothing and footwear

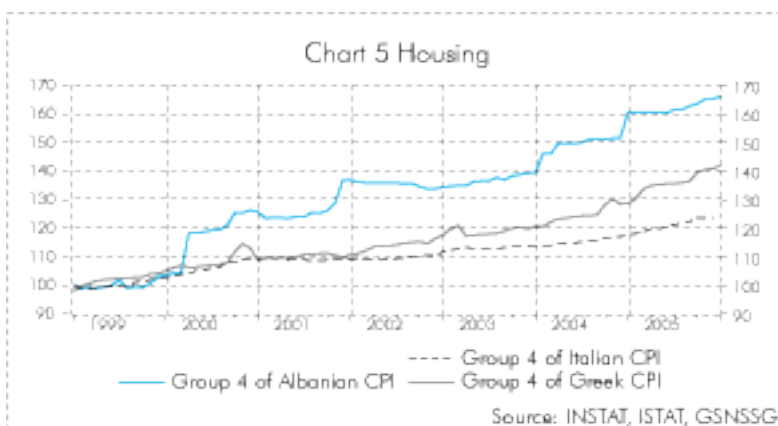
The price tendency of the third group products “clothing and footwear”, is falling in the Albanian case and rising in Greece and Italy cases. This difference in trends could be explained by the liberalization and increase of the competition in Albanian market of these goods, the appreciation of lek during these years and by the differences in the quality of these products traded in these countries. The weight of this group is nearly the same for Italy and Greece and lower for Albania. We observe a much higher seasonality in the Greek CPI. This seasonality can be explained by the sales after the winter holidays, in January and in summer season when tourism activity is very high. Seasonality



is observed even in the Albanian CPI but it is not as prominent as in the Greek case. The fact that Italy has a much more stable CPI could be explained by the reputation of Italy as a well known country for its fashion houses and an exporter of these goods.

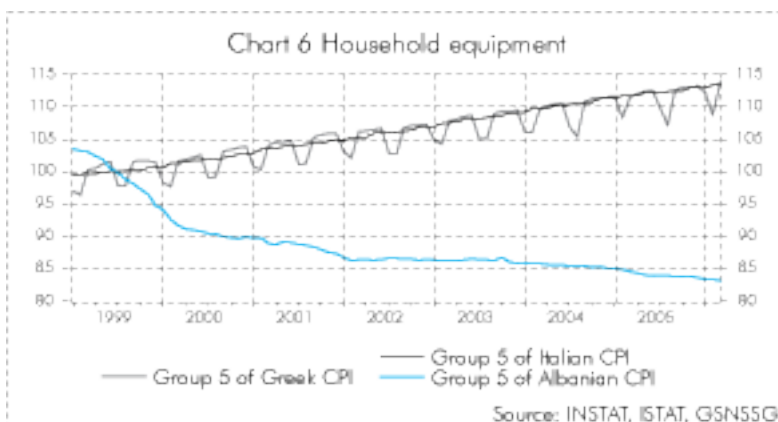
Group 4 – Housing

Housing prices display a general upward trend in the three countries. A very important subgroup of group “housing” is electricity. Albanian electricity market looks more like a monopolistic market with KESH the main generator, transmitter, distributor and seller of the energy. The problems that this company faces to cover costs, have led to the increase of the electricity prices during these years. Another factor influencing the increase of prices of this group is the continuous increase in housing prices. The upward tendency for Greece and Italy could be explained by the increase in the price of energy (even in the global market) and the increase in the rent and housing prices.



Group 5 – Household equipment

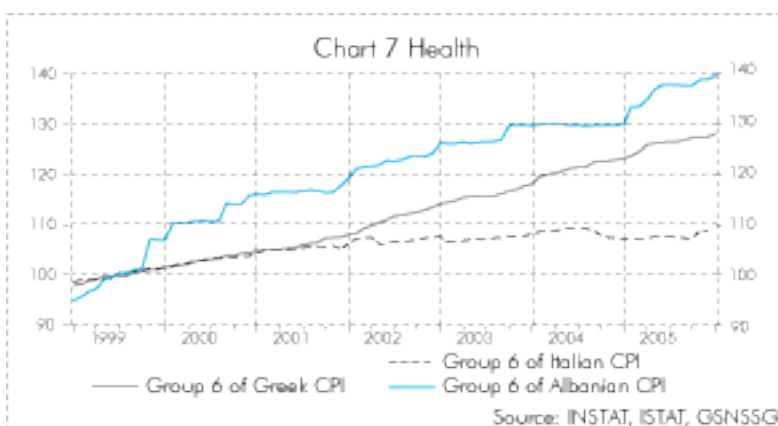
Analyzing price tendencies of the “Household equipment” group, we face the same picture as that of the third group of the CPIs basket. The developments in the Albanian market, the downward tendency of prices, could be explained by the



liberalization of the market, increasing of the competition fuelled by the increase of the domestic products and the appreciation of lek against euro. In the Greek CPI we see the same seasonality that we have seen in the “clothing and footwear” group. We expect that the same factors causing seasonality in the third group can be true even in this case.

Group 6 – Health

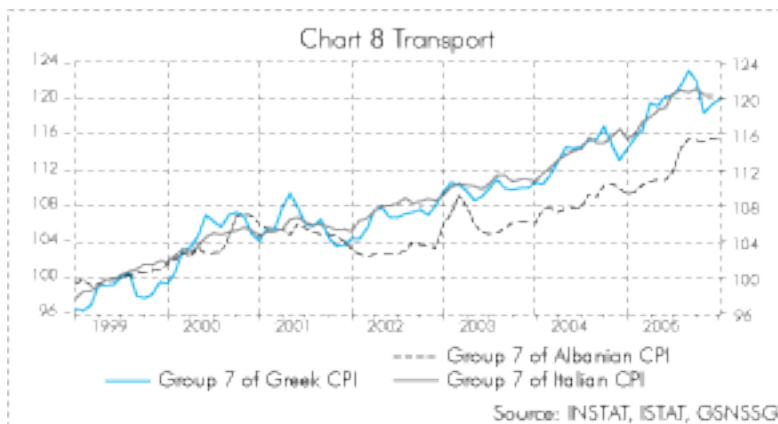
The fast rise of the Albanian prices for “Health” group in comparison with the two other countries could be explained by the low competition¹¹ in this market and the continuous increase in the prices of the medical services and medicines. The majority of the medical products, appliances and equipment in Albania



are imported. Medical warehouses, in general work by earning exclusivity on some articles, from the supplier firms which leads to low competition in the market. In Greece, imports comprise 95¹² percent of the market whereas in Italy 70 percent of medical devices and diagnostics used are imported. The public sector accounts for 70 percent of total medical purchases in Greece, mainly by public hospitals. Public hospitals in Italy account for approximately 75 percent of sales of medical equipment, while 25 percent of sales go to the private sector. These facts can bring more light in explaining why the CPI of Greece is rising faster than the Italian one. We could not find any evidence that there are big differences in the aging of the population between these countries. Old age dependency ratio is nearly the same for Greece and Italy. The weight that the group “health” has in the basket is greater in the Italian and Greek case and lower in the Albanian one.

Group 7 – Transport

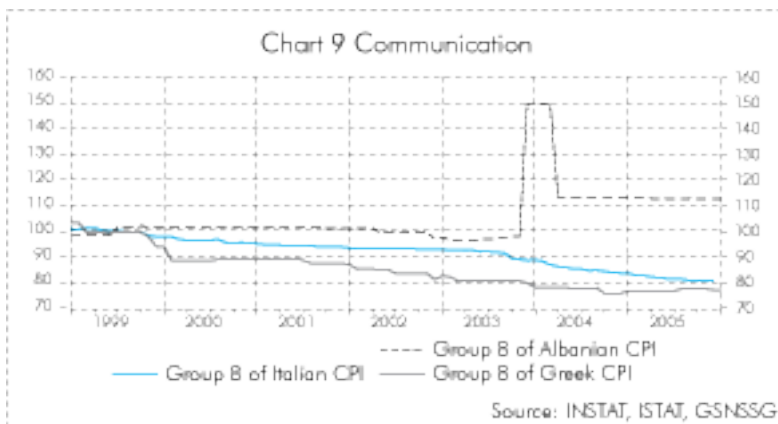
In Albania the “Transport” group has about 5 percent weight in the inflation basket. This group consists of three subgroups: purchase of vehicles, operation of personal transport equipment and transportation services. Out of these subgroups the most important one because of its weight is the operation of personal transport equipment component with a weight of 2 percent. The price of this group is directly affected by the increase and



decrease of oil prices in the international market, which has been very volatile in the last years. Albania demonstrates similar fluctuations in prices (increases and decreases) with Greece and Italy. However, there are periods when changes of the oil price in Albania did not reflect changes of oil price in the international market. This is due to the appreciation of lek in the last years, especially toward US dollar. Thus, as oil is traded in US dollars, the appreciation of lek against usd has helped to amortize the effect of increased oil prices in the international market.

Group 8 – Communication

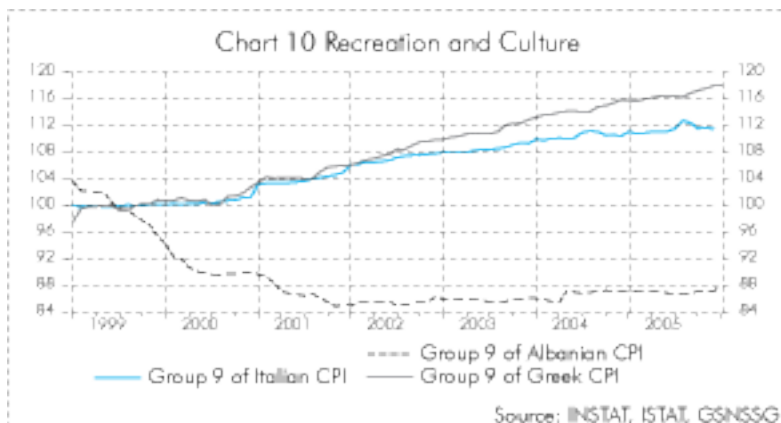
The trend of this group in the Albanian CPI is very different from that of the other two countries. Whereas Greece and Italy show patterns of a competitive market that drives prices down (Chart 9). Albania shows a pattern of a controlled or uncompetitive market. There are two important moments in the communication sector in Albania: the first is the decrease in the price at the beginning of 2003 attributed to the promotional packages offered by Vodafone Albania that caused a slight decrease in prices at that time; and the second is the immediate increase in prices at the end of 2003 attributed to Albtelecom, the sole fixed telephony provider in Albania. This price increase was reflected in the market immediately. Albtelecom in the middle of 2004 decreased prices, affecting the market in general again. After this moment there did not seem to be a change in prices. This is because the Albanian communication market consists of only



one fixed Telephone Company and two cellular ones and thus, it reflects the characteristics of a market that does not stimulate competition.

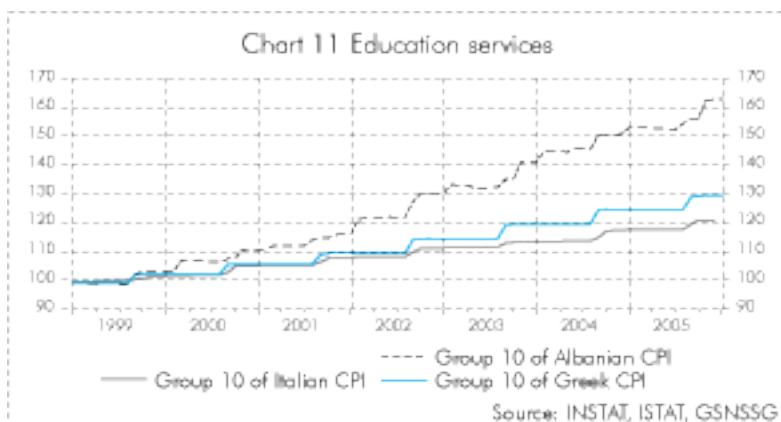
Group 9 – Recreation and Culture

The Albanian CPI of this category is comprised of three subgroups which are: “audio visual, photographic equipment and their repair”, “entertainment and cultural services” and “newspapers, books and school supplies”. The most important subgroup in this group is the “audio visual, photographic equipment and their repair”. This subgroup is comprised of imported goods and supplies, whereas the other two subgroups include domestic services and products. From the chart we can see that the trend of Albanian prices is decreasing especially up to 2001. Meanwhile Italy and Greece show rising price tendencies. This could be attributed to the different development levels of these countries and the influence that euro had in the Euro zone markets.



Group 10 – Education services

In this group are included all education related services. This group has a weight of 0.1% in the Albanian basket of goods. When comparing price trends of these services in Albania to those of Italy and Greece there seems to be a higher upward

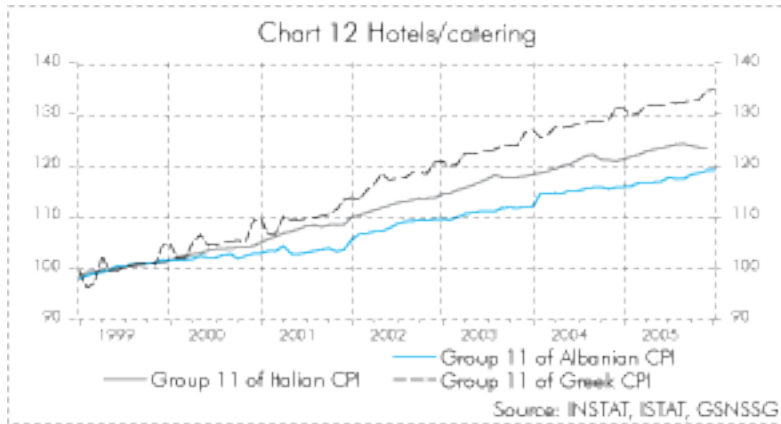


tendency of prices for these services in Albania. This could reflect the moment of the entrance of private schools and educational institutions in this market which charge high prices for the services they provide as opposed to the free public education system. Italy and Greece seems to have a recurring pattern of price increases in September when the academic year starts. However, Albania seems to show price increases even in other months like January, explained by the beginning of the second academic semester. The Albanian price development for this group and its irregular changes throughout the years could be attributed to the entrance of the new services and perhaps with gaps or deficiencies in the regulatory or legal framework, that might put some price stability in this sector.

Group 11 – Hotels/catering

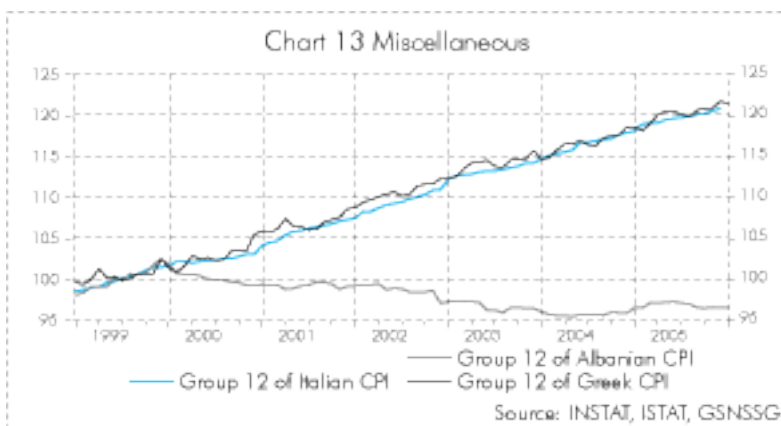
As far as the group “hotels/catering” is concerned, the three countries demonstrate a similar trend of price increases. In the three cases, we can distinguish seasonality of prices. However, the only noticeable difference is that the increase in prices in Italy and Albania occurs in the month of August, which is the peak of the tourist season in both countries. On the other hand, the tourist season starts earlier in Greece, namely in April or May right around Easter. This could be explained by the high numbers of Northern European tourists, who start vacation earlier than the beginning of the summer. In Albania, we can not talk of a true

tourist seasons, mostly about the inflow of Albanian emigrants that live abroad. Thus, during this period, the Albanian market reflects an increase of the prices of these services.



Group 12 – Miscellaneous

This category consists of goods and services such as personal hygiene products, or household cleaning supplies. Albania has a different price pattern than those of Italy and Greece. This could be attributed to the fact that both other countries are EU members and therefore have strict quality criterion on the products traded in their countries. For Albania, the same products are



mostly imported and do not obey to such strict quality criterion. They are mainly imported from non EU countries or have been produced for the Albanian market and hence are on low cost. The Euro zone membership has affected prices for Greece and Italy since the introduction of the euro prices were rounded up. These products could be categorized as luxury goods and their prices are influenced by the cost of living. This could explain the downward tendency of prices in the Albanian market. Another explanation for the downward trend in the Albanian prices could be the increase in competition in the domestic market and the appreciation of lek.

II. TESTING FOR STABILITY AND CONVERGENCE

In the first part of the paper we compared the CPI of Albania, Italy and Greece. By this comparison we can say that prices in one country are rising or falling but we can not tell whether prices are higher or lower in one country in comparison with another. An individual country index measures price levels over a specific time period in that particular country and not absolute price levels. Furthermore, convergence in the rate of change of prices does not imply convergence in price levels. Considering this, in this part of the paper, we focus on finding whether the price differences, in inflation rates or in levels, between our country and that of Italy and Greece are diverging, are converging or have converged.

In the literature on convergence the general tests used to describe if the series have converged or are in process of converging are unit root test and stationarity test. Unit root tests are more useful to establish whether the variables are in the process of converging. Stationarity tests are more appropriate to verify if the series have converged, i.e. whether the difference between them remains stable.

In our paper, we refer to the testing strategy described by Busseti, Fabiani, Harvey et al, (2006). They present a testing strategy to establish whether the convergence occurs in relative prices or just in rates of inflation. They have applied their strategy

on the monthly series of the Consumer Price Index in the Italian regional capitals over the period 1970-2003. They argue that the use of unit root and stability test in first differences and levels allows us to distinguish if series have con/diverged or are in the process of converging and establish if convergence occurs in relative prices or in rates of inflation. In this paper is presented the same testing strategy but this time established to investigate convergence in levels or differences of the 12 groups of the CPI between Albania and Italy, and Albania and Greece.

Methodology, tests and data

In our exercise it is of interest to test the hypothesis of stability of convergence in both levels and first differences. In this way we can see the dynamics of both relative prices and inflation differentials. If $P_{i,t}$ is some weighted average of price in country i at time t than the price indexes are:

$$p_{i,t} = P_{i,t} / P_{i,b}$$

where b is the base year. The difference, or contrast, between (the log of) the price index and countries is:

$$y_t^{i,j} = \log p_{i,t} - \log p_{j,t}$$

Where, $y_t^{i,j}$ is the logarithm of the relative prices between two countries. It is not possible to discriminate between relative or absolute convergence with price index; all that can be investigated is convergence to proportional law of one price. The appropriate test for stability is ξ_1 . On the other hand, a test of convergence can be based on DF statistic, τ , formed by taking the base to be the last period.

The contrast in the rate of inflation, or inflation differentials,

$$\Delta y_t^{i,j} = \Delta \log p_{i,t} - \Delta \log p_{j,t}$$

are invariant to the base year because this cancels out yielding $\Delta y_{i,t} = \Delta \log P_{i,t} - \Delta \log P_{j,t}$. The Null hypothesis that there are no

permanent, or persistent, influences on an inflation rate contrast is tested by applying ξ_0 stationary test to Δy_t . Similarly, the null hypothesis of no convergence can be tested using τ_0 obtained from an ADF regression without a constant.

Based on the results of the unit roots and stationarity tests we can distinguish between groups of CPI that have already converged (rejection of unit root and non rejection of stationarity test) and groups of the CPI that are in process of converging (rejection of both tests). Since both levels and differences are of interest, the order of testing is also important. Dickey and Pantula (1987), argue that it is best to test for a unit root in first differences and if it is rejected, to move on to test for a unit root in the levels.

On the other hand, stationarity of the levels implies that the spectrum of first differences is zero at the origin, thereby invalidating a stationarity test on first differences. This suggests that the sequence of stability test should be one in which the stationarity of Δy_t is tested only if stationarity of y_t has been rejected.

The starting point, of this testing strategy, is the unit root test on inflation differentials. If this hypothesis is not rejected we have the case of non convergence (divergence) (option E in the figure below), while rejecting the unit root test in first differences leads to the test of unit root hypothesis in relative prices. The rejection or acceptance of the later test will lead to stationarity test in levels or differences. The final results, as described in the strategy used by F. Busseti, et al, (2006) are:

(A) Relative prices are converging: rejection of unit root in first differences and levels; rejection of levels stationarity test.

(B) Relative prices have converged: rejection of unit root in first differences and levels; non rejection of levels stationarity test.

(C) Inflation rates are converging: rejection of unit root first differences but not in levels; rejection of first differences stationarity test.

(D) Inflation rates have converged: rejection of unit root in first differences but not in levels; non rejection of first differences stationarity test.

(E) Non convergence: non rejection of unit root in first differences.



Data

The data used are the same monthly series of the consumer price index but the base period has been changed to March 2006. The series have been seasonally adjusted and transformed by the changes in the exchange rate lek/euro. Then we have calculated the series of the difference –or contrast- between the log of price indexes and the series of differences in the inflation between countries and the tests are applied on these series.

All test results are given in table 1 and 2. To better understand the results of this tables we can provide an illustration of the price and inflation contrast between Albania and Greece for the first group “food and non alcoholic beverages” of the CPI. The null hypothesis of non convergence is rejected at 1% level by the ADF test on inflation differentials. The unit root test in levels is also rejected but the level stationarity test is not rejected leading to the conclusion that the relative prices of “food and non

alcoholic beverages” have converged, Option B. One aspect of these results that might be a concern is the fact that although prices seem to be converging; the stationarity test on inflation differentials rejects the null hypothesis.

The properties of the first differences stationarity test depend on whether the initial condition is small or large. In the former case the test is undersized, in the later it is oversized. Oversizing occurs for a large initial condition with the degree of oversizing increasing with the magnitude of the initial condition. Intuitively this oversizing problem can be explained if we think of a converging path in levels (starting from a large initial value): the first difference is the slope of the series which keeps changing mostly in the same direction in order to bring the level to its long run value. Notice that these large values of the initial conditions, for which oversizing occurs, are quite typical for converging series.

The results of the tests on inflation and price differentials on the 12 groups of the CPI are reported in table 1 and table 2. For the inflation contrasts we give the significant levels of rejection for the ADF test with and without a constant term, respectively τ_1 and τ_0 . For price contrast we report significant level of rejection of the ADF test with a constant τ_1 and without a constant τ_0 term and Kwiatkowski, Phillips, Schmidt and Shin (KPSS) stationarity test ξ_1 . In both cases, the maximum lag values according to the Akaike Information Criterion were 11.

In all cases, the unit roots tests on inflation differentials reject the null hypotheses, so we exclude the case of non convergence or divergence. In the first table we gave the results of the compared prices between Albania and Italy. In this case we have: 1 A, converging relative prices, 9 Bs, convergence in relative prices and 2 C, converging inflation rates. In the second table, we have compared Albanian and Greek prices. In this case we have: 11 Bs, convergence in relative prices and 1 C, converging inflation rates.

Table 3 Test results on the prices between Albania and Italy

Albania-Italy							Outcome
	Inflation contrast			CPI contrast			
	τ_{13}	τ	ξ_0	τ_1	τ_0	ξ_1	
Groups of CPI							
Food, non alcoholic beverage	1%	1%	1%	5%	1%	-	B
Alcoholic and tobacco	1%	1%	1%	-	-	-	C
Clothing and footwear	1%	1%	1%	-	-	-	C
Housing	1%	1%	1%	1%	1%	-	B
Household equipment	1%	1%	1%	-	5%	-	B
Health	5%	1%	1%	5%	1%	10%	A
Transport	1%	1%	1%	10%	1%	-	B
Communication	1%	1%	1%	-	5%	-	B
Recreation and culture	1%	1%	1%	-	5%	-	B
Education services	1%	1%	1%	-	1%	-	B
Hotels/catering	5%	1%	1%	10%	1%	-	B
Miscellaneous	1%	1%	1%	-	5%	-	B

Table 4 Test results on the prices between Albania and Greece

Albania-Greece							Outcome
	Inflation contrast			CPI contrast			
	τ_{13}	τ	ξ_0	τ_1	τ_0	ξ_1	
Groups of CPI							
Food, non alcoholic beverage	1%	1%	1%	10%	1%	-	B
Alcoholic and tobacco	1%	1%	1%	-	5%	-	B
Clothing and footwear	1%	1%	1%	-	-	-	C
Housing	1%	1%	1%	1%	1%	-	B
Household equipment	1%	1%	1%	-	1%	-	B
Health	5%	1%	1%	1%	1%	-	B
Transport	1%	1%	1%	-	1%	-	B
Communication	1%	1%	1%	-	1%	-	B
Recreation and culture	1%	1%	1%	-	5%	-	B
Education services	1%	1%	1%	-	1%	-	B
Hotels/catering	5%	1%	1%	-	5%	-	B
Miscellaneous	1%	1%	1%	-	10%	-	B

Table 5 Test results on the prices between Greece and Italy

Greece-Italy							Outcome
	Inflation contrast			CPI contrast			
	τ_{13}	τ	ξ_0	τ_1	τ_0	ξ_1	
Groups of CPI							
Food, non alcoholic beverage	1%	1%	1%	-	-	-	C
Alcoholic and tobacco	1%	1%	1%	-	-	-	C
Clothing and footwear	-	-	-	-	-	-	E
Housing	-	5%	5%	-	10%	-	B
Household equipment	1%	1%	1%	-	-	-	C
Health	1%	1%	1%	-	5%	-	B
Transport	1%	1%	1%	5%	1%	-	B
Communication	1%	1%	1%	5%	1%	-	B
Recreation and culture	5%	1%	1%	-	1%	-	B
Education services	-	5%	1%	-	-	-	C
Hotels/catering	1%	1%	1%	-	1%	-	B
Miscellaneous	1%	1%	1%	5%	1%	-	B

III. CONCLUSIONS

In this paper, are analyzed price tendencies between Albania on one hand and Greece and Italy on the other. In the conclusions found must be taken into consideration the different level of economic development between these countries, the differences in the consumer price indices and the short period of time series used in this methodology.

- Initially, in this paper, we make a comparison of the price tendencies of the 12 groups of the CPI, between Albania, Italy and Greece. From this analysis, it results that in the Albanian market there are two main tendencies:
 1. A decreasing tendency in the prices of the groups "Clothing and footwear", "Housing equipment", "Recreation and culture" and "Miscellaneous" in comparison with the two other partner countries.
 2. A faster increase of the prices for the groups "Housing", "Health", "Communication" and "Education" in comparison with Italian and Greek ones.

Price developments in the first case could be explained by market liberalization, assignment of the Free Trade Agreement with the countries of the region, increase of the domestic production and the appreciation of the exchange rate¹⁴. In the second case, when the Albanian prices are rising faster than the prices of the two other countries, we need to take into consideration the nature of these goods and services and the fact that a good part of them are administered prices.

- Then, in the paper are applied the unit root and stationarity tests to investigate whether series have converged, are converging or diverge in relative prices and inflation rates. Tests are applied on the monthly series of the consumer price indices that have the same division into 12 groups, for the three countries, but change in the weights of the groups, in the division into subgroups and in their weights. In the majority of the cases, tests lead to

the convergence in the difference of the relative prices. Anyhow, taking into consideration the differences of the consumer price indices between these countries and the oversizing problem we want to emphasize that the most important conclusion of this paper is that in all cases tests reject the hypothesis of divergence in inflation rates.

- For the future, we think that it will be of interest to apply this testing strategy on longer time, updated, series of the CPI. The future results can be of interest because some of the actual noises could be eliminated.

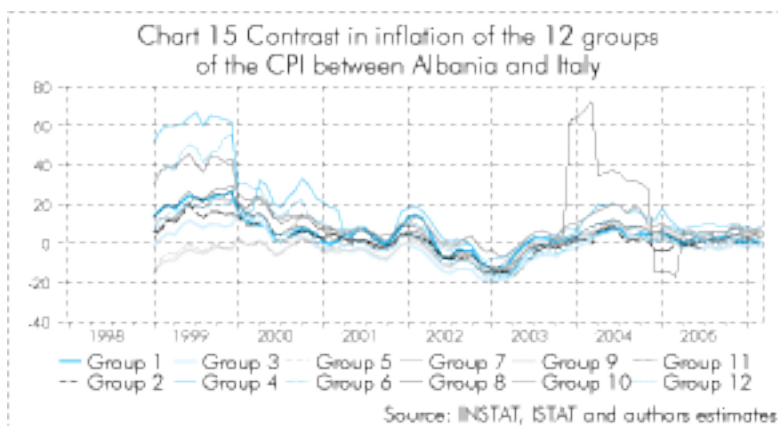
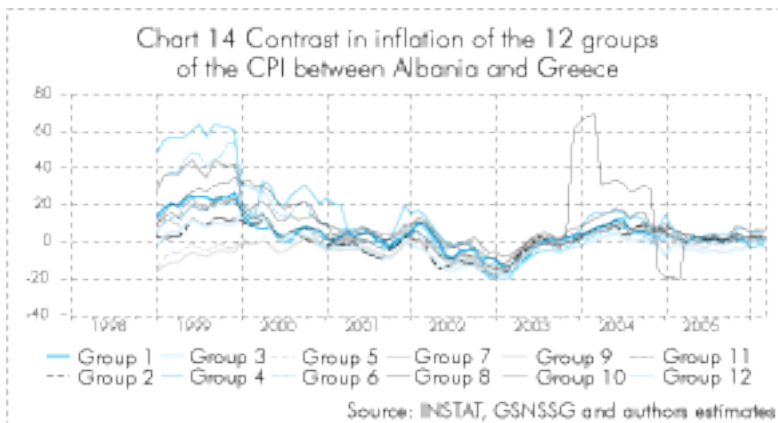
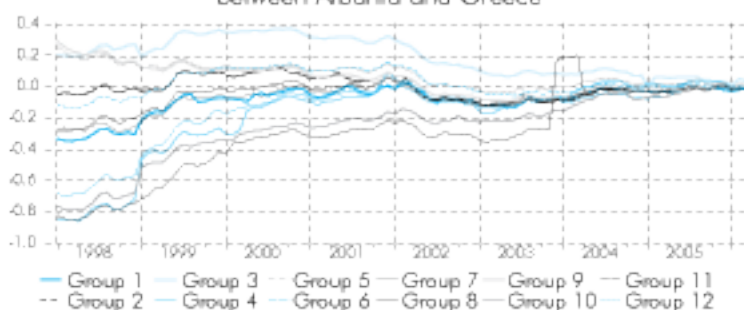
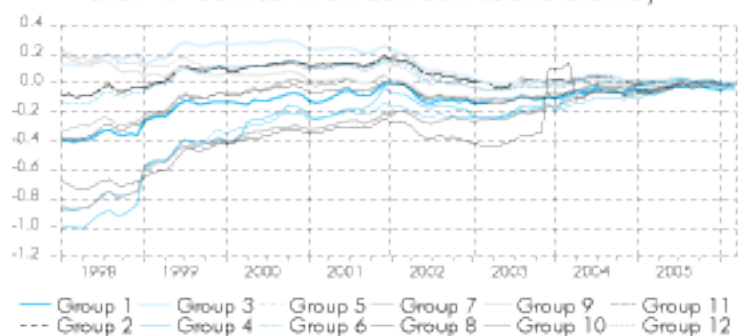


Chart 16 Contrast in relative prices (CPI)
between Albania and Greece



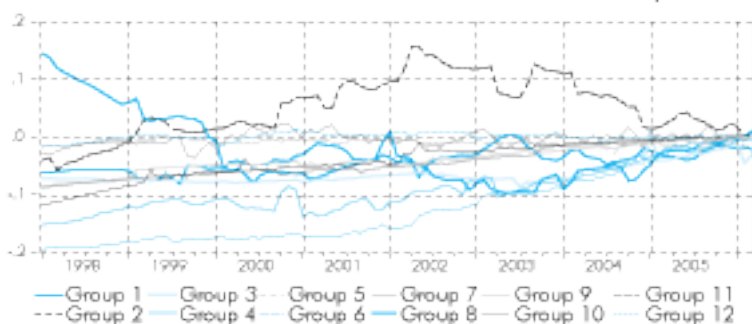
Source: INSTAT, GSNSG and authors estimate

Chart 17 Contrast in CPI between Albania and Italy



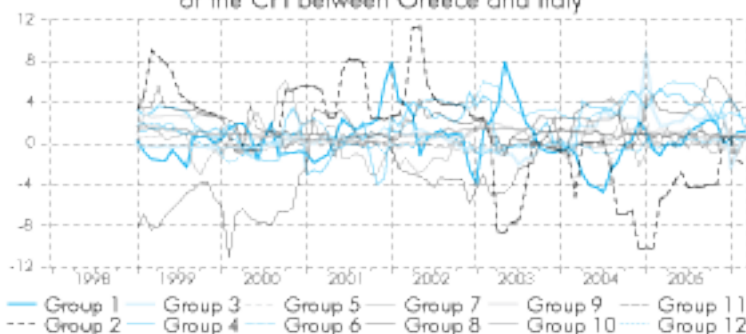
Source: INSTAT, ISTAT and authors estimates

Chart 18 Contrast in CPI between Greece and Italy



Source: ISTAT, GSNSG and authors estimates

Chart 19 Contrast in inflation of the 12 groups of the CPI between Greece and Italy



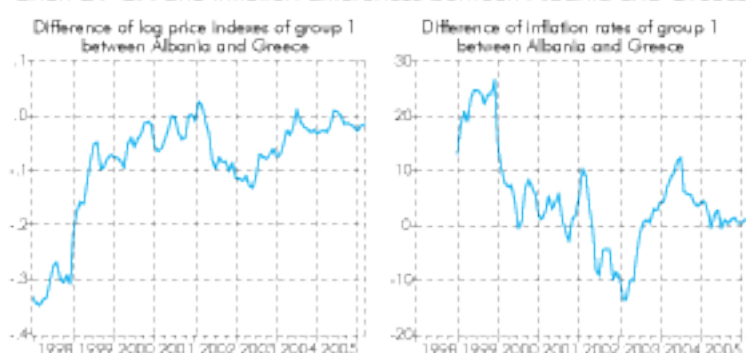
Source: ISTAT, GSNSSG and authors estimates

Chart 20 CPI and inflation differences between Albania and Italy



Source: INSTAT, ISTAT and authors estimates

Chart 21 CPI and inflation differences between Albania and Greece



Source: INSTAT, GSNSSG and authors estimates

NOTES

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The views expressed here are those of the authors and do not involve the responsibility of the Bank of Albania.

¹ Exports with Italy, in 2005 comprise 72.4 percent of the total exports and with Greece 10.5 percent. Imports with Italy, in 2005 comprise 29.3 percent of the total imports and with Greece 16.6 per cent of the total.

² Source: Periodical Reports of the Bank of Albania.

³ Jan Peter Olters "Is inflation too low in Albania? Macroeconomic foundations and socioeconomic development", Fifth Conference of the Bank of Albania.

⁴ Not including transport services.

⁵ Speech by the Deputy Governor Mr. Panayotis Thomopoulos: "Supervision of credit and financial institutions - Structure of the Greek banking system". Euromoney Conferences, Greece's rapidly changing banking sector, Athens, 1-2 November 2006.

⁶ Source: Monetary Policy Interim Report and Annual Report, Bank of Greece.

⁷ Source: Annual Report 2005, Bank of Italy.

⁸ S. Fabiani, A. Gattulli and R. Sabbatini, July 2004, "The pricing behavior of Italian firms: New survey evidence on price stickiness".

⁹ There are differences in the classification and weights of subgroups of goods and services in the 12 groups of the CPI between these countries.

¹⁰ Imports of food and non alcoholic beverages, from Greece, comprised 17 percent of total imports in 2005.

¹¹ The competition could be considered lower taking into account the appreciation of lek during these last years.

¹² U.S. Department of Commerce. Mission Statement U.S. Healthcare Technologies Trade Mission. Greece, Italy, May 22-27, 2006

¹³ Unit root test without constant τ_0 , unit root test with constant τ_1 , stationarity test without constant ξ_0 , stationarity test with constant ξ_1 .

¹⁴ The subgroups of these groups are comprised mainly by tradable goods.

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NEW LAW "ON BANKS IN THE REPUBLIC OF ALBANIA" AND ITS COMPLIANCE WITH THE SUPERVISORY REGULATORY FRAMEWORK. OBLIGATIONS FOR REGULATORY CHANGES IN THE IMPLEMENTATION OF THE DIRECTIVES OF THE EUROPEAN UNION. JUNE 2007

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Key words

- Legal framework - EU Directives - Banking activity - Licensing - Supervision -

ABSTRACT

This paper deals with the compliance of the Law No. 9662, dated 18.12.2006 "On Banks in the Republic of Albania" with the existing supervisory regulatory framework, and the obligations for regulatory changes arising from the implementation of provisions of the Directive 2000/12/EU consolidated with the Directive 2006/48/EU.

The paper makes a comparison between the new Law No. 9662, dated 18.12.2006 "On Banks in the Republic of Albania" and the Law No. 8365, dated 02.07.1998 "On Banks in the Republic of Albania", which has served as a basis in drafting the existing supervisory regulatory framework. In this aspect, detailed analyses are made about all articles of the above laws and also they are compared to respective regulations that reflect these provisions.

From such analysis, we draw the conclusion that some of the existing regulations need to be revised, so as to reflect the novelties arising from the implementation of the new legal framework. Another element of this analysis is the reflection of provisions of the Directive 2000/12/EU consolidated with the

Directive 2006/48/EU, including the obligations deriving from the Stabilization and Association Agreement in the field of financial activities.

1. Compliance of the Law No. 9662 dated 18.12.2006 "On Banks in the Republic of Albania" with the supervisory regulatory framework. Needs for making regulatory changes, in implementation of the Directives of the European Union

The Law "On Banks in the Republic of Albania" No. 9662, dated 18.12.2006 is an improved version of the Law No. 8365, dated 02.07.1998 "On Banks in the Republic of Albania" and deals differently with a number of elements. The Law is designed taking into consideration the EU directives, the Basel Committee core principles on Banking Supervision. It is also drafted in compliance with the obligations deriving from the Stabilization and Association Agreement. As a consequence, the need for improvement and adjustment of the existing supervisory regulatory framework with the requirements of this law arises.

Given the above, the compliance of the Law "On Banks in the Republic of Albania" No. 9662, dated 18.12.2006¹ with the supervisory regulatory framework will be analysed according to respective chapters of the Law.

1.1 Chapter I: "General provisions"

This chapter is composed of general provisions, defining: the purpose of the Law, its scope, the structure and extension of the banking system in the Republic of Albania, definition of terms used in the Law, the rights and revocations in exercising banking activity, obligations for providing information on banking and financial system situation, the legal form of the bank and measures against using the banking system for purposes of money laundering or terrorism financing.

In Article 1 (which describes the purpose of the Law) and Article 2, point 2 of the Law (which describes the persons, entities of the Law), the term "bank" means either a bank with head-office in the

Republic of Albania or a branch of the foreign bank, licensed by the Bank of Albania, without making any distinction as concerns the establishment, licensing or activity they carry out in the territory of the Republic of Albania (Article 5 of the Law). Such a treatment is in full compliance with freedom of establishment or freedom of provision of banking and financial services (Article 11 of the Law), cited also in the Directive 2000/12/EU, Article 23/5 and in Directive 2006/48/EU, Articles 38/1 and 38/3. More concretely, the Directive defines that: member states should not apply to branches of credit institutions, with head-office outside the territory of the EU, at the moment of starting or while carrying on its activity², provisions that result in a more favouring treatment than the treatment against branches of credit institutions with head-office inside the territory of the EU..

Despite the same treatment to banks and branches of foreign banks regarding the establishment and exercising of their activity in the Republic of Albania, an important element is the need for carrying out a differentiated supervision between banks and branches of foreign banks, in compliance with Article 27 of the Directives 2000/12/EU and 2000/12/EU consolidated with Article 41/1 of the Directive 2006/48/EU. This Article states that: Host member states shall retain responsibility in cooperation with the competent authorities of the home Member State for the supervision of the liquidity of the branches of credit institutions:

Whereas Article 28 of Directive 2000/12/EU and Article 42 of the Directive 2006/48/EU state that: this cooperation between supervisory authorities of the home and host country on supervision and monitoring of the activity of credit institutions should include, besides liquidity, also the management, ownership structure, solvency, large exposure limits and internal audit mechanisms..

Article 4 of the Law (on definition of terms used in the respective Law) provides improvements in the definition of some terms of the old law, and definition of some new terms. Briefly, this article provides the definition of the following terms: “bank”, “banking activity”, “licence”, “monetary deposits”, “persons or

group of connected persons”, “control”, “branch of a foreign bank”, “executive director”, “nonbanking financial entity” as well as terms related to bank’s equity; risk, “voluntary liquidity”. Consolidated supervision is also defined.

From the viewpoint of consolidated supervision, new terms are also defined, such as: “initial minimum capital”, “initial paid-in capital”, “banking group”, “financial holding company”, “superordinate bank in a banking or financial group”. Among other new terms, we may mention also the definitions given for “credit registry” and “deposit insurance agency”. In this respect, the need for updating the existing supervisory regulatory framework arises, with the purpose to approximate the national legislation to that of the EU in the field of banking and financial services. (*Directive 2000/12/EU, Article 1 consolidated with Directive 2006/48/EU, Article 4, provides detailed definition of terms used in the abovementioned directives*).

1.II Chapter II “Licensing banks and branches of foreign banks”

This chapter of the law presents the characteristics, phases and requirements related to necessary documentation for receiving a licence to carry out banking and financial activity in the Republic of Albania; initial approval of the licence, refusal to grant the licence, commissions applied for receiving a licence; cases of licence revocation; publication of decisions for licence approval or revocation, initial minimum capital requirements, additional activities that may be carried out by banks or branches of foreign banks, as well as changes in the capital structure.

The Law vests the Bank of Albania with the executive right to license banks and branches of foreign banks, for carrying out financial and banking activity in the Republic of Albania (Article 14 of the Law), in full compliance with the *Directive 2000/12/EU, Article 4 consolidated with Directive 2006/48/EU, Article 6 and 28/1*. According to the Directive, it is stated that: The right to commence banking and financial activity is acquired only after a bank or a branch of a foreign bank has acquired a license.

Article 15, point 1 of the law specifies licence characteristics, as an administrative act issued by the Bank of Albania. The licence is perpetual, non-transferable, and what is new compared to the old law, it is not tradable.

Article 15, point 2 of the Law, unlike the old Law, extends the area of activities permitted for banks and branches of foreign banks with financial activities, defined together with banking ones, in the annex that is an integral part of the licence. This part of the Law complies with the *Directive 2000/12/EU, Article 21/1 consolidated with the Directive 2006/48/EU, Article 28/1* which states that: *credit institutions should notify in advance competent authorities of the activities on the list in the Annex of the banking licence acquired.*

Article 17 of the Law brings about a re-designing of the old law, as concerns the requirements related to documentation for receiving a licence to carry out financial and banking activity in the Republic of Albania, making a distinction between banks and branches of foreign banks. These requirements were previously specified only in the regulations of the Bank of Albania, but are presently defined in the new Law, thus highlighting their importance. Also, more requirements are provided in relation to legal documentation for acquiring a licence, directly reflected in the Law, as for example concerning direct or indirect participation in bank's equity to not less than 5 percent; capital structure; information about any agreement or any other regulatory form by virtue of which control or influence on the decision-making process may be exercised in any other way; accounts and annual report of the legal person, consolidated accounts and annual report, and certified auditor's opinion (Article 17/1) as well as in relation to foreign bank's ownership structure; the name of the supervisory authority and its consent to the opening of the branch of the foreign bank, as well as information on Deposit Insurance Agency (Article 17/2).

Another new element is also the prevention of limitation of appointing by parent bank at least two resident administrators for managing the branch of the foreign bank. These changes

should be presented in the Regulation “On granting a licence to carry out banking activity in the Republic of Albania”³.

Regarding the compliance with *point 1* of this Article with the EU Directive, we may underline that some of provisions of the latter are reflected quite well. More concretely, information on: the subscribed share capital and documentation evidencing the lawful source of contributions in the capital; capital structure; qualification; reputation and experience of at least two administrators; the business plan for the first three years of the activity; name, and address of every person that proposes to own qualified holding, all comply with the requirements of the provisions of the Directive 2000/12/EU and the Directive 2006/48/EU⁴.

We may draw the same conclusion also about the compliance of points 2, 3 and 5 of Article 17. So, information on statute of the foreign bank, accurate address of the legal seat, description of activity, amount of capital, management structure of the bank and its administrators; endowed sum of the initial minimum capital; permission for exercising banking activity granted by the competent authorities of the country where the legal seat is located; as well as list of activities for which the foreign bank is licensed; ownership structure of the foreign bank; conditions to be met by a branch of a foreign bank that proposes to own a qualifying holding in a bank; the BoA’s right to request additional information, all reflect rigorously the information required under the Articles of the provisions of the Directive 2000/12/EU and Directive 2006/48/EU⁵.

Article 18, point 1 of the Law (on capital requirements), complies with the requirements of Article 5/1 of the Directive 2000/12/EU and Article 9/1 of the Directive 2006/48/EU, for depositing the initial minimum capital to acquire a licence to carry out banking and financial business. The provisions of the EU directives stipulate that the initial minimum capital shall be no less than EUR 5 million, whereas the BoA regulatory acts stipulate that this capital shall be no less than ALL 1 billion (approximately EUR 8 million). This higher level is due to the fact

that the regulatory acts of the Bank of Albania take into account country risk whilst setting forth this amount.

Article 19, point 1 of the Law stipulates that the Bank of Albania shall have the right to grant or not to grant an initial approval for a licence (within three months of the receipt of application for a licence submitted by a bank or a branch of a foreign bank). This right given to the supervisory authority is also reflected in Articles 10 and 13, respectively of the Directives 2000/12/EU and 2006/48/EU, but with a distinction, that the above directives specify that: the maximum term of granting or not granting an authorisation is within 6 months of receipt of application.

Further to the old Law (that specifies the condition of existence of at least three shareholders for the acquiring of a licence by a bank or branch of a foreign bank), *point 2/d* of Article 19 specifies that the Bank of Albania shall give its initial approval for a licence only after it has been satisfied that no shareholder owns more than 1/3 of the capital or shares with voting rights of the bank. This re-designing should be reflected also in the Regulation "On granting a licence to carry out banking activity in the Republic of Albania".

Article 19, point 2/d (operational and control structures, including procedures and policies of banks or branches of a foreign bank) and *point 3* (cases when the Bank of Albania shall refuse initial approval of a license for a bank or a branch of a foreign bank), are new elements compared to old Law requirements. In this way, the need to include them in the Regulation "On granting a licence to carry out banking activity in the Republic of Albania" (Article 6) arises.

Article 20, of the Law provides that one of necessary conditions for acquiring a licence by banks or branches of foreign banks is the submission of application and complete documentation to Deposit Insurance Agency, for receiving the deposit insurance certificate. Also, Article 22 of the Law stipulates that a bank or a foreign bank may not carry out banking activity without

acquiring the deposit insurance certificate. Given the above, the need to include the conditions in the Regulation *“On granting a licence to carry out banking activity in the Republic of Albania”* (Article 7) arises.

Articles 21 and 29 on the announcement and publication of the decision for granting a license or for revoking it, are based respectively on Articles 11 and 14/2 of the Directive 2000/12/EU and Articles 14 and 17/2 of the Directive 2006/48/EU, which stipulate that: The name of each credit institution to which authorisation has been granted shall be entered in a list. The Commission shall publish that list in the Official Journal of the European Union. Also, in case of revoking a licence, the competent authorities shall provide the reasons of such revocation and shall publish this decision.

Article 24 presents cases when a bank or a branch of a foreign bank should apply for prior approval of the BoA on issues related to its activity. Unlike the old Law, additional cases are provided for prior approval, being presently specified in the Law (not only in the BoA regulations), for example: open a branch, subsidiary or representative office inside and/or outside the territory of the Republic of Albania or transfer ownership of a qualifying holding or the control of the bank to third parties. Furthermore, additional requirements are provided, such as: change of the statute, distribution of its capital and increase of the percentage of a shareholder with qualifying holding exceeding 20, 33 or 50% of the bank's capital or its voting rights or to such degree that the bank becomes its subsidiary. The last requirement is in full compliance with Article 16/1 of the Directive 2000/12/EU and Article 19/1 of the Directive 2006/48/EU.

These directives prescribe also two specific cases which may be considered as important also for the Albanian reality. The natural or legal persons (Article 16, Directive 2000/12/EU and Article 20, Directive 2006/48/EU) are required first to inform the competent authorities if he proposes to reduce his qualifying holding in a credit institution, owned directly or indirectly, so that the proportion of the voting rights or of the capital held

by him would fall below 20, 33 or 50 percent. Secondly, the requirement for information in favour of competent authorities arises not only for natural and legal persons who propose to acquire qualifying holding in credit institutions, but also for credit institutions proposed to be acquired (Article 21, Directive 2006/48/EU).

Points 1/c and 1/e of the Article 24 provide additional information. Letter c has been enriched with the fact that the Bank of Albania determines through its by-laws the criteria for entering into agreements⁶ with third parties, for exercising the functions and duties for the administration and management of the bank. *Letter f* specifies that prior approval of the Bank of Albania is required in cases of repurchasing bank shares or those of its connected persons, directly or through another person, by granting credit or issuing guarantees.

Article 24 point 3, which stipulates that the Bank of Albania grants or refuses to grant the prior approval within 3 months from the adequate submission of the request, in accordance with the documentation as defined though by-laws, is in compliance with Article 16 of the Directive 2000/12/EU and Article 19/1 of the Directive 2006/48/EU.

Article 25 specifies the cases when a person, who requests to change his qualifying holding in a bank, should address himself to the BoA to receive the prior approval. Point 6 of Article 25 stating: If a person holds a qualifying holding in the bank without the prior approval of the Bank of Albania, the action resulting in such occurrence shall be deemed null and void, complies with the requirements of Article 16/5 of the Directive 2000/12/EU and Article 21/2 of the Directive 2006/48/EU.

An important element is the distinction with the old Law, specifying that in case a person possesses a qualified holding in a bank, without prior written approval by the Bank of Albania, the licence was revoked (Article 13); the new law specifies that no right to vote is known to such shareholder.

Article 26 is a summary of cases found in various provisions of the old Law, adding some additional cases when banks and foreign bank branches should notify the Bank of Albania about the existence of facts or verification of risky situations for the continuity and stability of their activity. We may mention here cases when: maximum permitted exposure limits are reached, when the liquidity or solvency of a bank or branch of a foreign bank is threatened, the financial position of the bank has changed to the extent that the bank does not possess any longer the regulatory capital or does no longer reach the minimum capital adequacy, the regulatory capital of the bank falls beneath the minimum initial capital required for the commencement of banking activities, etc..

Point 2 of this Article, on the requirement of the bank or the branch of the foreign bank to notify the Bank of Albania of cases when there are changes in the organizational structure, changes of the legal seat and its address, dismissal of administrators, reflects the requirements of Article 20/6 of the Directive 2000/12/EU and Article 26/3 of the Directive 2006/48/EU.

The only change between the provisions of this Article and the aforementioned directives stands in the term specified for the notification. The bank or the branch of the foreign bank notifies the Bank of Albania within 30 days from the moment of verification of any of the above cases, whereas in the EU Directive the obligation arises at least *30 days prior to the adoption of the decision for the aforementioned changes, so that adequate time is given to competent authorities for their approval.*

Article 27 brings about a novelty in comparison to the old Law, as concerns the obligation of the licensed bank or branch of foreign bank to pay annual commission to the Bank of Albania for the validity and use of the licence. The amount of this commission remains to be specified by the BoA by-laws, which leads to the need for reviewing the Regulation "On granting a licence to carry out banking activity in the Republic of Albania" (Article 14).

Article 28 provides additional cases, when verification constitutes a motive for revoking the licence of the bank or of the branch of foreign bank. We may mention here: breaches of this Law or by-laws issued by the Bank of Albania, which may lead to or cause a significant financial loss; breaches of national and international legal standards on accounting; exercising of activities that risk the liquidity and the solvency of the bank; the bank or the branch of the foreign bank is not able to provide sufficient own funds, and is no longer able to be relied on to fulfil its obligations towards its creditors and particularly no longer provides security for assets entrusted to it.

Point 4 of Article 28, unlike the old Law, adds the requirement for notifying also the Deposit Insurance Agency for such a decision. This should be reflected also in the Regulation "On granting a licence to carry out banking activity in the Republic of Albania (Article 10, point 3). Cases of licence revocation (point 1) and communication of revocation of licence (point 4), generally comply with Articles 14 and 17 respectively of the Directive 2000/12/EU and Directive 2006/48/EU. Also point 1, letter e, about non-commencement of activity by the bank or the branch of the foreign bank, complies (as concerns the penalty) with Articles 14 and 17 of the Directive 2000/12/EU and Directive 2006/48/EU, but with the distinction that the term specified in the latter is 12 months from acquiring the licence and not 6 months, as specified in the Law.

I.III Chapter III "Organization, management and audit of the bank and branch of the foreign bank

Chapter III defines clear rules on organising, managing and auditing the activity of banks and branches of foreign banks, with the purpose to create a safe and sound banking system.

Article 31 of the Law speaks for the independence of the bank and the branch of a foreign bank and is improved and more complete than the respective article of the old Law (Article 16), since it stipulates that:

The bank and the branch of a foreign bank is administered and governed based on free market and fair competition principles. No subject or public person may interfere without authorization to influence the administration or the governing structures of the bank or branch of a foreign bank, except when complying with by-laws of the Bank of Albania, execution of orders from the judiciary organs or when it is so stipulated in the Law. This Article entitles the bank to operate in the market based on the principles of fair competition.

Article 32 stipulates the directing organs of the bank and branch of foreign bank. Unlike the provisions of the old law (Article 17), which states that banks are directed only by the Steering Council, the new Law specifies that the bank is directed by the Steering Council and the Directorate, making also a distinction between directing organs of the bank and of the branch of a foreign bank (point 4).

Article 33 on internal by-laws regulating the activity of the bank and the branch of a foreign bank, point 1/d (boundaries to the powers of the directors) is enlarged, including not only administrators and other employees of the bank, but also any other person that acts in the name and on behalf of the bank. Also, this Article brings about a novelty, allowing the internal by-laws of the branch of the foreign bank be issued in accordance with the regulatory acts of the parent bank (foreign bank) as long as the latter do not contradict with the Albanian legislation in force.

Drafting a Regulation on Corporate Governance, which would define accurately the processes through which credit institutions are directed and audited, and all relations, not only reporting but also auditing ones, which exist among groups of interest: shareholders, governing board, administrators and staff or other persons the institution is related with, is of special importance.

Article 35 on the composition of the Steering Council, brings about a new element in point 2 of this Article. So, the number of

members, unlike the old Law (Article 19) which defined only their minimum number (5 members), requires not less than 5 and not more than 9 members. It also adds that the initial members of the Steering Council shall be nominated in the Statute (point 3), unlike the old law which does not mention such a thing. New elements of the Law are also the criteria for electing or dismissing members of the Steering Council. We may mention point 4, which stipulates that: At least one third of the members of the Steering Council shall be composed of individuals that at the time of their election and throughout their mandate are not connected through private interests with the bank, shareholders that control the bank or its executive directors. In consequence, these elements should be presented in the Regulation "On administrators of banks and foreign bank branches".

Article 36 (meetings of the Steering Council) and some points of *Article 37* (powers of the Steering Council) are new elements of this Law. So, the *point 1* of *Article 37* stipulates clearly the criteria and motives guiding members of Steering Council in exercising their powers. *Point 2* stipulates the main responsibilities of the Steering Council, and *Point 3* provides the right of the members of the Steering Council to request "appropriate, timely and adequate information", in discharging their responsibilities during the decision-making process. Therefore, these novelties should be presented in the Regulation "On administrators of banks and branches of foreign banks".

Article 38, point 1 on Audit Committee, contains more detailed provisions in comparison to the old Law as concerns the re-election, since such a thing was not provided in the old Law. *Article 38, point 3* on duties of audit committee, provides new elements in relation to: considering internal audit reports and monitoring the way conclusions from such reports are dealt with; evaluating the financial situation of the bank based on the report of the statutory auditor; approving the financial reports and statements prepared by the bank and which the bank intends to publish. *These changes should be reflected in the Regulation "On internal audit in banks and branches of foreign banks" (point 6.4).* *Article 38* provides also restrictions for members of

the Audit Committee (point 5) and the requirement of the Audit Committee to report to the Steering Council (point 8). Point 6 entitles the Audit Committee to select external auditors, unlike Article 20/3 of the old Law, where this power belonged to the Steering Council.

Article 41 extends the disqualifying criteria for administrators of banks and branches of foreign banks. More concretely, there are mentioned cases in relation to: shareholder of more than 5 % of the voting rights or the shares in another bank or a person connected with him; an employee of the Bank of Albania, penalized by the Bank of Albania in the past 5 years for a serious breach of this Law or for carrying out activities for which there was no license in force by the Bank of Albania; etc.. Also, a person who acts or has acted, at any time for the past 5 years, as administrator of a bank, which has been subject to compulsory liquidation procedures pursuant to the provisions of this Law, is disqualified from the duty as administrator of the bank or branch of the foreign banks. The aforementioned period changes from the 12-month term defined in Article 21 of the old Law. All changes and novelties provided in Article 41 should also be reflected in the Regulation *"On administrators of banks and branches of foreign banks"* (Article 4).

Article 44 on prevention and resolution of conflicts of interests defines accurately in point 2, the sources of private interests of the administrator, adding their number in comparison to the old Law, with: interests deriving from: gifts, promises, favours, preferential treatments; negotiations for potential employment or any other form of relationship constituting a private interest for the director in the future, after leaving the position as administrator carried out by him whilst in the position of the administrator of the bank; engagement in private activities with the view to profit or any other activities which generate income. Point 5 provides as new element, the responsibility of the Steering Council for the approval of the internal by-laws which determine the basic methods of prevention and efficient resolution of the conflict of interest, having also the right to set up and authorize *ad hoc* committees (composed of non-

executive members of this Council), who would be responsible for dealing appropriately with the conflict of interests in the bank. *Article 46* which that speaks about internal audit unit, provides new elements as concerns powers of the Steering Council for setting out the rules for the functioning and implementation of the internal audit system (point 2); appointing the members of internal audit unit by the decision-making organs of the foreign bank (point 4); prohibiting the employees of the internal audit unit to have any other position in the bank or in the branch of the foreign bank (point 5). The latter ones should be reflected also in the Guideline "On internal audit of banks and branches of foreign banks" (point 6.3). *Article 47* on financial reports, specifies, in its point 1 and 2, that the bank or the branch of the foreign bank shall maintain accounts and prepare financial reports on individual or consolidated basis (unlike the old Law where such a thing was not mentioned, and in compliance with the provisions of the Directive 2000/12/EU, Article 22/1 and the Directive 2006/48/EU, Article 29/1.

Point 3 (The Bank of Albania requires that every bank or branch of foreign bank shall have management and accounting procedures as well as sufficient mechanisms of internal auditing, on individual or consolidated basis) and *point 4* (on the right of the Bank of Albania to define the form, type, methodology, contents and the time of reporting of banks and branches of foreign banks to the Bank of Albania) are new elements.

Article 48 on statutory auditors, provides for the first time in the Law, the fact that the branch of the foreign bank is audited by the statutory auditor that audits the foreign bank (parent bank) or a statutory auditor approved by the Bank of Albania (*point 3*). *Points 6* and *7* of this Article provide limits regarding the key audit partner in an auditing company, who carries out a statutory audit on behalf of the audit company. The above cases are specified in the Law and not in the by-laws, thus emphasising their importance. *Point 5* of this Article specifies that the statutory auditor or the key audit partner responsible for carrying out the statutory audit on behalf of the audit company, shall rotate from the statutory audit engagement within a maximum period of

seven years from the date of appointment as statutory auditor, and is allowed to participate in the audit of the audited bank or branch of a foreign bank, after a period of at least two years. These new elements should also be reflected in the Regulation "On statutory auditors" Article 8, point 8.1.

Article 49 on audit from the statutory auditor, extends the powers on audit and statutory auditor, which should be added to the Regulation "On statutory auditors of banks", precisely about policies of writing-off balance sheet items; consolidated reports; accounting registration; accuracy and adequacy of reports submitted to the Bank of Albania; and adequacy of accounting procedures and regulatory compliance.

Article 50, point 1, adds the requirement of the statutory auditor to produce copies of the auditing reports to the Shareholders' Assembly. *Point 2* defines in a detailed way the cases when the statutory auditor shall immediately notify the Bank of Albania of facts or decisions of the bank or branch of foreign bank which put the activity at risk. These cases should be amended to the Regulation "On statutory auditors of banks". *Point 4* (The statutory auditor of the bank or branch of foreign bank shall also immediately notify the Bank of Albania of any such facts found in the course of discharging his duties in a subject who is a connected person with the bank) and *point 5* (The notification submitted to the Bank of Albania by the statutory auditor of the bank or branch of the foreign bank shall not constitute a breach of any contractual, legal or regulatory provisions of transparency and the statutory auditor shall be entirely discharged of any liability thereto), are new elements in the Law and fully comply with Articles 31, point 1/b; 31/2; 53/1 and 53/2 of the Directive 2000/12/EU and 2006/48/EU.

Article 53 of the Law (on transparency) specifies that the bank or branch of the foreign bank shall publish periodical reports on its financial situation and its risk position, at least once every three months. The bank shall prepare and publish its report on annual basis. This article envisages the need for re-designing the Guideline "On transparency of banking operations and

services” or for drafting a new regulation on transparency and it is in consistency with the requirements of Articles 145/1 and 147/1 of the Directive 2006/48/EU (where the term specified is at least on yearly basis).

I.IV Chapter IV “Permitted activities for banks and branches of foreign banks”

This chapter provides permitted banking and financial activities that may be carried out by banks and branches of foreign banks, documentation required to be maintained by the latter ones as well as documentation related to credit transactions.

Article 54 makes a distinction between financial and banking activities that may be carried out by banks and branches of foreign banks as well as financial activity that may be carried out not only by the latter but also by non-bank financial entities (*Article 126*). Such a division is made in point 2 of this Article, which unlike *Article 26* of the old Law, brings about a new designing relating to the exercising of these activities. Point 2 of *Article 54* does not condition the exercising of these Activities with necessary supplying of a certain level of capital, but extends the power of the organisational units within the Bank of Albania⁷ to consider whether the subjects of this law should be permitted to carry out certain financial activities since the licensing moment or even later on, upon request of the entity itself.

Unlike the old Law (*Article 26*), *Article 54* of the new Law extends the range of financial activities that may be carried out by banks and branches of foreign banks. We may mention here: consumer loan, mortgage loan, factoring, financing of trade transactions, as well as other payment services, where besides credit and debit cards, payment cards are also included.

Financial activities listed in *Article 54*, point 2, comply fully with the activities listed in Annex I of the Directive 2000/12/EU and Annex I, point 2-14 of the Directive 2006/48/EU.

I.V Chapter V “Risk Management”

The main purpose of Chapter V is to define clearly the rules for risk management the bank or branch of the foreign bank is faced with or undertakes whilst carrying out its activity. This chapter is designed as a separate chapter and contains more detailed rules than the old Law.

Article 59 on regulatory capital, capital adequacy and guarantees is a re-designing of Article 30 of the old Law. *Point 3* specifies that the ratio of regulatory capital adequacy is determined through by-laws of Bank of Albania and shall not be less than 8 %, thus reflecting this value even in the Law⁸. Also *point 6* of this Article states that the regulatory capital adequacy ratio shall be calculated on individual or consolidated basis, thus being in consistency with Articles 40/2 and 40/3 of the Directive 2000/12/EU, where such a fact is also stated. *Point 4* (specifying that in exceptional circumstances, the Bank of Albania shall, through by-laws, have the right to determine that a bank have a higher regulatory capital adequacy ratio, where it finds that such a bank carries out or is involved in higher risk activities) is in consistency with Articles 47/1 and 47/2 of the Directive 2000/12/EU, which stipulates that: *Credit institutions shall be required permanently to maintain the ratio of capital adequacy at a level of at least 8 percent. Notwithstanding the above, the competent authorities may specify higher minimum ratios as they consider appropriate.*

Point 7 (on requirements of the branch of a foreign bank to invest part of its initial endowed capital in at least one of the following assets: deposit in the Bank of Albania, securities issued by the Government of the Republic of Albania or the Bank of Albania and assets bearing low risk, *point 8* (on the criteria of investment, in relation to the initial endowed capital) and *point 9* (on guarantees for the settlement of liabilities of the branch of the foreign bank towards third parties in the Republic of Albania) are new elements amended to this Law. In consequence, the need for dealing with them more specifically in BoA by-laws arises.

Article 60, point 2 stipulates that the weighted coefficient for asset items on and off-balance sheet shall be determined according to the coefficients specified by the Bank of Albania. But, unlike the old Law, it envisages the right of banks, with the approval of the Bank of Albania, to apply other methods and models for the evaluation of credit risk. Precisely, *point 3* of this Article (the bank may, with the approval of the Bank of Albania, apply other methods and models for the evaluation of credit, market and other risks) is in consistency with Article 84/1 of the Directive 2006/48/EU.

Article 64 on the maximum permitted exposure brings about a novelty in its *point 2*, because it reduces the maximum exposure to a person or persons connected to the bank from 30 percent to 25% of the regulatory capital (when the connected person or persons are a parent company, a subsidiary of the bank, one or more subsidiaries of the parent bank). Also, the law now specifies that the bank's exposure towards connected persons may not exceed 10 percent of its regulatory capital (*point 3*). These elements should also be reflected in the relevant regulation. *Point 1* (the bank's exposure towards a person or a connected person to it cannot exceed 20% of the regulatory capital), *point 2* (where such person or connected persons thereto are the parent company, a subsidiary of the bank, one or more subsidiaries of the parent bank, the exposure may not exceed 25% of the regulatory capital) and *point 4* (the bank may not undertake large exposures, which altogether exceed 700% of the regulatory capital) change from the provisions of the EU directives. More concretely, in *Article 49 of the Directive 2000/12/EU* and *111 of the Directive 2006/48/EU*, the percentages specified are respectively 25 percent, 20 percent and 800 percent.

Article 68 on Reserves for covering losses and *Article 70* on capital investments are also mentioned in the old Law, but are now presented in a more detailed way. *Point 1* specifies that: the bank may invest in the purchasing of shares of commercial companies which are not banks or financial institutions or may be a partner of a commercial company, for an amount not exceeding 10% of the capital of that company, but the

investment at any time may not exceed 15% of the regulatory capital of the bank and *point 2* which states that: The maximum allowed investment of a bank in several commercial companies which are not banks or financial institutions or the maximum holdings as a partner in such commercial companies shall not exceed 60% of the regulatory capital of a banks *comply with the limits specified in Articles 51/1, 51/2 of the Directive 2000/12/EU and Articles 120/1, 120/2 of the Directive 2006/48/EU.*

I.VI Chapter VI "Supervision"

Chapter VI contains general provisions relating to the supervision process of banking and financial activity carried out by banks and branches of foreign banks.

Article 72 stipulates clearly and in a summarised way the ways through which supervision is carried out, unlike in the old Law where such ways are implied.

Article 73 on supervision of a bank, a branch of foreign bank and a branch of banks outside the territory of the Republic of Albania, unlike the old Law, in *point 5* entitles the authorised employees of the foreign supervisory authority, in charge of banking supervision in that country, following an agreement with the Bank of Albania, to be allowed to inspect a bank which is a branch or a subsidiary of the foreign bank, which has its head office in that country or has a qualifying holding in the foreign bank, the legal seat of which is situated in that country. This point complies with the requirements of Articles 43/1 and 139/2 of the Directive 2006/48/EU where the principle of reciprocal cooperation with the home country is stated, with the purpose to exercise supervision of credit institution. Also, *point 6* (on allowing the control and cooperation with the inspectors of the Bank of Albania and the statutory auditor, approved by the Bank of Albania) and *point 7* (the branch of the foreign bank, at least once a year informs the Bank of Albania on the names of the shareholders and their participation in the capital of the foreign bank) of this Article are in consistency with Articles 141/1 and 21/1 of the Directive 2006/48/EU.

Article 79 and Article 81 on implementation of rules for risk management and of requirements on capital adequacy ratio, unlike *Article 44* of the old Law, stipulate clearly and in a detailed way the measures taken by the Bank of Albania when finding that there are breaches of risk management rules, or that the ratio of capital adequacy of the bank is lower than the minimal ratio stipulated in *Article 59* of this Law. Now the Law provides also the requirement of the bank or branch of foreign bank to meet the legal obligations relating to deposit insurance (*Article 79*, point 1/i and *Article 80/i*). These elements, together with the above legal obligation, should be reflected also in the “Manual of corrective actions for banks and branches of foreign banks in the Republic of Albania”.

1.VI.1 Subchapter I “Consolidated supervision”

The Law No. 9662 of 18.12.2006 “On Banks in the Republic of Albania” treats for the first time, and as a separate subchapter, the consolidated supervision, pursuant to the principles of Basel Committee on Banking Supervision and the standards specified in the EU directives, for a safe and prudential supervision. This subchapter defines in a detailed way the most important constituent elements of supervision process on consolidated basis of banks and branches of foreign banks. The provisions of this subchapter define the concepts of banking and financial group, superordinate and subordinate companies. Also, necessary legal space is provided to the concluding of cooperation agreements with domestic or foreign competent supervisory authorities, to raise the quality of consolidated supervision.

Article 84 on risk management in a banking group specifies that: A banking group shall be organized in such a way that a superordinate bank in a banking group is able to monitor the risks to which the banking group is exposed and implement the measures for managing those risks. Such an element should be reflected in the Regulation “On consolidated supervision”, in the framework of raising the quality of consolidated supervision (*Article 8*). Also point 3/d, specifies that: A banking group as a whole shall determine the consolidated position of investments

in the capital of non-financial institutions, arising the need for reflecting this element in the above Regulation, in its Article 7.

Article 85 on consolidation of financial statements of a banking group, *point 2*, states that the frequency of consolidation should be specified by BoA bylaws. Such a requirement should also be specified in the Regulation "On consolidated supervision" (*Article 10*). Also, *point 4* states that the Bank of Albania may order a bank in a banking group to carry out the consolidation of individual items or individual operations or groups of operations within the banking group, if such is necessary for the complete and objective presentation of the financial position and operating results of the banking group as a whole or an individual bank in the banking group. This raises the need for presenting these elements also in the abovementioned Regulation (*Article 10*).

Article 86 (consolidation in other cases) and *Article 88* (submission of data) are new elements that should be also reflected in the Regulation "On consolidated supervision".

1.VI.II Subchapter II "Sanctions"

The Bank of Albania, in its role of the supervisory authority of the banking system, has the right to take measures against banks, branches of foreign banks and nonblank financial institutions, in cases of breaches of the Law and/or of the bylaws issued by it. Sanctions, unlike preventive, supervisory measures for the implementation of risk management rules and measures for the implementation of requirements of capital adequacy ratio, aim to correct not only the deficiencies or weaknesses observed whilst exercising the activity, but also the to ensure the compliance of operations of the licensed subjects with the standards of a safe and sound banking and financial activity. Subject to aforementioned measures may be either bank management organs or the bank itself.

Article 89 on penalising measures, unlike the old Law (*Article 44*) lists in a detailed way all cases when the Bank of Albania decides for taking penalising measures, such as fines, written warning

notices to the administrators of the bank or branch of a foreign bank, reaching to extreme measures, such as revocation of the licence of the bank or branch of the foreign bank or placing the bank into conservatorship or liquidation. Point 6 the Law stipulates a new condition as concerns the capital adequacy ratio. In Article 44/3 of the old law, the BoA required from the shareholders to mend the situation if the ratio dropped below half of the minimum required capital. In the new Law, the BoA takes penalising measures if this ratio is more than half of the minimum initial capital, but less than the minimum required capital, thus applying more prudential measures. Such a change should be reflected also in the manual on corrective actions, in the part of capital adequacy.

Article 91 on the requirement to protect professional secrecy, in its point 1, unlike the old Law, obliges also the inspectors and Bank of Albania employees to keep the professional secrecy, in consistency with Article 30 of the Directive 2000/12/E and Articles 44/1 and 44/2 of the Directive 2006/48/EU on keeping this secret. But, unlike the above directives, the new Law extends this obligation also to administrators, employees or current and previous agents of the bank or branch of the foreign bank and not only to employees of supervisory authority or to auditors and experts of the bank or of the branch of the foreign bank.

Unlike Article 44, point 1 of the old Law which gives the right to seek redress from the court within 8 days from the notification of the decision, the Articles 93/1 and 93/2, stipulate the administrative recourse to the Governor of the Bank of Albania as a necessary condition to enable the subject to seek redress from the court. The right to seek redress from the court is also prescribed in Article 33 of the Directive 2000/12/E and Article 55 of the Directive 2006/48/EU.

1.VII. Chapter VII "Conservatorship and liquidation"

1.VII.1 Subchapter: Conservatorship

This subchapter mentions cases of placing the bank into conservatorship, legal effects of conservatorship, qualifying

and disqualifying conditions of conservator, powers, duties and reporting, as well as termination of conservatorship process.

The new Law, *Article 89 point 4/d*, unlike *Article 44 point 2/f* of the old Law, does not require the placing into conservatorship and control by the Bank of Albania, but mentions the placing of bank into conservatorship as a penalising measure applied by the Bank of Albania. Therefore, the revising of the Guideline "On conservatorship and liquidation of banks" in points 22-27 is needed.

Article 96, in points 3 and 4, unlike the old Law, envisages also the publication of the decision of the Bank of Albania for placing any of the banks under conservatorship in the Official Journal of the Republic of Albania, Official Bulletin of the Bank of Albania, as well as in one or more of the national newspapers. The Bank of Albania shall notify of its decision the bank, subject to this decision, as well as the Deposit Insurance Agency. The decision of the Bank of Albania for placing under conservatorship any of the banks shall be included also in the register it maintains for the public in its premises.

Article 99 provided qualifying criteria for the conservator, thus emphasising their importance in the Law as well, not only in its by-laws.

Article 100 on disqualifying criteria for the conservator, which is a novelty of the new Law, enlists in its point 1 the cases when a person can not be appointed as a conservator. All these disqualifying criteria should be also reflected in the relevant guideline.

The new law envisages in a separate article, precisely in *Article 102*, the periodical reports the conservator shall submit to the Bank of Albania, which in the old Law is envisaged indirectly (*Article 49*, point 7).

Article 104/1 on the evaluation of results of the conservatorship every 3 months, provides some re-designing of the old Law

(Article 50) and of the Guideline “On conservatorship and liquidation of banks” (point 12), bringing about the obligation for the approximation of this guideline to the requirements of the new Law.

I.VII.II Subchapter II: Liquidation

This subchapter deals with stages through which a bank or branch of a foreign bank passes, in case it is placed into (voluntary or compulsory) liquidation, starting from the initial moment, reaching then to bank’s selling and reporting to the Bank of Albania.

Article 106 on types of liquidation, distinguishes, for the first time, between *voluntary liquidation and compulsory liquidation*, unlike the old Law, which in its interpretation seems as if it is addressing only to compulsory one.

Articles 107/3 and 107/4 underline the importance of the protection of interests of the clients of the bank or the branch of the foreign bank, being focused on two directions: first, through notification to the Deposits Insurance Agency for it to exercise its powers under the Law “On deposits insurance; secondly, through the obligation of the shareholders, who, in case the bank or branch of the foreign bank has been placed into liquidation, must meet all the creditors’ claims. *Given the above, these new elements should be reflected also in the Guideline “On conservatorship and liquidation of banks.*

Article 108 on circumstances for compulsory liquidation, specifies and extends the conditions related to the placement of the bank or branch of the foreign bank into compulsory liquidation.

Article 115 on Liquidator’s independence and protection of confidentiality, is a new specific Article, which gives the liquidator the right of exercising independently the activity, and his obligation to keep the professional secret.

Article 120 on claimed liabilities, *point 3* is a new element that specifies clearly the Court as the competent organ where the claim by the claimant shall be submitted against the Bank of Albania's decision for placing the bank or the branch of the foreign bank into liquidation, unlike the old Law that does not specify the responsible organ.

Article 121 on the order for debt repayment, in its *point 1* enlists, *inter alia*, even the obligation for the settlement of claims of the Deposit Insurance Agency before other debts.

I.VIII. Chapter VIII: Final Provisions

This chapter of the Law, unlike the old Law, deals with a number of new elements, such as: protection of client and protection of secret of information of the client, nonblank financial subjects, legal protection in the exercise of duties and the executive character of administrative acts of the Bank of Albania.

Article 125 on protecting the secret of information of the client, further reinforces protection of interests of the latter, specifying for the first time the principle of protection of this information in a legal provision. This is done by including this obligation in the content of the agreement or contract concluded between the bank or branch of the foreign bank and the client. (*point 2*). This Article, being a new element of the Law, *may be reflected in the Guideline "On transparency of banking operations and services"*. *The above article complies with Articles 30 and 44 respectively of the Directive 2000/12/EU and 2006/48/EU.*

Article 127, unlike the old Law, provides for the first time the maintaining of a credit registry by the Bank of Albania. The purpose of maintaining such a registry is to assist banks to take decisions based on complete and accurate information when extending loans to their clients, and to strengthen the supervision of the Bank of Albania on the banking system in Albania.

Finally, *Article 132 point 1* extends the range of individuals subject to this legal protection in discharging the duty to

employees⁹ of the BoA as well, besides the administrators and the members of the Supervisory Council.

Given the above, we may conclude that the provisions of the Law No. 9662, dated 18.12.2006 "On Banks in the Republic of Albania", are generally in consistency with the requirements of provisions defined in the Directive 2000/12/EU and Directive 2006/48/EU.

NOTES

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¹ Hereinafter the Law "On Banks in the Republic of Albania" No. 9662, dated 18.12.2006, will be referred to as "the Law".

² If a credit institution of a member state would like to establish a branch in another member state, it must obtain in advance the approval of the supervisory council of the home country. The latter one should notify within three months the supervisory authority of the host country for such a fact. After carrying out the supervision by the host authority on the institution under discussion, within two months the approval or refusal on branch establishment will be given (see Articles 4, 20/1, 20/4 of the 2000/12 Directive and Articles 6, 25, 26 of the 2006/48 Directive).

³ The naming of this regulation should be revised in order to include the term "financial activity" in it.

⁴ For more information, we may refer to Articles 6, 7, 20 of the Directive 2000/12/EU and Articles 11, 12, 21, 25 of the Directive 2006/48/EU.

⁵ For more information, we may refer to Articles 7, 21 of the Directive 2000/12/EU and Articles 12, 19, 25, 28, of the Directive 2006/48/EU.

⁶ This is a novelty of the Law and as such it should be reflected in a new regulation on the conditions of concluding an agreement.

⁷ Licensing Office of the Supervision Department of the Bank of Albania.

⁸ The value of the capital adequacy ratio stated in the new Law, refers only to banks. Concerning branches of foreign banks we will refer to the Regulation "On supervising the activity of branches of foreign banks in the Republic of Albania".

⁹ As for example, inspectors of the Bank of Albania.

LENDING ACTIVITY: THE ABSENCE AND THE ADVANTAGES OF A CRUCIAL DEVELOPMENT FACTOR

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Key words

- Banking System - Lending - Investments - Deposits -

BANKING SYSTEM PERFORMANCE AND CREDIT PERFORMANCE

INTRODUCTION

The role of the financial system in the real sector of economy is a widely debated and studied issue in the economic literature. The different findings, often contradictory, have raised much debate among the economists. A big group of researchers, being among them Nobel prize winners, consider overvalued the significance given to the financial system as a factor of economic growth, while they think that it has a more supportive function since “entrepreneurship leads – finance follows” (Levine 2004). Meanwhile, during the recent years, an increasing number of researchers present empirical evidences that show a strong positive correlation between the financial system and the long-term economic growth, and that countries with performing banking system and markets grow fast. Furthermore, evidence at micro level proves that relaxed financing restraints is one of the channels through which financial system supports firm growth and economic development¹.

In order to perform its core functions, a financial system can be based on banking institutions and capital markets. Depending on its economic traits, a country could have more developed banks or capital markets. Developing countries in general, have less developed institutions and financial system is based on banking system (Demirgüç – Kunt and Huizinga 2000). Economic growth brings financial system participants development, and there is a general inclination in rich countries (with some exceptions like Germany and Japan) where capital markets grow with a faster pace (Demirgüç – Kunt and Levine 2001).

The financial system core functions in our country are nearly totally performed with banking intermediation. The last two years, the banking system activity has significantly increased while the ratio total assets-to-GDP has risen by more than 30 per cent. The highly stressed credit expansion has brought more dynamics in the banking activity and economy. Credit process not only provides resources distribution on lucrative projects affecting economic growth, but it contains risks that relate to the institution and could be transmitted to the economy. Under these conditions, the determination of opportunities and risks takes special meaning toward undertaking proper policies with the purpose of taking advantage of opportunities and eliminating or reducing risks.

The Albanian banking system has an almost 15 years period history of evolution. Despite growth oscillations in the first half of this period, the events after 1997 have shown a major progress of the system followed by activity regulation through the 1998 banking law and respective framework. The first years of transition were portrayed by legal, institutional and structural reforms. The approval of 1998 law determined the end of “foundation construction” stage and led to the normality of the banking operations. New banks were established during the following stage and gradual deepening of financial intermediation took place through new products offered and credit base expansion. The latest has been evidenced as one of the convulsive activities that highly effects not only the banking system, but the entire economy. Such factors has drawn our attention for further examination.

Based on literature and other countries experience, we will try to make an analysis of credit activity developments by indicating the activity characteristics and the reasons behind such major increase of the recent years. We will also try to identify opportunities and risks, which associate the intense activities of expanded loan portfolios and increased banking services.

CAUSES OF CREDIT GROWTH AND LOAN PORTFOLIO CHARACTERISTICS

CAUSES OF CREDIT GROWTH

Cottarelli, Dell’Ariccia and Vladkova-Hollar (2003) in a study on rapid credit growth on East and South European countries have defined Albania as a “Sleeping Beauty” due to a low ratio of loans to private sector-to-GDP (less than 1% during 1998–2002) compared to other countries. Nevertheless, since then the situation has changed significantly. Loans have increased moderately until 2004, followed by a sharp increase in the next two years, 82 per cent in 2005 and 55 per cent in 2006. Actually, the ratio loans-to-GDP accounts for more than 20 per cent.

In theory, there are identified two main reasons behind credit growth: supply shift and demand shift. An important factor that induces the demand is productivity shift (Keeton 1999). The source of loan supply is the banking system or the other non-banks financial institutions, while on the demand side are lined up individuals and business companies.

On one hand, the loans increase due to supply shift is a result of promoting policies of financial institutions for their customers, through decreasing interest rates or adding flexibility to the selection process or requirements toward collateral or financial analysis. On the other hand, the loans increase could be a result of an increased demand from borrowers. Such increased demand can be based on productivity shift, due to better projects

or technological improvements, or based on other factors related to their specific financial situation.

For many years, the commercial banks have been applying a conservative approach toward private business. The deposits collected from the public have been mainly invested in treasury bills or similar securities with high security and low return. The loan to economy, for the private activity as well as for the individuals, has been restricted, with high interest rates and long and careful procedures. The following table shows that the loan to public sector has been quite small and decreasing. In the meantime, the loan to private sector, the high portion of the loan portfolio, has been at low levels due to the fact that fewer assets have been invested in such activity (table 1).

Table 1 Loan structure according to allocation in economy (in % to total portfolio)

	2001	2002	2003	2004	2005	2006
Domestic loan structure						
Domestic loan (% M3)			71.5	68.9	70.0	71.8
Loan to the government (% M3)			60.2	55.1	48.9	43.4
Loan to economy (% M3)			11.3	13.8	21.1	28.4
Loan portfolio structure for the banking system						
Public sector	1.95	0.1	0.3	0.17	0.05	0.09
Private sector	83.31	81.4	75.2	68.82	69.41	66.91
Individuals and others	14.75	18.5	24.5	31.01	30.54	33.00

Source: Bank of Albania

The privatization of the biggest bank of the system in 2004 obliged the banks to reconsider their business strategies. The activity, which mostly felt such policy changes, was lending. The best part of the banks started applying a more active approach toward financing the economy. In this framework, the strategies of the banks generally included the relaxation of strict procedures, interest rates decrease and increased number of services offered. Such behaviour aimed at increasing the loan portfolio, market share and reinforcing their market position.

The borrowers' demand has always been steady, high and with an increasing trend. Despite the conservative approach from the banking system, high costs and low range of products offered, the businesses and individuals have always referred to banks' desks to finance their consumption, investments or fulfill the short-term liquidity requirements.

Based on the lending demand and offer dynamics, we could say that the sharp increase of crediting in the last two years is a product of combination of an incremented offer in a high demand environment. The increased competition in a stable macroeconomic environment with a high loan demand, established the necessary settings for the banking system to become active in the process of financing the economy.

The following part outlines our estimation about the main factors that effected the crediting increase.

- Macroeconomic stability. Duenwald, Gueorguiev and Schaechter (2005) in a study on rapid credit growth on three Eastern Europe countries assert that a steady macroeconomic environment with a high GDP growth and low inflation brings to a rapid credit expansion. During the last decade, it is estimated that Albania has reached a stable macroeconomic situation; the gross domestic production has steadily increased, during 1999 – 2005 the real GDP has increased 6.5 per cent on average and inflation has been kept within the target range, fluctuating at around 3 per cent. The economic increase has been associated with unemployment decrease and income per capita increased. Since Albania is an economy in transition and aims at adhering the European Union, the economy and income will keep on with the increase in order to converge toward the western standards. The security associated with such a process and the stable macroeconomic environment have eased the future developments predictions. The increased security has affected the individuals and companies decisions to finance their consumption and investments as well as banks decisions to relieve more funds to the public and to lower interest rates (table 1).

Table 2 Some macroeconomic indicators

	1999	2000	2001	2002	2003	2004	2005	2006
Real GDP growth (%)	8.9	7.7	6.5	4.7	6	6	5.5	5.0
GDP per capita (USD)		1086	1329	1,438	1,807	2,329	2,620	2,855
Average inflation (v/v)	-1	4.2	3.5	1.7	3.3	2.2	20.	2.5
Unemployment rate		16.9	14.6	15.8	15.0	14.6	14.2	13.8
Budget deficit (% of GDP)	12.3	9.4	8.0	6.2	4.6	4.5	3.3	3.2
Current account (% of GDP)		- 7.0	- 6.1	- 10.0	- 7.9	- 4.8	- 7.3	- 7.6

Loans / GDP (in %)	8.4	5.31	4.7	5.9	6.8	8.5	15.3	22.0
Lending increase (%)	12.7	-31.05	0.22	37.72	31.1	38.1	74.3	56.8
Loan interest rate (%)	25.5	25.5	25.5	25.5	25.5	25.5	25.5	25.5

Source: Bank of Albania

- Restoring public confidence in the banking system. The actual level of relationships between banks and the public is a result of several factors and events, positive and negative, occurred since the creation of banking system. There are some elements with negative impact that need to be mentioned. It has often been debated about the low banking culture of the public. Such culture has been mostly expressed in the lack of knowledge toward banking products and avoiding the repayment of loan obligations. The latest has been induced by the preferential selection of the borrowers from the former-government owned banks. While the characteristic of the private banks has been restricted funds offered with high costs, which has somewhat created the opinion for non-equal selection of the applicants. Moreover, during the transition years, the banking system has faced two critical moments, the 1997 crisis and the 2002 panic, which shook the public confidence. Such events have affected the trust relationship between banks and the public and have held back the public non considering the bank as a partner in its activity.
- Meanwhile, the positive elements have had a major impact. Prudent policies, from banks and supervising authority, have brought continuous increment and stability in the financial activity, especially in the last years. The development of the system has created the necessary environment for the restoration of public confidence in banks. The increased competition and the introduction of reputable banks in the international markets, have affected the consolidation of mutual relations, which is expressed in deposits increase and wide usage of banking products. The product of such events has been the activation of interrelated factors trust – banking culture. The latest developments have shown

that earlier behaviours such as non-repayment of loan obligation, have radically changed. Consciousness over the financial burdens has brought back the mutual trust and the further extension of business relations between the bank and the customer.

- Low crediting base, catching-up hypothesis (see table 2, loans / GDP). One of the reasons of crediting increase is related to the very low loan level to the economy. The low economic development combined with the crisis effects, prudent policies on risk management of foreign banks, ceiling over credits set by the Bank of Albania for certain banks as well as behaviour/public non-trust, have negatively affected the banking system development in general and lending activity in particular. The improvement or the removal of these hurdles, has naturally inflicted banking development and activity increase.
- Property effect. The literature has identified a mutual empirical correlation between loans and real estate prices. For several years, the real estate prices have continuously increased. Prices increase affects crediting increase via two channels: (i) collateral value increase. Real estate is one the main objects required as collateral, hence its price fluctuation determines the borrowing capacity; (ii) future positive expectations, since real estate constitutes an important part of individuals or companies properties. Changes of asset prices impact on consumption and investment planning of the consumers.
- Ownership structure changes and new licences. The entrance of new banks in the market has significantly increased competition. Recently licensed banks, aiming at gaining market share and approaching more and more customers, have offered to the public a higher range of products. But, the major effect was in the market given the ownership change of the biggest bank in the country, which used to be the last ranked in terms of lending. The

resurgence of this bank deposits has given a strong burst to quantity and variety of products offered. The most typical product provided is lending and, as mentioned above, the market demanded it with eagerness. However, the struggle between the new banks fighting to increase and the existing banks, which tend to maintain their shares, has brought to lending increase. Foreign shareholders, as major owners of banking system shares, have brought in the Albanian market the experience of the consolidated European markets and induced competition, “awakening” the sleepy banks. Ownership change is a continuous process that proceeds with the latest entrance in the market of big banks, a French one and an Italian one.

Table 3 Number of licenses for banks (after 1997)

	1998	1999	2001	2002	2003	2004	2005	2006
New banks	2	2	-	1	1	1	-	1
Shareholders change				1		1		2

Source: Bank of Albania

- Banks balance-sheet structure. As shown in table 4, banks assets have not been used in lending, hence its increase is expected to be the banks’ focus (considering that the biggest bank in the system, possessing more than 50 per cent of the assets until 2004, was prohibited from lending). Moreover, banks, for years, used to have high adequacy ratios², which demonstrates their high capacity to undertake risks. Although profitability ratios announce good position, the main income resource related to the placements in banks outside the country, treasury bills investments and commissions from banking services, mainly transfers.

Table 4 – Banking system financial indicators

	1999	2000	2001	2002	2003	2004	2005	2006
Systems assets / GDP		50.2	53.5	51.6	50.2	51.9	59.3	69.4
Capital adequacy ² (%)	8.2	42	35.3	31.6	28.5	21.6	18.6	18.1
ROA (return on assets, %)	0.6	2.1	1.5	1.2	1.2	1.3	1.4	1.36
ROE (return on equity, %)	16.4	20.7	21.6	19.1	19.5	21.1	22.2	20.2
Deposits / Liabilities (%)			86.2	84.0	87.5	87.0	87.2	83.3
Loan / assets (%)	16.4	10.4	8.9	11.5	13.6	16.4	25.7	31.5

Source: Bank of Albania

CHARACTERISTICS OF CREDIT PORTOLIO

- Credit structure according to currency. In the Albanian economy, the usage of foreign currencies, particularly U.S. dollar and EURO, as references in transactions is widely spread. Until 2001, US dollar was considered the most important currency and it has been used since in most of the commercial activities, as a mean of protection from currency depreciation and for facilitating the transactions with the foreign companies. USD lost its prevalence with the entrance of Euro in Euro Zone in 2001. Reflecting this trend, the currency structure of banks' deposits was mainly made of these currencies. On the other hand, banks themselves have found the use of these currencies more convenient in their crediting activity to avoid the risk of exchange rate and interest rate fluctuations. The stability of exchange rate was in line with banks' prudence in risk taking activities and the stability of interest rate was in line with the careful planning for future revenues. The banks had also low incentives in investing in LEK since the interest they were receiving from investing in treasury bills was satisfactory enough. For the above reasons, the foreign currencies were dominant in the loan structure according to currencies. Furthermore, the public has not preferred loans in LEK since the interest rate applied was higher. As shown from the table, such trend has changed recently. The stability of LEK, the high liquidity and the increased competition has increased lending in home currency.

Table 5 Credit structure by currency (in % of credit portfolio)

	2001	2002	2003	2004	2005	2006
Loan portfolio by currency						
Loans in LEK	18.3	20.9	17.9	19.5	24.5	28.1
Loans in other currencies	81.7	79.0	82.1	80.5	75.6	71.9
Loan portfolio by maturity						
Short-term loans	55.11	47.72	40.3	26.74	26.16	25.57
Mid-term loans	19.01	23.38	29.6	35.27	30.60	30.78
Long-term loans	5.40	7.56	9.2	15.75	23.15	19.03
Real estate loans	14.90	17.09	15.6	15.14	13.00	19.39
Leasing	0.0	0.0	0.0	0.0	0.05	0.02
Other	5.57	4.24	5.3	7.10	7.04	5.21

Source: Bank of Albania

- Credit structure by maturity. At the beginning of lending activity, as the low economic development suggested, the loans were issued on short terms and mainly for working capital purposes. As the economy of the country was mainly based on commerce with other countries than financing in short terms in compliance with the commercial cycle was more preferable. Only few investments were financed in long term. Such tendency has strongly changed and long-term financing has gained more ground. This is due to the increased investments in the economy as well as to the increased demand for real estates from the individuals, the latest has had the major impact. Earlier, a loan with a maturity longer than 5 years could not be issued, while actually the maturity on mortgage loans can be as long as 20 years.
- Credit structure by economic activity. From table 6 can be noticed that loans for real estates have increased significantly, considering that loan growth was 82 per cent in 2005 (see comments for maturity in the upper paragraph). Nevertheless, credit to industry and services have decreased, despite the sectors internal processes. Loan to agricultural sector, despite the increasing trend, still remains low in percentage of the entire portfolio. The best applicable type of loan to this sector could be the micro one, but the banks have not been able to provide it due to high expenses and the appropriate infrastructure it requires. There are some non-bank financial institutions that provide such loans, but their capacity is still not comparable to the banks. Meanwhile, the data show that construction remains important in the economy and the recent events have shown an increase in housing prices.

Table 6 Credit distribution by economic sectors (in % of credit portfolio)

Economy sector	2001	2002	2003	2004	2005	2006
Transport & Services	58.4	57.7	57.8	43.8	36.8	
Industry	24.5	20.3	21.1	20.2	16.9	
Construction	12.5	8.6	10.0	9.8	13.0	
Real estates	6.3	9.1	13.0	9.8	14.2	
Agriculture	1.0	0.8	1.0	1.5	2.7	
Other	0.8	7.7	5.1	19.3	22.1	

Source: Bank of Albania

- Credits supported by deposits. Banks balance-sheets show that loans-to-deposits ratio is low and the deposit-to-assets ratio is high (table 4). Such fact is mentioned to show that the entire lending activity has been supported by public's funds (deposits). As mentioned above, the structure of the deposits according to maturity and currency has influenced the structure of the loan portfolio. Banks have rarely used external financing to support their credits. In different banks, loans-to-assets and/or deposits-to-assets ratios are various. The smaller ones have higher ratios of loans-to-assets and lower ratios of deposit-to-assets, while the contrary situation is faced for bigger banks. This is a sign of competitiveness and the struggle the smaller banks are making to maintain their market share. Such developments might bring changes in the future, like mergers of banks or purchase of smaller banks by larger ones, as the case of American Bank and Italian-Albanian Bank shows.

Table 7 Deposits structure by currencies (in % of credit portfolio)

	2001	2002	2003	2004	2005	2006
Deposits in Lek	11.4	10.5	9.3	16.6	37.3	40.3
Private sector	7.1	6.6	4.5	6.0	8.7	11.3
Individuals	1.3	1.3	1.6	6.5	24.3	23.9
Deposits in foreign currencies	42.6	44.0	47.3	55.4	72.7	94.0
Private sector	8.9	9.0	10.0	10.6	12.8	20.9
Individuals	28.6	30.1	33.7	41.5	55.2	68.0

Source: Bank of Albania

OPPORTUNITIES AND RISKS

OPPORTUNITIES

Banks play a crucial role in the economic activity of most developed and developing countries. Rapid developments in the capital markets and the continuous improvements in the technology of information have lessened the importance of these institutions in the developed countries, while in developing countries banks still occupy the primary position in the intermediation process and remain an important source of economic growth. In literature it is emphasized a strong interaction

between finance and the real sector. On one hand, financial development stimulates productivity and economic growth and on the other hand, economic growth is associated with wider, deeper and more developed financial system. Levine (2004) argues that financial development occurs when the financial structure – its instruments, markets and institutions – ameliorates the effect of information, enforcement and transaction costs. Albania has a bank based financial system. The privatization of the largest bank in the system has driven on competition, stimulating a chain reaction in the banking system per se and in the economy. Banks are expanding geographically, are introducing new and more complex products and services. At the same time, through this active crediting policy the dormant capital, stored in the safety vaults of the banks, now is channeled. An active crediting policy eases financial constraints imposed on firms, stimulating growth and generating several positive effects. In the following part we will try to analyze the consequences that credit expansion and financial development might have in the real and financial sector.

The main function of a financial system is to facilitate the allocation and development of the economic resources in time, space in an uncertain economic environment. This is a narrow definition of the financial function and is far from being complete. Under a functional perspective, a financial system in addition to the function of pooling funds provides (ii) a payment system for the exchange of goods and services; (iii) mechanisms that transfer funds in time, space and across industries; (iv) tools to administer uncertainty and risk; (v) price information for a better decision making process in various sectors; (vi) techniques to ease the asymmetric information and incentive problems between parties, Merton (1995).

Asymmetric information is a critical issue in the crediting activity undertaken from banks, as one party, in this case the bank, does not have all the information on a certain project regarding the expected return and the real risk. This situation creates problems in the financial sector in two directions: before the occurrence of the transaction, creating the adverse selection

problem³, and after the transaction, leading to moral hazard situation.

Adverse selection in financial markets is evidenced when banks select to finance borrowers that are most likely to become “bad credit risks” – poor projects or high risk, since it is difficult for banks to determine the quality of some borrowers. At the same time, investors that are involved in high risk projects are willing to accept high interest rates as they are the primary benefactor if the project is successfully finalized.

The moral hazard issue in financial markets might be observed when the borrower, after the loan is extended, gets involved in activities that are undesirable from the perspective of the lender as they might increase the probability of default. This situation is the result of the asymmetry of information between the lender and the borrower. The lender lacks information regarding borrower’s activities, permitting the latter to engage in activities that constitute moral hazard. Anyhow, asymmetric information is not the only reason for the occurrence of this phenomenon. High enforcement costs make it very expensive for the lender to prevent moral hazard despite being fully informed regarding borrower’s activities. The main reasons behind this situation are linked with the incentives that some borrowers have to invest in high risk projects in which if the projects are successful the borrower is the main beneficiary, otherwise the loss falls upon the lender.

To avoid the conflict of interest, result of adverse selection and moral hazard, lenders may decide to reduce the supply of funds, affecting the credit to the economy and the investment process. However, banks employ other means to reduce the effects of asymmetric information, such as collateral or the production and sale of the information on the activities of individuals and firms involved in projects that require capital. Collateral, giving the right to the lender to sell it in case of default, reduces bank’s losses, lessening the effects of adverse selection and moral hazard. While with the production and sale of information, the problem is dealt in a rather different

manner. Lenders buy information on the activities of the investors who seek funds for their projects to lessen the asymmetry of information. However, the presence of free riders, persons who profit, free ride of, from the information that others pay for, diminishes the advantages of this tool. Banks help in reducing asymmetric information as these institutions are involved in long term relation with their costumers, enabling them to become experts in the production and sale of information on individuals and firms. Banks avoid the free rider problem by making private loans and exerting monitoring and enforcement activities to collect information.

The information produced by banks can be used not only to reduce the effect of asymmetric information between parties, but it is also used to evaluate firms, managers or the economic environment. Banks collect, process and produce information and sell it to investors. This process helps investors reduce research and evaluation costs and at the same time improves economic resources allocation among higher value investments.

In the context of factors that stimulate the economic activity, it is emphasized the importance of foreign direct investment (FDI). FDI contribute in the modernization and development of the host country economy through technological transfer, managerial skills, know-how, productivity gains etc. Despite this fact, it is widely agreed that domestic market conditions and the degree of financial system development are determinants of the quantity and quality of FDI. Economies with better financial systems are more efficient in the resource allocation process, as they improve the absorption capacity of the economy and develop the operating environment of domestic and foreign firms. The practice of banks' activity in the country shows that in general foreign banks tend to target (build stronger relations) with customers from their countries of origin. In this perspective, the presence or the entrance of banks from various countries will not only be a support to the business from the respective country of origin but at the same time is expected to attract new investors and business in the production and services sector.

RISKS

Financial crises often are the negative and undesirable effects of the risky activities that banks are engaged in. Banks manage their operational activity trying to optimize between profitable and prudential activities. Lending activity is a core function performed by banks and very often is considered as the main purpose of the banking activity. That is why banks dedicate considerable resources – human and capital, for a continuous development and improvement of this process. Despite being a source of profits, lending activity is as well a source of risk. In the following section we try to elaborate the macroeconomic and microeconomic risk that might arise in the presence of rapid credit growth.

RISK DETERMINANTS

The empirical evidence of many countries has shown that the lending behavior of the financial institutions is procyclical and loan supply is closely related to the business cycles of the economy. In the expansion phase of the economic activity lending supply increases significantly, to fall during downturns. During this phase of economic activity, credit supply can fall dramatically as to create the situation known as “credit crunch”. Credit crunch usually is an extension of recession and in the presence of this situation it is difficult for companies to finance their projects because of high bankruptcies or defaults rates. Generally, changes in lending are more than proportional compared to the changes in economic activity, so loan supply tends to reinforce the business cycle. In the same line with lending supply behave loan performance problems. Reflecting the expansionary phase of the business activity loan performance indicators are in low values, to raise in high values during downturns. This suggests that the risk undertaken by the banks during expansion is materialized latter in time as it takes time for non-performing loans to appear.

There is a vast literature about the factors that explain fluctuations in bank lending policy and as the main factor is

identified the (irrational) behavior of banks' managers. The irrational behavior of bank's managers will have an immediate effect on a misvaluation of credit risk and accumulation of problems. Management behavior is explained in the context of four main theories: disaster myopia (Guttentag and Herring, 1984, 1986), herd behavior (Rajan, 1994), agency problem and institutional memory hypothesis (Berger and Udell, 2003).

Disaster myopia arises when it is impossible to assign the probability of a future event. The occurrence of such event depends on changes in the economic regime, legal framework or several other hard to predict factors. Banks tend to underestimate the probability of low-frequency shocks over. For this reason, in the expansionary phase of the business cycle, banks will increase lending supply while in downturns, when the probability of low-frequency shocks increases, will decrease it drastically.

Herd behavior theory supports the idea that bank managers are concerned only for their performance and reputation in the short run. This behavior is noticed particularly in those managers that are not successful or those who constantly lose market shares. To avoid getting fired managers have incentives to follow their successful peers targeting as customers the same industries or groups. This behavior tends toward a similar evaluation of clients and accentuation of the lending and problem loans cycle. Short term performance and reputation of the managers prevail on bank's long term and steady growth.

Principal agency theory inside an organization can be evidenced in two levels of hierarchy. The first level is between shareholders and high management. Shareholders put pressures on managers to achieve high profits and based on manager's performance, measured through different bank performance systems, the shareholders apply the reward scheme. However, the strategy followed here becomes important. If quantitative measurements of performance prevail over qualitative ones, then irrational behavior of managers might be expected. Their decisions will be directed toward quantitative growth and expansion leaving behind the financial worthiness of their decisions.

On the second level, the principal-agency may arise between the managers of different levels inside the institutions. Delegation of duties and responsibilities is followed by the establishment of measures of performance for managers of lower levels. Even in this case the accurate choice of measurements of performance becomes important for the bank to take the right decisions in compliance with the overall strategies. To some extent, the managers of a lower level might find it easier to find another job, which causes them less incentive toward the proper functioning of their entity.

Berger and Udell (2003) have elaborated a hypothesis named “the institutional memory”. According to this theory bad loan customer or relation are forgotten for two reasons. First, there exists a knowledge and professional gap as new employees are hired and the older ones retire. Second, loan officers, as time passes build confidence and forget past experiences and mistakes. It can be summarized that some employees / loan officers might have never experienced “problem periods”, while some forget past valuable experiences, this will result in an easing of credit standards, meaning higher risk.

In addition to management’s irrational behavior there is another institutional factor that can trigger risk – collateral. The collateralized level of the loan can, in many cases, shadow the qualitative evaluation of the customer. Jiménez and Saurina (2004) have dedicated a thorough analysis to this problem. The high level of collateral makes the loan officer lay back / shirk and devote less attention to the problems of the borrower. Such a problem is enforced by the type of borrower or the experience of the bank. As in the first stage of relation between the bank and the customer, officers are more attentive, while in a long term, consolidated bank – customer relation and when banks expand locally, the information asymmetry that might arise could in many cases be covered with the requisite for higher collateral.

With regards to risks there are other institutional factors that determine it. Godlewski (2004) has listed the following factors that lead to high risk taking:

- inadequate credit policy;
- inadequate risk administration structures;
- inadequate internal control procedures;
- inadequate systems of non performing loans identification;
- poor corporate governance and excessive concentration of decision authority.

These factors, combined or separately, are evidence of institutional weakness and can create incentives for possible failures and distress.

MICROECONOMIC RISKS

Microeconomic risks are mostly related to individual institutions or the whole banking sector. There are two approaches to analyze these types of risks. There are internal governmental decisions that lead to high and uncontrolled risks and there are uncertain situations which lead to tighter measures or reduced activity or even performance. As for the first case, we presented a brief overview in the previous part; here we will go through the second type, always having as reference credit growth.

The first and most direct source of risk is the one related to credit. Credit risk consists in the non-fulfillment of obligations from the borrowers' party. Delayed repayment of loan obligations causes the deterioration of the credit portfolio. Banks need to create more reserves to cover for losses, which in turn will impair their profits. The high level of nonperforming loans leads to contraction of credit activity due to both internal initiatives to reduce further risk taking and central governmental restrictive measures.

Bad loans creation significantly reduces profits, which as a result hinders the capital accumulation ability. Low capital levels put serious impairments to bank's further development; at least slows down the activity in the short run. As result of the risks undertaken, the bank has to meet the requirements of central bank for maintaining certain levels of risky loans in relation to

the regulatory capital reflected in capital reduction. Lower capital availability will significantly deteriorate bank's financial position. In extreme situations, the high level of losses can deteriorate the financial position of the bank up to the bankruptcy point, with consequences in the banking system.

High insolvency rates affect the banks ability to fulfill its financial commitment toward third parties. This leads to the next risk source, liquidity. In the case of Albania, banks' investments have been mainly focused on low return and low risk securities such as treasury bills and short term placements in other banks. There have been few cases when investments have been directed to other countries' capital markets, but still the security has been the main criteria of choice. This prudential / conservative strategy has provided banks with enough liquidity, but on the other side banks have put low efforts on the management of funds. As the situation is under radical change, the past secure situation of banks is being put under hazard. Liquidity concerns are making banks reconsider their old policies and expand their diapason of interrelationship between financial institutions inside and outside the country. Maturity matching of assets and liabilities has been one requisite of central bank control, though in the situation of increased long-term loan creates what are called maturity GAP⁴. Despite the fact that actually in the banking system, loans are totally covered by deposit, the maturity gap is increasing. The average maturity for deposits is one year, while for loans the maturity period is substantially higher, up to 20 years for mortgages / housing. Liquidity management is taking an important role in bank's risk management process.

As it was mentioned in the first section, loan portfolio is compounded of several different currencies, with foreign currencies constituting the majority. The high quantity of foreign currency used in the country gives space to exchange rate risk effects. Such a structure of loan portfolio is a result either of funds (deposits) available or market demand. Under the context of risk management, banks manage their foreign currency funds through open position⁵. The level of the open position determines the level of exposure toward currency developments

- appreciations/depreciations. Exchange rate volatility can damage balance sheet, assets – liability structure, in that currency, impairing its payment capacity, liquidity situation and profitability. Accumulated losses are covered by the bank's profits or capital creating a "domino effect", which is related to the sources of risks mentioned previously.

Actually, in the Albanian banking system there is a large scale of borrowers that generate their revenues in one currency and have to pay their contractual obligations in another currency. Very often, bank policies compel customers to borrow in a certain currency despite their revenue currencies. In this way borrowers are exposed to adverse movements of the exchange rate, increasing the probability to default.

In addition, the dominance of foreign currency in loan portfolio increases interest rate risk. Banks build their interest rate policies based on reference interest rates of respective currencies in use⁶. Usually banks issue loans based on basic interest rate adding a spread / margin. The matching strategy of different maturities of assets and liabilities of the same currency is needed to help them protect from adverse developments in the international environment.

All these risks lead to scarcity of funds for the banks. Therefore, to cope with this deficiency banks will seek funds in the financial market or customers. But a weak / poor payment capacity will have serious repercussion in the institution. From one side banks or other financial institutions will have less incentive to collaborate and on the other side public trust might be threatened. The second case is what is called episode of panic that leads to so called bank run. Such situations are harmful not only to one or few institutions; they might spread to all sectors with serious consequences for the whole economy.

MACROECONOMIC RISKS

Banking distress and economic downturns are highly correlated to one another. There is an extensive debate among economists

on the direction of causality, which is the one that causes the other, but all seem to accept that there is a high degree of interaction. Even in this case, it is obvious that there are two ways of approach when analyzing the risks. As we will have a look upon the economic situation as a whole, a combination of cause-effect analysis on both sides will be included.

As the Albanian economy and banking sector are still in the early stage of economic development, they are both in a growth phase of business cycle. In a recent study, IMF (2005) assesses that the financial system in Albania does not seem vulnerable to short-term shocks. However, the rapid credit expansion during the last year has caught the attention of this institution as well as other institutions in the country.

The Bank of Albania has proposed some restrictive measures to relate credit growth with bank's capital level. Such measures consist in the estimation that credit growth above a given threshold is considered risky; hence a higher weighting ratio is applied and the bank can issue loans as much as its capital adequacy allows.

Kaminsky, et. al (1998), in a literature review on banking crises, report that five out of seven studies find credit growth to be an important determinant of banking and/or currency crises. In the same study they find that three out of four credit booms are linked to banking crises and seven out of eight to currency crises. Kaminsky and Reinhart (1999) name the interrelation of these as twin crises. In fact, a currency exchange rate fluctuation will deteriorate the bank's financial situation due to the open position it creates (see footnote 6). In addition, the bank's borrower financial situation will worsen with currency crisis. It is a fact that many borrowers in Albania have a different denominated currency business cash flow from the loan currency. As they might receive their income in ALL and have to repay back the loan in another currency, say EUR, the depreciation of ALL toward EUR will weaken their liquidity position. Therefore, it will have a strong impact on the nonperforming loans. With the rapid credit growth, such impact is expected to be even higher.

In emerging markets credit booms are closely linked with economic downturns. While, during the development period credit booms are associated with higher domestic interest rates and deterioration of the current account deficit (IMF 2004a). In periods of high competition and credit growth, banks are in need of funds. One of the actions they might take is increase deposits from the public through the increase of interest rates. This is more typical for smaller banks that have less available funds. In events of crises, those are the most fragile ones and the main generators of panic or bank run.

Unexpected changes of interest rates might damage banks. Loans interest rates are settled based on a reference interest rate and have the option to adjust them generally for a period not shorter than one year. In the long run, banks can adjust their policies and interest rate, thus reduce exposure to unexpected interest rates changes. While, in the short run, covenants in the contracts prevent banks to adjust quickly which leaves them exposed. Interest rates management is an existing function in the bank, but still the level of maturity mismatching between assets and liabilities leaves them exposed to such risk.

Loan growth stimulates investment and consumption. Higher investment and consumption rates generally are associated with prices increase, so higher inflation. High inflation, on the other side, hinders economic activity, affecting the financial situation of businesses and households. A deteriorated financial situation of the economic agents is reflected in arrears, unpaid loans or even bankruptcies. Credit growth leads to higher assets prices; as a matter of fact there is a strong interaction between the two. There is an increasing trend for mortgage loans in response to the high demand for houses / real estate. In most cases, such houses are used as the collateral for the loan. Usually banks evaluate the collateral and its value is always higher than the loan amount. Just recently, the Bank of Albania has warned about the possibility of the housing prices bubble and that a subsequent burst would have severe consequences in the banking system balance sheet and in the economic activity as well.

Increased domestic demand is also reflected in higher imports and a subsequent deterioration in trade balance and current account. The domestic economy is heavily dependant on imports thus this chain of events could bring serious danger to the economy in the form of higher prices and wages and real appreciation of the domestic currency. To sum up, deterioration in trade balance reflected in current account deficit, hazards the macroeconomic growth. Weak macroeconomic environment, on the other hand, has its repercussion in the financial positions of firms and individuals increasing the probability of borrowers' insolvency and this one to the creation of nonperforming loans.

CONCLUSIONS

In this material we tried to analyze the latest developments in the banking system, with a special attention to the credit activity. During the last 3-4 years the Albanian economy, like many other emerging economies in South-Eastern Europe, is experiencing a rapid credit growth. We believe that economic stability, the restoration of public trust in the banking system under the close supervision of the responsible regulatory authority have created the necessary conditions for a normal and stable activity in the banking sector and the economy. During this period banks were able to build financial and human capacities, which under the pressures of competition were materialized in a more developed banking system with credit activity on the lead. In addition to lending activity, the fierce competition has forced banks to improve existing products and services, to introduce new ones, expand geographically etc.

Developments in the banking system are expected to be transmitted in the real sector of the economy. By offering more products and services banks support their customers in the saving and investment decisions stimulating growth. At the same time, the banking system might improve the operational environment of domestic and foreign firms. But on the other side, rapid credit growth posses risks to the financial and economic stability. Credit cycles tend to follow business cycles,

expanded high credit supply and low levels of nonperforming loans indicators, while in downturns low credit supply and elevated levels of nonperforming loans indicators. Thus, the risk undertaken during the growth phase will start to appear when the economic activity will start to moderate its pace. In addition, rapid credit growth might build inflation pressures, deteriorate trade balance and increase the exposure towards international shocks through adverse movements in the exchange rate and interest rates.

Banks per se are fragile institutions, prone to risks, as result of adverse selections or of the risky environment they operate in. In these conditions, it is vital to have the timely and prudent intervention of monetary and supervisory authorities with the purpose of maintaining under control the negative effects and leading the progress toward a steady growth.

NOTES

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¹ For a detailed analysis of the studies over the correlation of finance and economic growth refer to Ross Levine, 2004, "Finance and growth: Theory and evidence", JEL Numbers: G0, O0

² This ratio is used for supervisory purposes. It is calculated as the ratio between the bank regulatory capital and the risk weighted assets. With the entry into force of the new banking law, it is required to be 8% at lowest, from 12% previously required.

³ Adverse selection, also known as "the lemon problem", was first noted by the American economist George Arthur Akerlof during the 70'. This situation arises from the inability of traders/buyers to differentiate between different qualities that certain products might have. The typical example cited to illustrate this situation is the second hand car industry. Refer to Majluf (1983) and Mishkin (1991), for a deeper analysis of the adverse selection problem in the financial system.

⁴ GAP is calculated as the difference between assets and liabilities of the same maturity. For its accuracy it is measured as a percentage of total assets or profitable assets. It is generally measured for 1, 3, 6 or 12 months in order to determine bank's solvency toward the individual depositors.

⁵ Open position in a currency is the difference between assets and liabilities denominated in the same currency. It is said to be long when assets overcome liabilities and short in the contrary situation. The regulatory framework of the Bank of Albania requires that this position must not be higher than 20% of the regulatory capital for each currency and not higher than 30% for all the open positions.

⁶ Actually there are three currencies in use in the Albanian banking system, USD, EUR and ALL (Albanian Lek). LIBOR / EURIBOR interest rates are taken as reference for USD and EUR loans and treasury bills discount rates for ALL loans.

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NATIONWIDE REMITTANCE BENEFICIARIES SURVEY

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Key words

- Remittances - Migration - Inflow - Albanian households - Income -

ABSTRACT

This study addresses the issue of workers remittances that Albanian households receive. Notwithstanding many studies over the economic, demographic and social impact of international migration, there is only a partial knowledge of this phenomenon. Very little is known about the characteristics, the dynamics, trends and impact on various levels of the personal, household and community life. This study is an additional contribution to our knowledge of migration phenomenon, from the beneficiary households' point of view.

INTRODUCTION

Social-economic phenomenon of migrant labor is an accepted fact of life in Albania today. Almost everyone has a relative or friend who is working or living abroad. Due to the lack of formality, which follows this phenomenon in Albania - high number of unregistered migrants' workers - consideration over the right number of Albanian migrants is impossible. However, it is estimated that, out of a total population of 3.2 million people in Albania, 1 million have immigrated to Greece and Italy (Lianos and Glystos, 2004).

Intimately tied with the migration issue are worker remittances¹ – money or goods sent by migrant workers to households back home.

Worker remittances constitute an increasingly important mechanism for the transfer of resources from developed to developing countries (Russell 1992) and are among the largest source of external funding for developing countries (Ratha 2003).

Consideration regarding the development impact of worker remittances to Albania comes from their size, frequency and tendency these inflows show in years. At macroeconomic level, over the period 2000-2006, these inflows, averaging 13.8 percent of GDP, play a major role in supporting the balance of payments. Worker remittances are increasingly important relative to other foreign exchange-earning economic activities, rising to 65% of trade receipts and averaging 133 percent greater than tourism receipts. Remittances make up 86 percent of current transfers, dwarfing other sources of external support to the country. Remittance flows are normally greater than foreign direct investments, almost 4 times larger.

Thus, the data show that worker remittances are a significant source of foreign currency and liquidity for the country.

Aggregate data on worker remittances, however, tell us little about their welfare effect on beneficiary households, the form of utilization (consumption, saving and investments) and interfere with the investigation of the impact these flows have in micro levels. Bank of Albania survey shows that remittances have had comparable positive impact across all Albanian regions. The influence has been slightly higher in less developed regions, alleviating to some extent income disparities.

Notwithstanding many studies over the economic, demographic and social impact of international migration, there is only a partial knowledge of this phenomenon. Very little is known about the characteristics, the dynamics, trends

and impact at various levels of the personal, household and community life.

This study is an additional contribution to our knowledge of migration phenomenon, from the beneficiary households' point of view. In the following, section 1 and 2, present the scope and the survey methodology. Section 3 contains the detailed results and analysis of the survey. Section 4 recaps the main findings and conclusions of the survey.

1 SCOPE

Data on remittances are collected largely to estimate balance of payments flows as well as to assess their developments impact. One of the approaches that researchers have used to estimate remittances flows is to conduct household surveys of recipients. In our case this approach is the most acceptable due to the informal nature of these flows.

This survey presents information at the national, regional, rural and urban levels. The sample of this survey is representative of the Albanian territory, which makes it a reliable and timely instrument for the issue of family remittances.

The information collected enables to analyze the impact of remittances on the economic and social policies at the urban and rural levels as well as at the national level.

Nationwide survey of beneficiary household focuses on different aspects regarding the remittance peculiarities. It includes a range of dimensions in order to estimate the annual remittances flows and assess other characteristics of remittances as frequency, use of formal and informal channels and tendencies of these flows in Albania.

1.1 GENERAL OBJECTIVE

This study contributes to the knowledge of the Albanian households receiving remittances from their relatives abroad, as

well as with information that may serve as the basis for decision making in the political, economic and social fields.

1.2 SPECIFIC OBJECTIVE

- (i) Provide information on the volume, origin, frequency and destinations of money transfers (remittances) from Albanians abroad.
- (ii) Provide information on the utilization of banking means for the receptions of remittances as well as the degree of bankarization of recipient households.
- (iii) Provide information on the use of remittances in Albania.

2 METHODOLOGY

2.1 DESIGN OF THE SAMPLE

The survey was conducted in cooperation with the Institute of Statistics (INSTAT). INSTAT constructed the sampling frame and collected the information through face-to-face interviews methods, during November 2006. The sample includes the Albanian households that receive remittances, having at least one member who has migrated. To construct the sample frame INSTAT used the LSMS² 2002 results. The 2002 LSMS in Albania was conducted and managed from the World Bank.

Living Standards Measurement Study (LSMS) household surveys, part of the World Bank³ studies on Living Standards Measurement, have become an important tool in measuring and understanding poverty in developing countries. The Albanian 2002 LSMS was organized one year later than the Population and Housing Census (PHC), conducted in April 2001. The 2002 LSMS was in the field between April and July. The sample design included 450 Primary Sampling Units (PSUs) and 8 households in each PSU, for a total of 3600 households.

Using LSMS data, INSTAT calculated the number of households we needed to survey, in a total of 1017 households.

2.2 INSTRUMENT FOR THE COLLECTION OF INFORMATION

The questionnaire is designed by the Bank of Albania. A primary consideration in designing the questionnaire for use to elicit information from beneficiary households is the inclusion of both quantitative and qualitative issues. The questionnaire has 23 questions structured under 5 main rubrics to collect information on: (i) households' composition and geographical location; (ii) households' income; (iii) remittances and savings in Albania; (iv) savings and investment attitudes of beneficiary households; and (v) others.

2.3 FIELDWORK

The information was collected through the face-to face interviewing method. The interviewer had to visit the household more than once in order to complete the interview, in those cases where the information could not be collected at the first visit.

The field working team was selected by INSTAT and made-up of interviewers with previously experience on such a survey in the framework of the LSMS. The interviewers were previously trained. In addition, they know the places where the survey was conducted since they had experience in the LSMS.

Furthermore, the fieldwork had a direct supervision, appointed by INSTAT, to ensure the good quality of the information.

2.4 PROCESSING THE INFORMATION

Data from the survey was encoded and processed using the Statistical Program for Social Scientist (SPSS) in the Bank

of Albania. In order to obtain correct estimates, the data need to be weighted. A file with household weights was provided by INSTAT.

3 ANALYZING THE RESULTS OF INVESTIGATIONS

Statistical results of the survey presented below enable the analysis of different characteristics of remittances received by Albanian households, from their relatives abroad.

3.1 HOUSEHOLD PROFILE

The survey reported 189,736 from 728,000 or around 26 per cent of households in Albanian territory, receiving family remittances from abroad.

Geographical distribution indicates that Tirana (19 per cent), Vlora (12 per cent), Shkodra (11 per cent) and Fieri (8 per cent) have the majority of households receiving remittances; (table 1 and table 1 in the attached annex).

Annual average flow of remittances per household is estimated at around 1,897 euro and varies from city to city.

Table 1 in the attached appendix, reports descriptive statistics of the beneficiary families and the yearly average amount of remittances received per household by cities in Albanian territory. Households located in Kuçovë, Peqin and Pogradec report the lowest remittances flows during the year (less than 1,000 euro on yearly basis), while, Puka, Tropoja, Bulqiza and Gramshi faced the highest amount of remittances per household (between 3,000 to 8,000 euro per year).

Table 1 Geographical distribution of beneficiary households and remittances flow for 2006

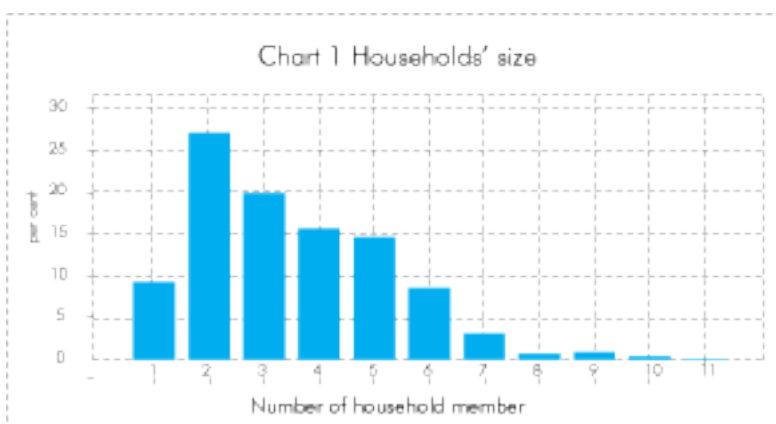
District	Population*	Area (km. ²)	Cities	No. of households	Sum (euro)
Berat	193,855	1,802	Berat, Kuçovë, Skrapar	11,396	13,312,843
Dibër	191,035	2,507	Bulqizë, Dibër, Mat	10,787	23,121,223
Durrës	247,345	827	Durrës, Krujë	15,622	21,442,827
Elbasan	366,137	3,278	Elbasan, Gramsh, Librazhd, Peqin	13,810	16,890,509
Fier	384,386	1,887	Fier, Lushnje, Mallakastër	29,825	40,166,439
Gjirokastrë	114,293	2,883	Gjirokastrë, Përmet, Tepelenë	8,423	13,763,310
Korçë	266,322	3,711	Devoll, Kolonjë, Korçë, Pogradec	15,759	14,317,155
Kukës	112,050	2,373	Has, Kukës, Tropojë	9,303	13,246,747
Lezhë	159,792	1,581	Kurbín, Lezhë, Mirditë	11,110	14,008,983
Shkodër	257,018	3,562	Malësi e Madhe, Pukë, Shkodër	17,970	57,741,055
Tiranë	601,565	1,586	Kavajë, Tiranë	26,663	63,541,383
Vlorë	193,361	2,706	Delvinë, Sarandë, Vlorë	19,068	49,704,523
TOTAL	3,087,159	28,703		189,736	341,256,998

* Population and Housing Census 2001

The majority of remittances sent to Albania are received in rural areas. Around 59 percent of the recipient households are located in rural areas and 41 percent in urban areas. In addition, rural areas absorb almost 64 percent of the yearly volume of remittances.

Table 2 Regional distribution of remittances

	Yearly average of remittances received per household (euro)	% of total Sum	% of total No. of households
Rural areas	2029.4	63.9	58.7
Urban areas	1624.8	36.0	41.3
Total		100	100



In accordance with the survey, the recipient households are mainly medium size households, with an average of 3.5 members per household.

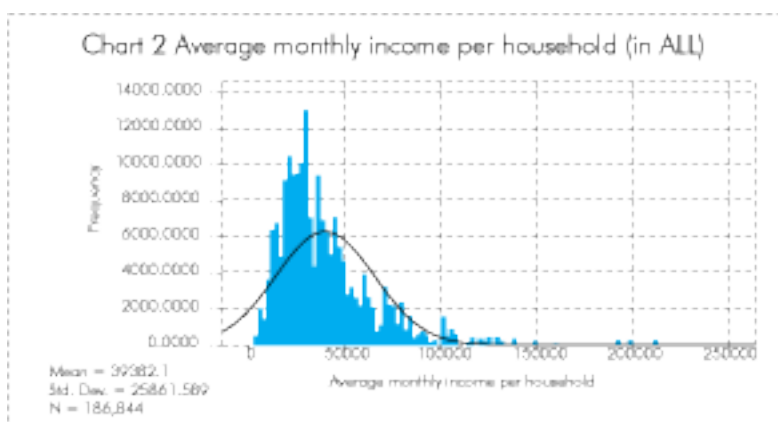
Around 72 percent of households have up to 4 members and 22 percent up to 6 members per household.

3.2 INCOME AND SAVINGS PROFILE

Household monthly income does not have a normal distribution. Chart 2 shows a frequency histogram of monthly income per household. On average, monthly income per household is estimated at 39,382 ALL, with income at the 75th percentile (49,500 ALL) approximately 2.3 times greater than income at the 25th percentile (22,000) (table 3 in the attached appendix).

Households in urban areas belong to higher monthly income levels than those in the rural areas.

The average household monthly income in rural areas is around 34,787 ALL (chart 1 and table 4 in the attached appendix). While the average household monthly income in urban areas is around 46,038 ALL (chart 2 and table 4 in the attached appendix).



Around 51 percent of households report having business operations or farming. On average, monetary income from farming and business operations together contribute to 19 percent of disposable income (table 3.).

Monetary incomes from farming contribute up to 21 percent of rural household's disposable income, while incomes from business operations occupy 4 percent of disposable income in these households. Meanwhile, it is estimated that on average 11 percent of urban households income comes from business operation activities.

Table 3 Income source of beneficiary households

Item	Average percent of total income	Frequency
Farming	11.6	84,209
Business operations	6.6	16,967
Salaries (public or private)	19.6	55,035
Pension	15.7	107,821
Social aids	0.6	11,404
Temporary work	3.3	17,888
Remittances	40.7	168,703
Other sources	1.8	8,902
TOTAL	100.0	186,844

Survey data indicate that remittances have become a critical source of income for households, reaching 40.7 percent of disposable income of an average household recipient.

Remittances have had comparable positive impact across all Albanian regions. The influence has been slightly higher in rural areas reaching 45.7 percent of disposable income (table 4).

		Rural areas	Urban areas
Mean		45.7	36.7
Percentiles	25	25	16
	50	42	33
	75	67	51

Empirical estimates show that the level and severity of poverty are significantly reduced among those households receiving remittances.

Descriptive statistics for daily income per capita (table 5.) show that excluding remittances these households in almost 40 percent will fall under poverty level⁴.

Table 5 Daily income per capita (in ALL)

		With remittances	Without remittances
Mean		457	283
Standard deviation		408	286
Minimum		33	7
Maximum		4,093	3,333
Percentiles	10	148	67
	20	208	108
	25	228	123
	30	253	138
	40	300	176
	50	350	222
	60	417	270
	70	500	308
	75	533	333
	80	604	387
	90	836	525

Households tend to perceive their economic status as more improved in presence of remittances flows. In only 21 percent of the cases, households show pessimism regarding the overall wellbeing generating potential of remittances (table 6.).

Table 6 Remittances impact on overall financial situation of beneficiary households

	Frequency	(%)
No improvement	39,132	20.9
Improved slightly	91,278	48.9
Significant improvement	56,434	30.2
Total	186,844	100.0

Around 53 percent of the respondents said they were able to save money, with higher frequency in rural areas (62 percent). Annual savings, for the respondent households, is estimated at around 63,115 ALL (or 508 euro).

Table 7 Annual savings per household (in ALL)

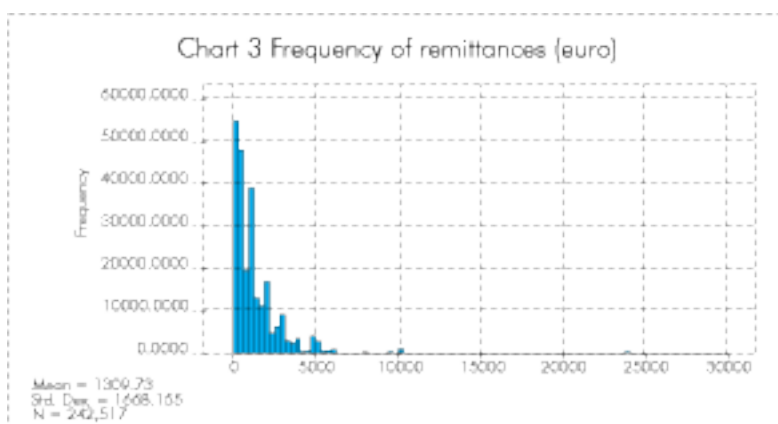
No. of households		186,844
Mean		63,115
Percentiles	10	-
	20	-
	25	-
	30	-
	40	-
	50	10,000
	60	30,000
	70	50,000
	75	60,000
	80	100,000
90	200,000	

While 30 percent of beneficiary households hold a bank account, in the majority of cases they keep their savings in cash.

To measure the respondents considerations on the preference where to keep their savings, respondents were asked to rate the choices (in bank, at home, in investments) on importance from 1 (less important) to 5 (the most important). Households prefer to keep their saving in banks account (the calculated degree of importance 3.87). Meanwhile, still a consideration number of households prefer holding their savings in cash at home (degree of importance 3.39). Investments alternative is less preferred (the degree of importance 2.37).

3.3 REMITTANCES

The proportion of their incomes migrants send home depends on a myriad of factors such as the migrants' profile⁵, salary level, cost of living in the host country, the volatility of the home currency, and differentials in interest on savings between the host and the home country. According to the survey, the number of Albanian migrants, sending remittances at least one time a year, is estimated at around 242,517. "Albanian migrants have a high propensity to save money; with an average annual saving level estimated at approximately 5,390 euro per household" (Nicolaas de Zwager and al., 2005).



Anecdotal evidence suggests that sending up to one third of their monthly income is more frequent.

From our survey results, the annual average of remittances per migrants approximate 1,310 euro (chart 3 and table 8).

Table 8 Descriptive statistics, annual remittances per migrant (euro)

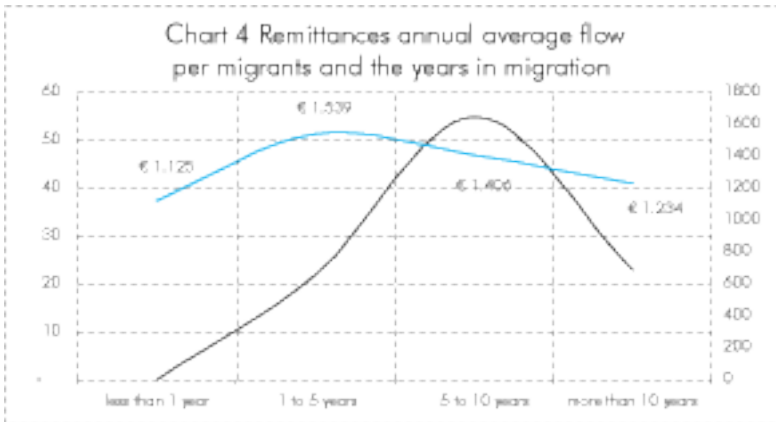
No. migrants		242,517
Mean		1,310
Minimum		20
Maximum		30,000
Percentiles	10	161
	20	290
	25	400
	30	483
	40	580
	50	900
	60	1,000
	70	1,500
	75	1,610
	80	2,000
	90	3,000

Sending patterns vary over the migration period as well. There has always been concern that remittances decline over time, in total and from particular households and individuals, due to lower migration rates, recession and a decrease in migrants' willingness to remit.

Furthermore, it has been suggested that, even with continued migration, the anticipated decline in remittance rates is likely to occur due to family reunification and greater integration of the migrants in the host communities (Connell and Brown, 2003). This process reduces migrants' ability and willingness to remit: ability because of the increased number of dependents now living in the migrants' households, and willingness because of fewer ties at home.

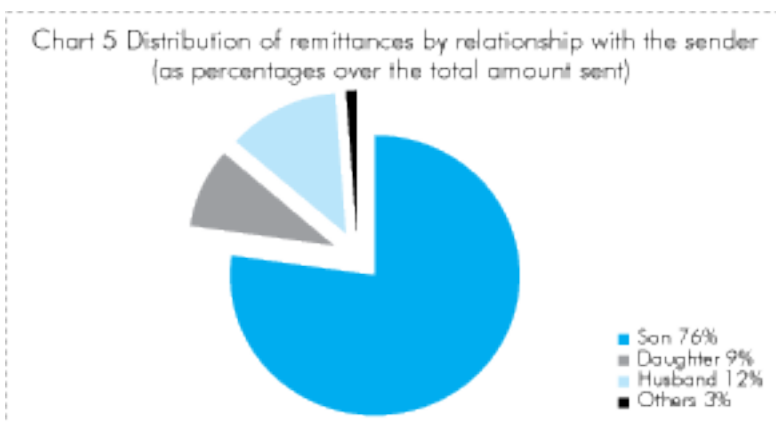
Our survey results showed a curvilinear trend in sending remittances: migrants in their 5th to 10th year abroad send the most. Whereas, recent migrants (less than 1 year on migration) remit less than do migrants who stay on for more than 10 years (chart 3).

The chart suggests that the amount of remitting per migrants declines with length of absence, reporting the highest level within 1-5 years on migration (approximately 1,539 euro).



Survey results show that relationship has much to do with the sending of remittances. Almost 85 per cent of remittances were sent by sons or daughters of household head. This indicates that there is a very strong family tie with the nuclear home (chart 5).

Sons show the highest frequency as well as send the biggest part of money to sustain financially the households at home country (table 9). Though in 20 percent of cases remittances are sent by family's daughters, they show the lowest mean per yearly



remittance (table 9). Patriarchal authority structures still present in Albanian families constrain women's migration (Germeñji, 2005). Family reunion has been the main reason for migration of women from Albania (Misja, 1998; Carletto et al, 2004).

Meantime the consort sent the highest amount of remittances (yearly average of 2,448 euro), since direct dependency on him of the family back in Albania. It is noticeable that this category is not of a high frequency, due to the fact that the migration cycle of it is shorter; husband return back home or get the family reuniting in the host country.

Table 9 Annual remittances by relationship with the sender (in euro)

Relationship with sender	No.	% of no	Mean (euro)	% of total remittances
Son	175,223	72.3	1,380	76
Daughter	45,704	18.9	624	9
Spouse/husband	15,925	6.6	2,448	12
Others	4,331	1.8	853	1
Brother	575	0.2	5,775	1
Wife	595	0.2	1,856	0
Total	242,354	100.0	1,310	100

Regarding the frequency, in the most cases, households report to receive money *2 times per year*. In only 3 percent of the cases households receive remittances every *month* (table 10).

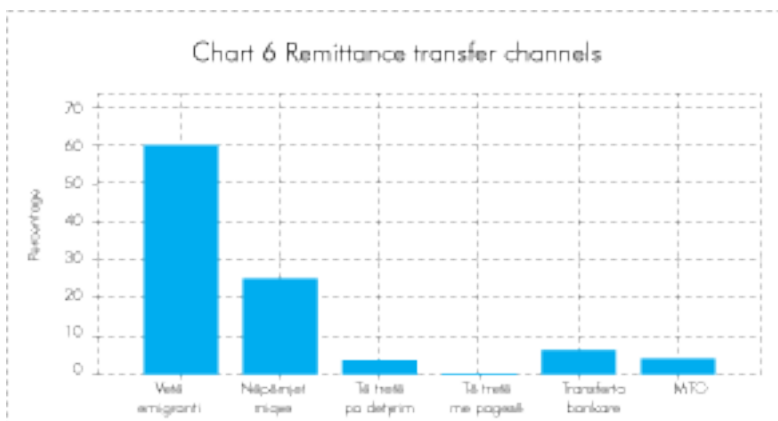
This is an apprehensible outcome of the survey if we cross the information of frequency with that of remittances channels. In 59 percent of the cases remittances comes hand carry by migrant himself (chart 6). Geographical vicinity of Albania to Greece and Italy enable frequent visits of migrants to families back home.

Table 10 Remittances frequency

	Frequency	No. of migrants	%
Valid	1 to 2 times per year	163.884	69
	3 to 4 times per year	49.515	21
	5 to 6 times per year	15.389	7
	Every month	7.164	3
	Total	235.952	100
Missing		6.565	3
	TOTAL	242.517	100

Our surveys show that the bulk of remittances to Albania were channeled through unofficial channel (89 percent), (chart 6). Albanian migrants residing in Greece and Italy largely prefer to resort to informal channel, hand-carry (in 83 percent of the cases). This in part is reflection of the short geographical distance between Albania and these countries.

Use of formal channel is low, accounting for only 11 percent of the cases. Although in host country Albanian migrants are familiar with banking system (findings from Nicolaas de Zwager et.al 2005, reveal that 74.4 percent of migrants hold their savings in banks) the majority of remittances are destined for rural areas, where the extension of banking system is restrained.

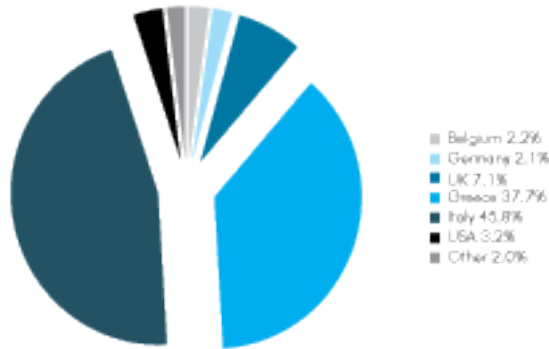


In contrast with other remittance-receiving countries, banks in Albania still have only a small market share in remittance services (less than 10 percent, chart 6).

The main country of origin of the remittances is Italy, with 45.8 percent, followed by Greece with 37.7 percent.

Greece is the top destination for Albanian migration (table 2, attached appendix); however in terms of volume Italy appears to be the most important source of remittances, with 45.8 percent of the total (chart 7).

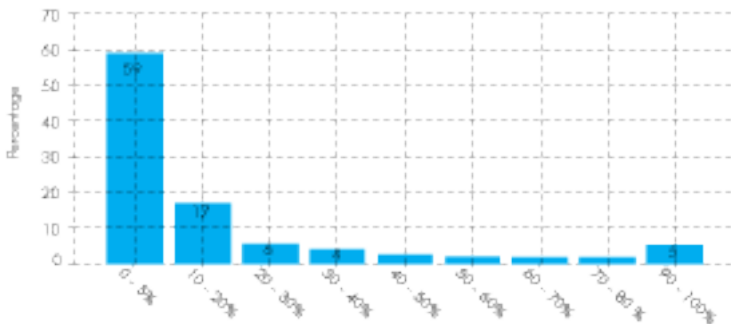
Chart 7 Distribution of remittances by countries of origin



In addition, the average delivery per migrant living in Italy results higher than the one from migrants living in Greece. According to a recent study undertaken on the issue of Albanian migration⁶, Albanian migrants in Italy report higher saving rate compared to the Albanian migrants in Greece.

Aside from monetary remittances that Albanian migrants send to households 'back home' in Albania, a part of support for these households is coming in the form of goods, that had been supplement of financial flows in 36 percent of the cases. The value of goods received per household during the year is estimated at around 202 euro.

Chart 8 Remittances savings rate



Saving rate is low. For those how specified allocation, more than half (59 percent) allocate up to 10 percent of the remittances they received to savings (chart 8).

Households express confidence regarding the amount of remittances they will be receiving in the following years, in almost $\frac{3}{4}$ of cases they do not expect decrease over the next two to three years. Meanwhile, 21 percent of households experiencing decrease flow over the past years, express pessimism for the future (table 11).

Table 11 Remittances expectations

		In following years			Total
		More	The same	Less	
In previous years	More	7,4	8,3	2,8	18,6
	The same	5,5	40,5	8,7	54,7
	Less	2,3	3,7	20,8	26,7
	Total	15,2	52,4	32,4	100,0

3.4 USE OF REMITTANCES

It is necessary to emphasize that is not strictly possible to identify the precise use of income from remittances as opposed to other sources. In other words, remittances increase as households' income and thereby affect their consumption and saving behaviors.

The examination of the main destination for yearly remittances shows the following scenario:

- 41.8 percent of remittances are oriented towards consumption expenditures that include expenses for food, clothing, household items and other types of consumption expenses; 16.4 percent of the remittances are used for education and medical expenses, which are beneficial for the country as social investments.
- 33.9 percent of remittances are destined for investments. These results show the significant economic impact of remittances. In other words, it means that one third

of remittances go directly to finance the operation of businesses (6.0 percent), the purchase of assets (5.8 percent), the construction of houses (12.3 percent), and savings in bank (9.9 percent).

- 6.6 percent of remittances are destined for intermediate consumption, which is interpreted as a resource to generate added value. In this category are expenditures for payments of loans.

4. CONCLUSIONS

This study is an additional contribution to our knowledge of migration phenomena, from the beneficiary households' point of view.

As an outcome of the survey, around 26 percent of the households in Albania receive workers remittances from abroad. Total amount of remittances a household receives yearly is estimated at 1,897 Euro.

Remittances are now the mainstay of the external economy, both in terms of contribution to the balance of payments and in providing disposable income for beneficiary households (reaching 41 percent of disposable income of an average household recipient). Our estimates show that the level and severity of poverty are significantly reduced among those households receiving remittances. Descriptive statistics of daily income per capita show that excluding remittances, these households in almost 40 percent will fall under poverty level.

Remittances impact is not present only in household level. Our calculations show that 59 percent of the households live in rural areas with 2/3 being involved on business or farm activity. Spending remittances in rural areas might have higher multipliers effect, as remittances tend to be spent on locally produced goods.

Remittances are mainly used to finance consumption, showing the primary goal of the migrants to support their families financially.

There has always been the concern that remittances decline over time. Our results show that with the passing of time in migration, there is decrease in the remittances level. To preserve the overall macro stability and assure financing current deficit continuity, the priority stands for channeling remittances toward investments.

The use of formal or informal channels for transmitting remittances may have an effect on the potential uses of remittances. Data from the survey indicate that the bulk of remittances to Albania are channeled through unofficial sources (89 percent). The majority of remittance senders and receivers use informal channels because, often, they lack access to the financial system in the host country and/or the home country. A combination of the high transaction cost of remittances, and the socio-economic deprivation of migrant families—for example, that of recipients living in rural sectors and/or with low schooling levels—may be the most important factor in the continued use of informal channels.

Remittances capacities to generate well-being are tightly connected with their inclusion into financial system. The majority of the receiving households is unbanked (74%), and lacks flexible deposit accounts. One third of household heads have a bank account, nevertheless their use to receive the remittances is minimal. However, there are encouraging signs of the demand for new technologies, innovative partnerships and entry points to reach disadvantaged.

Some Greek and Italian banks have established a branch network in Albania. In addition, Albanian banks work mainly with various partner banks to remit money, primarily with Italy⁷. These are welcomed developments for increasingly inclusion of remittances into the financial system. The 'bankarization' of remittances may be seen as an important lever to promote financial deepening in Albania.

STATISTICAL APPENDIX

Table 1 Summary report

Cities	No. households	Annual average (euro)	Sum (euro)	% of Total No.	% of Total Sum
Tropojë	638	3,894	2,484,219	0.3	0.7
Bulqizë	2,860	3,428	9,803,246	1.5	2.9
Berat	8,249	1,250	10,309,007	4.3	3.0
Dibër	2,637	2,902	7,652,487	1.4	2.2
Durrës	15,007	1,381	20,728,520	7.9	6.1
Devoll	2,957	1,124	3,323,668	1.6	1.0
Elbasan	9,483	578	5,480,192	5.0	1.6
Fier	17,667	1,493	26,373,341	9.3	7.7
Gjirokastrë	3,509	1,309	4,594,439	1.8	1.3
Gramsh	1,429	3,316	4,737,995	0.8	1.4
Has	1,053	1,907	2,007,691	0.6	0.6
Krujë	615	1,161	714,307	0.3	0.2
Korçë	4,546	720	3,275,068	2.4	1.0
Kolonje	5,171	1,030	5,328,341	2.7	1.6
Kukës	7,612	1,150	8,754,837	4.0	2.6
Kuçovë	1,593	578	921,323	0.8	0.3
Kurbini	4,666	1,250	5,830,494	2.5	1.7
Librazhd	2,353	2,699	6,351,297	1.2	1.9
Lezhë	6,444	1,269	8,178,490	3.4	2.4
Lushnje	9,249	1,113	10,293,734	4.9	3.0
Mallakastër	2,909	1,203	3,499,365	1.5	1.0
Malësi e Madhe	4,037	1,168	4,715,722	2.1	1.4
Mat	5,290	1,071	5,665,490	2.8	1.7
Peqin	545	589	321,026	0.3	0.1
Pogradec	3,085	775	2,390,078	1.6	0.7
Përmet	2,131	2,691	5,733,873	1.1	1.7
Pukë	1,822	8,353	15,218,331	1.0	4.5
Shkodër	12,111	3,122	37,807,002	6.4	11.1
Skrapar	1,554	1,340	2,082,513	0.8	0.6
Sarandë	3,572	2,478	8,850,982	1.9	2.6
Tepelenë	2,783	1,234	3,434,998	1.5	1.0
Tiranë	26,663	2,383	63,541,383	14.1	18.6
Vlorë	15,496	2,636	40,853,541	8.2	12.0
Total	189,736	1,897	341,256,998	100	100

Table 2 Remittances by countries of origin

	No of migrants (%)	Mean per migrant (euro)	% of total Sum
Argentina	0.1	563	0.0
Austria	0.3	189	0.0
Australia	0.1	1,855	0.1
Belgium	0.8	3,706	2.2
Canada	0.6	812	0.4
Switzerland	0.2	2,416	0.3
Check Republic	0.0	1,933	0.1
Germany	1.8	1,483	2.1
France	0.6	681	0.3
United Kingdom	5.1	1,812	7.1
Greece	45.1	1,094	37.7
Croatia	0.0	1,500	0.1
Hungary	0.1	3,479	0.2
Italy	40.0	1,498	45.8

Kosovo	0.1	786	0.1
FYR of Macedonia	0.1	50	0.0
Holland	0.1	743	0.1
Norwegian	0.1	805	0.0
Saudi Arabia	0.1	403	0.0
Montenegro	0.1	966	0.1
Sweden	0.0	2,013	0.0
US	4.3	964	3.2
n.a.	0.2	888	0.1
Total	100.0	1,310	100.0

Table 3 Monthly income per household (in ALL)

Mean		39,382
Standard deviation		25,862
Minimum		3,000
Maximum		212,000
Percentiles	10	15,000
	20	20,000
	25	22,000
	30	24,000
	40	28,600
	50	32,500
	60	38,000
	70	45,000
	75	49,500
	80	55,000
	90	72,500

Table 4 Monthly income per household (in ALL)

		Rural areas	Urban Areas
Mean		34,787	46,038
Standard deviation		21,598	29,783
Minimum		4,000	3,000
Maximum		138,300	212,000
Percentiles	10	14,000	17,500
	20	19,000	23,000
	25	20,000	27,844
	30	22,000	30,000
	40	25,200	33,500
	50	29,000	39,000
	60	33,500	45,000
	70	40,000	54,140
	75	44,000	60,000
	80	47,000	65,000
	90	62,800	79,349

Chart 1 Average monthly income of households in rural areas

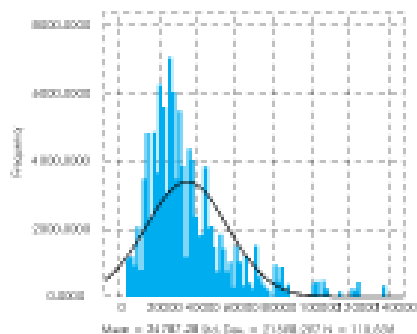


Chart 2 Average monthly income of households in urban areas

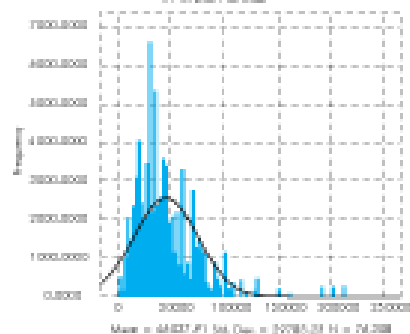


Chart 3 Daily per capita income

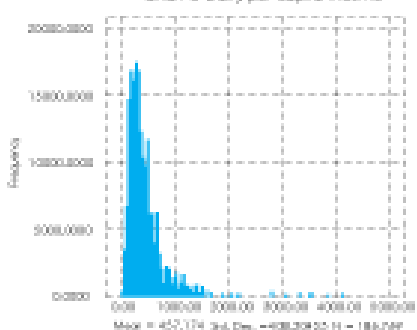


Chart 4 Daily per capita income in urban areas

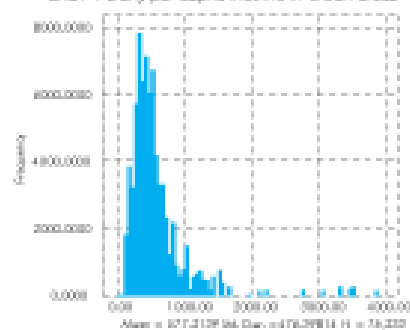


Chart 5 Daily per capita income in rural areas

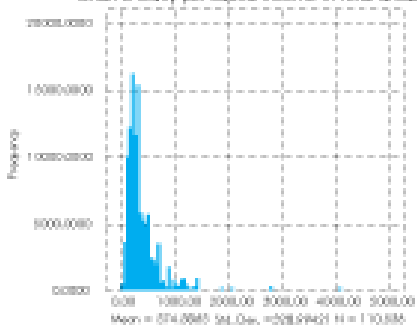


Chart 6 Daily per capita income excluding rent finances - rural areas

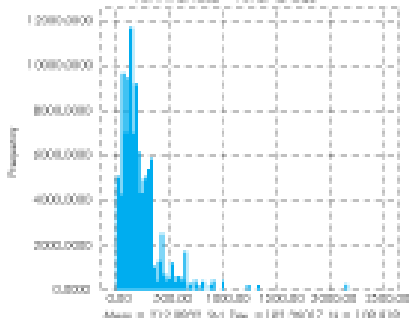
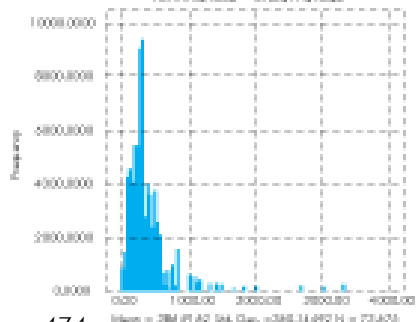


Chart 7 Daily per capita income excluding rent finances - urban areas



NOTES

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Opinions expressed in this paper are of the author and do not necessarily reflect the official opinion of the Bank of Albania.

¹ Worker remittances are defined as international transfers of money sent by Albanian migrants abroad to their relatives or friends in Albania.

² Living Standard Measurement Study

³ For more information, refer to <http://www.worldbank.org/lsms>.

⁴ Referring to poverty level of 2\$ per day determined by the World Bank

⁵ For more on the characteristics of Albanian migrants, see "Competing for remittances" Nicolaas de Zwager et. al. (2005).

⁶ "Competing for remittances", 2005.

⁷ Following the initiative of the World Bank for the development of Italy-Albania Remittance Corridor (finalized at "Remittances: An Opportunity for Growth. The Albanian Migration to Italy as a case study", Bari, 3-4 March 2006), the Albanian Association of Banks (AAB) and the Italian Banking Association (ABI) started, in 2006, to work together to expand cooperation between Albanian and Italian banks in order to encourage greater use of banking channels for remittances.

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REAL ESTATE PRICES AND FINANCIAL STABILITY

*Juna Bozdo**

Key words

- Real estates - Bank lending - Collateral - Price performance -

1 PREFACE

Bank lending is the primary source of real estate funding. Over the last couple of years, the coincidence of cycles in credit and property markets has been widely documented in literature (IMF, 2000, BIS, 2001).

However, the question of the direction of causality between bank lending and property prices has remained an unexplored issue. From a theoretical point of view, causality may go in both directions. Property prices may affect bank lending via various wealth effects. First, due to financial market imperfections, households and firms may be borrowing constrained. As a result, households and firms can only borrow when they offer collateral, so that their borrowing capacity is a function of their collateralisable net worth. Since property is commonly used as collateral, property prices are therefore an important determinant of the private sector's borrowing capacity. Second, a change in property prices may have a significant effect on consumers' perceived lifetime wealth, inducing them to change their spending and borrowing plans and thus their credit demand in order to smooth consumption over their life cycle. Finally, property prices affect the value of bank capital, both directly to

the extent that banks own assets, and indirectly by affecting the value of loans secured by property.

On the other hand, bank lending may affect property prices indirectly, augmenting the funds at the borrowers' disposal. A rise in lending, may lead to a fall in the interest rates of real estate loans and thus to an increase in the demand for lending from households and firms. This increase in demand toward a temporarily stable level of real estate supply (due to the time needed to construct new flats) may lead to higher increase in the real estate prices.

As a result, we may say that property prices fluctuation might therefore influence not only the risk taking capacity of banks but their policy to extend loans as well.

2 REAL ESTATE LENDING AND THEIR TREATMENT FROM A SUPERVISORY POINT OF VIEW

Real estate lending is one of the most important components of bank loans¹. For such reason, the measurement of the bank's credit risk exposure, is very important not only for bank managers but for the supervisors as well. Credit risk, however, is not confined to the real estate sector. Because real estate assets are also widely used as collateral for other types of loans, fluctuations in property prices would have an effect in banking system's balance sheets and even broader effects on the profitability and collateral value of the banking industry as a whole.

Anyway, before we consider the effect of real estate prices fluctuations on the asset quality, bank's exposure, capital adequacy and the lending capacity of the banking system as a whole, we will consider different types of real estate loans and their supervisory treatment according to international² and Albanian banking system standards.

2.1 TYPES OF REAL ESTATE LOANS AND SUPERVISORY STANDARDS ACCORDING TO BASEL I

Real estate loans are generally classified as:

- Residential real estate loans;
- Commercial real estate loans.

Residential real estate loans are granted to retail borrowers. The loan is fully secured by residential properties that are either occupied by the borrower or rented by the borrower to a third party. Most residential real estate loans are granted to retail borrowers to finance the construction or the purchase of their home. The terms and the conditions of real estate loans vary greatly across countries³ and within the same country, between banks.

Commercial real estate lending is lending to commercial borrowers who use the commercial real estate loan to fund the purchase, construction, or development of real estate properties. Commercial real estate loans are fully secured by mortgages on:

- office buildings;
- industrial buildings;
- single-purpose commercial premises, for instance a factory;
- multi-tenant commercial premises, for instance, stores, warehouses, shopping centers, hotels, etc.

A special type of real estate loans are also construction loans. Construction loans are granted specifically to fund the construction and development costs of a residential or commercial building. The funds are usually advanced at specific stages of construction in 'progress payments' which are secured by claims on the property. This payout mechanism ensures that the loan is funded in incremental amounts so that funds are available to the builder as construction progresses. At the same time, this mechanism ensures that the outstanding balance is

in step with the increasing value of the property. These loans are offered to commercial borrowers and include the following construction lending:

- land development loans
- commercial construction loans
- residential development loans

Land development loans are loans extended for the purchase and development of land in anticipation of construction and subsequent sale of the property. Such development may include the granting of land, installation of utilities, and construction of streets.

Commercial construction loans can encompass a wide range of projects including factories, company buildings, office buildings, shopping centers, and hotels. Each type of project requires special skills and expertise on the part of the developer to successfully construct, manage and market the project.

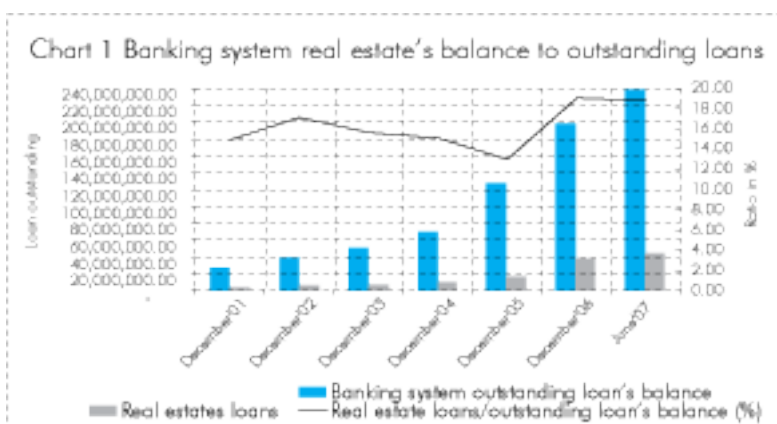
Residential development loans are loans made either on a speculative basis (where houses are built to be sold to yet to be identified buyers), or on a pre-sold basis (where buyers have already obtained prearranged financing) the builder's financial condition, experience and reputation, along with the lender's past experience with the builder, are key factors in determining the terms of the lending agreement.

Under Basel I, real estate loans are risk weighted at 100%, with the exception of mortgages on residential real estate, which are risk weighted at 50% (the loan is fully secured by a mortgage on the real estate that is occupied by the borrower or rented by the borrower to a third party). Under Basel's II Standardized Approach, a preferential risk weight of 35% is available for residential loans provided strict prudential criteria are applied. Under Basel II, commercial real estate loans may receive a preferential risk weight of 50%, as an exception, and subject to specific and strict operational requirements.

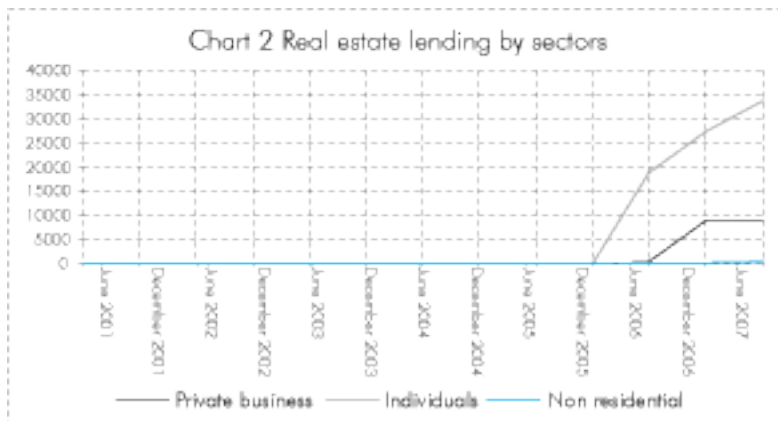
2.2 ALBANIAN BANKING SYSTEM AND THE REAL ESTATE MARKET

2.2.1 Real estate loans allocated from the Albanian banking system

The year 2006 evidenced a considering expansion of the banking system's loans. Hence, outstanding loan's balance evidenced an increase of 70.2 billion lekë⁴ compared to 57.6 billion lekë balance at the end of 2005. This significant increasing pace compared to the year end 2005 is also reflected in the remaining maturity loan structure: short term loans evidenced a decrease of 0.7 per cent (26% at the year end 2006 compared to 26.2% at the year end 2005) hence, shifted to medium term reflecting a slight increasing pace about 0.18 per cent. Meanwhile an increase in the long term loan is also noticed, especially compared to to the year end 2005⁵. The ratio "real estate loans/ total outstanding loan's balance" peaked during the year 2005-2006 (from 13% in december 2005 reached to 13% in december 2005) as a result of a more aggressive promotional offers made by the banks about real estate loans. Structural developments in the portfolio's remaining maturity reflect an increase in the demand for individual's real estate, as well a business orientation toward investments in fixed assets needed for technology improvements or further activity improvements.

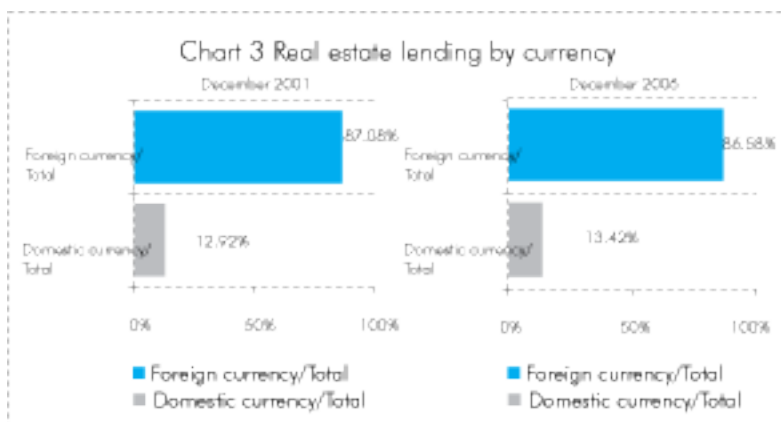


During 2006, the volume of real estate loans increased by 21.77 billion lekë (or 131 per cent compared to the previous year), where the individual's sector weights 80.62⁶ per cent and the foreign currency loans weight about 86 per cent of the total portfolio. We can make the same statement about the first half of the year 2007 so, notwithstanding the volume increase of the real estate loans about 6.72 billion lekë, its weight to the total outstanding balance shows a declining pace during the above mentioned period. Therefore, the ratio "real estate loans/ total outstanding loans" indicates the value 18.85 per cent in june 2007, compared to 19.39 per cent at the year end 2006. This fact is due to upward trend of the total outstanding loans compared to the the total disbursed real estate loans during the above mentioned period, respectively 41.3 billion lekë toward 6.71 billion lekë (chart 1).



The main attributes/features of real estate lending process in the previous years are as follows:

- *the dominance of real estate loans for (Chart 2); it has the dominant weight to the total real estate outstanding loans 80.62 per cent, meanwhile the total loans disbursed to businesses and non-residents which respectively 18.53 per cent and 0.85 per cent, as well:*
- *the dominance of the real estate loans in foreign currency (chart 3).*



Regardless of the dominance of the real estate loans in foreign currency, it is observed a slight increase of loans in local currency for the period december'01- december'06 (13.42 per cent compared 12.92 per cent), in the meantime year 2006 indicates a declining trend of 29 per cent compared to december' 06 (table nr.1).

Table 1 Loan value by currency (in billion All)

	December '01	December '02	December '03	December '04	December '05	December '06
Real estate lending	4.21	6.66	7.92	10.62	16.61	12.062
Domestic currency	0.54	0.59	0.76	0.97	2.28	1.62
Foreign currency	3.67	6.07	7.16	9.65	14.33	10.44

Source: The above information and data are obtained from the Banking Supervision Department.

2.2.2 Opinion of the banks operating in Albania

In order to identify the types of real estate loans and the risks associated with the real estate lending, a questionnaire for becoming aware of the opinion of the banks⁷ operating in the Albanian banking system, was compiled⁸.

According to the results of this questionnaire, real estate loans in the Albanian banking system are classified as follows:

- *Residential real estate loans*: residential real estate loans are granted to retail borrowers. The loan is fully secured by residential properties that are either occupied by the borrower or rented by the borrower to a third party. Most residential real estate loans are granted to retail borrowers to finance the construction or the purchase of their home. Depending on the fact that the residential property used to fully collateralize the loan, is owned or not by the borrower, this type of loan may be considered as a medium risk asset, thus receiving a risk weight of 50% (in case is owned by borrower) or as a high risk asset, thus receiving a risk weight of 100% (in case the borrower is not the owner of the property).
- *Commercial real estate loans*: commercial real estate loans are loans granted to commercial borrowers in order to fund the purchase or the restoration of the premises where they intend to develop or exercise their commercial activity. This may include: a) the purchase of a new non-civil building; b) the restoration of an existing building or c) the purchase of an existing building and/or of the land etc. This type of loans is fully secured by a mortgage on a real estate property which may or not be owned by the commercial borrower. Unlike residential real estate loans, this type of loans is considered as a high risk asset and receives a risk weight of 100%, independently the fact that the property is or not owned by the borrower.
- *Loans collateralized by real estate properties*: are loans granted to retail or commercial borrowers for different purposes, collateralized by a real estate property. More concretely, we mention the following type of loans:
 1. retail borrowers, who intend to *exercise an activity*, are funded by the bank for the purchase of a real estate property where they will exercise the activity.
 2. private sector, according to the purpose:
 - i) *for business development*, for the purchase of different equipment and machinery;
 - ii) *for trade*, are funded through overdrafts and loans for working capital, in order to fulfill their short term liquidity needs.

This type of loans, which is collateralized by a mortgage on a real estate property owned or not by the borrower, are considered as high risk assets and receive a risk weight of 100%.

2.2.3 Risks associated with the real estate lending

Real estate lending is subject to some unique risks. The banks are exposed from two different sources:

- risks associated with the borrower;
- risks associated with real estate securing the loan

A. Risks associated with the borrower

There are two distinct categories of real estate borrower, retail borrower and commercial borrowers. Residential real estate borrowers have a strong incentive to repay their loans, to maintain possession of their homes. Nevertheless, some borrowers do default due to a variety of factors, including:

- borrowers become too heavily burdened with debt;
- adverse economic conditions, including increases in the cost of leaving and interest rates
- a decrease in income due to, for example, unemployment or change in employment
- change in family size or marital status (e.g. divorce)

In case of commercial borrowers, the repayment ability may be influenced by:

- economic conditions such as adverse changes in demand
- increased competition and rises in interest rates;
- deterioration in the firm's management and business model

B. Risks associated with real estate securing the loan

The lender should pay careful attention to all of those circumstances that might affect the value of the real estate. It is very important for the bank to regularly review the value of

the property on timely basis. Risks associated with real estate securing the loan might arise from:

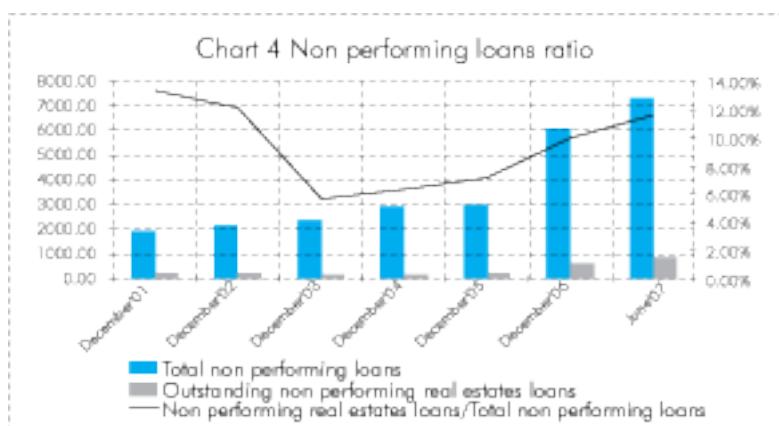
- *Nature of real estate markets*: real estate is prone to volatility. Real estate markets are affected by many factors and declines can quickly erode the margin of protection for real estate lenders. As a result, lending against the value of real estate carries risks that must be closely reviewed and assessed.
- *Catastrophic events*: catastrophes such as fire, floods, earthquakes, terrorist acts and wars can damage or destroy property. One technique, lenders can use to protect themselves, is to make it a condition of providing the financing that borrowers obtain insurance coverage against loss from such events.
- *Changing economic conditions*: economic downturns can adversely affect borrower's repayment potential and at the same time might lessen a bank's collateral protection, augmenting its exposure for the unsecured amount of outstanding loan.
- *Legal issues*: laws, its implementation and delays in their implementation, may affect the lender's ability to promptly and efficiently take possession of a property once the borrower has defaulted on its obligations. During these delays, the value of the real estate collateral may deteriorate as the borrower may not be prepared to devote resources to provide needed maintenance. The possession of the property of the collateral in a non adequate manner, with no rapidity and above all with costs to be afforded by the bank, potentially increases the bank's exposure in case of a depreciation of the value of the collateral.

The above mentioned risks should all be assessed in a sound and accurate manner. Although, banks should avoid granting loans based solely on the value of the collateral. In the event of default, physical collateral, especially in the form of real estate often proves difficult to liquidate.

As a result we consider that the assessment of the creditworthiness of the borrower is essential when granting a loan and includes: assessment of the applicant's income, liquid

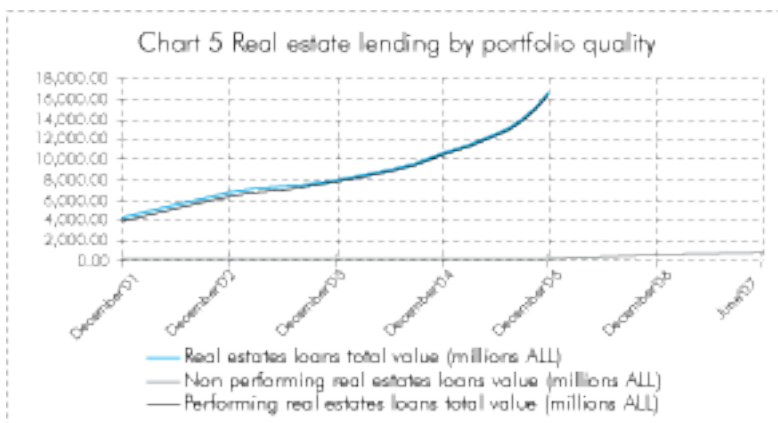
assets, employment history, credit history, and existing obligations as collateral only provides extra protection for the bank.

The outstanding value of non performing loans in the Albanian banking system has increased significantly evidencing/ recording a value of 7334.86 million lekë by june'07 compared to 6047.24 million lekë recorded by the end of the year 2006 and 2981.36 million lekë by the end of the year 2005. The value of real estate non performing loans has increased significantly as well for the period december'05 - december'06, showing/ reaching a value of 604.7 million lekë against 214.01 million lekë during the year 2005, or in other words has increased by 182.56 per cent. The upward trend is also being observed for the period december'06-june'07, where the value of non performing real estate loans has risen by 249.3 million lekë. Notwithstanding, the volume of real estate compared to the volume of outstanding non performing loans in the banking system, is still considered to be low, respectively 604.7 million lekë against 6047.24 million lekë by the end of december'06 and 854.02 million lekë against 7334.86 million lekë by june'07. The same conclusion can be educed also for the real estate non performing loans weight compared to outstanding non performing loans of the Albanian banking system. Such a weight, eventhough performing increasing values during the last three years, stands for a relatively low percentage weight of 10% to the outstanding total value of non performnig loans in the



banking system by the end of december '06 and 11.64% by june'07, but still to be continuously monitored (see chart 4).

The performance of the real estate loan portfolio quality during the period december'01-june'07, has been characterized by an upward trend in the total volume of real estate lending. This trend, has recorded always increasing values of performing loans in the banking system portfolio⁹ and above all, these values have been several times higher compared to the values recorded by the volume of non performing loans in the banking system portfolio (see chart 5).



Non performing real estate loans record a slight increase during the period December'01-December'02, records almost half values during December'03 to record again increasing values during the period December'04-December'05 (see table 2).

Table 2 Real estate lending by portfolio quality

	December '01	December '02	December '03	December '04	December '05	December '06	June '07
Total real estate loans (million lekë)	4,214.57	6,656.42	7,923.10	10,622.29	16,612.65	38,378.94	45,098.57
Non performing real estate loans (million lekë)	259.99	262.12	132.74	186.05	214.01	604.70	854.02
Performing real estate loans (million lekë)	3,954.58	6,394.30	7,790.36	10,436.24	16,398.64	37,774.24	44,244.56

Source: The above information and data are obtained from the Banking Supervision Department.

Based on the above table we may say that the quality of real estate loan portfolio remains good. These low values for non performing real estate loans, might be explained with the fact that the volume of lately disbursed real estate loans has evidenced a rapid increase during december'05-june'07, but also because the international experience suggests that a rapid increase of loan portfolio is accompanied by a deterioration of its quality in the following periods.

3 FINDINGS AND RECOMMENDATIONS

3.1.1 Findings

- The year 2006 evidenced a considering expansion of the banking system's loans. Hence, outstanding loan's balance evidenced an increase of 70.2 billion lekë¹⁰ compared to 57.6 billion lekë balance at the end of 2005. The volume of real estate loans increased by 21.77 billion lekë during the year 2006 (or 131 per cent compared to the previous year) with a weigh of 19.39% to outstanding loan's balance.
- The volume of non performing real estate loans evidenced a significant increase during the period december'05-december'06 by 182.56 per cent (604.7million lekë against 214.01 million lekë during the year 2004) and its contribution in the upgrowth of outstanding non performing loans in the Albanian banking system's balance for the year 2006, is estimated at about 10 per cent.
- The weigh of non performing real estate loans to outstanding non performing loan's balance has evidenced an upward trend during the last three years, form 6.29% during the year 2004, to 7.18% during the year 2005 and performs a value of 10% by the end of year 2006, announcing the need for a prudent monitoring of such phenomenon on a timely basis.
- The performance of the real estate loan portfolio quality during the period December'01-June'07, has been characterized by an upward trend in the total volume of real estate lending (respectively 45,098.57 million lekë against

4,214.57 million lekë). This trend has recorded always increasing values of performing loans in the banking system portfolio, witnessing its good quality. However, we cannot come to a conclusion about the expecting performance of real estate portfolio, because low values of non performing real estate loans can be explained not only because the volume of newly disbursed real estate loans has rapidly increased during the mentioned period, but also because the international experience suggests that a rapid growth of the portfolio is accompanied by a deterioration of its quality in the following periods.

- The main attributes/features of real estate lending process are the dominance of real estate loans to individuals and the dominance of real estate loans in foreign currency. Real estate loans to individuals weigh about 80.62 per cent to outstanding real estate loan's balance, whilst the weigh of real estate loans to businesses and to non residential is estimated respectively by 18.53 and 0.85 per cent; real estate loans in foreign currency weigh 86.58 per cent to outstanding real estate loan's balance during the year 2006. Though the dominance of real estate loans in foreign currency, a slight increase in the weigh of real estate loans in domestic currency is being evidenced during December'01-December'06, from 12.92 per cent to 13.42 per cent.
- Real estate loans in the Albanian banking system are classified as follows: i) residential real estate loans; ii) commercial real estate loans; iii) loans collateralized by real estate properties. From the interviews had with some of the Albanian banking system's banks nearly 90 per cent of the collateral accepted by the banks, other than for real estate loans, is comprised of real estate properties.
- Real estate lending is subject to two different types of risk: i) risks associated with the borrower; ii) risks associated with the real estate securing the loan.
- Among the main factors that explain the current level of real estate loan's volume banking system's banks list some inciting and some pleclusive factors for the further development of the lending process. Relating to inciting

factors, banks evidence the rise in real estate loans demand and the increased competitiveness in the banking system, while the banks evidence the absence of a secondary market of collateral as a preclusive factor.

- The expectations of the banking system for the real estate loan portfolio are positive, meaning that the majority of the banking system's banks expect a rise not only in the real estate loan to individuals but to businesses as well in the banking system portfolio. Banks pronounced for a further increase in the land and commercial constructions prices, but are more hesitating on the performance of flats prices.

3.1.2 Recommendations

- The majority of the banking system's banks reappraise the financial conditions of the borrower as well as the collateral market value on a one year basis, or in case of a parallel or a new loan demand. A potential/possible change in real estate prices might have a considering effect not only in consumer's welfare in general, but also on loans collateralized by real estate properties, because potentially this affects not only the bank's exposure but also their loan portfolio quality as well. For such reason, banks should be more prudent and to evaluate on timely basis the financial condition of the borrower and the value of collateral.
- An increase in the market value of collateral as a consequence of a rise in real estate prices, might lead to a higher demand for credit in the economy. The increased demand might affect the banking system's banks conservatism¹¹ in fulfilling specific requests in being credited, increasing their flexibility and thus affecting the problems to deal with in the forthcoming periods. Thus, banks have to be strict and rigorous in implementing their regulatory framework and their internal loan policy.

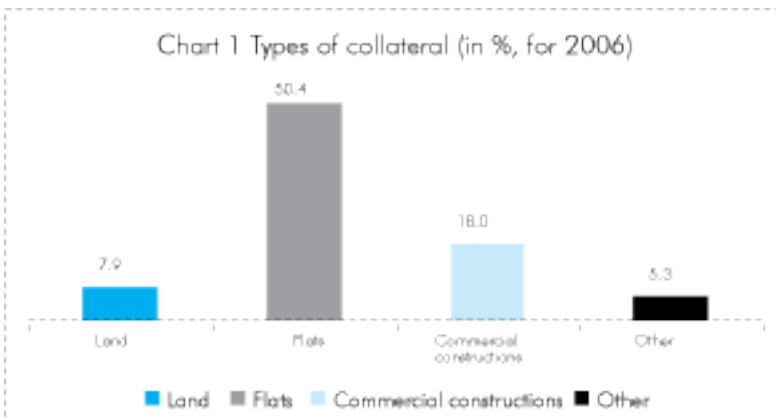
ANNEX

1. According to your opinion what is the percentage of the bank's current collateral for real estate loans is taken for each of the following products?

Land	_____%	Business facilities	_____%
Apartments	_____%	Other	_____%

In the following chart it is shown the composition of the collateral taken from the banks for mortgage loans (real estate loans), where loans for apartments dominate with 50.4 per cent.

From all the interviewed banks it is evidenced a common characteristic: the owner of the taken collateral for mortgage or real estate loans is not always the borrower. The real estates accepted as collateral is preferred to be located in the main cities of Albania, mainly in Tirana and Durrës. In the cases when the borrower is not the same with the owner of the property, the owner must have a strong relation with the borrower and preferably be a client of the lending bank.



According to the collected data, another characteristic is evidenced: 90 per cent of the collateral accepted from the

interviewed banks for loans other than real estate loans, is composed of pledges.

2. Which is the method you use to evaluate the collateral?

- | | |
|---|-------------------------------------|
| Current cost method | <input type="checkbox"/> |
| Market value | <input checked="" type="checkbox"/> |
| Price method | <input type="checkbox"/> |
| Present value of the expected future cash flows | <input type="checkbox"/> |

All the banks evaluate the collateral based on the market price method.

3. What the collateral appraisal frequency?

- | | | | |
|-------------|--------------------------|-----------------------|--------------------------|
| Once a year | <input type="checkbox"/> | Less than once a year | <input type="checkbox"/> |
|-------------|--------------------------|-----------------------|--------------------------|

Referring to the collateral appraisal frequency, only five banks (or 31 %) evaluate the collateral once a year, while the other eleven banks (the dominating banks or 69%), e reappraise it in periods longer than one year or in the cases when a new loan is approved for the client.

4. While appraising the collateral the banks rely upon:

- | | |
|--------------------------------------|--------------------------|
| 1. Internal appraisers | <input type="checkbox"/> |
| 2. Outsourcing (external) appraisers | <input type="checkbox"/> |

Twelve banks (or 75 per cent of the total banks), rely only on external appraisers, while four of them (25 per cent) rely on both external and internal appraisers. It is worth it to mention that Banka Kombëtare Tregtare has an internal "ad-hoc" unit "The buildings' appraising and maintenance department". This unit reappraises regularly the maintenance of the collaterals from the borrowing clients, considering it as a very strong defensive rigor for the bank.

5. Would you please specify the ratio credit volume/yearly income for each group:

- | | |
|----------------|-----|
| 1. Individuals | !_! |
| 2. Businesses | !_! |
| N.A. | |

6. Please specify the yearly interest rates for each currency (base + spread), for mortgage loans:

- | | | | |
|----------------|------|-----|-----|
| | Lekë | Eur | Usd |
| 1. Individuals | !_! | !_! | !_! |
| 2. Businesses | !_! | !_! | !_! |

Hence, we can conclude that banks apply either fix or floating interest rates for both local and foreign currency (mainly eur and lekë) loans. Minimal and maximal applied interest rates in either local or foreign currency for mortgage loans are shown in table nr.1 Fixed interest rate applied for local currency fluctuates mainly between the values less than 10 per cent and more than 13 per cent (19 per cent of the banks apply these interest rates respectively for individuals and businesses). Meanwhile, fixed interest rates for foreign currency (eur and usd) vary from minimum less than 9 per cent to maximum 9-13 per cent, both for individuals and businesses. Currently, the interest rates less than 9 per cent for individuals and businesses (respectively 21 % and 23%) dominate the euro currency, while the interest rates between the interval 9-13 % for individuals and businesses dominate in usd currency (respectively 21% and 23% of the total weight). Therefore, we can state that the fixed interest rates for both individuals and businesses in local currency are higher than applied interest rates for the loans in foreign currency.

Table 1 Fixed interest rates by currency

	Individuals		Private sector	
	Minimum value	Maximum value	Minimum value	Maximum value
Fixed interest rates in ALL (%)	<10%	>13%	<10%	>13%
Fixed interest rates in eur and usd (%)	<9%	9-13%	<9%	9-13%

A summary of the floating interest rates in both foreign (eur and usd) and local currency is shown in table nr.2. Floating interest rates applied in local currency for both individuals and business loans fluctuate between the minimum value TB+3/+5 per cent and maximum value TB+5/+7 per cent (respectively 38% and 31% of the banking system apply these interest rates). With reference to eur currency these rates fluctuate between minimally euribor+2.5/+3.5 and maximally euribor+>7 for both individuals and businesses. The interest rates euribor+5.5/+7.5 dominate the main weight (29 % of the banks apply for individuals and 29% apply it for businesses). Whereas, with reference to usd currency these interest rates vary between minimally libor+2.5/+3.5 per cent to maximally libor+>7 for both individuals and businesses. The interest rates euribor+3.5/+5.5 dominate the main weight (25 % of the banks apply for individuals and 19% apply it for businesses). Hence, the floating interest rates for both individuals and businesses in local currency are higher compared to applied interest rates for foreign currency.

Table 2 Floating interest rates by currency

	Individuals		Private sector	
	Minimum value	Maximum value	Minimum value	Maximum value
Floating interest rates in ALL (%)	TB+3-5%	TB+7-9%	TB+3-5%	TB+7-9%
Floating interest rates in Eur (%)	Euribor+2.5-3.5%	Euribor+>7%	Euribor+2.5-3.5%	Euribor+>7%
Floating interest rates in Usd (%)	Libor+2.5-3.5%	Libor+>7%	Libor+2.5-3.5%	Libor+>7%

7. Which is the term structure for real estate loans by currency:

Lekë	Eur	Usd
Min Max	Min Max	Min Max

1. Individuals
2. Private sector

Term structure for the domestic currency, for the european currency and us dollars for individual class, vary from a minimum of five years up to a maximum of twenty years (see table 3), whilst for the private sector class, the term structure for the domestic currency is up to twenty years; for foreign currencies is shorter, with a maximum of 15 years. The brunt for individuals in domestic currency is occupied by 5-10 years term structure and for the private sector from the 5-10 year term structure. For the european currency and for us dollars the brunt for individuals is occupied by 15-20 year term structure and by 5-10 years term structure for the private sector. So, we might say that we notice some linearity between the term structure of three currencies for individuals and private sector classes.

Table 3 Term structure by currency (in years)

	Individuals		Private sector	
	Minimum value (in years)	Maximum value (in years)	Minimum value (in years)	Maximum value (in years)
Term structure for ALL	<=5	15-20	<=5	15-20
Term structure for eur	<=5	15-20	<=5	10-15
Term structure for usd	<=5	15-20	<=5	10-15

8. Please rank by importance the criterions used by your bank in evaluating the custom's payment capacity (where 1 is less important and 5 the most important):

1. Strong collateral
1 2 3 4 5
2. Capability and faculty in managing the business
1 2 3 4 5
3. The borrower's business is well collateralized
1 2 3 4 5
4. The reputation and good name of the borrower
1 2 3 4 5
5. The borrower's history in principal and interest payment
1 2 3 4 5
6. Financial condition
1 2 3 4 5
7. Other (specify)
1 2 3 4 5

Below are listed the criteria, by their importance, used by banking system's banks, in evaluating borrower's payment capacity:

- Borrower's financial condition;
- Capability and faculty in managing the business and the borrower's history in principal and interest payment (receive the same evaluation by banks);
- Strong collateral, good name and the borrower's reputation (same evaluation by banks);
- Well capitalization of the borrower's business;
- Other.

9. If there exists, which level of covering ratio does your bank use for each group?

Individuals _____%

Private sector _____%

Table 4 Covering ratio

	Individuals		Private sector	
	Minimum value	Maximum value	Minimum value	Maximum value
Loan value/collateral value (%)	120-130%	> 150%	100-120%	> 150%

In table 4 the limits used by the banking system's banks for the covering ratios are given. The minimum limits for this ratio are higher for individuals compared to those applied to the private sector, meanwhile maximum limits offer the same loan covering by collateral value. The average weigh of this ratio hovers around 130-140 per cent for individulas and for the private sector as well.

10. Have your bank ever had to execute the collateral?

Yes !_!

No !_!

The majority of banking system's banks (67% of them) declared that they have had collateral executing procedures, while only a small part of them (33%) declared that never had collateral executing procedures.

11. In case of affirmative response, how many months lasted collateral executing procedures for each of the following groups?

Individuals _____ Private sector _____

These procedures, in most banks, have lasted over one year for individuals and for the private sector as well.

12. In case you think that collateral executing procedures are too prolonged, which of the following factors might affect most:

Social problems _____
 Legal issues _____
 Other (specify) _____

Legal issues are listed as a key preclusive factor in accelerating the collateral executing procedures, in 87 per cent of the cases in the banking system's banks.

13. To your opinion, how volume of real estate loans should be affected by the acceleration of the procedures?

	Will grow	The same	Will fall
1. Individuals	!_!	!_!	!_!
2. Private sector	!_!	!_!	!_!

To the question that how would the acceleration of the procedures affect the volume of real estate loans, most banks answered that not only for individuals (67% of the banking

system's banks) but also for the private sector (64% of them) this would have a positive impact.

14. To your opinion, rate according to their importance each of the following factors that explain the current level of real estate lending ((where 1 is less important and 5 the most important):

1. The competitiveness growth in the banking system, has promoted a higher demand for real estate loans from customers

1 2 3 4 5

2. The increased demand for real estate loans (e.g. demographic movements) has affected the level of lending

1 2 3 4 5

3. The expectation for an increase in the real estate prices

1 2 3 4 5

4. As a consequence of a better portfolio diversification

1 2 3 4 5

5. The absence of a secondary market for collateral

1 2 3 4 5

6. Other (specify)

1 2 3 4 5

Below are listed the factors that mostly explain the current level of real estate loans, according to the judgement expressed by the banking system's banks:

- The increased demand for real estate loans;
- The competitiveness growth in the banking system;
- The absence of a secondary market for the collaterals;
- The expectation for an increase in the real estate prices;
- As a consequence of a better portfolio diversification;
- Other, where we can mention the tenor of living.

15. To your opinion, what will the pace of real estate portfolio be in the future:

	Will grow	The same	Will fall
1. Individuals	!!	!!	!!
2. Private sector	!!	!!	!!

To the question that what will be the pace of real estate portfolio in the future for individuals and for the private sector, most of the banks answered that they will grow in both classes (75% and 60% of the banks expect a rise in the demand respectively for individuals and for the private sector), meanwhile just a few of them answered that they expect no changes (25% and 33% of them).

16. Which is your judgement regarding the pace of real estate prices in the future:

	Land	Flats	Commercial constructions	Others
Lower	!!	!!	!!	!!
Higher	!!	!!	!!	!!
Equal	!!	!!	!!	!!

Regarding the judgement on the pace of real estate prices in the future expressed by the banking system's banks, 94 per cent of banks phrased for an increase in the land prices, 93 per cent phrased for an increase in the price of commercial constructions, 60 per cent for an increase in flat's prices and 67 per cent in their items procis. So, we may conclude that the banking system's expectations are mostly for an increase in the real estate prices (see table 5).

Table 5 Pace of real estate prices

	Lower	Higher	Equal	N/a
Land in %		94%	6%	0%
Flats in %		60%	40%	7%
Commercial constructions in %		93%	7%	14%
Others in %		67%	33%	33%

17. What are some of the measures that your bank would take in case of a depreciation in the collateral value (downfall in prices)?

To this question, 43 per cent of the system's banks answered that would take no measure because they consider their banks as well capitalized through the coverage ratio; 43 per cent of the system's banks answered that they would demand for an increase in collateral value (supplementary collateral); and just 14 per cent of them would simply ask for a reappraise and a monitoring of the collateral value.

NOTES

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Opinions expressed in this paper are of the author and do not necessarily reflect the official opinion of the Bank of Albania.

¹ In the majority of industrialized countries like: Portugal, Ireland, Spain and Greece, real estate lending occupies almost one third of total bank lending and in some other cases even more. The data are published by the European Mortgage Federation

² According to international supervisory standards, we will refer to the effective supervisory framework, Basel I.

³ For example, floating interest rates are widely used in Great Britain and fixed interest rates (for 5-10 year period) in Germany. Differences, according to premature loan payment, do exist as well. In Germany, such a procedure is permitted but the borrower is obliged to pay a bank penalty, while in the USA, where loan maturity is up to thirty years, the borrower pays nothing.

⁴ Whilst outstanding loan's balance in domestic currency increased by 24.44 billion lek or 78.2 per cent, outstanding loan's balance in foreign currency evidenced an increase of 45.73 billion lek or 47.4 per cent.

⁵ Short term loans perform a weight of 25.6% to outstanding loan's balance during 2006 year, compared to 26.2% it performed during 2005 year. Medium term loans have a weight of 30.78% (30.6 % during 2005), hence shifting these last ones toward long term loans, which evidenced a weight of 38.4 % during 2006 year, compared to 36.2 % by 2005 year end.

⁶ Datas are obtained from Call Report.

⁷ For such a purpose, some interviews were performed with bank managers and employes, in the following banks: American Bank of Albania, Italian-Albanian Bank, Tirana Branch of Alpha Bank, Procredit Bank, Raiffeisen Bank, Tirana Bank, National Commercial Bank, Tirana Branch of National Bank of Greece, Credins Bank, Popular Bank and Emporiki Bank.

⁸ A summary of this questionnaire is reported at the end of this study.

⁹ The term "performing loans" refers to the sum of the value of standard loans and special mention loans.

¹⁰ Whilst outstanding loan's balance in domestic currency increased by 24.44 billion lek or 78.2 per cent, outstanding loan's balance in foreign currency evidenced an increase of 45.73 billion lek or 47.4 per cent.

¹¹ All interviewed banks declared that in case of a further rise in the collateral market value, as a consequence of increased real estate prices, the client's possibility in getting credit should be higher as well.

LABOR PRODUCTIVITY IN ALBANIA: THE PROCESS OF SECTORS' CONVERGENCE

Vasilika Kota*

Key words

- Labor productivity - Sectors' convergence - Employment - Convergence -

ABSTRACT

This paper investigates the impact of sectors' convergence in labor productivity growth in Albania over the period 1996-2005. A decomposition exercise is utilized for this purpose. The results show that there is sectors' convergence especially for the agriculture sector, while the other sectors tend to move towards a higher equilibrium point. However sectors' developments support an ongoing labor productivity growth in Albania.

I. INTRODUCTION

Basic growth theories (Solow model and endogenous growth) account for physical and human capital as determinants of economic growth. Non developed countries are characterized by a shortage of capital; i.e capital earns high profits which stimulates its inflow from other countries. As a result, a convergence process should develop and the difference between developed and non developed countries should diminish. However new empirical evidence derived from micro data shows that regardless of capital flows towards less developed countries, there is no economic convergence (Burges, 2003).

The economies of countries with different levels of development manifest a lot of heterogeneities and dynamics in sector or firm level. These countries are characterized by different levels of productivity and its performance is the fundamental long term source of economic growth. Differences in total productivity between countries have mainly two reasons (Kilvits, 2002):

- The productivity in (sub)sectors is different (technological level, capital–output ratio, skilled labor);
- Labor is concentrated into (sub)sectors of different productivity. This is caused by earlier activities and investments undertaken according to the special characteristics of each country;

If labor is concentrated in sectors of different productivity which is inefficient, then a re-structuring process will take place. Labor source will shift from less productive sectors to more productive ones. The process will lead to labor source reallocation resulting in higher aggregate and sectors' labor productivity, thus in higher economic growth of the country.

This process of labor source reallocation is of particular interest for the emerging economies of Central and Eastern Europe and former Soviet Union. These countries have moved from a central planning system (thus concentrating labor in strategic sectors regardless of the efficiency level) to a market based economy (productivity determines sectors' employment). As a consequence, there is a strong need for restructuring the economic activities and reallocating the labor input.

Estrin and Svejnar (1998) find that in Czech, Slovak Republic and Poland there was a quick employment adjustment by firms at the start of transition. The same pattern appears also for Brown and Earle (2005), who find that job reallocation in Ukraine has increased considerably after liberalization and that the employment reallocation has become productivity-enhancing. However, the study undertaken by Loecke and Konings (2005) for the manufacturing sector in Slovenia, finds that substantial total factor productivity growth, was mainly explained by firms becoming more efficient

and entry of more efficient firms, rather than a shift in employment shares towards the more efficient existing firms.

The purpose of this paper is to study labor source reallocation across the Albanian sectors and thereby quantify its impact on aggregate labor productivity. Albania is a successful story of economic growth reaching a level of 6 percent per year. Given that aggregate data suggest substantial labor productivity growth, it is interesting to identify the factors contributing to this growth. For this purpose, the methodology applied decomposes aggregate labor productivity growth in the contribution of three factors: intra-sector productivity growth, labor source reallocation and sectors' convergence to a mean productivity level, which can be considered as an equilibrium level.

The outline of the paper is as follows. Section II gives the basic pattern of labor productivity in Albania. Section III discusses in detail the methodology, data construction and sources; section IV presents the results in the aggregate and sector level of the economy. Conclusions are given at the end of the paper.

II. GROWTH AND PRODUCTIVITY TRENDS

During the start of transition¹, 1990-1992, Albania's real GDP decreased by a cumulative of 39 percent. The macroeconomic stabilization policy established in 1993, led to a sustainable economic recovery. Between 1993 and 1996 the average annual growth picked up to 9.3 percent. The pyramid scheme crisis in 1997 caused an economic decline of 11 percent. However Albania was able to recover fast and growth rate of real GDP for 1998 reached 8.6 percent. This growth pattern was even higher for the next year, and stabilized during 2001-2002 with an average of 6.5 percent. During the energy crises of 2002 the economy grew only with 4.3 percent. Meanwhile, starting from 2003 the average annual growth rate was 6 percent.

Albania inherited a non-efficient structure of the economy and definitely the transition process led to restructuring of

the economy's composition. Starting from 1990 the share of the industry sector has declined from 39 percent to about 24 percent in 2004. However, within the industrial sector, the construction sector experienced a great expansion from about 3 percent of GDP in 1990 to 13 percent in 2004. The tightening experienced by the industry sector allowed resources to be used by other sectors, such as services that increased its share of GDP from 33 percent to 54 percent. The share of agriculture sector first increased from 23 to 32 percent up to 1997 and then went back to 21 percent in 2005.

The substantial restructuring of the economy's composition in Albania suggests that transition caused resource reallocation from less productive activities to more productive ones. Below we present labor productivity performance of the four major sectors, differences in employment shares and real wage developments.

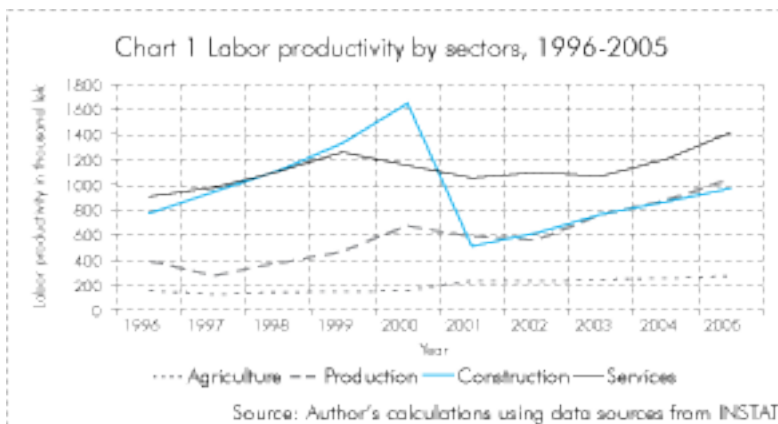


Chart 1 presents labor productivity for the sectors of: agriculture, manufacturing, construction and services. The productivity is given as the ratio of real value added to employment for each sector. Chart 1 suggests that the process of sectors' convergence toward the mean aggregate level of productivity is missing or is irrelevant. In general, the sectors' development of productivity shows similarities only over the period 2002-2005, while most of the sectors experience productivity growth. Further

in the material we will discuss the case when all of the sectors are converging towards a higher equilibrium level different from the aggregate level of the economy. Below we analyze the individual development of the productivity indicators for each of the sectors.

Over the period 1996 to 2000, manufacturing sector was the most productive in terms of labor input; however from 2001 to 2004 it ranked the second after the services sector. This impressive difference in the productivity levels of the two consecutive years may be induced by a structural break in data due to INSTAT new methodology for employment². The new classification of employment for each sector during this period is reflected in the labor productivity developments. This change has a notable impact on the construction sector whose employment weight after 2000 increased considerably.

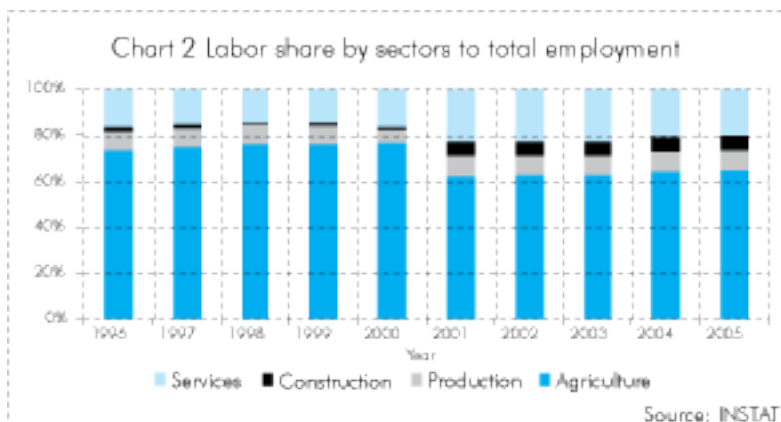
The agriculture sector ranks the last in terms of productivity performance. This development implicates expected developments of two possible processes:

- a) Low levels of agricultural productivity should lead to labor source reallocation from this sector towards more productive sectors.
- b) If there is a sectors' convergence process, then the agriculture sector should reflect higher productivity growth in order to catch the aggregate mean of labor productivity.

The analysis we carry out in this material tests which one of this processes has been developed in the Albanian economy.

Chart 2 gives labor share of sectors to total employment. Agriculture sector has the largest share of employment; though it has decreased from about 74 percent to 64 percent. Services labor share has increased to about 20 percent of total employment. However the largest increase in labor share is experienced from the construction sector which in 1998 had only 1 percent of the total employees, but in 2005 it already grew to more than 6 percent. Manufacturing labor share does

not reveal significant changes and is stable at the rate of 8 percent.



The developments presented in Chart 2, indicate that there is no relevant labor reallocation among the sectors. Only after 2000 employment in the services sector, with a high level of productivity, is increased considerably; and agricultural employment with low productivity is decreased. Over the period 2000-2001 (the restructuring of the employment classification) the process of labor reallocation among sectors is relevant.

Chart 3 presents the developments in real wages for the sectors of manufacturing, services and construction. Their performance helps to estimate the level of convergence among sectors. If there is a convergence of the sectors' productivity, this process is also expected to cause also wage convergence.

The manufacturing sector has the highest level of real wages while the construction sector has the lowest, which does not fit with its high productivity. A preliminary conclusion is that there is no wage convergence. Starting from 1997 there is a tendency of wages to diverge, especially for the manufacturing sector. Following the theoretical assumption that productivity convergence is translated to wage convergence, given that this process is missing, it might implicate that there is no productivity convergence to the equilibrium level.



III. LABOR SOURCE REALLOCATION AND ITS IMPACT ON LABOR PRODUCTIVITY

III.1 METHODOLOGY

This section investigates the contribution of labor shifts across sectors to productivity growth. We use the method of aggregate productivity growth decomposition as presented by Maliranta and Ilmakunnas (2005). This method is extensively used to analyze the impact of labor reallocation on labor productivity (e.g Fagerberg, 2000; Timmer and Szirmai, 2000; Jalava et al, 2002; Van Ark and Timmer, 2003).

Below aggregate labor productivity is decomposed by sectors:

$$(1) \quad LP_t = \frac{Q_t}{L_t} = \sum_i \frac{Q_{it}}{L_{it}} \cdot \frac{L_{it}}{L_t}$$

where LP_t stands for aggregate labor productivity, Q_t is total aggregate output, L_t stands for total employment, Q_{it} for total output in the relevant sector i and year t and L_{it} is the respective employment. Equation (1) gives aggregate labor productivity as a weighted sum of the labor productivities of individual sectors

and weights being the share of each sector employment in total labor. Terms without subscripts refer to entire economy measures. The term L_{it}/L_t in equation (1) refers to labor share of the sector i in total labor and the term Q_{it}/L_{it} refers to labor productivity of the same sector. Renaming the former as LSH_i and the latter as LP_i , equation (1) can be rewritten as follows:

$$LP_t = \sum_i LP_i \cdot LSH_i \quad (2)$$

Next we consider changes in labor productivity from one year to another. This change can be written simply by subtracting the level of labor productivity at the end of period (1) from that at of period (0):

$$LP_1 - LP_0 = \sum_i LP_{i,1} \cdot LSH_{i,1} - \sum_i LP_{i,0} \cdot LSH_{i,0} \quad (3)$$

Rearranging with some algebraic manipulations⁴, the following is obtained:

$$LP_1 - LP_0 = \sum_i \overline{LSH}_i \cdot \Delta LP_i + \sum_i \overline{LP}_i \cdot \Delta LSH_i \quad (4)$$

where \overline{LSH}_i is the average labor share of sector i for the periods 1 and 0 and ΔLP_i is labor productivity difference for sector i for the same periods, \overline{LP}_i is the corresponding average productivity level and ΔLSH_i is the labor share difference of sector i for the periods 1 and 0. This formula is applied over the period 1996 to 2005 resulting in 9 figures for labor productivity change ($LP_1 - LP_0$). Renaming labor productivity change as ΔLP_t and dividing each side by the average aggregate productivity of the two corresponding years (\overline{LP}_t) to rearrange equation (4) in growth terms⁵, the following is obtained:

$$\frac{\Delta LP_t}{\overline{LP}_t} = \sum_i \overline{LSH}_i \cdot \frac{\Delta LP_i}{\overline{LP}_t} + \sum_i \overline{LP}_i \cdot \frac{\Delta LSH_i}{\overline{LP}_t} \quad (5)$$

The first term on the right-hand side in equation (5), i.e. average labor share of sector i for year 1 and 0 multiplied by

labor productivity change during this period, describes internal productivity growth within the individual sector and measures the “intra-sector productivity growth”. Therefore, intra sector effect measures the change in aggregate labor productivity growth if the labor share does not change over time. The second term measures changes in aggregate labor productivity due to changes in labor share of the sectors (i.e labor shifts) with sector productivity being held constant. In other words, this effect measures the changes in aggregate labor productivity resulting from the movements of labor across sectors with different productivity levels. When the employment share of sectors with high productivity levels rises, this implies a reallocation of labor towards sectors whose productivity is growing rapidly.

However, the denominator used in the sum on the right-hand side of equation (5) is the average aggregate productivity, \overline{LP}_t , not the average productivity of the respective sector i , \overline{LP}_i . In order to get a pure intra sector effect, the average productivity of the sector i should be used as a base. Maliranta (2003) decomposes further the first term on the right-hand side of equation (6) as:

$$\sum_i \overline{LSH}_i \cdot \frac{\Delta LP_i}{\overline{LP}_t} = \sum_i \overline{LSH}_i \cdot \frac{\Delta LP_i}{\overline{LP}_i} + \sum_i \overline{LSH}_i \cdot \left\{ \frac{\overline{LP}_i}{\overline{LP}_t} - 1 \right\} \cdot \frac{\Delta LP_i}{\overline{LP}_i} \quad (6)$$

where the first term on the right-hand side can be called the pure intra sector effect, which is the labor share weighted productivity growth of sector i . The second term can be considered as a convergence term. If a sector i experiencing productivity growth ($\overline{LP}_i / \overline{LP}_t - 1 < 0$) has an average productivity larger than average aggregate productivity, ($\Delta LP_i / \overline{LP}_i > 0$), it shows that sector i is trying to catch up sectors with high productivity growth, that is, sectors' labor productivity are converging.

Finally equation (5) is rewritten including the new decomposition given in equation (6):

$$\frac{\Delta LP_t}{LP_t} = \underbrace{\sum_i \overline{LSH}_i \cdot \frac{\Delta LP_i}{LP_i}}_{\text{Intra-sector effect}} + \underbrace{\sum_i \overline{LSH}_i \cdot \left\{ \frac{\overline{LP}_i}{LP_t} - 1 \right\} \cdot \frac{\Delta LP_i}{LP_i}}_{\text{Convergence term}} + \underbrace{\sum_i \frac{\overline{LP}_i}{LP_t} \cdot \Delta LSH_i}_{\text{Labor shift effect}} \quad (7)$$

Productivity growth is decomposed in 3 main effects: intra sector effect, convergence term and labor reallocation across sectors of different productivity. During the next section, the above decomposition is applied to Albanian data in order to test which effect has contributed more to the labor productivity growth.

III.2 DATA DESCRIPTION

Labor productivity during a period t (LP_t) is measured as output (Q_t) divided by labor input (L_t):

$$LP_t = \frac{Q_t}{L_t} \quad (8)$$

Output can be represented by value added or gross output. Although which one to use depends on the availability of data, the use of value added is preferred in case of sectors' productivity because changes in labor productivity estimates based on gross output, may not reflect a change in technology or efficiency but rather, substitution between labor and intermediate inputs (Cobbold, 2003).

Taking into account both reasons, output in this paper is represented by real value added for the four major sectors: agriculture, manufacturing, construction and services. Sectors' value added data are obtained from the national account statistics (INSTAT). Value added data are normalized by the respective deflators with the 1996 as the base year to calculate real value added.

The most appropriate method to compute real value added is to use the double deflation method where intermediate goods deflated by its price index is deducted from the real gross output

(Cobbold, 2003). However, the unavailability of the intermediate good price index in Albania does not allow using this method.

The labor input is represented by the number of employee as data on working hours are not available. Labor data source is INSTAT.

Data quality is crucial for conducting good economic analyses. Data on agriculture employment are problematic as they follow the assumption that all persons owning a land (and their family members) are employed. As a result of this methodology, there is an overestimation of employment in this sector which might underestimate its labor productivity. The agricultural sector in transition countries has low productivity thus even if employment is overestimated, regardless of the possible shift in productivity, its performance will still be lower compared to other sectors.

Data on employment in nonagricultural sectors are obtained once data on informal market measured through Statistical Observation of Families (LMSI) is added to official employment. However, this methodology does not guarantee that the final result gives the real developments of labor market; the informal sector might be larger than measured by LMSI.

The inclusion of informal market in the data used in this paper even if it didn't affect productivity, would estimate a pure labor source reallocation across sectors. Labor market informality is estimated through nation consumer's questionnaires, which goes beyond the purpose and possibilities of this study. The result we will present will be discussed keeping in mind the restrictions of official data.

IV. RESULTS OF LABOR PRODUCTIVITY DECOMPOSITION BY EFFECTS

The results of the decomposition exercise for the entire economy are presented in Table 1. The average aggregate productivity growth for 1996-2005 is around 7.6%. The Intra sector effect, i.e within sector productivity growth, is the major

contributor to aggregate productivity growth for all the period 1996 to 2005 excluding 2001. On average it contributes by 105 percent of labor productivity growth for the whole period. During 2001 intra sector effect is outperformed by labor shift effect. The results are expected as the change in classification of employment by economic activities by INSTAT, means labor source reallocation across sectors. Therefore the analysis will be conducted for two periods, 1996-2000 and 2001 to 2005.

Table 1 Aggregate productivity growth decomposition

Entire economy	Year	1997	1998	1999	2000	2001	2002	2003	2004	2005
	Aggregate productivity growth (%)	-8.1	7.6	12.9	5.5	22.9	3.5	4.2	7.8	11.8
	Intra-sector effect (%)	169.9	122	61.7	116.7	87.9	83.9	105.4	97.5	76.6
	Labor shift (%)	45.2	-59.4	9.6	50.9	119.3	-3.1	-10.6	-27.8	-9.6
	Convergence term (%)	-115.1	37.4	28.7	-67.6	-107.2	19.2	5.2	30.3	33

Source: Author's calculations

*Implies the effect with the largest contribution.

For the period 1997 to 2000 average labor productivity growth is about 4.46 percent. The largest contribution with more than 100 percent is given by the within sector productivity growth. On average only about 12 percent of aggregate productivity is caused by labor source reallocation across the sectors, while the convergence term indicates the presence of catch up process, excluding 1997. During 1997 there was a decline in aggregate productivity therefore the negative convergence term indicates divergence of the sectors from the aggregate productivity level.

For the period 2001 to 2005, excluding the first year, the largest contribution on labor productivity growth is given by the intra sector effect. However, compared to the first period, its contribution has diminished. As expected, labor source reallocation had the largest contribution during 2001, with an impact of over 100 percent. Starting from 2002, labor shift effect has a negative impact on aggregate productivity. But on the other side, the convergence term starts to contribute positively to productivity growth, with an average of 22 percent.

The large impact of labor source reallocation during 2001 is also reflected in high sectors catch up for this year, being mainly a statistical issue.

It appears that 2001 is the turning point for the contribution of the sources of productivity growth. Before 2001, labor source reallocation was sustaining the within sector productivity growth. After 2001, the intra sector effect was supported by the convergence term, while there is no positive contribution of labor source reallocation across sectors.

Below we extend our analysis in sector level. Table 2 presents the contribution of the sectors to the sources of productivity growth. The results indicate that much of the intra sector contribution came from the agriculture sector with an average of 65 percent for the whole period. This sector has consistently contributed to productivity growth, while the other sectors have at times counter affected productivity growth.

Table 2 Decomposition of aggregate productivity growth by sectors and effects

		1997	1998	1999	2000	2001	2002	2003	2004	2005	Average	
1.	Aggregate productivity growth (%)	-8	8	13	5	23	4	4	8	12	8	
2. Percentage of aggregate productivity growth explained by:												
2.1	Intra sector component	Agriculture	155	63	31	91	118	34	26	40	29	65
		Production	33	32	15	45	-4	-11	57	15	13	22
		Construction	-4	3	1	5	-18	35	33	10	6	8
		Services	-14	25	15	-24	-8	26	-12	32	29	8
		Total (a)	170	122	62	117	88	84	105	98	77	102
2.2	Labor source reallocation	Agriculture	-6	10	-1	4	-28	1	6	7	2	-1
		Production	-7	-3	-2	-68	17	-1	-13	20	0	-7
		Construction	22	-16	0	16	59	1	-2	-9	1	8
		Services	37	-50	13	99	72	-4	-1	-45	-12	12
		Total (b)	45	-59	10	51	119	-3	-11	-28	-10	13
2.3	Convergence term	Agriculture	-81	-34	-17	-53	-63	-17	-13	-21	-16	-35
		Production	4	3	4	27	-2	-2	19	9	9	8
		Construction	-8	7	4	15	-29	7	13	6	3	2
		Services	-30	62	38	-56	-13	32	-14	37	37	10
		Total (c)	-115	37	29	-68	-107	19	5	30	33	-15
3	Total effects	Total (a) +(b)		100	100	100	100	100	100	100	100	
		+(c)										

Source: Author's calculations

On average, the manufacturing sector has contributed negatively to labor source reallocation, which means that its

labor share of employment is reduced. This result is expected. The agricultural and manufacturing sectors have low productivity. Therefore labor is expected to shift from these sectors to services and construction, with high productivity. However, the negative effect of reallocation is expected to be higher for the agricultural sector than for manufacturing, as agriculture has very low productivity.

An explanation for why the agriculture sector is not reallocating its labor resource is that the labor force that is shifted, does not possess the relevant skills required in the more productive sectors, or is reluctant to change jobs. This problem points to the need for skills upgrading to induce higher productivity and economic growth in Albania.

Finally we analyze the contribution by sectors of the convergence term. The agricultural sector is the only sector with lower than average productivity. The convergence term for agriculture is expected to be negative reflecting its catch up process. Over the whole period the low level of agriculture productivity is offset by positive growth rate of this indicator, indicating a catch up process of this sector towards the economy's average.

The sectors of construction, manufacturing and services have higher productivity than average. If these sectors were also catching up to the average level, their productivity growth would be negative, resulting in a negative convergence term.

Excluding 2001 when labor reallocation induced sector convergence, construction, manufacturing and services systematically diverge from the average aggregate level. This process means that the more productive sectors continue to have high efficiency growth and regardless of the convergence of the agriculture sector, the economy has not achieved a steady level of productivity, yet.

The process of continual productivity growth of the productive sector together with the convergence of the non-efficient sector will result in further productivity improvement in Albania.

These results indicate that the process of convergence and labor reallocation across sectors is low. Official data on employment for the sector is sustainable, probably due to non including informal market. Another possibility, which should be part of future research, is whether the Albanian economy has free capacities, thus it has not achieved a steady economic growth. In this case, free labor force might be able to satisfy the sectors demand for employment, without the need of labor reallocation.

Also, the convergence as used in this paper means convergence toward an average aggregate level of the economy. Our findings indicate that only the agriculture sector is converging to this level. However, given that the productive sectors have positive growth rates even though they are diverging more from the economy's average, these sectors might be converging toward a joint equilibrium. Such a process, might implicate that the Albanian economy has not achieved the steady level and is moving toward it. Even though as used in the paper, the sectors appear to diverge, they may be converging to a higher equilibrium point.

Lastly, the material discusses linear convergence of sectors productivity but this process might be represented better by another functional form. Using other methodologies might determine better this process.

V. CONCLUSIONS

This paper presents the basic trends of labor productivity and its decomposition into the effects of employment and convergence. The results indicate that within productivity sector growth is the largest contributor to aggregate productivity. Regardless of the expectations of a high labor source reallocation, its impact is small. A preliminary conclusion is that the Albanian economy has free capacities, reducing the need for labor shifts across sectors.

High productivity growth in efficient sectors and the convergence of the agriculture sector toward high productivity

level, support the continuous growth of this indicator in Albania. The Albanian economy has not achieved the steady level of economic growth yet, and is characterized by a dynamic and permanent stimulation of efficient production. Productivity is the promoter factor of long run economic growth and its positive growth rate will continue to induce development.

NOTES

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Opinions expressed in this paper are those of the author and do not necessarily reflect the official opinion of the Bank of Albania.

¹ Source data is WDI for 2003 for the period 1990 to 1995, INSTAT for the period 1996 to 2005.

² Employment according to the economic activities for the private nonagricultural sectors, up to 2000 is classified using data from the General Directory of Duty-Taxes. Starting from 2001 the classification is estimated using data from: Ministry of Labor and Social Affairs, General Registration of the Population and Housing and statistical observation of the families (LSMS) conducted by INSTAT.

³ Wage data for the major sectors are collected from the Annual Business Structural Survey, carried out by INSTAT. In order to compute real wages, these data are deflated by the value added deflator for the major sectors.

⁴ To verify that equation (4) equals equation (3) we follow these steps:

$$LP_1 - LP_0 = \sum_i \overline{LSH}_i \cdot \Delta LP_i + \sum_i \overline{LP}_i \cdot \Delta LSH_i$$

$$LP_1 - LP_0 = \sum_i \left\{ \frac{LSH_{i,1} + LSH_{i,0}}{2} \right\} (LP_{i,1} - LP_{i,0}) + \sum_i \left\{ \frac{LP_{i,1} + LP_{i,0}}{2} \right\} (LSH_{i,1} - LSH_{i,0})$$

$$LP_1 - LP_0 = \sum_i \frac{LSH_{i,1}}{2} \cdot LP_{i,1} - \frac{LSH_{i,1}}{2} \cdot LP_{i,0} + \frac{LSH_{i,0}}{2} \cdot LP_{i,1} - \frac{LSH_{i,0}}{2} \cdot LP_{i,0}$$

$$+ \sum_i \frac{LP_{i,1}}{2} \cdot LSH_{i,1} - \frac{LP_{i,1}}{2} \cdot LSH_{i,0} + \frac{LP_{i,0}}{2} \cdot LSH_{i,1} - \frac{LP_{i,0}}{2} \cdot LSH_{i,0}$$

$$LP_1 - LP_0 = \sum_i LSH_{i,1} \cdot LP_{i,1} + \sum_i LSH_{i,0} \cdot LP_{i,0}$$

$$^5 \frac{\Delta LP_t}{LP_t} \cdot \ln \frac{LP_{i,1}}{LP_{i,0}}$$

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THE MAIN METHODS OF TEMPORAL DISAGGREGATION

*Elona Dushku**

Key words

- Time series - Temporal disaggregation - Gross Domestic Product -

1. INTRODUCTION

Many time series are observed only at a low frequency (for example, annually), while most of the economic analyses study the behavior of the economy in the short run, increasing in this way the requirement for high frequency data. The process of deriving high frequency data from low frequency data is usually referred to as temporal disaggregation. The use of temporal disaggregation techniques by the statistics institutions is a practice, well known in many states. These techniques play a fundamental role, particularly in compiling quarterly national accounts.

The final aim of temporal disaggregation techniques is derivation of high frequency data and obtaining quarterly estimates even when the annual data may not yet be known. These temporal disaggregation techniques use all the available information in the best possible way, within a given model, guaranteeing that the high frequency information is coherent with the low frequency data.

Estimating the components of GDP is another important field in which temporal disaggregation techniques are intensively

applied. Nowadays, different countries estimate monthly indicators as well using all the available information and also guaranteeing consistency with the quarterly data.

This paper is organized as follows: section 2 describes the main methods of temporal disaggregation; section 3 presents the disaggregation of GDP in Albania and section 4 concludes.

2. ALTERNATIVE METHODS OF TEMPORAL DISAGGREGATION

Different studies have shown that there exist a number of techniques which can be classified as follows:

- Methods that do not use high frequency indicators to disaggregate data

This category includes methods which derive quarterly estimated from annual data based on purely mathematical criterion, providing smoothed quarterly series related to annual data. These methods can be used when there is missing information on the series to be disaggregated.

- Methods that make use of related indicators with high frequency to disaggregate data

These methods use all the available information from other indicators with high frequency to disaggregate the series.

Despite what method is used to disaggregate the series, all methods should take in consideration some main principles:

1. The model should include those statistical variables with high frequency, which are considered as good proxies of the aggregates to be estimated.
2. The set of basic information should include only variables associated with the economy of the country for which the quarterly estimations are compiled.

3. The mathematical and statistical models should not include any relationships between quarterly aggregates of different countries, except those regarding international relationships.

While, the estimations from the disaggregation methods should fulfill the below listed characteristics:

First: Time consistency

The sum of quarterly values of GDP must be equal to the annual value.

Second: Coherency

The sum of quarterly values of the GDP components should be equal to the corresponding quarterly value of GDP.

The processes of temporal disaggregation of annual data may be described as one of the below processes:

Distribution: when the annual data are either sums or averages of quarterly data (e.g. GDP, consumption, in general all flow variables, price indexes, etc).

Interpolation: when the annual value equals the value of the fourth quarter (e.g. population at the end of the year, money stock and in general all stock variables).

Extrapolation: when estimates of quarterly data are made as the relevant annual data are not yet available and not necessary the sum of quarterly value equals the respective annual value.

Based mainly on residual modeling we classify temporal disaggregation methods as following groups:

- smoothing methods;
- two-steps adjustment methods;
- time series methods;
- optimal methods;
- dynamic model methods.

SMOOTHING METHODS

These methods are usually based on purely mathematical techniques and are used when there is a lack of high frequency information.

Smoothing methods assume that the unknown quarterly trend can be described as a function of time. These techniques minimize the discrepancy between known annual values and quarterly estimations. Boot, Feibes and Lisman (1967) are the first authors that have used smoothing methods as temporal disaggregation techniques.

TWO-STEPS ADJUSTMENT METHODS

These methods take in consideration all the available information from quarterly indicators which is used as a dynamic path of quarterly estimated series. The two steps adjustment methods divide the process on compiling the data in two parts.

The first step consists of a preliminary estimation of quarterly data. These estimations can be provided directly or indirectly. Different tests have indicated that preliminary quarterly estimates are not accurate, as in general do not fulfill the main characteristics of time consistency and coherency.

The second step makes the adjustment of the preliminary estimations by distributing the discrepancy between annual data and the preliminary estimates. After the adjustment process, the estimated data have the same characteristic with the annual data.

One of the adjustment methods is that implemented by Denton (1971). In this procedure the final quarterly estimates are obtained by minimizing a quadratic loss function, which involves the preliminary estimates. A simple adjustment rule is "dividing by four" of discrepancy between the annual value and the sum of the preliminary estimates. However, this method is not advisable because it can create an unjustified discontinuity

between the estimate for the fourth quarter of one year and the first quarter of the following year.

TIME SERIES METHODS

Time series methods can be used when there is a lack of information and also as optimal adjustment methods. These techniques take into account the time series approach and to interpolate and extrapolate the data are based mainly in ARIMA models. Time series techniques include not only all the available information obtained from quarterly indicators but also dynamic elements of aggregated series.

Time series methods are particularly useful in situations with lack of quarterly information. They can be used to produce forecasts within the year, if quarterly time series related to the annual indicator are missing. This characteristic derives from the time series nature of the estimation process.

The time series methods were first presented by Wei and Stram (1989, 1990), who based their techniques on the relationship between covariance of the aggregate and disaggregate model.

In 1989 AL-Osh used a state space model for the ARIMA approach, which takes into account the characteristics of annual series to derive quarterly estimations. The estimated vectors and the corresponding covariance matrix are obtained by using the Kalman Filter procedure.

OPTIMAL METHOD

Optimal methods merge the steps of preliminary estimation and adjustment process in one statistically optimal procedure. This can be done using all available information from annual and quarterly data in a statistical regression.

The main characteristic of these techniques is the ability to evaluate the errors covariance matrix. The optimal estimation approach offers a natural and coherent solution to the

disaggregation problem. The new estimated data of quarterly series are directly compiled from the quarterly regression model.

The technique proposed by Chow and Lin (1971) is the most intensively used in National Statistical Institutes to disaggregate the data, especially in France and in Italy. Different versions of these techniques have been developed according to the different hypotheses related to the structure of the error in the regression model. The main error models are classified as follows:

- AR (1) model (Bournay dhe Laroue, 1979).
- Random walk model (Fernandez, 1981).
- Random walk- Markov model (Litterman, 1983, Di Fonzo, 1987).

The first model supposes that residuals follow an AR (1) process and are generated from the first condition of Markov process. This technique is based on the assumption that there is no correlation between series and it is appropriate when the series of residual are stationary.

In 1989 Fernandez proposed another method, which assumes that residuals follow a random walk distribution:

$$u_{t,i}^* = u_{t,i-1}^* + \epsilon_{t,i}^* \quad (1)$$

where: i presents the quarters and t the year, $u_{t,0}^* = u_{t-1,4}^*$ and $\epsilon_{t,i}^*$ is white noise with σ^2 variance and as a first condition, Fernandez supposes that $u_{0,4}^* = 0$,

The assumption made by Fernandez, improves the technique proposed by Chow and Lin, but this assumption is very specific for the behavior of residuals because it implicates the presence of a filter, that should eliminate the correlation of residuals of quarterly series.

In 1983 Litterman, showed that this filter can not eliminate all the correlation between the series, so he assumed that residuals can be described with the downward equations.

$$u_{t,i}^* = u_{t,i-1}^* + \varepsilon_{t,i}^* \quad (2)$$

$$\varepsilon_{t,i}^* = \lambda \varepsilon_{t-1,i}^* + \varepsilon_{t,i}^* \quad (3)$$

where: $\lambda < 1$ and $u_{0,4}^* = \varepsilon_{0,4}^* = 0$

DYNAMIC METHODS

Dynamic methods are an extension of optimal methods, but also include dynamic elements in the estimation. They take into account the impact of related indicators in the short run, and also their past impact on the variable we want to estimate.

According to Mazz and Savio (2005), the main difference between the above mentioned methods is the assumption used for the errors' distribution.

In general, the disaggregation methods can be described as below:

Let $y_{4(t-1)+i}$ be the unknown quarterly value of the aggregate in quarter i of the year t , and let y_{at} be the correspondent known annual value where $t = 1 \dots n$.

When disaggregating, the relationship between y and y_a can be written as:

$$y_{a,t} = \sum_{i=1}^4 y_{4(t-1)+i}, \quad t=1, \dots, n \quad (4)$$

The relationship between the quarterly series and the annual figures can be reformulated in a matrix form as presented below:

$$y_a = By \quad (5)$$

where y is a vector with dimensions $(N \times 1)$ of the unknown quarterly values and y_a is a vector with dimensions $(n \times 1)$, which

includes annual values of the series to be disaggregated. N is usually equal to $4n$, however in the case of data extrapolations $N = 4n + q$, where $q > 0$ after over sample estimations are obtained using annual figures. B is a matrix with dimensions $(n \times N)$, where its form depends on the disaggregation we want to consider:

$$B = \begin{bmatrix} c & 0 & \dots & 0 \\ 0 & c & \dots & 0 \\ \cdot & \cdot & \dots & \cdot \\ 0 & 0 & \dots & c \end{bmatrix}$$

where:

- $c = (1 \ 1 \ \dots \ 1)'$ for flow variables in the disaggregation process
- $c = \frac{1}{4}(1 \ 1 \ \dots \ 1)'$ for indexes in the disaggregation process

3. ALBANIA'S CASE

Data are considered as an important source of information on different economic indicators. They provide information on annual developments of the indicators but also on their fluctuations. Institute of Statistics (INSTAT) is the main institution which collects and calculates statistical indicators in Albania. The main indicators, which are published by the INSTAT, may be divided into two main groups: economic indicators and social indicators. The social indicators provide information on social and economic life evolution of the Albanian economy, while the economic indicators provide information on the performance of the whole economy.

However, time series in Albania are short and with low frequency. Most of the problems relate to the real sector of the economy, such as GDP which is published on annual basis with a time delay.

The above mentioned techniques showed that annual figures of national accounts may be disaggregated to higher frequencies if we have additional information related to the original series, and information on other indicators of the same economic environment, given that they are affected by the same factors. Below, we will present a first attempt to obtain quarterly GDP figures for the period 1996-2006 using the method of two-steps adjustment presented by Denton (1971).

The first step to disaggregate the data is determining the indicators to be used as the main forecasters for our series. There are two ways of determining the indicators:

1. Economic Intuition

To disaggregate GDP we may use its components: Consumption, C; Investment I, Government expenditures G and Net exports NX. The method of disaggregating GDP through its components is good, as it takes into account the characteristics of a small open economy like Albania, the business cycles of our country and that of foreign partners. Data on exports, imports and government expenditures may be provided on monthly basis but the other components are not only available on annual basis, but also estimated as residuals. According to this method, we should determine high frequency indicators for these components which will serve as forecasters of their development. Another alternative method is to use the total volume of sales in the economy as a whole or that of the sectors, which is an indicator widely used in countries such as France, Italy, Malaysia, etc.

2. Statistical Estimation

According to this method, we choose an indicator closely related to GDP based only on the statistical characteristic of the model, for example: the highest coefficient of determination R^2 , the lowest standard deviation, no autocorrelation, and no heteroskedasticity, etc.

To disaggregate GDP we use two different indicators, M3 and total volume of sales. We choose these indicators for a number of reasons:

The aggregate M3 is chosen instead of M1 and M2, because its relationship with the GDP has the highest R2 (0.98), Durbin-Watson=1.43 and the lowest standard deviation. We also know that monetary aggregate M3 includes all the currency outside banks, demand deposits and time deposits in domestic and foreign currency. Given that interest rates of deposits denominated in foreign currency are not affected by the politics of the Monetary Authority, the Bank of Albania, this indicator is more suitable for disaggregation purposes than M1 and M2. A good example of using the monetary aggregate is Chile, which uses State space model and Kalman Filter technique, as one of the most advanced methods.

On the other side, we choose total volume of sales as it serves as a good forecaster of the total production in a given period. This indicator is on quarterly frequency and is also used in many countries. Below we present the GDP disaggregation for Albania.

Data on monetary aggregate M3 are provided by the Bank of Albania for the period 1996Q1-2006Q4. After we aggregate quarterly M3 to annual figures, it shows that there is a strong positive relationship between M3 and GDP with a correlation coefficient of 0.98. The regression between GDP and M3 is given below:

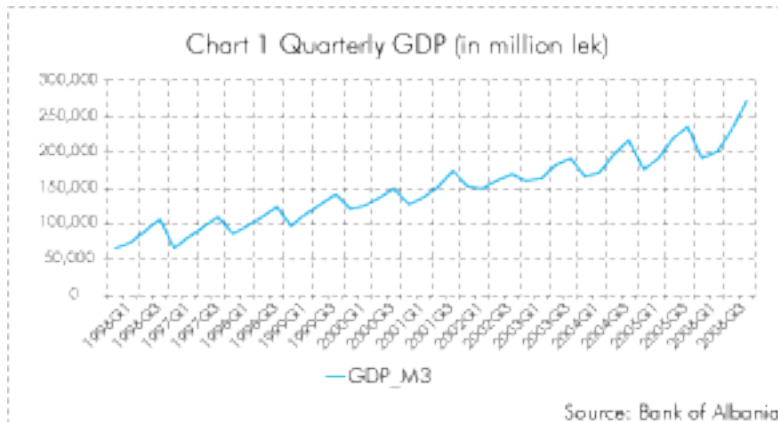
$$\text{GDP} = c(1) + 1.15 * \text{M3} + \epsilon_t \quad (6)$$

$$t\text{-stat} (9.59) \quad (31.14)$$

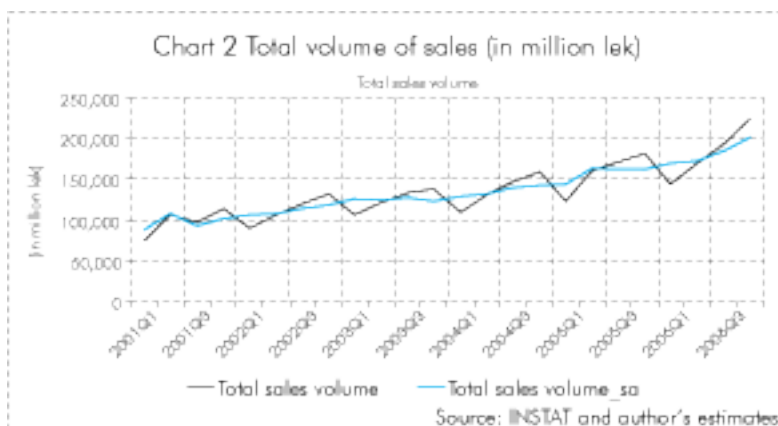
where: R2 = 0.98, D-W= 1.43, ϵ_t is the residual and c(1) a constant.

The preliminary results of the quarterly GDP are adjusted by the residuals generated by the method of Denton of "dividing by

four". The final results are given in Chart 1. The estimations are consistent because the sum of the quarters adds to the annual figure of GDP for the representative year.



The same procedure is applied for total volume of sales, which gives the absolute value of sales of the main sectors of the economy for each quarter. The series is provided by INSTAT for the period 2001Q1-2006Q4. A graphical representation of the quarterly figures for total volume of sales (Chart 2) shows that the series is seasonal. Therefore, we use two series of sales to disaggregate GDP, one with seasonality and the other seasonality adjusted with Tramo/seats method.



After aggregating both series of total sales in annual figures, we find that there is a strong positive relationship of this indicator with the GDP, which is reflected in the high correlation coefficient (0.98). The models are given below:

Model with unadjusted total volume of sales

$$\text{GDP} = c(2) + 0.92 * \text{Sales} + \mu t \quad (7)$$

t-stat (9.28) (20.58)

Where: $R^2 = 0.98$, $DW = 1.59$, μt errors and $c(2)$ is a constant.

Model with adjusted total volume of sales

$$\text{GDP}_{sa} = c(3) + 0.93 * \text{Sales}_{sa} + vt \quad (8)$$

t-stat (9.39) (21.17)

where: $R^2 = 0.98$, $DW = 1.64$, vt errors and $c(3)$ is a constant.

After obtaining the preliminary results and adjusting them, we derive the quarterly figures of GDP with and without seasonality. Even in this case, the sum of the quarters adds to the annual figures of GDP of the respective year. The results are presented in the chart below.

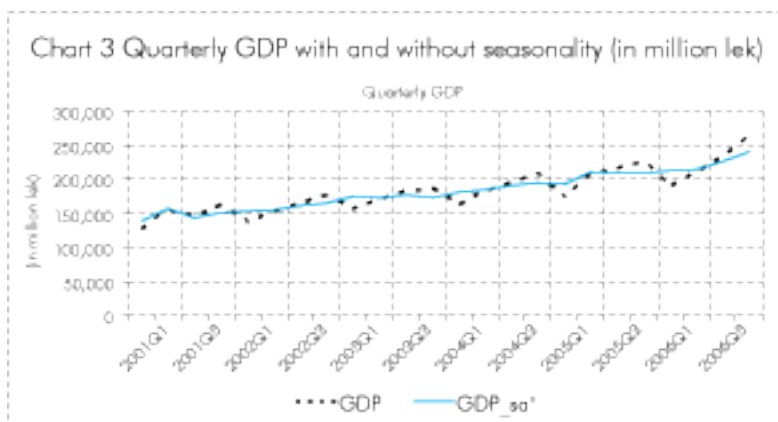


Chart 4 presents quarterly GDP obtained from the above mentioned models. We note that the series generated from M3 and un-adjusted volumes of sales indicate almost the same patterns and trends on different quarters, showing the same cyclical developments of the Albanian economy. On the other side, GDP series disaggregated with the total volume of sales, adjusted with the seasonality has the same trend as the other series, but it is smoother. Also, it is important to note that quarterly GDP estimations are both time consistent and coherent.

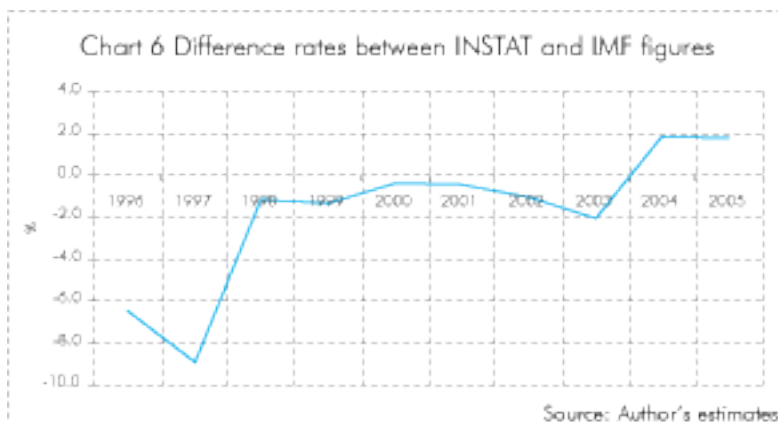
One of the main disadvantages of the two-steps adjustment method presented by Denton is the discontinuity between the fourth quarter of a given year and the first quarter of the following year. This drawback is not reflected largely in the case when the total adjusted volume of sales is used. The results of GDP quarterly estimations are presented in table 1.



The quarterly estimations of GDP are compared with the estimations of IMF. Chart 6 indicates the development of GDP derived from M3, total volume of sales and IMF estimations.

The above figure indicates that the IMF estimations are relatively close to the series derived from total volume of sales seasonally adjusted. During 2004-2006¹ the quarterly series of IMF is lower than our estimations because the annual figures of GDP published by INSTAT differ from those of the IMF. Chart 7

presents the difference rates between annual GDP estimated by IMF compared to annual figures published from INSTAT for the period 1996-2005.



4. CONCLUSIONS

The process of data disaggregating is important and indispensable in case of missing information. This process is useful to derive long time series, estimate unknown figures and improve short term economic analysis. Many methods can be used to disaggregate annual series and are related to the available information on a given variable. In this paper, we

present a first attempt to generate quarterly GDP figures from two series, M3 and total volume of sales. Both models have high determination coefficient $R^2=0.98$, thus 98 percent of GDP variation can be explained by M3 or total volume of sales. The models have also satisfactory DW figures. Given that the annual number of observations used in modeling is low and differs between the two cases, it is hard to compare their performance. However, the results may be considered as satisfactory for the first phase of GDP estimation, given that the series are short and do not allow further testing. As future research, it is important to generate quarterly GDP data using other disaggregation methods, high frequency information, longer time series and other software packages such as ECOTRIM, RATS etc.

ANNEX

Table 1 Quarterly figures of GDP (in million lek) derived from M3 and total volume of sales

Years	GDP_M3	GDP_Sales	GDP_Sales_SA
1996Q1	65,972		
1996Q2	74,463		
1996Q3	89,044		
1996Q4	107,129		
1997Q1	66,337		
1997Q2	81,734		
1997Q3	95,426		
1997Q4	110,144		
1998Q1	85,965		
1998Q2	97,143		
1998Q3	110,170		
1998Q4	123,730		
1999Q1	97,382		
1999Q2	114,909		
1999Q3	126,657		
1999Q4	141,633		
2000Q1	121,290		
2000Q2	124,949		
2000Q3	137,196		
2000Q4	149,542		
2001Q1	126,831	126,301	138,719
2001Q2	136,396	154,925	157,028
2001Q3	152,513	146,676	142,746
2001Q4	174,542	162,379	151,789
2002Q1	151,774	137,402	152,389
2002Q2	148,961	152,492	154,561
2002Q3	160,878	165,047	160,226
2002Q4	169,725	176,397	164,161
2003Q1	159,836	157,471	174,848
2003Q2	164,076	171,148	173,006
2003Q3	181,754	182,204	176,275
2003Q4	191,284	186,128	172,820
2004Q1	166,229	162,960	181,213
2004Q2	171,817	182,496	184,984
2004Q3	197,815	197,388	191,422
2004Q4	216,507	209,524	194,749
2005Q1	175,345	172,028	192,550
2005Q2	192,220	207,565	210,702
2005Q3	219,458	216,227	209,323
2005Q4	235,012	226,216	209,460
2006Q1	192,072	188,602	213,090
2006Q2	201,567	211,511	215,028
2006Q3	231,412	234,538	226,925
2006Q4	271,249	261,649	241,256

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Opinions expressed in this paper are those of the author and do not necessarily reflect the official opinion of the Bank of Albania.

¹ We have used preliminary estimation of IMF for annual value of 2006.

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