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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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RURAL FINANCIAL INSTITUTIONS AND FINANCING RURAL ECONOMIES

*Drini Salko**

1. INTRODUCTION

Rural producer's capacities to receive additional financial resources during transition are confronted with many restrictions of negative effects on output, farm restructuring, and investments to be made. These limitations are a result of mixed factors deriving from the expensive and deficient information on rural financial markets and a result of a number of specific problems incurred during transition. An effective rural financial market plays an important role in the development and growth of rural productivity. This implies building a financial market to meet the typical functions of market economy. Mobilizing and allocating resources without governmental interference and building an institutional framework to provide funds in compliance with the demand is also important.

Among both capital resources, domestic and foreign, the domestic ones are the most important element. In the majority of low-income countries, domestic funds represent a considerable part of investment resources. One of the main monetary resources to cover a considerable part of rural financing are also the savings of this sector.

2. AN OVERVIEW ON RURAL FINANCIAL MARKETS AND OPERATING INSTITUTIONS

Transition countries are mostly confronted with two challenges: first, is that the financial sector needs to be radically reconstructed by a governmental instrument which would collect savings and distribute funds through enterprises in a totally independent financial system capable of performing its functions within a market economy. And second, its regular functioning is a precondition for reorganizing and modernizing farmer economies and their efficiency. Information asymmetry is a characteristic of rural financial markets. This means that while performing a credit transaction, the borrower is well aware of his willingness and ability to repay the loan on time.

The credit institution, on the other side, does not know the real intentions of the borrower or whether he may change opinion after receiving the loan. In these circumstances, the risk exposure is high. The low profitability of farms is another problem of rural financing that restricts their ability to repay the debt. On the other hand, collateral commitments play an important role in the farmers' potentiality to ensure additional financing resources. In transition economies, collateral requirements from financial institutions to receive rural lending have been frequently high due to transitory factors such as: deficiencies in ownership entitlements, the lack of land markets, high inflation and insecurity, etc.

In addition, banks frequently refuse rural land as committed collateral even when ownership entitlement is complete and this is because of the lack of a rural market. This has enforced the establishment of appropriate institutional models to better manage the above risk and be better adopted in rural financing. Many governments use specialized rural banks as their core instrument to credit this sector. In most cases, the clients consider these institutions as pseudo-governmental and loans received by them as government subventions, not as business contracts. In these cases, rural banks continue to be government instruments that subsidize farms and the results are not so satisfactory[1].

2.1. BANKS AND FINANCING RURAL ECONOMIES

The reformation and the development of the Albanian banking system aims at providing support through bank products and services to various sectors of the economy. Credit applications by private farmers for financing inputs (chemical fertilizers, seeds, pesticides, etc) and mechanical appliances have been and continue to be ever large and growing. Rural credit and the supply of financial services have been largely suppressed by the bank incapacity to respond to the growing credit demand from the new private sector.

In spite of the fact that for rural financing there was a specialized institution as the Rural Commercial Bank (RCB), we may say that this institution did not work properly to support agriculture.

The incapacity of the Rural Commercial Bank to extend credit is shown in two aspects:

The first lies with the bank incapacity to meet credit demands of small farmers. This was because the RCB operated on commercial principles and as already known, the cost of managing credit to this large number of small clients was high. In addition, credit rates made credit cost be high as well.

The second lies with the limited extension of rural credit from the RCB. If we refer to structural data on the structure of credit by entity, we see that other sectors, such as trade, construction, etc) share a considerable part.

As of end 1996, RCB's outstanding credit structure indicates that credit activity and construction share 64 percent. Extended credits either by the RCB own funds or by other project funds financed by donors and channeled through the bank in most cases do not apply to economic activities of farmer economies. The deficiency of extending credits to the rural sector is reflected in the very high level of non-performing loans. As of end 1996, non-performing loans of three state-owned banks shared about

33% of total loans extended. The 1997 crisis deepened further this negative indicator.

After the '90s, in their effort to be provided with commercial loans, private farmers have used funds borrowed from moneylenders, friends or other relatives as additional financial resources.

According to the survey conducted over years 1993-1994, in 25 out of 36 cities, only 2 percent of 648 farmers resulted to have used bank loans. Amongst the difficulties pointed out by them for receiving bank loans are: high credit rates, the bureaucracy in procedures, the short-term maturity, etc. A considerable number of farmers have used loans granted from relatives or businessmen.

Besides the expansion of commercial banks (private ones), year 2000 was characterized by a strong growth of credit to the economy. Macroeconomic stability, the increased domestic safety, and the improved investment climate made banks raise rates of credit to the economy. Almost all banks, based on their policies, were interested in lending to medium and large-size businesses. Even those banks that have lending to small businesses in the core of their policy (such as the FEFAD Bank), focused their attention on the urban area clientele, denying credit extension to farmer economies. The very few credits extended in this sector covered agro-foodstuffs and the establishment of greenhouses.

A bank that has recently started to extend loans to agriculture is the "American Bank of Albania". However rural area clients of this bank are at a very restricted number and mainly operate in low western areas (where the most specialized farmers are situated in).

Amongst the main factors of banks' non-lending to farmer economies are:

- The commercial banks' lack of institutional capacity, as a result of the high cost of small credits. Banks consider the

activity of farmer economies as small business and lending to them as costly, consequently.

- The farms' small capacity and their insufficient income impede the absorption of formal investments in rural sector and other sectors related to it.
- The relatively high interest rates (due to the very high credit risk premium) are another factor. Small farmers can not repay commercial term credits provided by the banks. This results from the current practice and from the conclusions drawn from the survey on the budget of the farm.
- Banks do not engage in rural credits for they consider farms as not so stable and consistent activities. This is an aftermath of farmer families' moving tendency toward urban areas.
- Small farmers frequently lack collateral to meet commercial bank claims. The non-functioning of land market is a relatively large bar to crediting, as land is not yet preferred to serve as collateral by banks.
- The lack of bank infrastructure in the rural sector of economy is reflected in the non-extension of banking business in this sector of economy. The only bank to have a wide spread on the entire territory is the Savings Bank. This bank has stopped credit to economy as it is under the stage of restructuring and preparing for privatization. All other banks mainly operate in Tirana and it is only in the last two years that they have started to expand their credit activity to some other principal cities of the country.

2.2. ESTABLISHING MICRO-FINANCE INSTITUTIONS, AS VILLAGE-BASED ALTERNATIVE TO SUPPORT FARMER ECONOMIES

Banks' disinterest in financing farmer economies and the structural transformations of the rural sector as a result of the economic reforms made the establishment of rural financial institutions a necessity. One of the most effective institutional models represented by credit co-operative is nominated the

Savings and Loan Association (SLA) in our country. Their experience has been mostly successful. In Romania for example, the co-operative banks have been successful in providing credits to small private farmers. In Bulgaria a mutual fund program for agriculture developed with the help of EU Phare program. In Albania, the Albanian Development Fund and its rural component today, the Rural Financing Fund (RFF), have been successful.

The experience of transition countries is different. In Russia for example, the efforts to establish credit co-operatives did not bring the expected effect.

The establishment and running of these new financial institutions in the rural sector also reflect the various models of farm structure. The latter in many transition economies vary in size from very big to very small ones (table 1). This may require different institutions. Large farm applications for credit can be covered by commercial banks. On the other hand, small farms' credit demands, having higher transaction and financial intermediation costs can be better served by the credit co-operatives. In Hungary, Poland or Romania similar institutions are already functioning and have the tendency to expand.

Table 1 Rural Individual Indicator (RII) in some countries, year 1995[2].

Country	RII	Country	RII
Albania	94,2	Czech Republic	22,1
Armenia	81,8	Hungary	17,3
Latvia	80,2	Belarus	15,2
Romania	55,2	Ukraine	14,1
Bulgaria	45,4	Russia	12,1
Estonia	37,5	Slovakia	3,1

Source: Mathijs, E. and Swinnen, J. (1998) "Economic Development and Cultural Change".

It is noted that individual farms dominate the Albanian agriculture, a direct outcome of the economic reform in this sector. Rural land distribution to farmers has been a relatively rapid process in Albania. This resulted in the establishment of an extensively large number of small farms, around 380,000, with an average land area from 0.5 to 1.8 hectares per farmer family, divided into parcels. This indicator makes most clear the necessity for SLAs to operate in the Albanian economy, as an

adequate financial institution for this structure. These micro-finance institutions may mobilize the savings of this sector, using them for its development.

3. THE ROLE OF RURAL FINACING FUNDS. THE ESTABLISHMENT OF THE SLAs

The rural sector in our country during these years has provided additional financing from some resources. Here are included loans extended by the former-Rural Commercial Bank, from the international institutions (various credit funds from donors and development projects), as well as individual lenders (informal sector). The Rural Credit Project previously implemented by the Albanian Development Fund and currently by the Rural Financing Fund is the eldest project with the broadest spread in rural areas of the country. This program started to operate in the framework of the Poverty Reduction and Growth Facility, which aimed to relieve the transition period for the poor farmers. Later it turned into a micro-finance program. The program offered a new credit system based on the collaboration between two chains: the credit board of the village (CBV) and the credit officer. This program extended small loans to farmers who could not be supported with bank loans. Besides that, farmers and the CBVs were trained.

Credit extension is based on clear and well-understood criteria, on the borrower's capacities to repay the loan, investment potentialities, customer capacities and confidence, etc. This project adopted credit schemes based on the farmers' applications for small credits corresponding to the appropriate level of the farm. Credit ceiling, from some hundreds of US dollars extended at the early process is currently at $ 2 000, and credits are granted for a period of up to 3 years. In specific cases may be extended credits up to US$ 5,000.

The areas of intervention during these years have been the districts of Elbasan, Tirana, Vlora, Kruja, Gramsh, Peshkopi, Kukës, Pukë, Has and Tropojë.

For a long time, the main activity for using credits has been live animals. This fact related to the areas where the Rural Financing Fund extended its activity, to the credit amount and the emergency needs of rural families. It is ever-increasingly being evidenced a changing ratio in credit financed activities. To this period, 53.38 percent of the credit amount is used for live animals, while the cumulative average is 61.69 percent. Thus, it noted a falling tendency of credit use for live animals in the favour of other activities, such as green houses, trade, mechanical appliances, handicraft, etc, which are more profitable activities that significantly influence the development of farmer economies.

The extension of new villages around the cities and the growing interest to perform investments changed the credit demand, in terms of amount, term duration and the type of financial activities. Credit extension above ordinary ceiling was experimented to meet the demand and the project targets. Only in 1999 were extended 27 credits, from Lek 300000 to 500000.

Besides the average credits extended during this term (Lek 94462), the average credits increased by 20 percent compared to the average extended in 1998 (Lek 78940). This tendency went on, prudentially, since the credit guaranty is only moral, practically.

Based on what was mentioned above, the World Bank in agreement with the Albanian Government approved in early 2000 the financing of a new project, whose strategic target was the achievement of financial stability and the transformation of the existing rural micro-credit program into a stable institution that would progressively become self-financing.

The main objective of the new RFF project is to establish a SLA network and support the progressive development of their union in consistency with the current law on SLAs and based on the current system of RCF (rural credit funds, an NGO), as well as to expand the area of rural credit intervention, by expanding

the network in low land and coast areas as well as by expanding the range of financial services provided to farmers.

The project will support the transformation of the RCF into a stable system based on SLAs. The SLAs are organizations that will aim at extending loans to and collecting savings of members affiliated in. SLAs will have a larger democracy, autonomy and responsibility than RCFs. Being member-owned and capitalized organizations, SLAs will have a strong initiative to maintain the financial stability and to minimize the risk of non-performing loans. Many duties, actually performed by the Rural Financing Fund will be progressively shifted to SLAs, after they have obtained the required training and a greater autonomy and maturity. After a maximum period of 3-years, SLAs will be sustained to establish their union.

The establishment of a SLA network will be realized in two ways:

First: establishing SLAs through RCF's transformation into SLAs. The RFF, acknowledging and managing this experience, will play a very important role in putting this transformation into place. The acquired experience of co-operation and the capitalization capacities are good premises for achieving the establishment and functioning of these institutions. In addition to the technical assistance, the RFF extends credits of 11 percent rate to SLAs, which the latter extend to their members at 15 percent (the resulting spread covers their operational expenditures). Upon SLAs consolidation and capitalization and the establishment of their union, these institutions intend to become autonomous from the RFF. At the end of 2000, through this transforming mechanism, were established the first 18 SLAs which are still at the phase of consolidation. At the end of 2000, farmer economies have received RFF loans to US$ 1.8 million, out of which 300,000 are SLA loans and the rest are loans to cover current operational areas of the RCF. What is important is that through SLAs the farmers have the possibility to receive a larger credit amount (the current amount is up to US$ 5,000), being ever-increasingly oriented toward financing for investment

purposes. Some indicators of the RFF activity are provided in the following table:

Table 2 RFF operation indicators, in USD (US$ 1 = Lek 140,0).

	31.12.1999	30.06.2000	31.12.2000
Indicators			
Number of SLAs' members	0	112	505
Number of established SLAs	0	5	18
Number of SLAs in process	0	9	3
Outstanding loans	2 694 144	2 958 954	2 673 760
Number of active assets	5 754	5 415	4 423
Average loan amount	468	534	605

Source: RFF, Annual Report for 2000.

Second: Establishing new SLAs. If the first way presupposes the outside village alternative combined with that of the farmers, the second way is more original and is based only on farmers' initiative. This process is already at its first steps in our country[3].

Establishing new SLAs is another way that assumes special significance, considering also the deficiencies of the first way. In addition, from the economic analysis of the farmers' budget, it results that in perspective development areas, the savings capacity and the ability to repay the credit is higher. On the other hand, these areas have a better infrastructure and may be considered as urban areas or in the vicinity of urban centres. The establishment of new SLAs in these areas gains priority even for the fact that the rural population of these areas there are less premises or willingness to displace toward big cities. Until end 2000, with the technical assistance of the RFF were established three SLAs in the rural areas. From gross or monetary income analysis, it results that farmer families of these areas have higher incomes. Such areas are believed to include those village groups that encircle urban areas with micro-towns such as Vorë, Maliq, Milot, Divjakë, Novoselë, etc. The latter will serve as residences for SLAs' headquarters. On the other hand, this will help the increase of banking services provided to farmers. SLAs may be best and quickly established in those areas where co-operation is better developed. Similar farmer organizations that co-operate in marketing trade, etc., though few in number, do already exist. It is extremely important for

the establishment of the first SLAs to be successful, since our farmer first would like to see the example and then act. The establishment of new SLAs represents the only way for financing farmer economies of these areas, considering that the banking reform is creating a gap of financial services in the village areas.

The current established network of rural SLAs, including similar institutions established with the support of other projects, has reached 30. This is the reason why the review of the relevant legal framework has turned into an emergency. The changes proposed by the Bank of Albania in relation to the supervision of these institutions are of primary importance. The draft-law on SLAs, drafted with the participation of the Bank of Albania, is now in its final stage and expected to be passed by the Parliament. The speeding up of procedures for its approval is important considering that these institutions are beginning to mobilize the savings of their members.

Conclusions:

The banking system deficiency, which led to the liquidation of the Rural Commercial Bank, has also led to a paradox situation: Although Albania is a rural country, there are no institutions specialized in rural financing.

The current situation requires the establishment and functioning of financial institutions specialized in rural areas. As the most adequate model, we propose the establishment and functioning of credit co-operatives or otherwise called savings and loan associations. Only these institutions can establish a micro-credit system for the Albanian farmer.

Establishing new SLAs in rural areas with a clear developing prospective will include villages in the vicinity of urban areas or small towns with rural orientation. The best areas for establishing new SLAs are those where farmers' associations are created. In my opinion, it should represent the first example for establishing the SLAs.

In the next 2-3 years SLAs may be extended only in local level. When consolidated, this SLAs' network will naturally require the establishment of the first SLA unions and their final shifting into the most organized form, assuming all the features of an institution or a financial intermediary which will be subject to the legal, regulatory and supervisory framework of the banking system.

NOTES

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[1] As already known, the decision for the liquidation of the Rural Commercial Bank was taken after the deterioration of its credit portfolio.

[2] RII indicator measures the change from state-owned and collective farms to individual farms. It is measured as RII= (In 95-In89)/ (100-In89)(100), where In95 and In89 represent the share that individual farms occupy in the total of rural land for years 1995 and 1989, respectively.

[3] Although newly established SLAs, 5 SLAs have been established in the rural sector.

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APPLYING CORE PRINCIPLES OF BASLE COMMITTEE FOR AN EFFECTIVE SUPERVISION

Miranda Ramaj*

Governors of central banks from G10 group countries established at the end of 1974 the Basle Committee, as a body intended to make banking regulations and organize supervision practices. This committee does not have a supervisory authority and its conclusions do not have any legal power. The committee formulates broad supervision standards, prepares guidelines and recommendations for the best practices that individual authorities may apply in their national system.

The main target of the Basle Committee on banking supervision is:

'No foreign banking establishment should escape supervision; and supervision should be adequate'.

Weaknesses in the banking system of a country, whether developing or developed, can threaten the financial stability both within that country and internationally. The need to improve the strength of financial systems has attracted growing international concern. On this basis, the Basle Committee has prepared a document called 'The core principles for effective banking supervision'.

In developing the Principles, the Basle Committee has worked closely with non-G10 supervisory authorities. The Basle Core Principles comprise twenty-five basic Principles that need to be in place for a supervisory system to be effective. The principles relate to:

- Preconditions for effective banking supervision;
- Licensing and structure;
- Prudential regulations and requirements;
- Methods of ongoing banking supervision;
- Information requirements;
- Formal powers of supervisors;
- Cross-border banking.

These principles are minimum requirements that are implemented according to particular conditions of a relevant country in spite of its development level.

In drawing up these core principles for effective banking supervision the following precepts are fundamental:

- The key objective of supervision is to maintain stability and confidence in the financial system, thereby reducing the risk of loss to depositors and creditors;
- Supervisors should encourage market discipline;
- Supervisors must have operational independence and legal power to gather information and the authority to enforce its decisions;
- Supervisors must understand the nature of the business undertaken by banks and ensure that the risk incurred by banks are being adequately managed;
- The risk profile of individual banks should be assessed and supervisory resources allocated accordingly;
- Supervisors must ensure that banks have resources appropriate to undertake risks, including adequate capital, sound management, and effective internal control systems; and
- Close cooperation with the supervisory authorities of other countries is essential.

The Bank of Albania, in implementing its role of supervising the banking system has drafted a set of prudential regulations. Commercial banks are required to implement these regulations in order to reduce the risk they undertake while exercising their activity.

In drafting the regulatory system, the Supervision Department of the Bank of Albania is based on the international experience and also on 25 core principles for an effective supervision of the Basle Committee.

Treating the core principles of banking supervision, we will analyze their implementation in the legal and regulatory system of the banking supervision.

PRECONDITIONS FOR EFFECTIVE BANKING SUPERVISION

PRINCIPLE 1

An effective system of banking supervision will have clear responsibilities and objectives for each agency involved in the supervision of banking organisations. Each agency should possess operational independence and adequate resources. A suitable legal framework for banking supervision is also necessary, including provisions relating to authorisation of banking organisations and their ongoing supervision; powers to address compliance with laws as well as safety and soundness concerns; and legal protection for supervisors. Arrangements for sharing information between supervisors and protecting the confidentiality of such information should be in place.

The Law 'On the Bank of Albania', Article 12 clearly defines that the Bank of Albania is the responsible authority for the banking supervision:

'The Bank of Albania shall be exclusively responsible for the licensing and supervision of all banks in the Republic of Albania.'

The independence of this supervisory authority finds utterance in the Law no. 8269, dated 23 December 1997, 'On the Bank of Albania', where article 1, paragraph 3 states that: 'The Bank

of Albania shall be entirely independent from any other authority in the pursuit of its objectives and the performance of its tasks.'

Article 3 of the same Law defines the Bank of Albania objectives and responsibilities. Paragraph 4 of the same article asserts that: *'The Bank of Albania's duty is to license or revoke and supervise banks that engage in the banking business in order to ensure the banking system stability'*.

Hence, the legal framework of the Bank of Albania to successfully achieve the supervision of commercial banks is complete.

Legally sanctioned duties and responsibilities as well as international standards on bank supervision are vividly expressed in the Regulation 'On the Functioning of Supervision Department'. In addition 'The operational job manual' describes the responsibilities and objectives for each individual engaged in banking supervision.

This principle is further detailed in Article 41 of Law no. 8365 dated 2 July 1998 'On Banks in the Republic of Albania', which stipulates that: *'Banks or a foreign bank branches are subject to the supervision performed by Bank of Albania's inspectors'*.

In this context, to provide adequate regulatory support for the inspectors, the various adopted regulations concern bank and non-bank licensing, liquidity, the required capital, loan classification and provisioning, their open foreign exchange position, foreign exchange activity as well as market risks.

Article 44 of the Law 'On Banks in the Republic of Albania' envisages punishments and penalties as well as measures to be undertaken against banks or their administrators in case of legal infringement, violation of regulations or any other restriction found by the Bank of Albania's supervisors.

To fully apply this principle, it is required:

- The improvement and the completion of all regulations and operating job manuals with clear responsibilities and well-designed targets for everyone engaged in the department;
- Necessary legal changes to ensure the legal safety of supervisors.

LICENSING AND STRUCTURE

PRINCIPLE 2

The permissive activities of institutions that are licensed and subject to supervision as banks must be clearly defined, and the use of the word 'bank' in names should be controlled as far as possible.

This principle finds expression in Article 26 of the Law 'On Banks in the Republic of Albania' where the permissive activities of such institutions licensed as banks and subject to the Bank of Albania supervision are clearly defined. Article 6 (3) of this Law states: 'No person or entity will be permitted to use the word 'bank' or its derivatives, without being previously licensed by the Bank of Albania'.

PRINCIPLE 3

The licensing authority must have the right to set criteria and reject applications for establishments that do not meet the standards set. The licensing process, at minimum, should consist of an assessment of the banking organisation's ownership structure, directors and senior management, its operating plan internal controls, and its projected financial condition, including its capital base, where the proposed owner or parent organisation is a foreign bank, the prior consent of its home country supervisor should be obtained.

Article 2 of the Law, dated 2 July 1998 provides the definition for the terms, 'bank' and 'bank activity'; permitted for operation only on license granted by the Bank of Albania.

In chapter II (from Article 7 to 14) of the Law: 'On Banks in the Republic of Albania', the Bank of Albania is endorsed

exclusive authority on bank licensing. More specifically, Article 10 (2) of the Law provides the criteria for the Bank of Albania granting preliminary permission for bank licensing. In Article 3 of the same Law, it is stated that 'When the Bank of Albania decides to reject the preliminary license it explains the reasons for doing so'.

Chapter II of the same Law deals with the Bank of Albania's licensing authority and some general requirements further expanded in licensing regulations. Approved regulations on bank licensing include the Regulation 'On bank licensing in the Republic of Albania', the Regulation 'On granting a license to non-bank entities to exercise financial activity in the Republic of Albania' and the Regulation 'On compulsory requirements to be met by foreign bank and foreign bank branch administrators'.

Banks, foreign exchange bureaus and non-bank entities exercising financial activity are subject to Bank of Albania's licensing.

The regulation 'On bank licensing in the Republic of Albania' details the:

- The proposed banking organisation ownership structure, including the assessment of the shareholders' activity, their reputation, their financial condition and capital base to support the bank, if needed. The above regulation and the Law do not extend on the assessment of the shareholders' direct control, as required by the Basle Committee Principles;
- The proposed bank operating plan, its monitoring system and its internal structure. The operating plan includes the analysis and description of the market place the proposed bank intends to occupy, the activity it hopes to perform and its ongoing strategy. In addition, it describes the way the bank is managed and controlled.
- The information on bank directors examining whether they are morally and professionally appropriate or not. The licensing authority must be provided with sufficient information to assess the proposed bank's managing and

senior administrators' reputation, skills and experience. The regulation 'On the requirements to be met by foreign bank and foreign bank branch administrators' contains all the Bank of Albania's requirements for the assessment of any of the proposed bank directors or seniors.

- The financial project, including capital. The licensing authority must decide whether the bank has adequate capital to finalise the financial project suggested. The minimum capital adequacy, actually required by the licensing authority to perform banking activity, is Lek 700 million (or about US$ 5 million);
- The prior consent of the supervisory authority of the home country where the bank's shareholder is a foreign bank. When the owner is a foreign bank, Article 4.2.1 of the licensing regulation, specifically requires *'the prior consent from the respective supervisory authority for the financial activity of the head office of the foreign bank interested …'*

PRINCIPLE 4

Banking supervisors must have the authority to review and reject any proposals to transfer significant ownership or controlling interests in existing banks to other parties.

In Article 13 (2) of the banking law, the provided cases concern those cases when the granted license may be revoked. One of these cases included in paragraph (2) is when *'The owner of significant interests in the existing bank's capital has transferred or lost this right without the Bank of Albania's preliminary written consent….'*

In relation to the specification of Article 2 (e) of this Law 'significant or controlling interests' imply the direct or indirect possession of 10 percent or more of the joint-stock capital. As stated in Article 17 of the regulation 'On Bank licensing in the Republic of Albania', shifting significant ownership or controlling interests (10 percent or more) requests the delivery of the written permission by the Bank of Albania, after having observed the bank partners' consent, previously.

To grant a similar permission, the Bank of Albania requests from the proposed bank shareholder, the submission of the same documentation as in the case of approving preliminary consent for licensing.

PRINCIPLE 5

> Banking supervisors must have the authority to establish criteria for reviewing major acquisitions or investments by a bank and ensuring that corporate affiliations or structures do not expose the bank to undue risks or hinder effective supervision.

Bank's principal investments are permitted only based on legal restrictions of Article 30 and 33 of the Law 'On Banks in the Republic of Albania'. This principle finds application in the regulation 'On significant risks' where the maximum limits of bank exposure against a single or a group of beneficiaries are set. In the regulation 'On the participation of banks and foreign banks' branches in the commercial companies' capital', it is determined that the permitted investment should not exceed 15 percent of the regulatory capital of banks. Investments, exceeding 15 percent but no more than 25 percent of the regulatory capital must be accompanied with the preliminary authorisation submitted by the Bank of Albania. Based on this Law requirement, a regulation has been drafted where the established criteria concern receiving a similar authorisation by the Bank of Albania. The regulation is intended to balance banks' free activity through the participation of commercial companies' capital and the obligatory adherence to some supervisory ratios to prohibit banks face non-bank or financial risks.

PRUDENTIAL REGULATIONS AND REQUIREMENTS

PRINCIPLE 6

> Banking supervisors must set prudent and appropriate minimum capital adequacy requirements for all banks. Such requirements should reflect the risks that banks must undertake and must define the components of capital bearing in mind their ability to absorb losses. At least for internationally active banks, these requirements must not be less than those set in the Basle Capital Accord and its amendments.

Article 1.4 of the regulation 'Bank licensing in the Republic of Albania', sets the minimum capital adequacy to commence banking activity (Lek 700 million). Article 30, of the banking Law decides banks' liability to maintain the regulatory capital as established by the Bank of Albania.

The bank's component elements of the regulatory capital are specified in the guideline 'On banks' regulatory capital'. In the regulation 'On capital adequacy', assets and off-balance sheet items are classified according to the risk, giving respective coefficients, as well. The allowed minimum between the regulatory capital and off-balance sheet item average weighted by risk is termed adequacy rate. This ratio is fixed at 12 percent. If the adequacy rate falls below this limit, banks are forced to propose a new plan to reach or return to this required rate.

Article 48 of the Law 'On Banks in the Republic of Albania' specifies that when bank's capital adequacy is less than 50 percent of the required rate (thus less than 6 percent), the bank must readjust its statement within a six-moth term. If at the end of the six-month term bank's capital adequacy still remains less than 50 percent of the required rate, the Bank of Albania nominates bank's custody to take over bank management and control for no more than 12 months' term. If the situation does not improve, then it proceeds with the process of bank custody and bank liquidation after it.

Banks that have started operation before the approval of the regulation 'On bank licensing in the Republic of Albania', dated 31 March 1998 based on decision no. 143, dated 31 March 1998 of the Bank of Albania's Supervisory Council must complete the capital adequacy to no less than Lek 700 million within 31 March 2001.

PRINCIPLE 7

An essential part of any supervisory system is the evaluation of bank's policies, practices and procedures related to granting of loans and making of investments and the ongoing management of the loan and the investment portfolios.

Articles 28 and 29 of the Law 'On Banks in the Republic of Albania' specify the legal obligatory documentation that banks must maintain on the activity they have carried out. Based on its internal regulatory acts, the bank creates a set of necessary documents to successively proceed with its own activity, which is also monitored by the Bank of Albania. A component part of this documentation is credit papers, including credit policies and granting procedures. To track the performance of credit portfolio and reserve funds' provisions for covering the loss from loans, the Bank of Albania has approved the regulation 'On loans' classification and reserve fund provisioning to cover the loss from loans' where the specified standards of loan provisioning and classification are banks obligation.

To diversify the risk undertaken by banks, the Bank of Albania has approved these regulations:

The regulation 'On significant risks' defines bank's maximum exposure to 20 percent concentration of regulatory capital to a single beneficiary or to 700 percent for all beneficiaries that exceed 10 percent of the regulatory capital.

The regulation 'On open foreign currency positions' and the respective guideline, where maximum limits of open foreign currency positions are set for each foreign currency in particular and for all of them in general.

PRINCIPLE 8

Banking supervisors must be satisfied that banks establish and adhere to adequate policies, practices and procedures for evaluating the quality of assets and the adequacy of loan loss provisions and loan loss reserves.

Pursuant to Articles 28 and 29 of the Law 'On banks in the Republic of Albania', which defines banks' essential documents (including procedures and written policies), Article 31 (2), underlined banks' duty to classify and evaluate assets, loans provisioning and fix the time when the return on assets will no more be accounted.

During on-site inspections, Supervision Department inspectors perform estimations in accordance with the regulation 'On loan classification and reserve funds to cover the loss from loans', related to bank's capital adequacy provisioned assets, and the regulation 'On the capital adequacy' concerning the classification of assets and off-balance sheet items average weighted by risk.

At the end of on-site inspections, banks are given respective recommendations.

PRINCIPLE 9

Banking supervisors must be satisfied that banks have information systems that enable management to identify concentrations within the portfolio and supervisors must set prudential limits to restrict banks exposures to single borrowers or groups of related borrowers.

Such principle finds application in Article 30 of the Law on banks and in the regulation 'On significant risks' where commercial banks are requested to control their risk exposures and not create large concentrations.

During on-site inspections, Supervision Department inspectors make estimations in compliance with the regulation 'On significant risks', the guideline 'On interest rate risk management' and 'On bank liquidity' guideline.

PRINCIPLE 10

In order to prevent abuses arising from connected lending, banking supervisors must have in place requirements that banks lead to related companies and individuals on arm's length basis, that such extensions of credit are effectively monitored and that other appropriate steps are taken to control or mitigate the risks.

Chapter V (Articles 35, 36 and 37) of the Law 'On Banks in the Republic of Albania' provides the definition for related individuals to the bank: 'A person related to an administrator through marriage or a second blood relation or business interests, as defined in the Bank of Albania's regulation (Article

35 (b)).' The terms and conditions for granting credits will be the same as for bank customers.

As far as banks' related persons are concerned, there has been enforced a restriction in the new regulation 'On the classification of loans and provision of reserve funds to cover the loss from loans'. If those loans are not adequately collaterized or guaranteed, then the amount of non-collaterized loans is discounted from the bank's regulatory capital.

PRINCIPLE 11

Banking supervisors must be satisfied that banks have adequate policies and procedures for identifying, monitoring and controlling country risk and transfer risk in their international lending and investment activities for maintaining appropriate reserves against such risks.

As previously mentioned in Article 29 (d) of the banking law, banks must be equipped with appropriately written policies and procedures for identifying, managing or controlling country risks, including international risks, unless there is no law or specific regulation to address 'the country risk and the transfer risk'. Lending activities recently applied by banks in Albania are limited to relationships with Albanian customers or those establishing relationships with the parent bank in their country. Investments are limited to Albanian Government treasury bills. Meantime, these activities are expected to expand by international community. Similar overall requirements, as specified in Article 29, are currently adequate.

Considering the expansion of bank activity pursuant to this principle, it is intended to draft a regulation that will cover market risk and transfer risk.

PRINCIPLE 12

Banking supervisors must be satisfied that banks have in place systems that accurately measure, monitor and adequately control market risks; supervisors should have powers to impose specific limits and/ or a specific capital charge on market risk exposures, if warranted.

As previously mentioned in Article 29 (d) of the banking law, banks must have written policies and procedures to accurately identify, manage and adequately control market risks. In Article 30 of the Banking Law, the authority to enforce specific limits and/or a specific capital reserve for market risk exposures, if warranted, is granted to the Bank of Albania. To fix these limits the Supervisory Council approved the regulation 'On market risks'. The cases specified concern additional capital quota, where applied. This regulation is currently little applicable by banks, and this may be due to their limited activity. The new recommendations of Basle Committee on capital adequacy foresee involvement and analysis of market risks and off-balance sheet items; however, they are still at a study phase.

PRINCIPLE 13

> Banking supervisors must be satisfied that banks have in place a comprehensive risk management process (including appropriate board and senior management oversight) to identify, measure, monitor and control all other material risks and where appropriate, to hold capital against these risks.

The above-cited Article of the Banking Law gives the Bank of Albania the appropriate authority to practice an appropriate assessment of market risk as requested by this principle.

While performing on-site inspections, the supervisors must be based on the Supervision Manual and make a detailed analysis of risk management by banks.

PRINCIPLE 14

> Banking supervisors must determine that banks have in place internal controls that are adequate for the nature and scale of their business. These should include clear arrangements for delegating authority and responsibility; separation of the functions, accounting for its assets and liabilities; reconciliation of these processes; safeguarding its assets; and appropriate independent internal or external audit and compliance functions to test adherence to these controls as well as applicable laws and regulations.

Article 29 of the Banking Law requires that there must be written policies and procedures. Pursuant to that, the Supervision

Department has drafted a regulation 'On the internal audit of banks'.

This regulation requires from each bank to develop an effective independent internal audit system and to make a combination of these audits, in order to make sure that banks have a safe and sound operation.

Article 39 (1) of Banking Law stipulates that banks must be assigned an independent and certified accounting expert. In Article 41 of the banking law 'All banks are subject to Bank of Albania's performed inspections and audits from independent certified accounting experts'.

This principle is legally applied but not yet fully realized, as some difficulties exist with the licensing of distinguished companies as international experts from the Institute of Certified Accounting Experts.

PRINCIPLE 15

Banking supervisors must determine that banks have adequate policies, practices and procedures in place, including strict 'know-your-customer' rules that promote high ethical and professional standards in the financial sector and prevent the bank being used, internationally, by criminal elements.

This principle finds application in the Banking Law, Article 26 and in the regulation 'On money laundering prevention' approved by the Bank of Albania's Supervisory Council decisions, dated 3 March 1997 and 16 January 1997. Pursuant to these decisions, the Supervision Department estimates at any inspection the adequacy of 'know-your-customer' practices.

The law made effective in December 2000 'On money laundering prevention' requires the establishment of the Agency for the Co-ordination of the Fight against Money Laundering' at the Ministry of Finance.

METHODS OF ONGOING BANKING SUPERVISION

PRINCIPLE 16

> An effective banking supervisory system should consist of some form of both on-site and off-site supervision.

Part of the Supervision Department is On-Site Supervision Division which performs banking supervision. This division includes analysts actually serving as data collectors and as centre for data processing and preparing reports and analysis.

These analysts compile monthly analysis on the financial situation of the banking system, including main indicators and supervise the application of established standards by regulations on supervision. Banks' full or partial inspections are made on previously established schedules. Full inspections are exercised once a year.

The interval between two inspections is constantly tracked through banks reported data on a monthly or quarterly analysis. Analysts also accomplish the preliminary data supply for the inspectors' group. The co-ordination of operation between analysts and inspectors within these sectors produces bank supervision in consistency.

PRINCIPLE 17

> Banking supervisors must have regular contacts with bank management and thorough understanding of the institution's operations.

It has been set a regular monthly contact between bank managers made official by the monthly meeting with banks and foreign bank branch managers.

More contacts are urged by problems found during on-site inspections and during the examination of data reported from banks. As operating practice, the Supervision Department

presents the problems found during inspections to managers before they are made official by the Bank of Albania.

Before approving new regulations of banking supervision, bankers' specialised opinion is provided and the application of these regulations by commercial banks is analysed.

PRINCIPLE 18

Banking supervisors must have a means of collecting reviewing and analysing prudential reports and statistical returns from banks on solo and consolidated basis.

In Article 38 and 43 of the Law 'On Banks in the Republic of Albania' banks are required to maintain appropriate data and prepare brief reports for the Bank of Albania. These reports must be prepared on solo or consolidated basis (Article 43).

PRINCIPLE 19

Banking supervisors must have a means of independent validation of supervisory information either through on-site examinations or use of external auditors.

The Law 'On Banks in the Republic of Albania' (Article 39 and 41) assigns the performing of on-site inspections to Bank of Albania's inspectors and external auditors. The current Law (Article 39) requires the Bank of Albania approve the external auditors. Supervisors' or external auditors' validations are independent, however supervisors have the legal duty to inform the Bank of Albania in case of fraud, defects or deficiencies that lead to bank losses. Thus, in Article 39 of the Law, it is clearly defined that a copy of the opinion of the certified accounting expert on the performed inspection must be sent to the Bank of Albania.

PRINCIPLE 20

An essential element of banking supervision is the ability of the supervisors to supervise the banking group on consolidated basis.

Based on Article 43 of the Law 'On Banks in the Republic of Albania', Bank of Albania's supervisors are provided with a similar opportunity to perform the validation of bank's or foreign bank branch financial statement according to the banks' consolidated data. Performing on-site inspections of bank branches outside the country is conditioned by mutual agreements of supervisory authorities of respective countries.

This principle is not fully applicable as we have a regulatory system on solo basis.

INFORMATION REQUIREMENTS

PRINCIPLE 21

Banking supervisors must be satisfied that each bank maintains adequate records drawn up in accordance with consistent accounting policies and practices that enable the supervisor to obtain a true and fair view of the financial condition of the bank and the profitability of its business and that the bank publishes on regular basis financial statements that fairly reflect its condition.

In Article 38 and 40 of the Law 'On Banks in the Republic of Albania', banks are required to maintain adequate data and publish them in their annual report.

From January 1, 1999, banks have been consistently reporting to the Bank of Albania through using the 'Accounting Manual'.

FORMAL POWERS OF SUPERVISORS

PRINCIPLE 22

Banking supervisors must have at their disposal adequate supervisory measures to bring about timely corrective action when banks fail to meet prudential requirements (such as minimum capital adequacy ratios), when there are regulatory violations, or where depositors are threatened in any other way. In extreme circumstances, this should include the ability to revoke the banking license or recommend its revocation.

Chapter VII, VIII (Articles 44-65) of the banking law provides penalty measures and punishments that might be undertaken by the Bank of Albania in case of violation of law, regulations or any guideline included. License revocation is also included in these measures (Article 44 (2) (g)).

CROSS-BORDER BANKING

PRINCIPLE 23

Banking supervisors must practice global consolidated supervision over their internationally-active banking organisations, adequately monitoring and applying appropriate prudential norms to all aspects of the business conducted by these banking organisations world-wide, primarily at their foreign branches, joint ventures and subsidiaries.

Banking activity in Albania is limited. Bank branches or subsidiaries do not extend outside the country.

For this reason, the activity of Bank of Albania's supervisors is limited only in domestic activities.

PRINCIPLE 24

A key component of consolidated supervision is establishing contact and information exchange with the various other supervisors involved, primarily host country supervisory authorities.

On 18 January 1999, the Governors of the Bank of Albania and the Bank of Greece approved a common memorandum on banking supervision - Memorandum of Collaboration.

Albania records the operation of three Greek banks or branches, currently.

PRINCIPLE 25

> Banking supervisors must require the local operations of foreign banks to be conducted to the same high standards as are required of domestic institutions and must have powers to share information needed by the home country supervisors of those banks for the purpose of carrying consolidated supervision.

Based on Article 4 (1) (c) of the Banking Law, foreign bank branches are licensed by the Bank of Albania pursuant to all normative acts established by law and regulations. All operating banks in Albania, being bank branches or not are licensed as banks by the Bank of Albania.

In Article 58 (2) (i) of the Law 'On the Bank of Albania' it is permitted the exchange of Bank of Albania's information with other central banks or other supervisory authorities. This ensures more extensive information and helps to attain a consolidated supervision of foreign bank branches and subsidiaries.

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EURO IS AT THE DOORWAY

Selami Xhepa*

Box 1. Currencies to be withdrawn from circulation:

DM
FRF
ITL
NLG
BEF
LUF
IEP
ESP
PTE
ATS
FIM
GDR

INTRODUCTION

As already known, from January 1, 1999, the European Monetary System entered its final stage: A unique currency (EURO) and a common central bank (The European Central Bank) were established. The transition plan toward this phase envisaged a 3-year transition period in which economic and monetary convergence within the member states will be further extended as

technical preparations for the physical replacement of the member countries' currencies with the new currency will be made.

Not more than half a year is left when the world will see this new currency circulate as the only legal tender in the market. From January 1, 2002, the new currency will physically circulate in all member countries of Economic and Monetary Union. Decision-making authorities decided a six-month transition period for all member states (from January 1 to June 30, 2002) to make the physical replacement.

Later on, this term shortened in two months. This means that from March 2002, the current currency denominations of member countries will stop acting as legal tender. This paper aims to closely analyse some specific and practical concerns related with the physical replacement of these currencies, actually circulating in our country.

1. How and when will the physical replacement of these currencies be made?
2. Where can this replacement be made?
3. Will it be expensive for the customers and who will pay for these costs?
4. What decisions ought to be taken by domestic authorities (the Bank of Albania and the commercial banks)?

1. HOW AND WHEN WILL THE PHYSICAL REPLACEMENT OF THESE CURRENCIES BE MADE?

The physical replacement will not be made on the same calendar for every member state. Every country has adopted a calendar of its own. However, the date when this replacement will initiate is January 1, 2002. The European authorities have decided this operation to complete by February 28 (although their intention is that this changeover be made within two weeks).

Thus, from March 1, 2002, ITL, DEM, GDR, etc., will simply remain historical relics. Since an enormous quantity of currency

will be transported (also considered one of the biggest logistics challenges), Euro distribution by banks will start in September 2001. During September - December 2001, banks, on their side, will distribute Euro denominations in retail shops. Although the European Central Bank has rejected Euro distribution for customers before January 1, 2002, the very large size of this operation has created a kind of fear as to security and transportation of this extraordinary large amount of money (Euro 660 billion).

As a result, the monetary authorities have requested military intervention (besides the security and police forces). Excluding Germany, in all other countries, the customers may change the old currency with the new one at every bank agency. In Germany, banks will replace the currency only for their customers. Thus, every customer must open an account during this period. This measure has been taken to prevent money laundering that most analysts believe may enter from Eastern European countries.

Albanian customers, business-persons, foreign exchange dealers and other economic agents use and circulate various countries' currencies. Most circulating currencies correspond to member countries of the European Monetary Union, which will be removing them from circulation to replace with the new currency. This means that every bearer of such currency (see box 1 on currencies to be expelled from circulation), may start their physical exchange from January 2002. Is it important that Euro exchange be made according to the fixed terms for member countries? No, it is not because Euro components are not legal tender in our country, (they mainly function as reserve assets - thus as savings). So, although the changeover may start from January 2002 even in our country, their exchange is expected to take up to a 10-year term. (This term is decided as available for member countries of the Euro area). However, the old currencies can be used in no trade transactions, any more.

Anyone travelling in one of these states, from March 1 can not perform any kind of payment in the old currencies, except for Euro.

This period is most important for the Albanian businesspersons, performing trade transactions with one of these states. From January 1 onward, all imported goods payments from these states will be made in Euro, only. As a result, all businesspersons must contact with the banks where they hold accounts to receive necessary information from them.

The new currency

Central banks
From September, the 15 billion Euro banknotes and the 50 billion Euro coins will be moving from central banks to commercial banks and businesses.

↓

Commercial banks

↓   ↓

ATM(s)
Over 234,000 automated telling machines will be able to dispense the new currency by customers.

Retail shops
In the first days, retailers will need 10 or 100 times much more cash than at ordinary days.

↓   ↓

Customers
The 300 million customers must receive the new currency within 2 months, however, it is mostly intended that this be carried within two weeks.

↓

Old currencies
The circulating amount of the old currency in Euro area is estimated at 58 billion coins and 11 billion banknotes.

Source: Financial times, May 31, 2001.

How will the physical changeover be made? As already known, participating coins in the European Monetary Union have a fixed exchange rate against Euro. Thus, the ITL, the DEM and other circulating coins have got a fixed exchange rate against the Euro.

Table 1 Bilateral exchange rates

Countries	Exchange rate
Germany (DEM)	1.95583
France (FRF)	6.55957
Italy (ITL)	1936.27
Netherlands (NLG)	2.20371
Belgium (BEF)	40.3399
Luxembourg (LUF)	40.3399
Ireland (IEP)	0.787564
Portugal (ESP)	166.386
Spain (PTE)	200.482
Austria (ATS)	13.7603
Finland (FIM)	5.94573
Greece (GRD)	340.75

Reading the above table means that to buy Euro 1 you must hand over DEM 1.95583 or ITL 1936.27. Or if you have DEM 1000, you will receive Euro 511.3 = DEM 1000/1.95583 when bank exchanged.

This is the fixed exchange rate of the Euro zone. The Bank of Albania must take a decision on enforcing all banks to perform the exchange, observe this level of exchange rate. If someone decides to exchange Euro currency in US dollars, Euro exchange rate (hence, Euro component currencies) will be flexible. Thus, in this case, the customers must follow Euro exchange rate performance in the market.

2. WHERE WILL THE PHYSICAL REPLACEMENT OF CURRENCIES TAKE PLACE?

In member countries of the Euro zone, the physical replacement of currencies will be made at banks, financial institutions, ATMs, post offices or retail shops. Bank accounts will be automatically exchanged in the new currency (this has already been made); equity or debt security entitlements will also be expressed in Euro, as well.

What about the Albanian citizens holding these currencies outside the banking system and/or with banks?

If these countries' currencies are bank held, everyone would be able to attract the new Euro currency, as banks are preparing for their physical changeover.

If someone holds the currencies of these countries as household savings, thus not with the banks, their physical exchange at bank windows is still enabled.

However, the Bank of Albania must officially nominate banks (or foreign exchange bureaus), or make public announcements to this end. This would evade the possibility for speculations to the detriment of unprotected customers.

3. WHO WILL PAY THE COSTS?

Issuing new currencies has a certain cost as to printing paper, etc. According to the European Central Bank guidelines, the physical changeover of the currencies will not be accompanied with costs for customers. This process related the national central banks of member countries, which are concurrently responsible for the issue and distribution of currencies in circulation and would normally afford costs.

The physical exchange, in the case of countries outside the Euro area, must be made in formal agreement between central banks.

This means that the Bank of Albania must enter in negotiations with central banks of the Euro area to contract bilateral agreements on the currency exchange. It must be under the Bank of Albania's responsibility to decide contractual terms as to the hand-over of the existing currencies, reception of new ones, their distribution, etc. The Bank of Albania must take respective decisions to cover the costs from this process. Principally, these costs must be covered either by the Bank of Albania or be shared with the commercial banks. It would be pointless for customers to cover these costs.

4. WHAT DECISIONS MUST THE MONETARY AUTHORITIES OF THE COUNTRIES TAKE?

According to a European Central Bank decision, banks, financial or credit institutions will have the right to furnish bank branches, subsidiaries or their institutions outside the Euro area with the new currency. The Bank of Albania must enter in contacts with these institutions, in order to coordinate this process through formal agreements, ensure a normal transition and close the speculation gaps that may be established.

The Bank of Albania must address the operation of monetary exchange by officially nominating banks as exchange operators. It must ensure adequate supply with the new currency. This requires it subscribes a binding contract with the central banks of the Euro area to specify the details of this process, and with the commercial banks operating in Albania.

The Bank of Albania must also take care, so that this process has a smooth transition. This also requires an intensive campaign of public awareness, information, details related to this process etc.

5. IS THIS PROCESS RISK-EXPOSED?

The European Central Bank and the Euro area authorities have launched detailed instructions on security problems that will accompany this transitory phase. Although the new currency denominations go to Euro 500 denomination, no problems are expected ahead.

There is no reason to believe that this process may bear risks for the saving consumers or other economic agents of our country. The exchange process does not include an expiry date. The central banks of the Euro area will have the right to perform physical changeover on longer than 10-year term, although the current currencies can not be used. This means that the Bank of Albania in subscribing agreements with these countries' central

banks must envisage physical exchange possibilities on a longer term, as well. In essence, this process will be the same with any currency exchange, previously experienced in our country (as withdrawal of old denominations from circulation).

The physical exchange of currencies in circulation may be an occasion for money laundering through banks. Indeed, that is the biggest concern of the European banking system. It may happen that banks perform Euro exchange for counterfeit denominations, actually in circulation. This may be for the long queues that will be created at bank windows and the impossibility of bank officials to control every unit of the currency requested for exchange.

Although such a thing is not so likely to happen in our country, the Bank of Albania must deliver detailed guidelines to be applied by domestic banks and accompany this process with a prudential supervision.

The Euro is a new and non-counterfeit currency. However it may be exchanged for counterfeit denominations of ITL, DEM, etc., that may be either circulating in our country or enter from other countries of the region, where the most circulating currency is mainly in DEM.

Another concern relates to the exchange rate. If customers will not be willing to convert their household savings in ITL, DEM or GDR, etc., into the Euro, and select USD as their most preferred currency in the domestic market, this may set Euro under depreciating, artificial or speculative pressures. The Bank of Albania must play a restraining role in this direction, through prudentially pursuing the foreign exchange market situation and make the necessary interventions to prevent the likely speculations. Possibilities for speculation may be created especially in the informal foreign exchange market.

Concluding:

We believe that there is no reason to be worried about the physical exchange of other than USD household savings and/or

with the banks. This process will have an adequate time spread. The Bank of Albania must undertake the necessary steps to precede this process by a prudential supervision.

The Bank of Albania must make the necessary technical preparations for this process, deliver the necessary guidelines for banks and foreign exchange bureaus, familiarize customers with the new currency, etc. The Bank of Albania departments must highlight the specific matters related to this process and be prepared in due time.

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ECONOMIES OF THE REGION

Selami Xhepa
Diana Shtylla*

The recent day subject in Albania is concluding free trade agreements with the countries of the region. Without endeavouring to analyze the positive or the negative aspects of this process, one thing is obviously clear: the application of these agreements will lead to growing economic integration of the region. Besides benefits, the integration also increases the risk of transmitting economic or political problems of one or some countries in the region to the Albanian economy. At the same time integration creates new market spaces "to be conquered" by Albanian businesspersons as well. This process makes necessary the prudent pursuit of economic development in the region.

This paper analyzes the likely effects of FYROM crisis on the Albanian economy and the opportunities provided by Kosovo economy.

FYROM CRISIS

1. BACKGROUND OF EVENTS

The crisis of our neighbour country, that is FYROM, started at end February 2001 and is still going on. The political crisis' solution in this country still seems very unclear. FYROM government is ever more searching to find solutions for the

political crisis, establishing a dialogue with the Albanian factor. This has been the essence of all messages transmitted during the frequent visits of high American and European officials to this country as well as the high level meetings of the EU in Gothenburg. However, until now, it seems that both ethnic communities continue to deepen their division.

FYROM developments have remained in the framework of an internal political crisis, without causing any economic turbulence even for FYROM, itself[1].

2. FYROM MACROECONOMIC SITUATION, AND CURRENT YEAR FORECASTS

According to official reports[2] for 2000, FYROM recorded progress in the area of consumer price stability. Measured by the living cost (as agreed in the FYROM arrangement with the IMF), inflation recorded an annual rate of 6.1 percent. However, this indicator was higher than in the previous years and its effect was mainly a result of:

- Introduction of VAT (whose effect is given once);
- Rise in oil price (FYROM is net importer of power resources)
- Rise of prices controlled by the state (public services).

However, consumer price stability is considered a successful achievement in the sense that core factors generating inflation such as: the monetary policy, fiscal policies and exchange rate and the formation of wages have been under control. For 2001, inflation rate is forecasted to be less than 1.2 percent.

The monetary policy of the National Bank of Macedonia has as its anchor the maintaining of the domestic currency stability within the target ratio of Dinar 31 per DEM 1.

The maintaining of this exchange rate is the established objective for the current year. Its net international assets at the

end of 2000 reached at USD 713.6 million (with an annual growth of USD 235.5 million only for the past year).

Upon the removal of credit ceiling, the National Bank of Macedonia shifted exclusively to the application of indirect instruments of monetary policy.

External debt as at September 30, 2000 was USD 1,400.8 USD, while the short-term debt of private sector was USD 42.9 million. The external debt was estimated at 42 percent of GDP (a country with a moderate to average debt level).

3. CRISIS AND ECONOMY

Until now there is no evidence that the political crisis and the military operations have caused any rupture of economic balances in the country. FYROM is still included in IMF economic programs expected to be transformed in the paper of the Strategy on Poverty Reduction and Growth Facility.

The crisis may give its effects on the delay of economic reforms, such as the consolidation of the banking system, (merger of small local banks), closure of loss-generating economic units (4 such ones are planned to close down during this year, out of the list of 40 such enterprises).

About DEM 1 billion estimated as household savings of the population is not channelled through the banking system[3]. On the other hand, the rate of the monetary exchange is among the highest in this country[4].

In consequence, we do not think that any significant shocks may occur in the monetary policies at least for the present (the exchange rate of domestic currency against the DEM is within the annual target set by NBM). Until now, it seems unlikely that military operations have considerable effects on FYROM finances.

Press reports have cited statements of the Minister of Finance that FYROM has the monetary assets[5] to purchase new armaments, while it is already a well-known fact to the media that much armaments are given free of charge by such countries as Ukraine, Bulgaria and Greece.

FYROM foreign aids[6] declared until now are expected to be at USD 17 million military aids and about 38 million financing to the economy. Other financings are expected to be given in the framework of the Stabilization and Association Agreement with the EU, signed on April 9, 2001.

4. ALBANIA – FYROM ECONOMIC RELATIONS

Concerning the crisis' diffusive channels from one country to another, the literature evidences two of them as the most important: financial and trade relations.

Traditionally, throughout the whole transition decade, the economic and trade relations between both countries have maintained very low levels, which may be regarded as negligible. FYROM market has occupied the average of 2 percent in imports and 2.7 percent in exports. This is accompanied with a constant falling tendency for years 1994-1999. (See table 1). From this viewpoint, it can not be thought of any significant influence.

Table 1 Albania's foreign trade with FYROM (in millions of USD)

Years	Import	Export	Total imports	Total exports	Ratio to the total in % Imports	Exports
1994	14.5	6.6	601	141.4	2.4	4.7
1995	16.5	8.0	679.8	204.8	2.4	3.9
1996	19.5	5.6	922	243.7	2.1	2.3
1997	13.2	3.8	693.5	158.6	1.9	2.4
1998	11.3	3.1	811.7	208	1.4	1.5
1999	17.4	4.2	937.9	275.1	1.9	1.5
Average					2.0	2.7

On the other hand, no financial relations exist between both countries. We do not have relations of mutual financial liabilities

between us, so that they might affect any change in the interest or exchange rates. There is no evidence for individual savings of Albanians to be listed under Scope Stock Exchange securities that would be also affected by the changes of domestic monetary and economic circumstances.

An evidenced relation in service area consists mainly in goods transition toward Kosovo. According to talks with customs specialists, in the days of closing borders between FYROM-Kosovo, transition flows that increased in our country might have caused an increase in budget revenues just because of this factor. However, the scale of its operating effect is still insignificant. Closing borders operated within a short-period of time and they are actually re-opened. Moreover, closing borders might have resulted in an increased fiscal evasion in our country, through transiting frauds, while goods may have stayed in Albania, avoiding the payment of fiscal duties[7].

Another probable effect on our public finances would be coping with the emigration of Albanian population from FYROM to our country.

Even in this case, no significant development has been highlighted.

Even that small number of emigrants who passed through Albanian borders, has been in transit, having as destination other countries, such as Kosovo and Turkey. We think that even in the case of a larger deterioration of FYROM situation (the most pessimistic scenario), the budgetary charge to maintain a large number of emigrants would not result at unaffordable rates, considering their preferences to mostly emigrate in countries where they have their relatives (Kosovo, Turkey or other Western countries).

From all evidences there can not be drawn any parallel with Kosovo crisis.

A SHORT OVERVIEW ON KOSOVO

NATURE AND GEOGRAPHIC POSITION

Kosovo covers an area of 10,877 km2 and a population of 2.3 million inhabitants and it lies in the central part of the Balkan Peninsula. Besides its favourable geographic position, Kosovo has significant resources above and under the ground, an adequate climate and miscellaneous flora and fauna. Its core natural resource is its cultivated area. Amongst water riches, there must be mentioned its thermal resources, whereas coal reserves, used as power resource, are estimated at 11.5 billion ton. Kosovo is very rich in bauxite tint metals, lead, zinc and nickel ores.

PRIOR TO CONFLICT ECONOMY

In the post World War II, Kosovo, in the framework of the Socialist Federative Republic of Yugoslavia, mainly represented a rural economy. The economic transformation made under the structure of central planning brought about industrialization and development of extracting industry. Thanks to the financing ensured from a national investment fund, Kosovo's economic activity during 70-80s extended and developed mainly in extracting industry, the production of raw material and half prepared products (steel, coal, zinc and textiles); However, agriculture continued to remain important. Mid '90s brought about a deterioration of the economic situation as a result of the misadministration of resources.

In this period, the investment in most profitable sectors of the economy shrunk up considerably and unemployment reached high figures. Industrial sector was either state-owned or under social ownership (with enterprises owned by the workers) and banks' lending was based on political motives. The ethnic discrimination appeared even in economy, where industrial sector employees, especially in key positions were of Serbian entity, while the Albanian population was forced to

either engage in informal economy, in agriculture or emigrate. During this period, there were established parallel systems of education, health care and social benefits financed by emigrant remittances of Kosovo, and a parallel tax system.

CURRENT ECONOMY

It seems that Kosovo economy is making efforts to get out of the circumstance created over the two previous decades and cope with the heavy consequences left behind by the conflict of 1999. The economy has found fundamental support in domestic enterprises that have been and are being strongly assisted by foreign donors.

Donors' assistance together with the domestic savings and fund inflows from abroad are actually holding the main burden of Kosovo's economic recovery.

These funds, upon the termination of conflict, were mobilized to reactivate the rural sector or to start the repair of houses, of water and power supply network. To ensure the consumer price stability at the lack of a domestic currency, it was decided to legalize the use of German currency (DEM). Parallel to this, it was offered assistance to establish a payments and banking system of Kosovo. To the first half of 2000, agriculture is believed to have reached at 75 percent of the before war level. Construction appears as the most active activity, followed by some private services, as restaurants, hotels or shops. The foreign trade activity is dominated by imports, representing 85 percent of GDP. As observed from the table below, GDP per capita is estimated at USD 750, while expenditures amount at USD 1,125 per capita.

The large difference between income and consumption per capita is filled by emigrant remittances of Kosovo, which for year 2000 amounted to 40 percent of GDP. That amount is nearly 1.3 times higher than emigrant remittances sent to Albania in the same year.

The following table displays the levels of some core macroeconomic indicators for Kosovo and Albania in 2000. The figures for imports are particularly high for both countries.

Core macroeconomic indicators	Albania (2000)	Kosovo (2000)
GDP	3,734 mil USD	1,421 mil USD
GDP per capita	1,131 USD	750 USD
Fiscal balance	- 399 mil USD*	-103.7 mil USD
Trade balance	-814.3 mil USD	-1,203 mil USD
Import	1070.1 mil USD	1,203 mil USD
Export	255.8 mil USD	--
Current account	-151.8 mil USD	-487 mil USD
Individual transfers	438.6 mil USD	569 mil USD
Official transfers	94.4 mil USD	147.8 mil USD

Source: Year 1999, lacking data for 2000.

KOSOVO STATEMENT OF CURRENT INVESTMENT AND ONGOING PROSPECTS

Despite the attention paid by international authorities, Kosovo economy is undergoing a hard situation. The current economy suffers from the lack of foreign and domestic investments. Concerning causes justifying the lack of foreign investments in Kosovo, we may rank the difficult transition, the lack of laws and the risk of other conflict spots in the vicinity areas. Foreign media, frequently, make unreal reflections on the country situation, which paralyzes investors' willingness or initiative to enter Kosovo's market. The intervention of "Alcatel" corporation in Kosovo's fixed phone network was welcomed by the Albanian public opinion, reviving the hope for the arrival of foreign economic giants, which for the moment, seems to have been left in the shadow.

As far as Albania's investments from businesspersons to Kosovo are concerned, these are still limited in the small business field of restaurants, pizza shops and trade activity. Albanian investors still remain insecure to extend their activity in the sphere of industry. These investors also face a certain resistance from Kosovo market, which prefers cheap commodities from East to the more expensive goods arriving from Albania. The following summary comprises a disclosure on Kosovo's economic sectors where the displayed feasibility to generate small and mid-size enterprises

(SME) is according to a performed study in 1998. Although, this study was undertaken during the pre-conflict period, it is supposed that these developments have been very insignificant or absent in the recent two years. For this reason, Kosovo's domestic economy is still assessed as having need for recovery and exploitation of these potentialities that have much to offer. The Transitory Credit Unit established by the European Agency for Reconstruction (EAR) aims at helping SMEs. Other credit funds to support pilot projects are ensured by the World Bank, the EAR and the EBRD. Below, there are presented economy sectors deemed as interesting for investments.

RURAL BUSINESS

Rural business is ranked the first in the conducted study. The need for food articles is particularly emphasised after the 1999 situation, which is expressed in the highly imported foodstuffs from Kosovo. Owing to the development of individual economies and the existence of small rural areas, farms are considered as bearers of rural business activity. It is estimated that from common investments or those arriving from Kosovo Albanians living abroad, there may be realized programs from USD 8,000 to 100,000 providing profit rates up to 30 percent, as the principal investment may be paid within 2 or 3 years. Some of the following programs considered as fit for investments consist in milk processing industry, paste, meat, beer and honey prepared products, tinned fruit and vegetable, small slaughter-houses, running animal farms of cattle, chicken, sheep, goats, pigs, wild poultry and packet foodstuffs. From the assessment of post-war opportunities opened to Kosovo, this country may turn into an exporter of agro-business goods and of rural processed foodstuffs to EU countries in the future.

INDUSTRY

Industry or manufacturing presents a broad spectrum of Kosovo activities and over 20 percent of population are accounted to engage in it. This sector, comprised of public and

private enterprises, seems to have small capacities. To develop this sector of economy, the Department for Trade and Industry at UNMIK announced 10 enterprise tenders during 2000.

Industry may be treated in 3 main lines, processing industry, metal processing industry and the traditional industry.

a. The current data on the development of Kosovo's *processing industry* and their comparison to more developed countries indicate that Kosovo is characterized by a low level of the processing industry. To the early '90s, Kosovo has been able to produce chemical fertilizers, alcoholic and non-alcoholic drinks, cement and some metal and rubber products to partly meet the export needs. Although initially the processing industry was regarded as a large capacity industry, it has already started to be viewed as an industry varying from small to average capacities, in compliance with the technical and technological developments that have taken place in the world. Excluding the above products, which are no more produced, the processing industry needs to be expanded with other products like chemicals, medicine, pharmaceutical raw material; fats and oils; colours, polish products and other pigments; oil refined and wood processed products; plastic materials, rubber, wood, cellulose, cardboard, etc.

b. Metal processing industry must be based on the stimulation of small and medium-size enterprises, using the comparative priorities of individual supply of raw materials and the experience gained over many years. Kosovo is mainly rich in lead, zinc, cadmium, bismuth, silver, iron-nickel ores, etc.

Knowing that European largest producers have high demands for industrialized products from this industry, it is deemed that the Kosovo's industry may aim at meeting these requirements in the future, besides the partial or complete fulfilment of the country's needs for such products.

Kosovo's industrial infrastructure in the past has been satisfactory. Meantime, it is actually aimed to give priority

to the rehabilitation and regeneration of this infrastructure, exhausted from use in the recent decade. Small and medium-size enterprises are regarded as units which, upon starting operation in extracting industry, with modest investments and limited labour forces, may make use of the above-mentioned metals to produce half-prepared or final products.

To have initial production from lead, zinc, bismuth, and cadmium, an elementary condition to be met is installing a small electrical-inductive furnace of 20 KW capacity.

    c. Kosovo's traditional industry is expected to be based on the production of soap, washing detergents, package paper, glass industry, and porcelain and ceramic products, pharmaceuticals etc. Special emphasis must be laid on regenerating the Kosovo's traditional industries, such as textiles, wood processing and building materials industry, which have ensured high quality products in the past.

CONSTRUCTION

Construction has assumed a special importance in the last years, since the needs for re-constructing the destroyed or abandoned houses or buildings during the armed conflict have been large, indeed.

To the end of 2000, reconstruction investments are assessed to reach at half billion US dollars. According to an assessment made by the European Agency for Reconstruction, the domestic demand for building materials will continue to grow even for some other years in Kosovo.

Albania's contribution to Kosovo's reconstruction is materialized in the massive exports of wood, ensured from forests of Northern Albania. Feeling unsafe, construction firms or companies from Albania did not approach Kosovo, despite the large famine of the country to develop this activity. Kosovo actually recognizes the operation of 34 public enterprises and 95 private ones,

dealing with the production of tiles, bricks, cement, lime, wood processing for furniture, windows, doors, etc.

Also referring to the above study, Kosovo's small building enterprises may also be grouped into three different structures. The first type consists of enterprises, which have production, trade and projection of building material in their portfolios. Private enterprises exercising construction activity comprise the second type, that of mid-size business. If these enterprises attain the appropriate efficiency, they may increase their capacities.

The third type of small enterprises is believed to be created from the privatization and the restructuring of current social/ state-owned enterprises. The three types of enterprise are thought to mostly contribute to the reconstruction of post-war Kosovo and will be extended in the following lines: execution of public works, including high and low buildings, handicrafts, maintenance and execution of specialized works (foundation-geo-techniques, assemblage, isolations, ruins, mining, etc.).

COMMUNICATION

Kosovo's communication assumes a special importance, considering disorders naturally arriving after the 1999 situation. The massive displacement of the population on reverse directions from inside and outside Kosovo, the goods transition and the massive access of international administration are phenomena that make necessary the arrangement of an efficient communication through road, railway, airline, post office, and RTV networks. SMEs of communication are expected to realize goods and passengers' transition, maintenance of traffic infrastructure and of transport vehicles, etc.

TOURISM

Kosovo's natural and cultural riches comprise its precious tourism resources. Kosovo has optimum conditions for the

development of winter – mountainous tourism, healing baths, hunting, sportive fishing and other water sports. Though left aside for the moment, tourism may be considered a source of income within a not-too-distant future. Of priority herewith will be the rehabilitation of existing centres and the construction of new ones for massive tourism (mainly in Brezovica and Decan localities). Confirming tourism in fishing and hunting sports, the expansion of hotels and sportive centres and the re-designing of the "Boro and Ramiz" complex in Pristine, intending provision of possibilities for economic, sportive and cultural manifestation, comprise other priorities of tourism activity. Tourist agencies can play an important role in the revival of tourist activity in Kosovo, by expanding their activity from selling tickets to providing a qualitative tourist offer.

CONSULTANCY ACTIVITY

In view of carrying out consultancy activity in Kosovo, an almost total contraction has been noticed. The role of consultancy is viewed as strongly related to technological transfer, individual technical progress and exports perspective. Consultancy activity with regard to technological transfers within SMEs is viewed as concentrated in the pre-intensive stage of imported technology. The consultancy activity in this case consists in collecting respective data for different technology producers for a variety of products that will be produced at a given period. Taking into account the demands, this activity may be extended in the economic, financial and juridical sphere. Consultancy services are also very useful in the field of receiving loans from various international organizations, foreign creditors or in joint investments.

INFORMATION TECHNOLOGY

The generation of SMEs in information technology is viewed as closely connected with the trading of equipment, software, their instalment and software creation for business networks,

maintenance of networks and computerized education. The compilation of special respective software needed to various segments and the maintenance and provision of possibilities for their application comprise real and very favourable opportunities for the establishment of SMEs.

TRADE

Trade in Kosovo has had a dynamic development, mostly accentuated, in the two latest years. After the 1999's conflict, the Main Fiscal Authority operating in Kosovo, assessed as rational the setting up of a simple and neutral structure of the trade regime. This structure was deemed as suitable for stimulating economic growth on the side of private sector, accelerating construction and for providing suitable conditions for sound exports. Lacking administrative machinery that would realize collection of taxes on income and consumption, the UNMIK introduced the trade regime based on customs, as the main source of revenues for the local budget of Kosovo.

The main features of this trade regime consist in, first the introduction of a uniform customs duty of 10 percent and 15 percent on sales. This tariff structure was recommended because of its simplicity and the low applicable rate. At the same time, there were introduced and applied exemptions from customs duty for some rural and medical products; second, the foreign trade regime did not include non-tariff and quantitative restrictions; third, transparent and undiscriminating procedures of licensing and registering traders comprise a priority of the system.

As concerns trade development between Albania and Kosovo, it took a special leap in the recent two years, by being mainly materialized in exports from Albania. From the second half of 2000, Kosovo was ranked fourth amongst Albania's main trading partners. Taking into account the irregular condition of customs borders and the great "hunger" of Kosovo's market for basic foodstuffs, it is estimated that exports with this country must have been some times higher than the recorded figures. Exported

commodities initially pertained to foodstuffs' category (grains and articles thereof) water, machinery and equipment (mainly power supply generators) and products of press industry.

At early 2000, there was noticed a change of direction for these exports. In compliance with the gradual improvement of the living conditions and efforts for the economic recovery of Kosovo economy, Albania's exports, besides foodstuffs, are already being concentrated on miscellaneous articles (room furniture) as well as in fuels and mineral products. Goods inflow in the type of shuttle trade is estimated to be considerable during this period. During 2000 fuels and chemical industry products gradually replaced room furniture, occupying, till that moment, the largest share weight of Albanian exports to Kosovo.

The starting of operation of Pristine-Tirana airline and the opening of INSIG office in Pristine, as well as some other trade fairs opened for promoting these investments, relieved export activity. However, to turn into a strong trading partner of Kosovo compared to FYROM, Albania lacks many road and railway infrastructure facilities as well as sound marketing mechanisms.

Until now Albania is faced with an unfavourable situation in trade relations with Kosovo. Apart from high costs and difficulties of transport (missing the Durres-Kukes road), Albanian exports to Kosovo are submitted to a considerable fiscal charge. Strong trade relations between FYROM and Kosovo, normal infrastructure and the trade agreement between the Former Republic of Yugoslavia and Macedonia, ensuring to the latter the preferable status in trade, made exports from Albania have difficulties in finding their way to Kosovo. The efforts of the Ministry for Economic Cooperation and Trade of Albania, which has started negotiations for concluding a Free Trade Agreement, comprise a positive development in this direction. Such a thing would further prevent customs barriers for Albanian exports to FYROM and Kosovo. On the other hand, the Albanian Government and the UNMIK have never started negotiations for reducing customs barriers between the two countries. The above mentioned difficulties constitute a strong reason for the spread

of illegal operations, apart of the high costs they bring to those businessmen regularly submitted to customs duties.

Another unit that is making efforts to strengthen business relations between Albanian and Kosovo traders is the Union of Trade and Industry Chambers of Albania. This union, in collaboration with the Economic Chamber of Kosovo has worked and is working to arrange some meetings between the parties, in order to create conditions for the organization of some bilateral fairs.

BANKING SYSTEM

To ensure banking development in Kosovo, in November 1999 the UNMIK approved two regulations that defined the establishment of Banking and Payments Authority of Kosovo and some licensing regulations for commercial banks, their control and supervision as well. The Banking and Payments Authority of Kosovo licenses and supervises all financial institutions, banks or non-banks operating in Kosovo, holds monetary reserve in DEM banknotes and coins and Yugoslav Dinar; ensures deposit and payment services in DEM until the necessary capacities are created in the banking system. Operating as a Bank of Government, the BPK takes deposits from UNMIK and other official agencies and makes payments based on the Main Fiscal Authority and other depositors' orders. Apart from safekeeping the currency for security reasons, the BPK has not supplied deposit and payment services to enterprises in order not to turn into a direct competitor of the banking system that is still at its first steps of development. Since Kosovo's need for establishing a bank network is large, conditions for new bank licensing are estimated to be at nearly 3-5 times less rigorous than those applied in the region. Licensing procedures require a grading of commercial bank permitted activities, according to capital. Banks having DEM 1 million as minimum capital are permitted to provide payment services and deposit-taking. Banks that require granting consumer or business loans must meet a required minimum of three times as that. Whereas, for

banks that require to develop portfolio management activities of trading debt or equity securities, the required capital is DEM 5 million.

Kosovo actually recognizes the operation of three commercial banks and 10 non-bank financial institutions. Commercial banks mainly deal with deposit taking and bank transfers, while their lending activity is less developed or not developed at all. The above-mentioned institutions, which are subordinate to the World Bank, the EBRD and the EAR, aiming at extending low interest loans, play the lending role for the moment. Some of these foundations extend loans at 7-12 percent rate, while it is attempted to create the conditions for providing small loans (DEM 2000- 5000, or USD 1000-2500) to rural enterprises. In this way, it seems that pre-conditions for a mere financial market and a somewhat triggering environment are almost established.

Another support to the whole region in general, and to Kosovo in particular, derives from the Stability Pact adopted in 1999. In this framework, it is aimed at encountering emergent problems arisen from Kosovo crisis, to later concentrate on promoting development and stability in the whole South - East Europe. With all deficiencies and problems it carries over, the attention paid by vigorous international organizations to the region must be appreciated and made use of in due time.

CONCLUSIONS

The above disclosure transmits contradictory messages, which on one hand reveal the non-so optimistic reality of Kosovo investments and economy and on the other hand, intend to raise the interest of investors and traders to use opportunities, and especially the high demands of the country in various areas of economy. Under these conditions, it is difficult to lessen or cover the numerous problems deriving from the current political status of Kosovo and the fatal shock the country encountered in 1999. However, it seems that it is just the time to consider the

situation from a less pessimistic viewpoint, and to accept that Kosovo has hope and potentiality to accomplish it.

Market economy is one thing and moral or political motives are another. Based merely on the economic viewpoint, it might be said that frequently some courage and initiative is needed to cast a glance where others rarely dare, but where profit opportunities are plenty. Another viewpoint, which in our case might be translated Albania's and Kosovo's integration through the economy or some of its branches, has to be tested, always after it is confirmed that the acting on the basis of personal interest of all parties has given its own fruits.

NOTES

* This paper was prepared and adjusted for publication by Dr. Selami Xhepa and Diana Shtylla, Research Department.

[1] At the time when this paper was written, there was no economic report or index to indicate episodic or other developments of any aggravated economic situation in this country. In addition, we lack the data on the domestic economic developments. Actually, we lack the data on commercial, budgetary, tourism and transit developments, etc. As a result, it would be difficult, at least until today, to make an accurate analysis on the likely effects.

[2] Speech of the Governor of the National Bank of FYROM held in the Parliament on February 2001.

[3] Southeast Europe, EIS, February 2001.

[4] See: Bishev "Monetary Policy in the Balkan Region", WP, NBRM.

[5] Public finances recorded surplus in the previous year. It was mainly from the sale of Telecom shares. (51 percent of the shares were sold out for the cash amount of Euro 342 million and Euro 256 million was investments from Matav, Hungarian Company.) See: Southeast Europe, EIS, and February 2001.

[6] The Guardian, April 2001.

[7] The closing border must have been of more effect on Kosovo's economy, as the goods transition to Kosovo was carried through FYROM, which was due to the non-existence of customs barriers between them. Whereas, the applied customs tariff, in the case of goods transition through Kukes was 20 percent. These changes in the transition system must have given their effects even on the changing channels of the goods supply of the North-East area of our country (from Kosovo imports due to the lower prices) in their supply from Tirana. See: "Shekulli" newspaper, March 27,2001.

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BANKING SYSTEM AND THE POSITION OF MICRO-CREDIT INSTITUTIONS IN ALBANIA

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INTRODUCTION

Albania's tremendous changes occurring at early 90s required domestic economy reforms that would enable the transition from a central planning to a market system economy.

Banking and financial system reforms were a very important element in the structural reforms for all countries entering the free market economy. These reforms assumed a big significance in achieving the macroeconomic stability. Applying an efficient framework of monetary management without which it would be difficult to realize, is an interactive and evolving process that allows the facility of monetary policy restructuring through financial sector reforms and the vice-versa.

Our country's financial system conceived as an entirety of three components: the financial instruments, markets, and institutions, has been faced with several challenges and difficulties throughout its road of development and consolidation in the recent decade. The unfavourable macroeconomic and financial conditions as well as the undeveloped financial and banking institutions at the start of the reform did not suffice it. But, it was challenged with many other internal difficulties, mainly deriving

from the constant growth of bad loans, the lack of tradition in supervision, and the inefficiency in the payments system. These difficulties climaxed with the pyramid schemes' crisis, which served as a lightening to destabilize the whole country, and the Albanian economy entered the path of total collapse.

Considering the heritage and the achieved stage of development, the banking system occupies the most important share in the financial system of the country.

Years 1991-1992 marked the establishment of the new banking system in the viewpoint of organization according to the model of western countries. The legal framework in this period allowed the banking system's transition from one-level to two-tier system. The Bank of Albania was established as a first level bank enjoying all the attributes of a central bank. Whereas operating banks in the two-tier system were three state-owned banks such as: the National Commercial Bank (NCB), the Savings Bank (SB) and the Rural Development Bank which soon changed its name into Rural Commercial Bank (RCB).

Later year developments were characterized by these bank reforms as well as by the establishment and expansion of bank operations with new private banks. The banking system reform, which aimed at improving the efficiency in the banking market, besides the initial accomplishment of its restructuring, was based on their privatization.

Consequently, in mid-2001, there are 13 universal banks, operating in Albania and within the year the Commercial Bank of Kuwait is expected to start operation. A month ago this bank was licensed by the Bank of Albania's Supervisory Council. According to the capital structure, the Savings Bank is the only state-owned bank, whereas the rest are joint-venture banks (2), and private banks built on foreign capital (10). There are 13 foreign exchange bureaus and 3 non-bank financial associations, 36 savings and loan associations operating and a number of foundations that are not licensed by the Bank of Albania but carry out their activity in lending.

There were also noted developments in the operation of other non-bank financial institutions. Albania already recognizes two operating private insurance companies. Even the Social Insurance Institute is intended to privatize. Three investment funds have already been licensed, out of which the only one that has been active in the collection of privatization securities has not started investments yet.

Although not yet developed, the money market is operating, whereas the capital market is still at a preparatory phase. Developing premises of these markets base on efforts that have already started to be made for adding market operators and instruments dealt in it. The privatization of the public companies, already recognizing better rates during this year, is the basis for this market development.

1. BANKING REFORM AND PROBLEMS OF ALBANIAN BANKING SYSTEM DEVELOPMENT

The paper considers the following issues:

• The legal and the regulatory framework,
• The privatization of the banking system,
• The Bank of Albania and non-bank financial institutions.

2. LEGAL AND REGULATORY FRAMEWORK

The legal and the regulatory banking framework encountered constant changes during the recent decade. This is not only attributed to improvement but also as a result of the occurrence of negative phenomena in this sector.

In April and May 1992 were founded the legal grounds on the formulation of monetary policies, establishment of commercial banks and the regulation of their operating activity. Such bases were established with the approval of the Law "On the Bank

of Albania" as the supreme monetary authority authorized for the formulation of monetary policies and the arrangement of the banking system, as well as with the approval of the Law on "On Banks in the Republic of Albania" which defined the operating and structuring way of commercial banks. The two-tier banking system including the Bank of Albania as the central bank and commercial banks supervised by it were established in accordance with both laws.

These fundamental laws experienced considerable changes in 1966. The financial crisis of 1997 caused by pyramid schemes' insolvency confirmed that even in the legal banking framework there were noted noticeable deficiencies that permitted the bloom of these pyramid scheme companies.

Due to this reason, both laws "On the Bank of Albania" and "On Banks in Republic of Albania" encountered noticeable changes at end of 1997-1998, which intended enhancement of the Bank of Albania's transparency, as the principal monetary or supervisory authority, or the strengthening of the banking system through adjustments and improving supervision.

Besides the legal improvement, during the recent years the Bank of Albania has significantly improved the commercial banks' regulatory and supervisory framework through strengthening the licensing rules or applying standard international norms on various banks' operating indicators.

All Albanian banks or foreign bank branches, private or state-owned, or any other financial entities licensed by the Bank of Albania are equally submitted to the Bank of Albania's supervision and audit.

Foreign bank branches operating in Albania are allowed to be audited even by supervisory authorities from respective countries of origin, opening as such the way to the endorsement of bilateral agreements with these countries in the area of banking supervision, by further enhancing the stability and the safety of these institutions.

The drafting and endorsement of the legal and regulatory framework in the banking area is made in agreement with the Bank of Albania's strategy for an efficient supervision. The strategic target of banking supervision is establishing a safe and sound banking system. Achieving this strategic target is a dynamic process that requires the meeting of a number of short- and mid-term targets intending:

- The establishment of a legal and regulatory framework converging with the international standards of Basle Committee and EU directives on banking supervision;
- The provision of the rigorous observance and application of the legal and regulatory framework,
- The restriction of banks' excessive risks that may jeopardize the depositors.

The achievement of these targets is ensured through:

a. The supervision of new licensed banks (licensing);
b. The regulation of second-tier banks and their constant supervision of the rules' observation;
c. The supervision of the financial performance of banks (analyzing banks and banking system performance),
d. The supervision of problem banks (from taking corrective measures to revoking their license).

2.2 PRIVATIZING STATE-OWNED BANKS

The privatization of stated-owned banks started in 1995 with the approval of the Law "On changing state-owned banks to commercial companies and allowing their privatization". This process was later followed by other legal acts and regulations. These banks, lacking efficiency especially related to credit repayment, indicated that initial restructuring steps were not adequate and successful. The arbitrary credit delivery and the political pressure on their extension, the corruption that started to gain moral legitimacy through the payment of 10 percent for every loan received and the boom of pyramid scheme

phenomenon led the banking system to the verge of insolvency. The first measures taken to cope with the crisis of 1997 were the government decision for closing the Rural Commercial Bank and the Bank of Albania's Supervisory Council decision to suspend the credit extension from the state-owned banks. In 1998, the Parliament approved the privatization strategy for strategic sectors of Albanian economy. An important part of this strategy was the privatization of commercial banks with state capital: the National Commercial Bank and the Savings Bank.

Regarding the National Commercial Bank privatization, there were presented two alternatives: the first was the restructuring and later the privatization, or in case of an improbable and successful privatization the bank would be liquidated. We hope that the successful accomplishment of this process through a strategic investor will soon provide its considerable impact on the further consolidation and development of the banking system in Albania.

Therefore, banks' privatization requires first of all that the state resigns its direct governance of the bank institutions and take up its role as a regulator and supervisor of banks.

Other countries' experiences suggest that bank transition under private ownership is the only way to ensure an adequate management that allows the bankers take decisions on credit extension independently from the state. This represents the key to understand banks' role during transition.

The private ownership ensures adequate risk and reward system, which are the basis of the managing structure of businesses in free market economy.

2.2.1 Privatizing the Savings Bank

The Albanian authorities expressed themselves in favour of the Savings Bank's privatization and this process started since some years ago. We can already say that we are nearly at the end of this bank's privatization.

I must emphasize that the Savings Bank's privatization is given a special attention by the government authorities and other international financial institutions that closely follow this process. To assist this process, there have been endorsed a number of legal acts and regulations concerning the approval of bank's privatization program and strategy, its privatization formula, bank recapitalization and coverage of losses through T-bill issuing. A decision on the Savings Bank's privatization procedures has also been approved. It is worth mentioning that for the first time in the last ten years, the Savings Bank recorded profit in the past year and for 2000 this profit quadrupled, establishing a sound basis for the bank's future prospects.

Hence, the bank's recapitalization before the end of the privatization process (unlike the National Commercial Bank that was recapitalized at the time of its privatization) constitutes another advantage of the bank and makes it more attractive to foreign investors.

The Savings Bank's privatization through strategic investors aims at the extension of bank's efficiency and profitability, bringing new bank technologies and knowledge, improving the level of services and providing new products to bank clients according to the modern international banking practices which will certainly increase the bank's reputation and the customers' confidence in it. On the whole, it is recommended that the bank privatization be prepared in such a way as to stimulate a competitive environment, so that the financial sector is not dominated by a few banking institutions, as well as to ensure that the privatized institutions be really managed independently of the government.

3. CURRENT POSITION OF THE BANKING SYSTEM IN ALBANIA

Year 2000 is the third consecutive year, during which our country's macroeconomic situation is within the framework of mid-term development program.

The application of this program has ensured macroeconomic stability, creating supportive premises for long-term development and capacities to prepare developing strategies for specific sectors of the domestic economy and to strengthen institutions and engage in aspects of priority.

I would consider as most important the following developments in the Albanian banking system: developments in the framework of implementing the Bank of Albania's monetary policy, extension of credit to the economy as well as the improved situation of commercial banks.

In 2000 the Bank of Albania undertook all measures under its capacity to accomplish the transition from direct into indirect monetary policy instruments. It is a well-known fact that the Bank of Albania does no longer base on credit ceiling or minimum Lek time deposit rates to deliver signals to the market. Both instruments have become "obsolete". The role of reference rate has been already taken by Repo rates. In this process of exchanging instruments, the Bank of Albania acted prudentially and succeeded to accomplish its goals. This transition was enabled by the attained development of the banking system, the relative favourable macroeconomic environment created in the country and the safer collaboration with the Ministry of Finance concerning the management of budgetary deficit domestic financing.

The attained macroeconomic stability and the need to ensure economic growth enabled the Bank of Albania's opportunities for the third year successively to ease the monetary policy through constant reduction of interest rates. On the whole, interest rates on economy decreased. These factors are assessed to have influenced the growth of credit to the economy. In 2000 the credit supply resulted three times higher than in 1999, the newly accorded loans during 2000 almost equalled outstanding credits at the end of the year and credit repayment was considerable.

In 2000 the situation of the Albanian banking system is relatively assessed as safe and sound. Amongst the most important

developments we may rank the expansion of banking network, the changing capital structure of the system, the capitalization of the banking system as well as its financial condition.

- The banking system mainly expanded its operation outside Tirana. Alpha Credit Bank expanded its activity in Elbasan and Durrës, Tirana Bank expanded on subsidiary in Gjirokastra, FEFAD Bank started operation in Fier and Elbasan, the American Bank of Albania established an agency in Durrës and inside the American Embassy.
- The capital structure of the banking system has noticeably changed in non-public owners and foreign capital representatives. The completion of the National Commercial Bank's privatization made the state-owned capital in the banking system fall from 38.1 percent at end of 1999 to 13.4 percent at end of 2000. For the same periods, the weight of foreign capital in the country increased from 59.8 to 84 percent. This is a direct indicator of the increased foreign investments and relatively higher confidence that investors have in the banking system compared to the whole economy.
- The level of capitalization of the banking system is very satisfactory. The capital adequacy as the straightest indicator to measure the capitalization, increased from 8.2 percent at the end of 1999 to 41.8 percent at the end of 2000, exceeding the permitted minimum of the Bank of Albania by 3.5 times. This situation is a direct aftermath of Bank of Albania's decision[1] for increasing the level of the paid in capital from banks, and the Savings Bank capitalization from the government.
- It is for the second year in succession that the banking system has recorded profit. At the end of 2000 the profit reached to Lek 5.4 billion or 4.5 times higher than in 1999. The adding profit and the commendable capitalization mean more credits and investments from banks.

The increased foreign capital (private) presence, the improved financial situation, banks' adequate capitalization, increased competition and prospects for a stable economic situation have

created the conditions for banks to render a larger contribution to the domestic economy in 2001.

4.   DEVELOPING MICRO-CREDIT INSTITUTIONS

A very positive development evidenced in Albania in the recent years is the presence of micro-credit institutions represented by non-bank financial entities and savings and loan associations and 3 non-bank financial institutions and 4 credit foundations with a credit stock of approximately USD 8 million.

a) Non-bank financial institutions perform one or some related activities, characteristic of the licensed banks, but unlike them they are forbidden to take and collect any type of monetary assets from the public at large.
b) Legally the savings and loan associations are permitted to perform deposit taking, credit delivery and transactions with the third parties. It is also sanctioned by law that the deposit taking and credit delivery is only carried out within the community of members for these savings and loan associations.

Common aspects:

a) The object of their activity is in the areas not covered by the banking system. In this way, new actors emerging in the market to meet customer demands by concurrently increasing the competition complement the system.
b) Their clientele comprises mainly individuals from small business, mostly in rural areas.

Their prospect:

The most important thing is that their activity brings a constant strengthening of their financial statement, which in a general aspect, maintains and consolidates the financial stability of the system for many reasons:

First: although their current number and size is relatively small today, their current effect on the overall financial stability may be either small or insignificant but the basis of market discipline are precisely set in these moments.

Second: all legal spaces exist for broader expansion of operating activity of these institutions in all areas of the country.

Third: I may be more optimistic than the reality, but my conviction is that these institutions may serve as a basis where future banks can be established. I would consider as very important their professional experience in the area and as very positive their relationships with supervision right from their initial activity.

Arranging supervision:

As above stressed, supervision is exercised on behalf of a given right to exercise a certain activity, hence it is justified by the granting of the license.

1. For financial non-bank persons licensed by the Bank of Albania, supervision is exercised on all component elements, such as: licensing, arrangement, analysis, and on-site inspection. Whereas, for non-bank financial entities excluded from the licensing procedure, supervision is reduced only to exchanging information and dealing with the complexity of problems emerged from the delivered information.

2. Savings-loan associations. Based on the Law No. 8089, dated 23.03.1996, the Bank of Albania's role was only to exchange information. With the amendment to the law, which has recently passed in the Parliament but has not yet entered into effect, the Bank of Albania is vested with the right to supervise all elements, as it is charged with the duty of licensing all these micro-credit institutions. To this end, the World Bank has a project for supporting the training of

the human resources to build the complete framework of supervision.

Recommendations:

The future perspective for the majority of these institutions is positive. Personally I share the opinion that there must be taken some steps with respect to common organization to precede some upcoming phenomena.

First: I believe that it is time to think on how to communicate with the same language with one another, with the relevant international institutions, the Albanian public institutions, etc. In this respect, the common organization in the form of an association as that of bankers' is nothing else but a positive aspect.

Second: The current world is information. All efforts made today are not only to ensure it but concern the cost and velocity of data receipt. It is high time to reflect on how to create a common information centre where everyone will search and receive the information he/she needs. Let the credit information centre serve as its first department.

We are aware of the fact that the banking system lacks many aspects in order to be considered a modern system. To develop it, we will face many problems and challenges. Given the above, the banking system is further expanding and consolidating from day-to-day, being presented safe and sound, and with new participants added to it, improving mechanisms expanding bank products which create constant safety and confidence.

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* Fatos Ibrahimi, Bank of Albania's First Deputy Governor and Director of Supervision Department.
1 See the Bank of Albania's Supervisory Council decision of March 31, 1998, according to which all banks must have a minimum of the paid in capital of not less than Lek 700 million to the end of March 2001.

ANALYSIS OF INTEREST SPREAD BETWEEN INVESTMENTS AND DEPOSITS FOR YEAR 2000 AND THE FIRST QUARTER OF 2001

*Suzana Sheqeri**

During 2000 and the first quarter of 2001, the financial intermediation cost of the banking system by the difference of the average weighted interest on the newly posted deposits in domestic currency and the average interest on new investments in domestic currency had a slight gradual reducing tendency monthly. More precisely, from the average of 10.65 percent in 1999, it reached to 7.56 percent in 2000, having an average reduction by 3.09 percentage points. Banks' financial intermediation cost also reduced during the first quarter of 2001, reaching to 4.67 percent.

From year 1996, the data comparison indicates that the banking system financial intermediation cost estimated according to the difference is characterized by declining tendencies and year 2000 represents the year when the banking system reached the lowest level shifting for the first time under one-digit figures.

Table 1 Average annual spread (in percentage)

Years	Average annual spread
1996	19.70
1997	16.20
1998	13.83
1999	10.65
2000	7.56

The difference between the average weighted for domestic currency investments (new credits and T-bills purchased in the primary auction) and the newly posted deposits in domestic currency in the banking system during 2000 oscillated at 9.76-5.82 percent.

Chart 1 Interest spread between domestic currency investments and deposits of the system

The average weighted rate for the newly posted deposits in domestic currency decreased by 3.18 %, whereas the average interest of the newly extended credits in domestic currency and treasury bill investments in the primary auction decreased by 6.28 percent. For the first quarter of 2001, these reductions cite respectively 0.32 and 1.53%.

From the data it results that the reduction of average weighted interest for the newly accepted deposits has been lower compared to the reducing level of average weighted interest for the newly performed investments (for year 2000 by 6.28-3.18 = 3.09% and 3 ml 1.53-0.32 =1.21%).

The narrowing difference between the average weighted interest on newly performed investments and newly posted deposits in domestic currency is a deriving influence from a group of factors, affecting it. Amongst these factors, we may highlight:

- Bank of Albania's policy;
- Improvements in domestic banking system;
- Commercial banks' strategies in the area of domestic currency toward a more active management of domestic currency resources in the market;
- Banks' improving competition;
- Improvements towards the rising rate of Bank of Albania's transparency and cooperation with commercial banks relating to their appropriate understanding of monetary policy steps.

Thus, the Bank of Albania during 2000 has worked with respect to:

- Transmitting monetary policy signals to the market through fixed rate in Repo auctions. Considering it a core interest rate, it was intended to reduce market rates in accordance with the moving inflation and other monetary developments;
- Establishing Repo portfolio with such a size so that the changing size affects the level of Repo rates;
- The remuneration of required reserve, affecting the reduction of banks' financial cost;
- The management of banking system liquidity through the anticipation of government and banking system short-term needs;
- Triggering the development of interbank market;
- More active participation of second-tier banks in the market;
- Increasing the possibilities and the flexibility of Bank of Albania's interventions in the market;
- Improving the variety of second-tier bank instruments.

All these have influenced on enhancing market competition and on maintaining the economic, financial stability, producing effect on reducing the financial intermediation cost in the system, reaching the lowest level where the financial intermediates have moved appropriately to meet their expenditures and collect earnings.

From bank's viewpoint, the constant reduction of interest spread indicates that these banks have become more active in the market also in terms of funds management. Second-tier banks' visual track of this difference indicates that in some of these banks this trend has been downward, generally with slight oscillations at the line of this trend. The declining trend of this difference in these banks is an indicator of the rising rate in the management of domestic currency liquidity, constituting an indicator of the rising efficiency of their work against the domestic currency.

More detailed developments in the level of average weighted rate for the newly accepted deposits and new investments are presented below:

The average weighted rate for the newly posted deposits in domestic currency in the system reached the average of 5.14 percent for 2000 and 4.69 percent for January-March 2001 from 8.32 percent in 1999.

Such a reduction was affected by:

1.   The decrease of the interest rate for domestic currency deposits. During 2000, the Bank of Albania pursued a modified policy in the area of interest rates. The peculiarity lies in the form of applied transmission of this monetary policy in the market during the year. In the first half of the year, the direct instrument of interests was applied, through cutting the required minimum for time deposit rates in domestic currency in January, March and May 2000. State-owned banks reacted with delay to these Bank of Albania's decisions. This delay was reflected in changing interest rates for domestic currency deposits even for other banks. As a result, the average level of deposit rates almost remained the same, decreasing only in May and June. In the Savings Bank, the average level of interest rates reached to 5.55 percent in June 2000, from 6.82 percent in January of the same year.

Press and media attack against the Savings Bank and the fast

public reaction by withdrawing deposits, brought in consequence the Savings Bank hesitation to reduce the level of domestic currency deposit rates mainly in the first half of the year. Under these conditions, even other banks that followed with an average spread of 2 points higher than the Savings Bank did not haste to move their level of interest rates. The non-functioning of this mechanism made the level of average weighted rates for newly accepted deposits in the system reduce at low levels during the first half of 2000.

In the second half of the year, the Savings Bank set in motion, for the first time, repurchase agreements auctions. The interest offered by the Bank of Albania for the accepted amount in the auction had a declining trend. Initially it was 9 percent, whereas in the last quarter of the past year, it was stabilized at 6.5 percent. The Bank of Albania influenced the market through the management of Repo portfolio, making banks reduce interest rates.

Table 2 The monthly volume of excess reserves invested in REPO and average interest rate

	Invested in Repo (in millions of Lek)	Monthly interest average (in %)
June '00	1,150	6,58
August	4,299	6,75
September	6,999	5,37
October	4,999	4,62
November	33,091	5,74
Dec '00	23,216	6,45
January	20,994	5,20
February	34,000	6,10
March '01	43,000	6,20

This fact comes out clearly in the gradual reduction of the average interest on domestic currency deposits after July 2000. So, only the Savings Bank managed to reduce the average interest on the newly accepted deposits, from 5.26 percent in July 2000 to 4.32 percent in December 2000 and 4.8 percent in March 2001. Only time deposits had reducing rates for the same periods, from 7.87 percent to 6.94 percent and 7.0 percent.

Chart 2 Weighted average interest rate for Lek time deposits

Legend: — 12-month •• 6-month — 3-month — Average interest rate
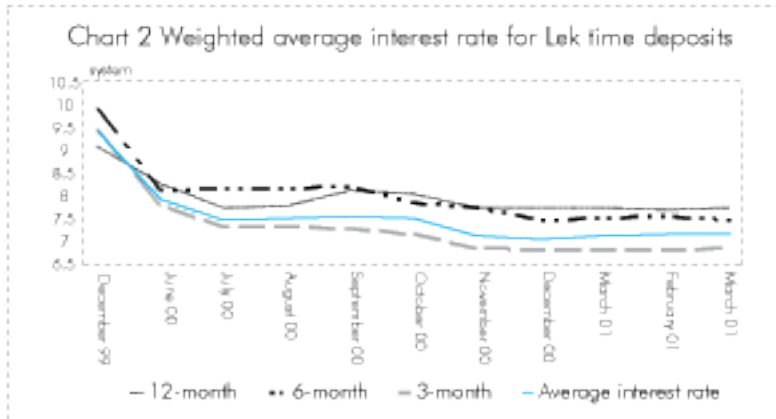
I. DEVELOPMENTS IN THE STRUCTURE OF THE NEWLY ACCEPTED DEPOSITS

The level of newly posted deposits is represented either by a growing tendency on time or demand deposits. However, from their comparison it comes out that the rising tendency in the new demand deposits has been higher than that of time deposits compared to 1999. Thus, changes in the structure of the newly posted domestic currency deposits in favour of demand deposits affected reduction of their average interest.

Table 3 Monthly average of the newly posted deposits in domestic currency (in millions of LEK)

Deposits	1999	Year 2000	Q III of `01
12-month	3.419	3.580	5.570
6-month	1.288	1.551	2.593
3-month	12.576	14.095	16.616
Total	17.283	19.226	24.779
Current accounts	14.903	17.362	21.105

In the first quarter of 2001 the tendency is reverse: New time deposits have higher growth than the demand ones. A similar structure of the new deposits brought about increase of their average rates in domestic currency. Thus, from 4.18 percent in December 2000, this level went up to 4.83 percent, 4.72

and 4.51 percent, respectively for January, February and March 2001.

Different banks display a different structure for the newly accepted deposits. Banks having the largest share in domestic currency deposits presented the following structures:

During 2000 the National Commercial Bank continues to maintain the same structure of newly posted deposits as in 1999. The specific weight of current accounts to total newly posted deposits, accounts for 78-85 percent of the total of newly posted deposits. Therefore, even the cost of newly accepted deposits stands at very low levels (not more than 3.0 percent).

Notwithstanding the above, the composition of newly accepted deposits of a higher level of demand deposits indicates the high degree of liquidity in lek, making this bank be more exposed to risk.

The Savings Bank's structure of the newly posted time and demand deposits is presented in table 4:

Table 4 The structure of the newly accepted deposits in the Savings Bank

Newly accepted deposits	1999	Year 2000	Q I of 2001
Total	24.3	28.23	34.46
Demand deposits	8.77	11.41	13.68
Time deposits	15.60	16.82	20.78

For year 2000, the level of newly accepted deposits maintains the same tendencies as in 1999. Time deposits hold the largest weight to newly accepted deposits. New demand deposits have been increasing in comparison to the total. Even though the weight of the newly accepted time deposits is higher than the demand ones, the growth at higher levels of the demand deposits led to reduction of average weighted rates.

Excluding the Savings Bank and the National Commercial Bank, the rest of commercial banks reflect a gradual reduction of average interest on newly posted deposits in domestic currency.

Despite of that, these banks, in total, result with a higher cost on the newly accepted deposits, compared to the Savings Bank and the National Commercial Bank.

This is expected because of the level of time domestic currency deposit rates in these banks, which is above that of state-owned banks.

Table 5 The average level of newly accepted domestic currency deposits and their average weighted interest

	Year 1999	Year 2000	Q I of `01
Average weighted interest rate on private bank deposits	7.2%	6.0%	4.39%
Monthly average rate on private bank deposits (in millions of ALL)	3.22	4.35	7.10
As a percentage to the total of accepted deposits in the system	10.6%	12.97%	15.54%

These banks' share to the total of newly accepted deposits in the system reflected a rising trend. The declining trend of the average weighted interest rate on domestic currency deposits and the rising trend of the monthly average on the newly accepted deposits confirm banks' improved competition in domestic currency deposit market.

II.   Banks' performed investments in the system reflected a constant decline of the average weighted interest in the banking system. From table 6, it is evidenced that this level shifted to one-digit figures over the first quarter of 2001.

Table 6 Average weighted interest on domestic currency investments (in percent)

	Year 1999	Year 2000	Q I of Year 01
Average weighted rate on Lek investments	18.90	12.70	9.36

Amongst the factors affecting such decline are the investments' structure and the rate of return on domestic currency investments. Out of their analysis we will also highlight the factor having the most significant effect on this decline.

1. Banks' investment structure according to the risk, would be as follows:

Table 7 New investments in domestic currency (in millions of ALL)

	Year 1999	Year 2000	Q I of Year 01
Domestic currency credits	410.30	263.21	219.27
Treasury bills	10,861.31	17,232.32	16,193.23
Investments	11,271.61	17,495.53	16,412.51

The data represent monthly averages.

Banks' investment structure assessed according to the risk has changed in favour of rising investments in Government securities, treasury bills and new credits. The newly extended credit in domestic currency as by monthly average occupies a small share compared to investments carried out in the primary market of treasury bills. January - March 2001 keeps the same tendency. Accordingly, even the effect of Lek credit portfolio on average weighted level of lek investments is noticeably small.

As in the previous periods of time, lek credit to economy continues to be carried out by the Fefad Bank, Tirana Bank, Malaysian Intercommercial Bank, and Alpha Credit Bank. The Fefad Bank and Tirana Bank occupy the main weight. The main tendency of credit delivery is mainly from 6-12 month credits and from 1-3 year credits.

The National Commercial Bank and the Savings Bank continue to invest only in the primary market of Government securities. Non-lending to economy by the largest bank of the country, which holds over 80 percent of the banking system liquidity in domestic currency has made investment in treasury bills be considered as potential means to cover the cost of interest expenditures and of interest-free assets.

This fact as well as other banks' increased participation in the primary treasury-bill market indicates that treasury bill investments in the primary market of securities continue to occupy the bulk of bank investments in domestic currency. Treasury bill investments in the primary market of securities occupy the

average of 36.0-40.0 percent of the total accepted deposits. Banks value treasury bill investments as the easiest way to cover the cost of deposit returns.

2. CREDIT RATE EFFECT ON DOMESTIC CURRENCY AND TREASURY BILL YIELD

The average weighted interest on domestic currency credits during 2000 continued to stay at high levels. Their level remained almost unchanged over the first half of the year. They had a month-to-month declining tendency only in the second half of 2000.

The average level of credits reduced significantly in the first quarter of 2001. According to the structure, the largest decline was in interest payables for 6-12-month term and over 3-year term.

Table 8 Average interest of credits in domestic currency by maturity term (in percent)

	December'00	January'01	February'01	March'01
Up to 6-month	21.19	23.58	18.92	20.92
6-12 month	23.70	15.11	19.61	16.10
1-3 year	23.70	22.90	20.71	22.19
Over 3-year	27.00	15.09	16.30	15.58
Average weighted for the system	23.54	16.63	20.00	17.61

The constant and gradual decline of other market rates, such as treasury-bill yield; deposit rates were also accompanied by declining interest rates on credit to the economy. These interests were the last to record market decline, after almost remaining at the same levels for a long period of time.
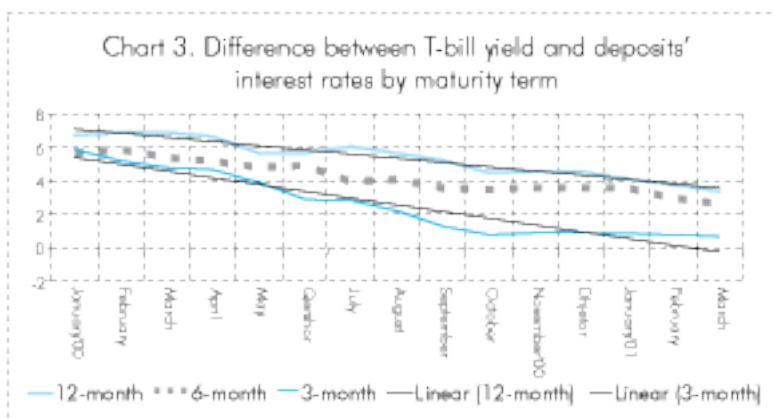
This fact as well the rising level of newly accepted deposits in domestic currency at public banks comprised positive premises that in the future these banks will provide ongoing support to the economy through domestic currency loans at higher levels than at present.

As the share of newly extended credits is small compared to T-bill investments in the primary market, the size of impact of the credit interest rate on the average weighted interest rate for investments is small. Therefore, the main tendency of average interest on investments is determined by T-bill investments.

Treasury bill yield has been falling. On average level, it has been reduced by figures presented in table 9 for the three maturity terms. During 2000, the reduction has been more significant for quarterly T-bills, while over the first quarter of 2001, the reduction has been more significant for 6- and 12-month T-bills.

Table 9 Treasury bill average yield and change (in percent)

	June'00 (1)	Change (1-12.99)	Dec. 00 (2)	Change (2-1)	March (3)	Change (3-2)
12-month T-bills	14.00	-1.65	12.33	-1.67	11.14	-1.19
6-month T-bills	13.06	-2.11	11.34	-1.72	10.14	-1.20
3-month T-bills	10.73	-4.15	7.83	-2.90	7.57	-0.26

Chart 3. Difference between T-bill yield and deposits' interest rates by maturity term

——12-month ▪▪▪6-month ——3-month ——Linear (12-month) ——Linear (3-month)

Reduction of treasury bill yield in the primary market of securities has given its main effect on the decreasing level of average weighted interest for Lek investments.

For the first time during the second half of 2000, there was rendered interest payment on required reserves held with the

Bank of Albania, beginning from August 2000 at one third of market rates and later in December at half of these rates. By means of the required reserve remuneration, the Bank of Albania intended reduction of investments price, by decreasing the intermediation cost of the banking system.

More precisely, for the period before the remuneration of required reserves, the cost of required reserves in domestic currency measured by the difference between domestic currency deposit and investment rates oscillated at 1.99-2.96 percent.

After the remuneration of required reserves at 1/3 of quarterly treasury bill yield according to the recent auction, the cost of the required reserve measured by the difference between domestic currency deposit and investment rates fell below 1.0 percent. More precisely, they were 0.44, 0.64 and 0.86 percent respectively for September, October and November 2000. The rising percentage of remuneration in December 2000, from 1/3 to 1/2 of the quarterly treasury-bill yield, despite the declining tendency of quarterly treasury bills, affected the reduction of the compulsory element of the required reserve. After this change, the cost of the required reserve measured by the difference between domestic currency deposits and investment rates continued narrowing, reaching minimum values for December 2000-March 2001 (0.86 percent).

The remuneration of the required reserve brought positive effects on releasing banks' cost by reducing the non-invested share. However, the rate of commercial banks' transmission of this effect to the market was different in invested prices in the market of treasury bills and credits. As to lending prices, they continue to remain at higher levels even after reductions. The spread between credit and deposit rates in domestic currency is about 2 times, not being very promoting for the lending market development.

Unlike credits, the treasury-bill yield had a gradual reduction, maintaining narrow differences with deposits. The fact that the Savings Bank is the main market bidder makes the price defined

by demand-supply somewhat disfigured and dictated by its ruling position in the market.

For non-public banks, the intermediation cost estimated according to the difference for year 2000 and the first quarter of 2001 reduced significantly compared to 1999. Also for the period of January-March 2001, its level maintained the same tendency. The reduction has been more significant in new investment rates compared to the newly posted deposit rates. Despite that, this level remains higher than this difference for the system.

Table 10 The difference for non-public banks

In percent	Average weighted for 1999	Average weighted for 2000	Change 2000-1999	Q I of 2001
Average deposit interest rates (1)	7.20	6.06	-1.14	4.39
Average investment rate (2)	20.41	14.18	-6.23	11.49
The difference (2-1)	13.21	8.12	-2.74	7.10

ESTIMATING BANKS' FINANCIAL COST ACCORDING TO BANKS' AND THE SYSTEM'S FINANCIAL RESULT

According to this method, based on banks' financial result for year 2000, the banking system presents better indicators on the gross and net margin than in 1999.

The changing figures of these indicators remain positive and at good levels even in the first quarter of 2001. From the chart it appears that gross and net margins are positive for all the months of the year 2000 and for the first quarter of 2001.

Table 11 The change in financial result indicators (in millions of Lek)

	Year 1999	Year 2000	Q/1 Year 2001
Interest margin	432.85	735.90	738.6
Gross	517.80	1,455.78	1375.1
Net	263.25	1,123.71	1024.2

The fact that the monthly change of interest margin had a year on year growing trend indicates that the banking system had a rising tendency for interest collections compared to expenditures.

Chart 4 The change of the banking system's gross and net margin
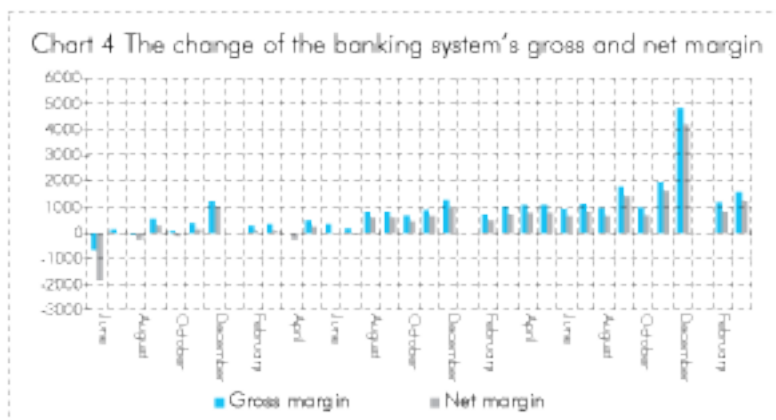
On the other hand, even the incomes from other operations, with some exceptions, have increased, bringing about growth of the monthly (average) change of gross margin year on year. After discounting operating expenditures, the change in the banking system's net margin remains at positive monthly averages. The periodical increase in their monthly change is either dedicated to the increase of interests received or other incomes, while the operating expenditures of commercial banks did not reflect any significant changes during the year.

The observed trends of these indicators in 2000 continued to be maintained even in the first quarter of 2001.

The estimates of these indicators for separate banks in the system indicate improved indicators for year 2000 and on. Estimates made in the Savings Bank reflect a positive statement of the monthly change for gross and net margin indicators per each month.

For private and joint venture banks, monthly movements of gross margin are generally positive for year 2000 and ahead.

Tirana Bank, Alpha Credit Bank, Fefad Bank and American Bank of Albania have good indicators of financial result. Net margin movements are positive in the aforementioned banks.

Given the above, we may specify that during year 2001 and the first quarter of 2001:

- The banking system reached the lowest level of spread:
  - passing to one-digit figures,
  - maintaining the declining tendency,
  - having slight and very smooth oscillations against the line of the trend:
- The reduction of average interest for investments (treasury bills) is higher than the reduction of average weighted interest on the newly accepted deposits in domestic currency;
- For January-March 2000[1], the average weighted interest on investments shifted under one-digit figures, reaching for the first time the lowest level in the system, 8.33 percent;
- Domestic currency investments in the economy continue to occupy a small share compared to total investments;
- Although posing a very insignificant effect as above stressed, we can not neglect the fact that the level of average weighted interest for the newly extended credits reduced during the first quarter of 2001 at a higher level than the previous periods;
- Generally, all banks of the system aim at reducing the intermediation cost, endeavouring to maintain lower spreads compared to the previous periods;
- Indicators, according to the commercial banks' financial result, indicate improvements of every bank operation in particular, and of the entire system in general;
- Under the conditions when the treasury-bill yield is higher than time deposit interest in domestic currency, the type of domestic currency investments in treasury-bills relieves banks' job for covering the cost of domestic currency deposits. But, on the other hand, it does not promote banks to undertake long-term investments in the economy, taking over risk.

Year 2000 is considered as the initial phase of basing the monetary policy on indirect instruments, and in general, it is assessed that the Bank of Albania's monetary policy has been transmitted to the banking system.

During 2001, the Bank of Albania will expand money market operations at a broader scope, intending the rising efficiency of these instruments to guarantee the achievement of its principal target.

The market intervention through open market operations and the stimulation of interbank market will impact on increasing the flexibility of monetary policy instruments. Through these developments, the stabilization of short-term interests and liquidity levels will be ensured in the banking system and its competition will be further enhanced.

On the other hand, the economy has premises to be more credited by the banking system. An important factor would be the foreseen reduction of the budget deficit financing level by the banking system resources, providing broader spaces for increased financing to the economy. The Bank of Albania's monetary program for 2001 has forecasted a growth of the stock of credit to the economy by Lek 8.1 billion, comprising 29.6 percent of its current stock.

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* Suzana Sheqeri, specialist, Research Department.
[1] The data have been made available by Supervision Department, monthly statement of income and expenditures. The financial result includes both the activity in Lek and in foreign currency.

WHAT IS THE ECONOMY EXPECTED TO, AFTER THE TERRORIST ATTACK?

*Fatos Ibrahimi**

It's still early to appropriately anticipate the effects of the gravest incident happening in the United States since World War II, when the military-naval basis of Pearl Harbor in Pacific Ocean was hit. This is so, because after the first reaction, it is hard to learn for how long financial markets, consumers and businesses will continue to react, and above all at what intensity the United States will react against this terrorist act (which according to President Bush statement is considered equal to declaring war against United States), as the rest of the states are united and support the United States in their war against terrorism.

This war that has already begun according to different statements, will be long, difficult, and unlike the traditional war scenarios developed until now. The difficulty in anticipation rests with the fact that it is an unprecedented case and beyond any forecast for the loss it brought about to human lives. However, numerous comments and analysis have been made about the case by prestigious institutions, such as research institutions, universities, central banks, etc. Irrespective of several questions about the future trends to be tracked by the American and the World economy, the following factors must be taken into account in order to make a forecast:

First: What was the position of the world economy and of that of the United States on the eve of the terrorist attack against both symbols of capitalization in the United States: the World Trade Center, as an economic symbol, and the Pentagon's, as a military symbol?

Second: What was the immediate reaction of financial markets was after the incident, in respect of:

- Capital market,
- Money market,
- Foreign exchange market,
- Labour market,
- Businesses' and the consumers' reaction.

And third: What will be the intensity, the time duration and the likely dimensions to be taken by the already commenced conflict between the United Sates and all other states that support international terrorism, with Bin Laden as a symbol?

Before answering each of the above-mentioned questions, it is necessary to consider three things:

a. Since the terrorist attack, ongoing economic forecasts will encounter many difficulties, because of increased insecurity, instability, the consumers' psychological shock, which will undoubtedly be reflected in future forecasts, making it more difficult than under normal conditions. Considering that many financial companies, market analysts, dealers and broker companies developed their activity in the World Trade Center (some are already dead and some others have experienced the terror of that dreadful event), gives the evaluation process a personal dimension.

b. It is important to separate and distinguish between the incident's short- and long-term consequences. As already known, immediate consequences were negative on consumer, markets and business side; however time has to go by to expect the mid-term consequences, which may serve as a better basis for future forecasts.

c. Also, according to the pronunciation of some world finance personalities, as the Director of the IMF, Kohler, Greenspan etc, long term effects will be relatively small.

Thus, long-term forecasts will be affected by the most essential factors, determining the economic developments such as the productivity, the fiscal position of a country, the statement of the balance of payments, reflecting the current and capital account, inflation and foreign exchange regimes, etc.

We should state that the American economy had given signs of descending growth rates since the previous year-end. Therefore, it was reacted through easing the monetary policy and constantly cutting the fed fund rates from 6 to 3 percent currently. After a ten-year bloom with a strong economic growth, low inflation, a stable-growing currency, reflecting the productivity of the world's largest economy with a low unemployment rate, largely below the rest of the world's, the American economy started to give signs of entering into a shrinking cycle of the overall business.

World economy forecasts were not optimistic at the end of the first six-month term. Indicators reflected clearly a slow-down of the economic growth in the USA, Japan and European economy.

The latest forecasts before the terrorist attack indicated an economic growth of the American GDP of no more than 1.5 percent, 4.8 percent decline in industrial output as well as 7.2 percent decline in high technology products compared to the previous year.

While the industrial output, business activity and business investment indicators had declined, the customer expenditures resulted at a very close indicator to consumer confidence indicator that kept the United States economy suspended, to escape from recession. However, Michigan University survey published on September 13, including the period up to September 10, one day before the terrorist attack, pointed out a drastic decline of customer confidence. Based on the fact that

consumer expenditures comprise the backbone of American economy, reaching at nearly 2/3 of GDP, the negative impact of this process on the economic growth of the country may be imagined. Irrespective of these indicators, many economists believe that the United States could escape a similar recession by supporting eased monetary and budgetary policies.

At a more difficult situation was the Japanese economy, reflecting evident signs of recession, together with Singapore and Taiwan. The problems of Japanese economy, according to several opinions by experts, are sharper than those of the United States' economy, if we abstract from the latest event. The Japanese economy, marking the fourth recession in ten years, was challenged by the need for structural reforms, especially in the banking system, in monetary and budgetary policies. Bad loans in the banking system continue to be problematic even currently.

Adjustments in economic activity are made more difficult, taking into account the economic recession, the export decline which is a vital component of the Japanese economy and the negative effect reflected in the employment rate and income level, which in turn affect the level of the aggregate demand.

The aggregate demand reflects not only the economic recession inside the country, but also the decreased demand for high technology products by the United Sates, which represent the main importer of these products. Decline of the demand for Japanese exports, accompanied with appreciating tendencies of Japanese Yen, indicate that the Japanese economy will be faced with many problems until it comes out of its declining cycle.

Although not at the same rates, the situation was not optimistic even in Europe. Economic indicators did not anticipate crisis, nor any dynamism or a satisfying growth potentiality.

Immediately after the terrorist attack in New York and Washington and after the several-day closure of the main USA capital markets, such as NYSE, NASDAQ AMEX etc., the instant reaction

was a decreasing value of shares by all American Stock Markets followed by the Main European and Asian Stock Exchanges. All stock market indicators as DOW JONES, NASDAQ, S&P, etc., underwent an average decline of 10-12 percent.

It must be said that the decline was not as dramatic as expected, considering that Dow Jones decline in 1987 was 22 percent and after one day, almost all stock markets began to pick up. The noted oscillation in the days to come was within the normal margins. It may be noted that capital markets are expecting for the shares to be developed in the future, either from the political and military viewpoint or from further actions and measures to be undertaken in the field of monetary or fiscal policy. Interest rate cut is also considered as an indirect support for capital markets being first supportive to businesses.

To urge the United States economy is not only acted through the monetary component but also through fiscal promoters, considering the fact that the United Sates Federal budget is forecasted with a surplus of nearly USD 175 billion.

As a first step, the United States Congress approved the proposal made by President Bush, to support military expenditures through a USD 40 billion package, and another USD 75 billion package will support those branches of the economy that have been mostly hit by the consequences of the terrorist attack of September 11th. The easing of the fiscal policy may be attained by operating not only on the side of expenditures but also on the side of revenues, through a further reduction of taxes, a promise made by President Bush during his electoral campaign. According to some analysts, as result of these actions, the United States budget may record deficit for 2002, that's why they suggested prudence with the fiscal component, in order to prevent long-term negative consequences.

The monetary markets reacted immediately. The Federal Reserve remained open even during the day of the terrorist attack, announcing that it was ready to offer liquidity to avoid any potential panic in the banking system.

Later on, it was operated by cutting interest rate twice, reaching the lowest level of 2.5 percent in 40 years. This easing of the monetary policy was for the ninth time in succession from the beginning of the year, and constitutes a very aggressive monetary policy. Before the terrorist attack, many economists believed that by easing the monetary policy, the United States might overcome the economic shrinkage without falling in recession.

However, hopes and optimism mostly fell after this terrorist attack and recession almost became inescapable. Other central banks as the ECB, the Bank of Canada, the Bank of Switzerland, etc., acted in the same way. Although more "rigid" than the FED with relation to interest rates, the ECB paved the way for a expansionary policy, cutting interest rate thrice, from May of the current year (from 4.75 down to 3.75 percent).

Other reactions are expected in the future, in terms of easing the monetary policy, and according to the forecasts, only by spring, of the next year, after leaving the shrinkage phase, the monetary policy is expected to change direction in the USA.

The reaction of foreign exchange markets was instant after September 11. There was a depreciation of the dollar in all the markets, either in relation to the EUR that reached USD 0.94 and has recently fluctuated by 0.91-0.92, or to Japanese Yen that was 116-117 per USD. However, there was an immediate cooperation among the central banks and a willingness to buy USD, as well as concrete operations were carried out in Europe and Japan, where considerable quantities of USD were bought, either by the Central Bank Japan or by the Ministry of Finance of Japan.

The Japanese authorities are worried because a weakening of the USD will further accentuate the weakening trend of Japanese exports, which would further decrease the demand of this country, which is presented as the key problem for Japanese to overcome the crisis. That's why the Japanese economy will continue to ease the monetary and fiscal policies, even though

the interest rates are just a little above the zero to support a weakening of the Japanese Yen.

The labour market also had an instant reaction. The most hit companies from the terrorist act were air travelling companies and those of producing passenger jets. The daily loss of air travelling companies recording USD millions enforced them to announce massive adjourning from work, which up to now reaches at 100 thousand persons. Many prestigious companies, such as Boeing and British-Air have advertised many of such announcements.

But the ones to immediately react against this terrorist attack were the consumers. Michigan University latest published questionnaire on September 24, indicated a further decline of consumer confidence, which means a further decline of the aggregate demand and ongoing perspective to emerge the economy from that general shrinking situation, where it happens to be currently, considering that consumer expenditures comprise nearly 65 percent of USA gross product.

On October 7, in the evening, it was announced that the British and American military jets started bombardments against the military bases and training headquarters in Afghanistan. Surely, the way these military operations will develop, their duration, the intensity and the dimensions they will get will have their effects on the development trends of American and world economy. Here must be also taken into account oil prices, as the basic stuff related to military operations, and their effect on the world economy. After September 11, we had an immediate upsurge of oil prices and later on the meeting of OPEC countries and the analysis of mutual factors reduced crude oil prices by USD 23-24 per barrel.

In spite of the above planned analysis, many economists see as optimistic the world economy perspective, expecting that the emergence of the United Sates economy, if evidenced in upcoming quarters, will be attained within 2002. Today, the world economy is valued as more prepared to confront crisis situations than in the previous decade.

Low inflation rate, world-wide and sound monetary and fiscal policies applied in co-operation with international financial institutions serve as supportive factors in this reasoning. So, analyzing all above-mentioned facts, the September 11 incident will impact on the world economy trends. It may be compared to hand full of sand cast in the gears of the world economy mechanism, befalling in the most inappropriate instant for this economy.

The terrorist attack of September 11, having a global impact, will for sure influence even our country. It needs to be prudentially analyzed to take heed of and avoid the negative impacts.

The Albanian economy is a small economy and its communication with the economy of the rest of the world is relatively small. Its most sensitive channel of communication with the rest of the world is the foreign exchange market. This market reflected its first reaction after the September 11 terrorist attack. After the decline of the USD to 141 Lek (that reflected USD reaction to EUR and other foreign exchanges), the US dollar stabilization internationally brought its stabilization in the domestic market.

To see this incident's likely impacts on the Albanian economy, the balance of payments must be studied, as the basic document where such effects are reflected. So, a general suspension of demand might have a negative impact over our domestic exports, estimated at USD 250-300 million.

Although this impact may be insignificant, it still can not be neglected but must be taken into account even concerning tourism, as more related to overall infrastructure and to the safety level.

It is still unknown how long this insecurity climate will continue. Concerning the capital account, it must be taken into account that for some time investments may remain in expectation of forthcoming developments, some investments may be postponed in time, and this is so because of the concentrated attention in another region of the world.

Banking industry in Albania is believed to be untouched from this incident, because domestic bank security portfolios occupy a very insignificant percentage, approximately 2-3 percent of the total bank assets and these investments are mainly in debt securities and not in equity securities, which have a higher level of sensitiveness and are likely to be influenced by such incidents.

Depending on business developments in mid-term periods, credit risks are not excluded.

Thus it is assessed that from the macroeconomic viewpoint, the Albanian developments will mostly depend on the domestic factors rather than on international developments.

Hence, irrespective of the optimistic aspect regarding the likely impacts of this terrorist act on the Albanian economy, we must take into account the fact that instability and insecurity have highly grown everywhere in the world. This requires a high level of engagement and co-operation among all responsible institutions to intervene in monetary or fiscal area by means of respective instruments, if necessary.

This incident has laid down before all responsible institutions the need for a better arranged cooperation and strict application of all legal requirements on money laundering prevention to intercept the financing resources of international terrorism.

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* Fatos Ibrahimi, First Deputy Governor of the Bank of Albania.

ALBANIA AND EURO

Gramoz Kolasi*

The approaching termination of 2001 corresponds with a very special event for the world international finances and business: with EURO "introduction" as physical cash. The size of this event is really great when remembering that the economic and social formations closely connected and interested are just the same either from the number or the geographical stretch.

The monetary unification of United Europe reached since at early 1999 will mark a new development from January 2002, becoming a noticeable and tangible reality for all. It seems that it is time to start self-education and familiarization with this newly expected phenomenon. It is reasonableness to get surprised from the reducing basket of foreign currencies in two or three major currencies, or more precisely we should not besieged by panic when instead of DEM, ITL or GDR we will hear a single word EURO.

From this paper or broad public practical interest's point of view, having a bit retrospection in history does not seem so very important. Just for curiosity, it would be interesting to mention some two or three basic moments bringing the introduction of the United Europe currency, to further pass on to the interpretation of many practical elements as its "virtual look", importance it has

for the Albanian economy, and the Bank of Albania'measures ahead, etc.

SOME HISTORY

The first political step to establish the United Europe corresponds with Rome Treaty of year 1957 when European country leaders agreed on the establishment of Common European Market intending the increase of economic welfare and a very close cooperation through peoples of Europe. Meantime, with the passing of years, it was added the cooperation and common European initiatives, especially, in political area, genuine decisions that preceded the economic and monetary unification of EU reached at something a bit later, at the beginning of 1986 through the Unique Act on Europe (1986) and European Union Treaty later in 1992.

The most important development corresponds to January 1,1999 when it was started the so-called third stage of monetary unification. More precisely, it was decided that the monetary policy of Euro-countries be common from the moment Euro was accepted as the common currency to count. The conversion of Euro component currencies with one other will be made based on fixed ratios, from the moment the 11 participating countries' currencies became national expressions, simply.

On January 1, 2001, Greece added the number of Euro-area countries, bringing the number of member countries in 12.

NEW EURO NOTES. HOW WILL THEY BE?

Perhaps not right from the start at January 1, 2002 but in the days to come everyone will get the opportunity to own an Euro note? Of what denominations it may be? What will be its common features and what is the meaning of used symbols and figures stamped on it?

These are natural questions arising right from the start. This intuitive curiosity becomes bigger, when, as already known until

now, Euro results a currency to account and the perception of individuals for this type of money is difficult as long as it remains intangible and it can not carried in the portfolio.

Euro designers have tried to maintain balance through each country identity and by means of used symbols indicate their unification. Denominational values of Euro coins are 1, 2, 5, 10, 20 and 50 cent as well as Euro 1 and 2 comprise the coin series[1]. The eight coins vary in size, weight, material and thickness.

Upon designing the coins it has been agreed that they bear a common front, whereas the reverse be national or otherwise reflect national symbols[2] for every member country. Reverse from banknotes, coins bear the same front side, whereas the reverse side is national, which means that it varies with the countries.

Irrespective of the reverse side, all Euro coins are legal tender in all member countries of EU.

Reverse from coins, Euro notes have the same aspect in all member states. The whole series is comprised of seven denominations EUR 5, 10, 20, 50, 100, 200 and 500 (figure 2-8). Inspired from "European Epochs and Styles" Euro notes are designed by the Austrian art-designer Robert Kalina. The seven selected architectural styles symbolize seven periods of European culture: Euro 5 = Classicism, Euro 10 = Romanticism, Euro 20 = Gothic Epoch, Euro 50 = Renaissance, Euro 100 = Baroque and Rococo, Euro 200 = Iron and Glass Architecture, Euro 500 = The Modern Architecture of Century XX. Architectural elements reflect each epoch typical style and they do not represent real monuments.

Common elements of each denomination specify the European flag additionally to EU 12 stars and the initials[3] of the European Central Bank in five linguistic variants, and Euro lettering in both Latin and Greek.

We find the reflection of other symbols such as the bridge on the reverse of the Euro notes symbolizing the close co-

operation and harmony existing between the people of Europe and between Europe and the rest of the world.

In conclusion, it must be said that Euro reverse size and color of each denomination is to facilitate their identification. The higher the denomination, the larger the banknote. On the other side, to assist the blind and the partially sighted, there are incorporated special distinguishing features.

To further extinguish the curiosity, it has been decided that on January 1, 2002, 14, 545 million Euro notes be available and dispensed according to the states and denominations, respectively presented as in figure 9-10.

The further curiosity may be further extinguished by giving more details on security features and printing techniques. It has been thought on how to provide more detailed explanations, but individuals and economic agents at the moment are more interested on how they will sound and the measures taken by the Albanian authorities in order that the issuing currency be as more natural as possible.

EURO AND THE ALBANIAN ECONOMY

The fact that majority of the trade developed with Euro area countries and the bulk of financial aids and credits launched to Albania from EU are in EUR, does not represent a new thing. In addition, foreign exchange inflows from emigrants working abroad will be in EUR, as long as most of them are settled in Greece, Italy and Germany. In this sense despite the Albanians liking of USD, most of foreign exchange inflows, as observed, will be expressed in EUR.

In this way, the domestic economy is exposed to a certain risk related to EUR exchange rate to other foreign currencies as well as against Albanian currency, Lek. A descending value of EUR against Lek would enforce that for every unit of imported goods, the Albanian traders pay less Lek(s) and the pressure of import prices over the domestic developments is smoother, consequently.

If the Albanian trader has to pay more than in the previous day for EUR unit, it is understandable that he will correct all retail prices in Lek with the tendency to increase them.

Additionally to macro implications, Euro flowing in circulation may be accompanied with different types of panic. A good part of Albanians set in liquid equity (with the banks or at home) is held in EUR. Although USD is estimated, as Albanians most preferred currency to treasury, it still exists the next alternative, that of holding them in Euro component currencies[4]. On the other hand, owing to the existence of informal economy, it may appear the case when many individuals and economic agents (businesspersons or foreign exchange dealers) hold a certain quantity of DEM, ITL etc. In these conditions it is not excluded the possibility that bank windows be "crowded" at a certain moment, which phenomenon at the absence of a previously conceived management may take the dimensions of panic, and the consequences may be felt either on the financial system stability or government itself.

Although two years have passed from launching Euro as a currency at accounts, still the majority of persons prefer to say that they own DEM, ITL or GDR. Indeed, they do not know that their exchange ratios to Euro are once fixed for good and there is no need to ask in the market on the daily exchange rate of GDR to Euro. Common people lacking knowledge on that may turn into a speculative factor, which combined with the likely consequences, above explained, may take bigger size.

Turning once more to conclusions drawn from the above paragraphs, we would evidence that while exchange rate related risk has mostly to do with core macroeconomic principles, other implications are mainly affected by subjective reasons. As a result, to avoid them is absolutely possible and, the Bank of Albania has for quite some time started the preparations.

WHAT IS THE BANK OF ALBANIA PLAN?

The Bank of Albania has considered the remaining term to January 1, 2002 as an intensive period for public information

and education, especially from September 2001. Practically, the conceived measure-plan additionally to the information campaign also consists in performing some operating actions, related to Euro issuing in circulation, as well.

However, these latter are more technical details, and handling them would be part of bankers' debate. What's most interesting is the public information campaign, whose purpose will be establishing an as more appropriate environment as to the more natural reception of Euro currency from the Albanian reality.

To serve this end, the Bank of Albania has understood that public information and education campaign will fail, if it (the Bank) can't cooperate and share this responsibility with other financial institutions in the country, with the bankers' association and media, generally.

This was the cause that urged the Bank of Albania after the termination of the first stage[5] (to August 31, 2001) commence an information campaign[6] on Euro aspect, security features, Euro component currencies' legal expiry dates, etc. The ample information on the above characteristics of the new Euro currency will be available in all ATMs of banking system, foreign exchange agencies and the rest of financial institutions licensed by the Bank of Albania.

To publish the information, both the written and the electronic media are invited to give their contribution. During the second phase, workshops organized by the Bank of Albania with detailed explication for the above dealt matters will provide great assistance. At the same time, to serve to a broad number of interested people, the Bank of Albania will be ready to hold special issues for visual media.

The second group of forecasted measures has an operating nature and will be intended to ensure that:

• On January 1, 2002 Euro be present in Albania as well;
• The conversion of foreign exchange holdings in domestic

currencies of Euro-area countries will be performed without excitement;
- It will be guaranteed control on exchange rate potential speculations.

To precede the completion of these three targets, the Bank of Albania deems that additionally to its operations, it (the Bank) will also require from the second-tier banks to take measures:

- To ensure sufficient cash funds in compliance with their Euro holdings in component currencies before December 30;
- To compile a measures' plan on how banks will solve this question.

The Bank of Albania, on its side, will take all measures to ensure own funds in cash based on the structure and volume of denominations to evade the likely exchange rate speculations.

INSTEAD OF CONCLUSION

The remaining period should not be considered as acceptably long, but on the other hand, it should besieged by panic. Similar facts like the non-existence of an approximate estimation on the total amount of Euro holdings held by the Albanian economic environment and individuals comprise worries nevertheless they can and must be exhausted.

On the other hand, it must be admitted that in the public information campaign every party must play its own role and the respective responsibility for the public awareness and education must be considered as shared in three, by the Bank of Albania, financial institutions and media.

NOTES

* A presentation of Mr. Gramoz Kolasi, Deputy Director of Bank of Albania's Research Department in the workshop "Euro flowing in circulation and dissemination".

[1] Euro coin is equal to 100 cent.

[2] Belgium, Luxembourg, Netherlands and Ireland have decided on one motif respectively, King Ludwig II, Henry, the Great Duke, Beatrice the Queen, national symbol of harpsichord. Coins minted in Italy, Austria and Greece have a single motif, as well. From coins minted in Germany Euro 1 and 2 bear the eagle of the Federation, meantime Euro coins 10, 20 and 50 cent inscribe the Gate of Brandenbourgh, and three other smaller-value mints Euro 1, 2 and 5 cent, a limb from an oak-tree. France, Spain and Portugal have used three different motifs, as Germany.

[3] EZB-BCE-ECB-EKT-EKP include initials based on 11 official languages of EU.

[4] Domestic currencies corresponding to 12 Euro area countries.

[5] During this phase, there are expected different informational publications and consultations with bankers' association.

[6] This campaign corresponds to the second stage, starting from September 1, 2001 to December 31, 2001. Breaking the campaign in two periods is relative to the fact that the European Central Bank has declared an intensification of its information and educational campaign starting from September 2001.

WORLD AND ALBANIAN ECONOMY AFTER THE TERRORIST ATTACKS OF SEPTEMBER 11, 2001

*Diana Shtylla**

The terrorist attacks of September 11 in New York and Washington are considered as a shock event for the United States and for the whole world economy.

Nevertheless, the ensuing period (September 11 and ahead) had some distinctive moments that can be divided as follows:

1. The terrorist attack on USA (September 11).

2. The false news on the starting attack of United States against Afghanistan (round September 21 and October 1).

3. The starting attack of United States against Afghanistan (October 7).

As stock markets represent the most sensitive and perhaps the most accurate thermometer of the political and economic situation worldwide, the following summary starts the introduction of the shock impact, precisely, with a description of stock markets around the world.

A. STOCK MARKETS

1. STOCK MARKETS OPENED IMMEDIATELY AFTER THE ATTACK - SEPTEMBER 17, 2001

The decision for not opening markets until September 17 could not prevent the expected decline in share prices. In the first day of activity, Wall Street recorded a declining index of Dow Jones with 7. 13 percent and NYSE index by 6 percent. The first companies to lose points in the stock markets were air companies and the big insurance companies. Directly injured from the terrorist attack were many financial companies suffering considerable material and human losses. A similar attack on the United States was unique. Moreover, from the type of the attack, the American people and policymakers highlighted the feeling of patriotism and solidarity. Although anyone could scarcely think of an incentive for purchasing shares as inspired from patriotic feelings, it was precisely that that happened in the first days of the opening of stock markets all over the United States. Perhaps the reduction of stock prices would have been higher at the deficiency of immediate coordination of expansive policy of Federal Reserve and the confidence injected in the capital markets through appeals and actions that supported the stocks purchase.

At the same time, looking with optimism the Federal Reserve's 17 September decision to reduce the money cost by 0.5 percentage points made the stock markets in Europe have a positive reaction recouping within the second half of Monday all losses suffered at the beginning of it. Concretely, Milan stock market recorded 0.17 percent increase, that of Paris +2.3 percent, London Stock Exchange +2 percent and that of Frankfurt + 2.9 percent.

2. THE END OF THE FIRST WEEK AFTER RE-OPENING

September 21 did not mail good news for stock markets all over the world. In the meantime, in New York excavations

continued under the World Trade Center. Various messages related to the United States' attitude to Afghanistan arrived from politicians and media. The fear that a merciless attitude of USA would instigate the same ferocious and unpredictable stand on behalf of terrorists made the stock markets list the lowest points at the end of the week. Shareholders, scared from what might be happening in the next two days (when stock markets were closed), hurried to largely sell their shares enforcing the stock markets record losses that varied from 5-7 percent at the end of the day. As the expectancy of declaring war from United States would not suffice that, the European stock markets found themselves in front of many technical problems and false alarms for bombs or surprise attacks. The idea in that time was that the European and United States stock markets had entered into a vicious circle that made the losses of one party be constantly reflected to the other and vice-versa.

After the lowest point reached in September 21, USA, London, Paris, Japan, Germany, Italy stock markets, etc., started a slow and insecure recovery, hoping that the suffered losses during the previous week would be recouped soon. Anyway, forecasts on the date of expected attack from USA over Afghanistan became a ruthless factor for the stock markets. So, on October 1 in response to expected attacks, NASDAQ lost 2 percent whereas Milan Stock Market, 2.2 percent. Almost the same movements were noticed in the rest of the stock markets all over the world.

The most sold out shares in the precise moment corresponded to high technology and telephone companies. The expected attack of USA was not the only cause for the reduction of share prices; the further coping with deep financial troubles from European and American companies was another cause of it. Some of the companies to be really put in financial difficulties were the British Airways, "KLM", "Swissair" and "Lufthansa". These companies requested financial support from the European Commission for Transports in Brussels. The latter did not consider their requirement pretending that no federal budget existed for European companies to support them in case of financial difficulties. The same scenario was noticed in USA

one week before. The difference in this case lied in the fact that the Congress credited the air companies put in financial difficulty with USD 15 million, from which 10 millions were soft-term credits.

With the passing of shock moments, stock markets came back to normality; surely, the experience of September 11 taught them something to learn forever.

B. EXCHANGE RATE PERFORMANCE

If taken a fast glance to the exchange rate performance by the international markets worldwide, we will come to the conclusion that the US dollar began to lose grounds against the Euro and the Japanese Yen (JPN), British pound (GBP) and the Swiss currency (CHF) from the end of June. The Euro, CHF, USD revealed signs of recovery by the end of August. This phenomenon can be explained with the more optimistic messages, arriving from the United States economy in this period. The idea that the economy potential would enable a fast and stable emergence from the difficult situation continued to be spread and believed to the moment when the unexpected attack hit the United States.

In the days that the United States stock markets remained closed, foreign exchange markets all over the world priced the new values for USD exchange rates to the rest of the currencies. It was precisely in these days that, the deceptive news on the starting attack of United States against Afghanistan was squeezed into the written and electronic media.

Table 1. Some currencies' exchange rates to USD during the lowest point days

The days with the lowest point of USD	Currency	Value to USD
September 19	Euro	1.08015
September 20	JPY	115.85
September 21	CHF	1.587
October 5	GBP	0.6759

While the Euro currency was faster, the British pound took two days to spin the USD at its lowest point in the last months.

From 19 September, the USD gradually strengthened to Euro, although its exchange rate displayed slight oscillations.

The current performance suggested a further strengthening of the USD or at least maintaining of its current value, although the last thing to be mentioned in the forecast corresponds to the way these economies, based on each of these currencies, will be developed. Almost the same scenario has taken place between USD and JPY currencies, with the only change that the USD appreciation was faster than the Euro, after September 20.

While the USD appreciated by 3.4 percent to EURO between September 19 and 25, it gained 6 percent of its value compared to JPY for the same period.

JPY also reached its top in exchange with EURO between September 19 and 20, but next months' developments cited a strengthening of the Euro currency to the Asian one. The CHF won over the USD or the Euro in the same day and its exchange rate to either USD or Euro was by 0.630 or 0.692 respectively. It must be said that while the USD was slower in reaching this point, EURO suffered an immediate discount within 3-4 days. CHF is gradually depreciated to the USD; however it remains still stronger from what it has been before September 11.

Related to CHF/Euro exchange rate, it has been noticeably more favourable to CHF from what it has been before September 2, confirming a further depreciation of the Euro.

The GBP started appreciation against the USD from the end of May, when 1 USD was exchanged with 0.723 GBP. Until today, this remains the USD's highest point during the last six months. On October 5, it reached the lowest point of 0.675 GBP, to further climb up to the level of the beginning of August.

After its lowest point to GBP on October 5, the Euro continued its decline against the GBP. The news on the British economy is more optimistic from those arriving from the rest of the Western Europe and Germany, especially. As evidenced from

the above developments, all powerful currencies worldwide reacted against the green currency, leading it to the lowest points surprisingly not at the initial moment when the false news on the expected war and the guesses on the terrorists' reaction caused fear and insecurity all over the world. From this complex picture of international markets, it might be assumed that the psychological effect and expectations play a very important role in the exchange rate performance.

C. THE FOREIGN EXCHANGE MARKET IN ALBANIA

Before passing to the consequences that the terrorist attack had on the United States currency exchanged in Albania, it must be said that the USD did not recognize positive developments in two months prior to the terrorist attack. The Lek/USD average rate in June was 148.55. It was a long time before, since October-November, previous year that USD did not record such a high rate.

June recorded the USD's last strongest point, which started to fall against the Lek, passing to the average of 147.8 Lek in June and 143.35 in August. It is understandable that besides the seasonal factors, such a situation was amply conditioned by the constant weakening of the United States economy, faithfully reflected in the USD/Euro rate. As it happened in the international markets worldwide, the USD also lost ground in the Albanian market during these months. The USD exchange rate was 126.8 Lek in June, 127.2 Lek in July and 128.9 Lek in August.

The terrorist attack on USA was first of all reflected in the instant decreasing value of the USD. In the subsequent fortnight, newspapers, released for pubic opinion, published headlines that still more added the public mistrust to the green currency. Still, according to these papers publicity, USD enjoyed "the heavens" in the Albanian market, only a few months ago. The psychological effects played a negative role in the USD's performance against

the Lek. In the second week after September 11, the USD lost 1.67 percent against the Lek, passing from 144 Lek/USD to 141.63 Lek /USD (September 21). The following chart presents the Euro/USD behaviour in the period of September 10-28, 2001.

Chart 1 The Euro/USD exchange rates measured in international markets and in Albania

Note: The Euro/USD ratio expresses the ratio of both currencies, calculated based on the exchange rates with the Lek. The Euro/USD ratio* displays both currencies' international rates.
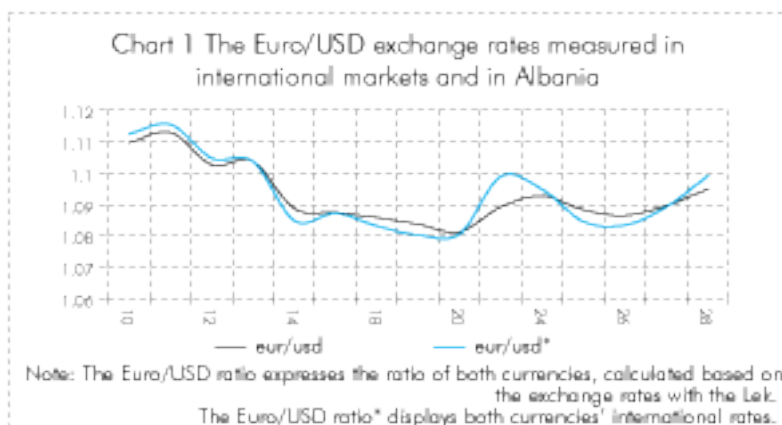
As evidenced from the above chart, the Lek/USD and Lek/Euro exchange rates during September have generally followed the same developments with those of the international markets. After this date and after the low exchange rate it had in the previous day, the USD appreciated immediately, being exchanged at 1.099 Euro in the world markets, while the same ratio recorded 1.089 in the Albanian market. The USD reached its lowest rates to Lek. On September 17, 20 and 26, it was exchanged at respectively 141.35, 141.37 and 141.21 Leks. September 20 has also recorded the highest monthly value for the Euro (130.75 Lek), the monthly average for both currencies was at 142.89 for Lek/USD and 129.83 for Lek/Euro.

During the current month the USD oscillated between Lek 142.26 and 140.66 rates. The last figure corresponds to October 9 and it was the lowest value attained throughout the month. In the meantime, the European currency moved through the values Lek 126.11 (October 26) and Lek 129.7 (October 5).

From these developments it seems that the Albanian foreign exchange market has moved in accordance with the international exchange market and has reacted to the developments noticed in this market.

D. THE CENTRAL BANKS' REACTION AGAINST THE TERRORIST ATTACKS OF SEPTEMBER 11 AND AHEAD

"The Federal Reserve System is open and able to work, whereas the discount window is ready to cover the needs for liquidity". This was the only statement released by the vice-president of the most powerful central bank in the world in the afternoon of September 11, 2001[1]. And it was also the same statement that made possible the injection of USD 80 billion in the United States' financial system to the end of this uncommon day. At the same time, the managerial authorities of the European Central Bank confirmed the ECB's readiness to provide the required liquidity from the European financial market. The German Bundesbank from this day acted as the greatest supplier of liquidity and in a few days it cleared through its clearing system an amount of USD 500 billion.

One day after the terrorist attacks, finance ministers and central bank governors of G-7 prepared a rescuing plan, including diminished costs of borrowing, aiming at adding liquidity in the market and encouraging the economy. The stock market closure during the first week let free way to several suspects and speculations regarding further developments in the stock market indexes. The prevailing fear and panic would lead to distinct prices of equity securities from the massive sales.

In this point the pressure exercised on the Federal Reserve to have an immediate cut of interest rates was very high. Perhaps, the only reason why the envisaged and almost certain reduction was not effected was some American experts' impression that such a step, taken at the moment when the United Sates were still

under the shock of views from the attack and the stock markets were not opened yet, would not have the expected impact on the financial markets. Apart "When?" the Federal Reserve also made another inevitable question: "What will be happening to the rest of the world after we lower the interest rates?

The answer to this question came no later than the beginning of the next week, immediately after the Fed declared for the eighth time during this year, interest rates and money cost reduction by 0.5 percent, bringing them down to 2.5 percent. The breaking news on the reduction of money costs was accompanied with the appeal that the Federal Reserve Governor, Mr. Alan Greenspan, addressed to banks to be more tolerant to customers put in difficult situation from the terrorist attacks. The Federal Reserve also asked all banks to be ready to credit different persons or companies presenting a pressing need for funds. With all these measures the Federal Reserve tried to encourage new investments and maintain the Americans' current consumption rate which comprises about 2/3 of GDP.

While the United States did their best to keep the economy in shape, in Europe the ECB announced the reduction of the refinancing rate by 0.5 percent half an hour after a refinancing operation wad made at 4.25 percent rate. Referring to the comments of a central banker "Europe had to tell to the whole world that it was on the side of the United States". Perhaps, not so amiable questions and comments made on ECB policy were attributed to its very prudential stand held to the reduction of interest rates, while the Federal Reserve did not show the slightest indecision to follow an expansive policy throughout the whole 2001.

Besides the two greatest central banks, the monetary authorities of Japan, Switzerland, Canada and Great Britain also had an immediate reaction to the United States developments. Immediately after the attack they injected considerable amounts of liquidity. The Federal Reserve entered in swap agreement with the ECB, the Bank of England and the Bank of Canada in order to relieve the financial markets' functioning and ensure liquidity

denominated in USD. The Bank of Canada and the National Bank of Switzerland had the same interest rate cut with the Fed and the ECB. The monetary authorities of England, Japan, Denmark, Sweden, New Zealand, Hong Kong and Korea also computed interest rate reduction at a later time.

The first reaction of the central banks was welcomed from the international markets and it was considered as a powerful and required support to specific economies. To November 6, the Federal Reserve cut twice the interest rate, leading them to 2 percent rate. At the same time, the Bank of England cut short-term interest by 0.5 percentage points, leading it to 4 percent, and the ECB made the same cut with the Bank of England leading its short-term rates to 3.25 percent. While the central banks' expansive trends are being supported by those that aim at promoting the world economy, they are looked with scepticism by those that are scared from the incapacity to manoeuvre in the long run. The most negative example of it may be the case of Japan, finding itself within a prolonged period of recession.

Interest rate reductions internationally are expected to be reflected in the decreased net earnings from the Bank of Albania's foreign exchange reserves deposited abroad the country. Additionally to this effect, these cuts are reflected and continue to be reflected in deposit rates denominated in different foreign currencies and especially in those denominated in USD.

E. RECENT EVENTS IMPACT ON LOW- AND -AVERAGE- INCOME COUNTRIES

Further to the recent events the international institutions such as the World Bank or the International Monetary Fund hurried to perform revaluation of their forecasts addressed to the performance of world economy in general and that of countries in particular.

It is clear that the lag effect of the global economy on each country depends on the typical features of the country in

discussion and the latter financial and trade relationships with the rest of the world. For this reason the analysis is made separately for a group of countries attached either in geographical vicinity or other common features of economic development.

For the developing countries[2] where our country is included, forecasts on GDP growth for years 2001 and 2002 are reduced due to their dependency on the economic advance of the developed countries. The most direct effects of world crisis over these countries are expected to appear in some forms that will be analyzed below:

Tourism - The insecurity that besieged the world economy after the terrorist attack was translated into instant reduction of the number of travellers using airlines. The flies in the United States and those from USA to Europe and between the European countries suffered from a tremendous decline of travelling demand some weeks after the tragedy. Flying tariffs underwent a considerable decline, which depriving the air companies from profits, served to somewhat fill up the empty lines. Although the initial wavering of travellers is already mitigated, the tourists' indecision to undertake tours remains high. Perhaps, it must take a long time before the tourists' behaviour comes back to normality.

In the light of recent developments, Albania being part of the Balkans Peninsula remains in the list of the countries presenting a not so small risk, and the United States surely did not help to mollify the perception of foreign or Albanian visitors.

In the subsequent months, that is for year-end holidays, it may happen that a part of Albanian citizens already European or United States residents will not come back to meet their families in Albania, because of the insecurity to take long trips. According to the Balance of Payments definition, the services these persons buy in Albania (travelling services) are classified under the category of exported services, occupying nearly 84.5 percent of the total. Traveller exported services over the first half of 2001 reached USD 194 million or about USD 66 million

more than the imported services, making the total balance of services be positive per USD 18 million.

If the subsequent months are accompanied with a decline in the number of Albanian non-residents visiting the country, it may happen that the balance of services deteriorates or loses the function it has played until now, as a balancer of current account.

Concerning the number of foreigners visiting Albania[3], it may also decline, however, the above-mentioned category, that of Albanian non-residents arriving to Albania to pass summer or winter vacations holds the main weight in our statistics.

On the other hand, if a reduction of tourism prices attracts more Albanians abroad the country, then the balance of services will probably narrow further. So the deterioration may be two-sided.

Financial markets: In September the capital market investment in developing economies indicated 35 percent decline compared to August.

While the interest rate reduction in USA in 1990 made the capital inflows have a considerable access to developing economies, the current situation may condition the level of lending and the number of countries to benefit from these funds.

Foreign direct investments, which are regarded as closely linked with business cycles in developed countries are likely to suffer decline, due to the not so positive performance of these countries' economies. Foreign direct investments do not depend only on the economic performance of the developed countries, i.e., on having or not having capital for investment, but also on the sentiment of investors which is not giving goods signs for a long time.

Chart 2 Albania's foreign direct investments from year 1993 to the first half of 2001 (in millions of USD)
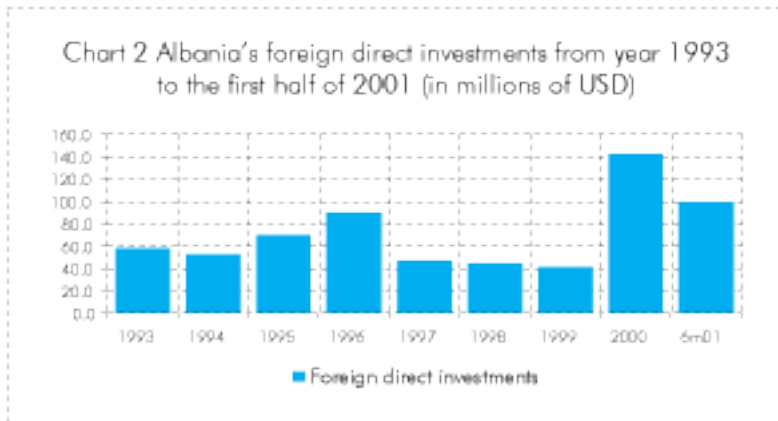
As clearly observed from the above chart, foreign direct investments in the country have increased in the last two years.

If the successive months are accompanied with a decline of investor's confidence worldwide and if the Balkans continues to be regarded as a hot area of conflicts, Albania's picture will probably change. What is more irksome to this forecast is the correlation between foreign direct investments and the privatization process.

While Albania is laying the grounds for the privatization of relevant economic and financial entities, the possibility for foreign investors to run away, in terms of the number or funds they offer, is not good news.

Main commodity markets - A protracted recovery of world economy might impede the increase of commodity prices, disclosing decline during the recent four years. The decrease of these prices was further emphasized after September 11, as follows[4]:

Table 2 Changes in some main merchandise goods prices

Product	Change in price (September 11 - October 24)
Oil	-4.5 usd
Rural products	-(6-8) %
Metals	-4 %

The reduction in these prices, while reflecting an advantage to the countries importing these products, it creates an unsafe situation for the export ones. Those countries that might be suffering more from the decrease of prices at the moment and further in the near future are those economies whose trade is based vitally on rural exports or textile originated products. As these countries are not big users and suppliers of oil, they do not benefit from the oil prices' decline, while they pay a fixed tax on exports' side. These developments may be regarded somewhat positive for the Albania's trade balance, due to the import/export structure presented in this way[5]:

Table 3: Weights of main group prices in Albanian imports and exports

Merchandise group	as % of total imports	as % of total exports
Oil (and power products)	8.9	1.9
Rural products	16	3.4
Base metals and their products	7.7	8.4

Taking into account that the import volume is higher than exports' (about 4.2 times) and the above ratios, it is easily concluded that the consumer price performance by international market means Albania's benefit on the side of import.

Trade - a lag in the world economy will mean decrease of the export demand and increase of trading costs in the developing countries. The most expected countries to suffer from these phenomena are countries with developed trade transactions that are remote from the markets where they export. The increase of the trading costs comes from higher c.i.f., due to higher risk perceived.

Albania's trade balance is largely conditioned by the trade transactions with the EU, with which Albania carries about 77 percent of imports and 93 percent of exports[6].

Talking about an economic lag, the first idea striking your mind is the reduction of our partners' domestic demand for goods imported from Albania.

The following table presents the performance of Albanian exports to the EU countries during the first nine-month period of 2001:

Table 4 Performance of exports with the EU countries, year 2001

Year 2000	Exports in billions of Leks	Change in % (y/y)
January	3,046	27
February	3,811	20
March	3,832	36
April	3,726	45
May	3,684	21
June	3,625	0
July	2,453	-26
August	1,960	-9
September	3,486	12

The year on year comparison is made to evidence the explanation of the core performance of seasonality phenomenon. Thus, it is evidenced that in June, July and August of 2001, Albanian exports to EU countries (mainly to Italy, Greece, Germany) have suffered a noticeable decline compared to these country exports of the previous year. With higher exports than in the previous year, September of the current year lags behind the growing rate of exports throughout the first months of the year. However one month is insufficient for jumping to conclusions.

Whether September exports stay at current rates or are lower, it might be said to a certain extent that import countries for goods made in Albania are passing a period of a downward demand for consumer goods.

It is understandable that the reduction of exports' rate compared to that of imports is not evidenced as a positive development for the current account and the balance of payments of Albania.

Emigrant remittances: Economic lag, frequently reflected in decreased work positions until now has been expected to influence on emigrant remittances. Jordan, Morocco, Tunisia that receive emigrant remittances from Central America and Western Europe, and some poor countries of Africa that benefit from emigrant remittances from USA are the countries to more meet with the decrease of emigrant remittances. Albania, whose

current account records about 36.6 percent of the income[7] from emigrant remittances, has emigrants in both, the Western Europe and the USA.

Chart 3 Albania's emigrant remittances (private transfers) over the first quarter, 2000 - third quarter, 2001 (USD million)
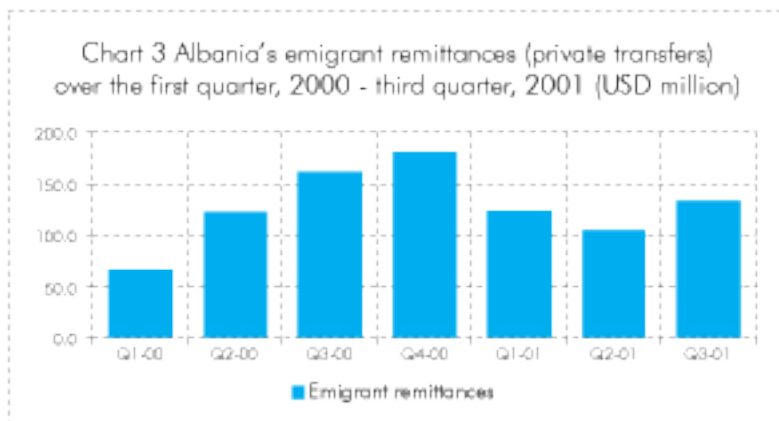
F. EMIGRANT REMITTANCES

In addition to the first quarter that discloses increase compared to the first quarter of the previous year, the other two quarters give the impression that the world crisis has also touched the emigrant remittances. The second quarter is at 10 percent lower than in the previous year, while the third quarter is 20 percent. If the third quarter, usually marking the peak of emigrant remittances (on the occasion of year-end holidays) is considerably lower than that of the previous year, then we must almost surely say that one of the robust items of Albania's current account is shrinking because of the world crises[8]. However, during the fourth quarter of the current year, we must prepare to see changes because of Euro introduction.

G. ENDING NOTE

Recently, the frequently met saying through economic newspapers and magazines is that "Starting from September 11, the world is not the same". While the terrorist attacks hit

only USA; the effects are expected to fall on the whole world. A fact making you believe that forecast is the almost synchronized economic performance of USA, Europe and Japan during the first half of 2001. The instantaneous economic lag in USA and Europe, the weakening of information and technology sector, the crisis in Japan and the deterioration of new markets' financial conditions confirmed more robust global relations than thought before 2001. In order to analyze the reaction of the economy immediately after the terrorist attacks of 11 September, the provided examples were many natural disasters.

However, it must be admitted that the indirect effects of September 11 would have been more different and perhaps more serious than those caused by the natural disasters.

As expected, in the first weeks following the attack, the first negative reaction appeared in the form of reduced customer confidence and private expenditures in USA, weakened business trust either in Europe or USA and increased insecurity perceived by measures worldwide.

However, economists base their forecasts on some strong points for a somewhat more optimistic future than the current year. First, major economies took adequate support that was stronger than expected from their respective governments. It's worth mentioning the measures taken from the United States government to increase the government expenditures by USD 45 million (from which USD 40 million were only to recover the damage caused by the September 11 attacks) and the projections on curtailing taxes in year 2002. These reductions are expected to amount to -1.6 percent of GDP[9]. Second, the economic basis worldwide is more robust than those of some previous years ago. These bases are reflected in lower inflation rates, stronger fiscal positions, more flexible exchange rate regimes and lower sensitivity of developing markets externally. Third, the terrorist attacks are not expected to considerably change the increase of the USA productivity. The recent events however indicated that the crises could do much more harm to the economy, when they find it at a moment of lag.

NOTES

* Diana Shtylla, specialist, Research Department.
[1] Cool Nerves at the Central Banks", Financial Times, October 1, 2001.
[2] By definition, Albania falls under the group of "transition countries - Central and Eastern European countries and Former USSR countries", but in the current analysis 'developing and transition countries' appear as a single group against the group of 'developed countries'.
[3] From the balance of payments viewpoint, foreign citizens not living in Albania and non-resident Albanians are considered the same, however, the division in this paper is as to the differences that both these traveller categories bear in the way of perceiving the country of residence.
[4] Source: World Bank Report "On the recent event in low and middle income countries.
[5] Source: Bank of Albania Statistical report data for 2000.
[6] The same source, data for 2000.
[7] Source: Bank of Albania Statistical Report data on year 2000.
[8] Private transfers (nearly USD 530 million for year 2000) mostly serve to offset Albania's trade deficit (about USD 820 million).
[9] Source: HSBC Strategies on US fixed income, October 2001.

INFLATION TREND IN ALBANIA DURING THE PREVIOUS DECADE: AN EMPIRICAL OUTLOOK

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Genti Hashorva

1. TIME SERIES AND THE IMPORTANCE OF THEIR STUDY

Creating time series or otherwise known as data basis comprises the first step in time series complexity. The majority of time series already has a longer than an 8-year history (beginning from year 1992), comprising a rather good basis for the analysis and conclusions to be drawn from these analysis.

As it will be noticed in the following, the time series of inflation and of other indicators (on a monthly basis), having their early origin in 1993, have at present about 93-94 terms, an adequate number to come to right conclusions. The main scope is that these data are available for analysis and forecast of the economic and the financial phenomenon taken under study.

One of the most important indicators for which the Bank of Albania is very interested to have as more realistic and compatible forecasts as possible is inflation. Recently the central bank has focused the final scope of performing studies on inflation forecasting, on attaining the application of Inflation Targeting Regime or "inflation target". As indicated from other countries'

experience and frequent recommendations left over by the IMF missions, the adoption of such a regime is carried out through time series and conclusions drawn from these analyses.

2. INFLATION PERFORMANCE

To create a clearer idea on the time behaviour of inflation figures from the visual viewpoint, the graphical presentations 1 and 2, where the applicable data have a quarterly frequency, would be very useful. The graphical presentation 1 takes into account the time duration for the sample of consumer price index series over the first quarter 1993 - the fourth quarter 2000.

A second presentation helps us evidence the evolution of the quarterly changes of price index or quarterly inflation (p_cpi) stated in percent.

Chart 1 CPI series from the first quarter 1993 to the third quarter 2001
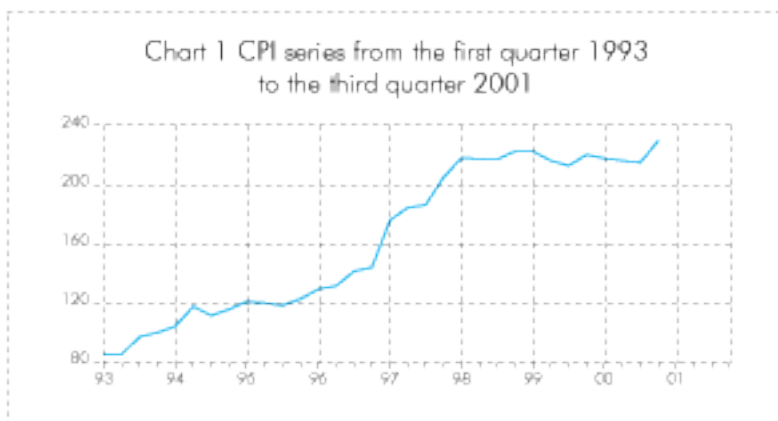
Chart 2 helps us recognize in the first view the existence of seasonality together with the rare component accompanying each time series.

From the analytical point of view, it would be necessary to measure the effect of each season (quarter) after the rare component is eliminated. The applicable method is additive as the inflation changes contain positive and negative terms.

Chart 2 The series of the quarterly changes of CPI from the first quarter 1993 to the third quarter 2001
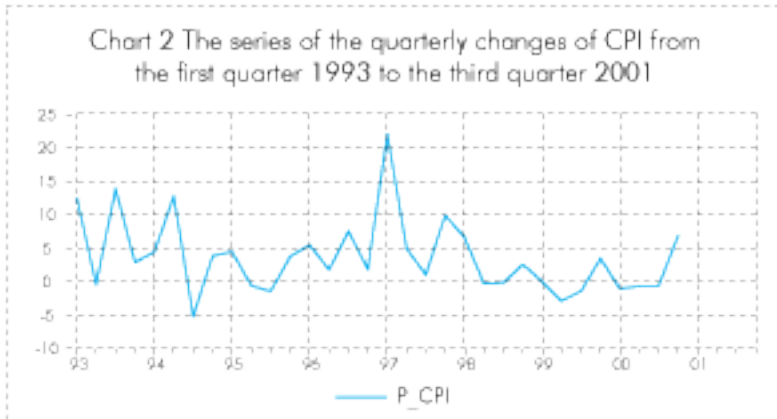
The series of the seasonal coefficients, in our case, contains four terms depending on the sign added or deducted from the quarterly level of trend respectively.

Marked c_cpi, the quarterly changes of inflation series in percent would be presented in the equation:

$$C\_cpi = T + S + R \qquad (1)$$

Where T – trend – S- seasonal component R – rare component

For forecasting purposes, it is also needed a cleared series from seasonality[1].

Thus, eliminating the seasonal component would transform the correlation (1) as below:

$$C\_cpi = T + R \qquad (2)$$

Table 1 Seasonal coefficients of inflation series

Sample: 1993:1 2001:4	
Included observations: 32	
Difference from Moving Average	
Original Series: P_CPI	
Adjusted Series: P_CPISA	
Scaling Factors:	
1	2.593065
2	-1.084623
3	-1.878914
4	0.370473

The above coefficients identified by means of the additive method indicate that the second and the third quarter, as expected, demonstrate a declining trend of inflation rates (throughout April – September period). The third quarter is the one that retains the most noticeable declines of consumer prices over the year. This fact is explained with the structure of the goods basket on whose basis the consumer price index (CPI) is accounted, where food beverages and tobacco comprise about 73 percent[2].

In this quarter, domestic products having a bulky disclosure additionally to imports (mainly fruit and vegetables) led to the reduction of prices by these products.

The first and the third quarter are characterized by growth of this indicator. Anyway, the most noticeable increases are evidenced in the first quarter each year.

Chart 3 The time series of quarterly changes of CPI and CPI cleared from seasonality
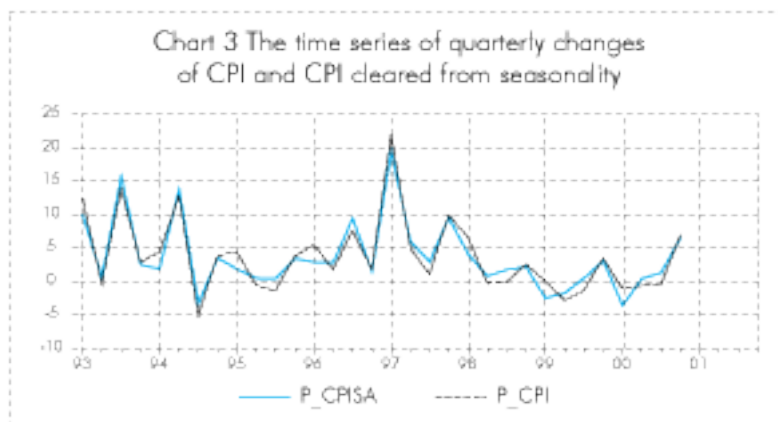
As evidenced from the Chart, the oscillations caused from the seasonal effects appear in the years of normal development of the economy ('95-'96 and after the second half of '97).

In the equation (2) that created the data series on the seasonally adjusted inflation it will be aimed to maximally clear the data from the rare oscillations.

This will be attained through the method of sliding averages or the exponential flattening.

Concretely for the series p_cpisa, it has been applied the method of exponential flattening or forecasting to gain the highest compatibility with the series trend.

We emphasize that this method offers the maximal elimination possible of the irregular component but not the total extinction of its effects.

If this elimination would be fully attained, then we would have to do with an ideal line of the trend.

Chart 4 The time series of the quarterly changes of CPI, CPI cleared from seasonality and the rare component and the ideal line of the series trend
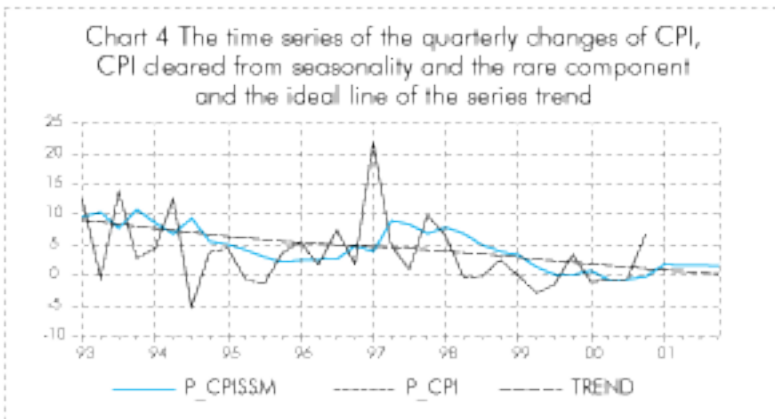
Although ideal, this line is not real. As a result it is inappropriate for forecasts, as a time series will be always submissive to the rare effects, irrespective of how unimportant they will be, they are not totally assigned and solely dependent on the time variable.

The data series p-cpissm is already maximally cleared from rare effects.

Finally, the only residual component in the equation would be that of the trend.

p_cpi or p_cpissm(t) = T   (3)

Chart 5 The time series of quarterly changes of CPI and CPI stripped off from the seasonality and the rare component

P_CPI ------ P_CPISSM
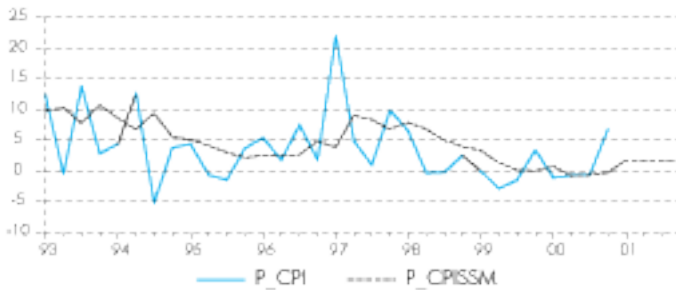
Chart 6 The time series of quarterly changes of CPI and CPI stripped off from seasonality and the series without seasonality and the rare component

P_CPISA ------- P_CPISSM ------ P_CPI
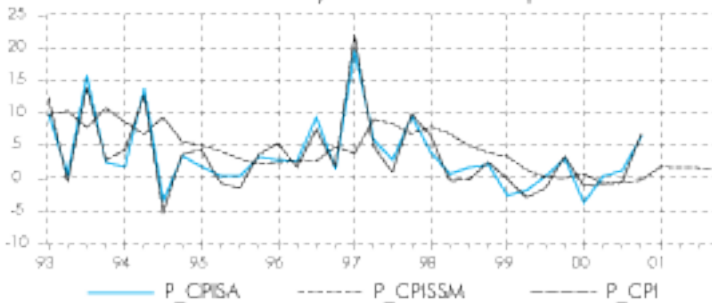
The above graphical presentations indicate visually the way the time series of inflation (p_cpi) is transformed to its best clearing possible from seasonal and rare components.

3. A SCENARIO FOR FORECASTING INFLATION

Let's proceed with finding the equation of the trend, i.e., with the way how p_cpissm dependant variable is explained by the time independent variable. For this, it is necessary to enumerate some of the possible forms of time- adjusted- inflation, which are somewhat suggested from the graphical presentation of time duration in p_cpissm series.

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The suggested forms require the construction of three samples, which state the dependency of time- adjusted- inflation on linear, squared and cubic forms.

Table 2 Linear dependence

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	9.140330	0.859140	10.63893	0.0000
TIME	-0.263097	0.044092	-5.966956	0.0000
R-squared	0.534566	Mean dependent var		4.667684
Adjusted R-squared	0.519552	S.D. dependent var		3.479530
S.E. of regression	2.411813	Akaike info criterion		4.657326
Sum squared resid	180.3220	Schwarz criterion		4.748023
Log likelihood	-74.84588	F-statistic		35.60456
		Prob(F-statistic)		0.000001

Table 3 Squared dependence

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	8.982488	1.361547	6.597268	0.0000
TIME	-0.236038	0.184632	-1.278426	0.2109
TIME*TIME	-0.000796	0.005268	-0.151070	0.8809
R-squared	0.534920	Mean dependent var		4.667684
Adjusted R-squared	0.503915	S.D. dependent var		3.479530
S.E. of regression	2.450748	Akaike info criterion		4.717172
Sum squared resid	180.1850	Schwarz criterion		4.853218
Log likelihood	-74.83333	F-statistic		17.25253
		Prob(F-statistic)		0.000010

Table 4 Cubic dependence

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	12.34452	1.741041	7.090310	0.0000
TIME	-1.341020	0.436872	-3.069593	0.0046
TIME*TIME	0.079253	0.029621	2.675581	0.0121
TIME*TIME*TIME	-0.001570	0.000573	-2.738279	0.0104
R-squared	0.630466	Mean dependent var		4.667684
Adjusted R-squared	0.592238	S.D. dependent var		3.479530
S.E. of regression	2.221896	Akaike info criterion		4.547811
Sum squared resid	143.1678	Schwarz criterion		4.729206
Log likelihood	-71.03889	F-statistic		16.49241
		Prob(F-statistic)		0.000002

Graphical presentations and the comparative analysis of results for the above three regresses confirm that the most implicit dependence is the cubic. This is indicated by t-statistic values and their respective probabilities. On the other side, such kind of sample is R-squared supported, which in the case of the cubic dependence takes a value over the average advisory power, which compared to other variables is considerably higher than them. The value of adjusted R-squared in the case of the cubic

dependence remarkably improves by about 10 percentage points the better elucidation of time-adjusted inflation.

If referred to other test criteria supplied from the program for the selection of the most appropriate samples, then the basic criteria "Akaike info criterion" and "Schwarz criterion" assuming minimum values in the cubic sample respectively (4.41 and 4.72) confirm that the cubic sample is the most appropriate.

Thus, the equation of the trend would be the following:

C_cpissm (t) = 12.34 − 1.34*t + 0.08*t − 0.0015*t3 (*).

Giving certain values to (t) time variable in this sample, the result would indicate the value of adjusted inflation (at the deficiency of the seasonality and rare component). As it is required an as more real value of the series as possible the seasonal effect, which increases or decreases the values of adjusted series must be taken into consideration.

Naturally a similar sample might be used to anticipate the quarterly change of time adjusted inflation (*) and the seasonal one. So, we would be having a result that takes as basis the trend (the symmetry that the phenomenon has demonstrated throughout the period under study) and the seasonal effect, if present.

Let's illustrate everything above-described with an assessing forecast on the variable inflation for the second quarter of 2001.

In this case, the value of the time variable will be given at (t) = 34, so from the beginning of the period for which we have available data to the end of the period (the first quarter 2001) we have 33, hence in the second quarter 2001 the period we are trying to forecast, the value of the time variable (t) would be t + 1, thus 34.

p_cpissm (34) = 12.34 − 1.34* (34) + 0.08* (34)2 - 0.0015*(34)3

p_cpissm(34) = 0.31.

The found value of the trend without the seasonal effect is 0.31 percent. Whereas considering the seasonal effect of the second quarter (-1.08), the quarterly change for the period (April –June 2001) will result –0.77 percent [0.31 +(-1.08)]. The value is more than acceptable if we refer to the preliminary statistical result, whose estimates take into account the real values of inflation series for the period including the first quarter of 1993 and on. Even if the same periods of the previous years are surveyed, when the country has almost passed through normal situations, we might have similar figures to the estimation (-0.77).

For example:

- In the second quarter 1995, the announced value of inflation was about - 0.65 percent;
- In the second quarter 2000, the announced value of inflation was nearly –0.72 percent.

In the second quarter 2001, the expected value of inflation would have been about -0.72 percent, while the announced value from INSTAT reached the figure of 0.38 percent. What would be the explanation for this evasion? Will it be really called a deviation as long as the estimate without the seasonality is nearly equal to 0.31 percent, while inflation figure for this quarter is nearly 0.38 percent? Do we have the right in the long run to presume that the seasonal effects in the performed diagnosis have almost been insignificant and why?

The deviation might have been due to the presence of a number of problems:

First, the received sample takes into account only inflation dependency from the time variable.

Second, the seasonal effects might have been eased thus not having a considerable decline in the consumer prices for the second quarter, 2001.

Generally this period confirms a significant reduction of prices by fruit and vegetable products due to the seasonal effect. The aggravated situation in the region and the conflict in FYROM caused a significant decline of imports in food products (fruits, vegetables and cereals), and significant components of the basket feel the seasonal effects at the same time. FYROM, considered as one of the major suppliers of these products, is estimated to have caused a rather significant decline in the market supply, implicating the increase of consumer prices for these customer- requested products. So, the consumer price index for the merchandise group of fruits and vegetables suffered an annual increase by 18.6 percent, fruits, especially, marked an annual increase by 6.7 percent and vegetables, by 35 percent. So, food, beverages and tobacco items marked for the second quarter of 2001 nearly 5.1 percent increase, compared to the same quarter of the previous year (INSTAT);

Third, although the applicable method has maximally avoided the rare casualty in the model, this does not mean that this avoidance has been totally complete. The rare (occasional) component has always been present in the time series and will surely transmit deviations, even small ones, from the real data.

It must be stressed that it is not only the time variable (the previous trends) and the seasonal effect that might help in forecasting a relatively accurate inflation for the future. The time factor gives only a likely inclination of it. It is an already acknowledged and tested fact that the political events influence inflation rates, especially on the rising side. In many developed countries, the feasibility of a similar effect is not exempted.

4. THE IMPACT OF POLITICAL EVENTS ON INFLATION

During the recent decade our country has faced specific situations certainly related to political events. Amongst these events we can mention the various electoral campaigns (parliamentary or local elections and different referendums)

and many other political events. The specialists' opinion is that irrespective of the intensity they are developed, they have not apparently affected core economic indicators, mainly those of inflation.

Excluding the first half of year 1997 when the economy faced the phenomenon of the falling pyramid schemes, in the majority of other cases the immune system against the political developments seems to have worked and their effects might be considered momentarily unimportant especially for inflation. Inflation performance confirms this fact.

Below we will present our effort, explaining that inflation changes prior and after the political events have been statistically important. In this way, the analytical methods used verify the above raised hypothesis from specialists.

To carry out an as grounded analysis as possible we deem that inflation time series taken under study must have a monthly frequency (month-to-month changes). That choice is based on the fact that we are generally interested in the fact whether we discern important changes of inflation two months before and after the political event, thus we will be considering 5 months totally, including the month when the political event has taken place or has reached its crest.

For the monthly series of inflation, the already explained stages must be followed to find the equation of the trend.

Time period that entail the political events will be further intervening in this model one after the other. To shape these interventions, qualitative variables or (dummy) indicators will be helpful.

The modelling or identification of these effects on inflation is attained through the agreement when;

Dummy variable = 1, the series values correspond to the period of the political event;

Dummy variable = 0, the series values do not correspond to the period of the political event but to the rest of the period.

The presentation of inflation monthly data indicates that in this series are present both, the trend and the seasonal components without exempting the casual component.

Chart 7 The monthly series of CPI

CPI_monthly

Chart 8 The monthly series of CPI changes cleared from seasonality, the rare component and the ideal line of the trend

CPI_MONTHLY ------- CPI_MUSM ----- TREND
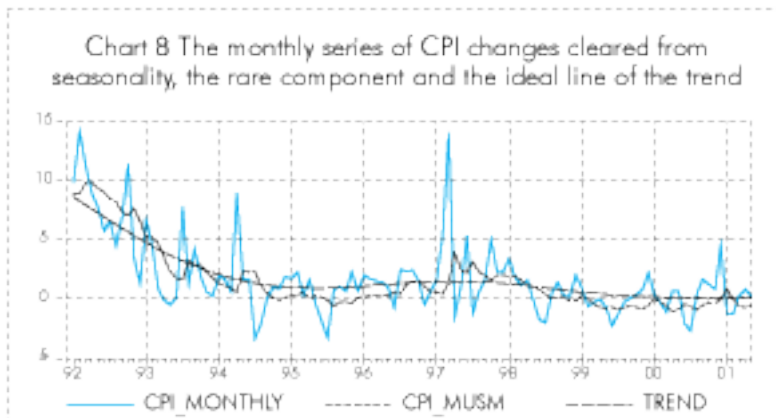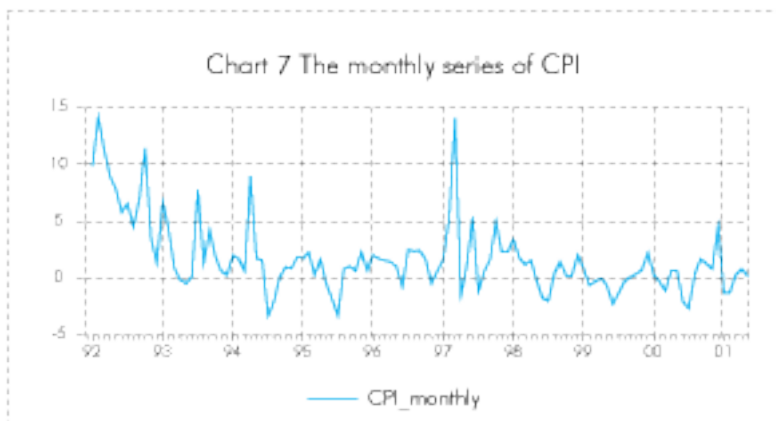
The above presentation reinforces the idea that in the monthly series of inflation, the dependency between inflation and time is of third rank, meaning that the equation of the trend is cubic. These results indicate that the regress explaining the inflation time correlation is cubic and is statistically important on the whole. Coefficients are totally important, even at high levels of

confidence. R-squared is also high and statistically important at the same time. The equation of the trend (omitted seasonality) will be:

$$cpi\_musm = 10.72 - 0.52 * time + 0.08\ time2 - 4.06E - 05\ time$$

Variables can already intervene in this equation one after anther according to the time they represent from January '92 to December '00.

Table 5 Cubic dependence and (dummy) variables

Dependent Variable: CPI_MUSM				
Method: Least Squares				
Sample(adjusted): 1992:01 2001:05				
Included observations: 113 after adjusting endpoints				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	10.71643	0.411305	26.05472	0.0000
TIME	-0.514910	0.031108	-16.55220	0.0000
TIME*TIME	0.008143	0.000633	12.87324	0.0000
TIME*TIME*TIME	-4.06E-05	3.65E-06	-11.11469	0.0000
R-squared	0.854112	Mean dependent var		1.600844
Adjusted R-squared	0.850097	S.D. dependent var		2.730014
S.E. of regression	1.056987	Akaike info criterion		2.983479
Sum squared resid	121.7772	Schwarz criterion		3.080024
Log likelihood	-164.5666	F-statistic		212.7169
Prob(F-statistic)	0.000000			

The results indicate that generally the political event, particularly the pre and post electoral situations and referendums do not significantly affect on inflation changes. The coefficients are statistically unimportant (t-statistic values do not verify the statistical importance of coefficients).

The contrary happens with high-tension situations of the country in general and of the Albanian economy in particular. The point herewith is the crisis of year 1997 and Kosovo crisis in spring 1999. It is statistically evidenced and verified that both these hard situations had a significant effect on changing inflation. The '97 situation priced a considerable growth of monthly inflation, while Kosovo crisis marked a decline, perhaps also due to the large arriving inflows in aids, causing reduced prices for the main basket items.

Table 6 Cubic dependence and (dummy) variables

Variable	Coefficient	Std. Error	t-Statistic	Prob.
Dependent Variable: CPI_MUSM				
Method: Least Squares				
Sample: 1992:01 2001:05				
Included observations: 113				
C	9.721167	0.627728	15.48626	0.0000
TIME	-0.461565	0.041930	-11.00798	0.0000
TIME*TIME	0.007172	0.000776	9.245203	0.0000
TIME*TIME*TIME	-3.51E-05	4.22E-06	-8.330145	0.0000
DUMMY92	1.279724	0.531025	2.409913	0.0177
DUMMY94	-0.590168	0.406905	-1.450382	0.1500
DUMMY96	0.585665	0.307602	1.903967	0.0597
DUMMY97	2.434477	0.406164	5.993829	0.0000
DUMMY98	-0.664394	0.414841	-1.601563	0.1123
DUMMY99	-1.372991	0.413034	-3.324158	0.0012
DUMMY00	0.037030	0.435231	0.085080	0.9324
R-squared	0.916038	Mean dependent var		1.600844
Adjusted R-squared	0.907806	S.D. dependent var		2.730014
S.E. of regression	0.828925	Akaike info criterion		2.554902
Sum squared resid	70.08597	Schwarz criterion		2.820400
Log likelihood	-133.3520	F-statistic		111.2834
Durbin-Watson stat	0.555027	Prob(F-statistic)		0.000000

5. EXCHANGE RATE IMPACT OVER INFLATION

One of the most important factors estimated to impact over future values of inflation series, thus over the expected inflation is even the exchange rate. As long as it is an indicator, against the changes of which the public, business and banks' common sensitivity is great, we think that it must be treated carefully. The fact that imports comprise the majority of trade transactions and estimate to be more than three times than exports indicates

Chart 9 The monthly series of changes in USD exchange rate and CPI
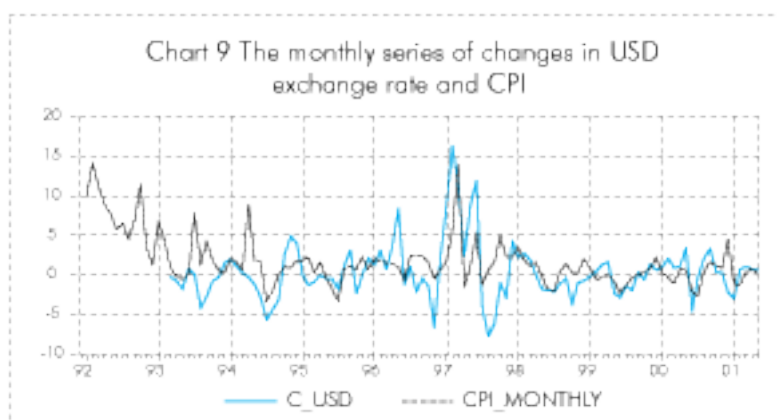
that in general the economy is first significantly linked with the exchange rate. Second the exchange rate changes affect consumer price changes, logically related to inflation.

It is clearly and graphically observed that exchange rate changes in USD are transmitted with one month lag to inflation indicator.

Inflation and exchange rate indicators are reflected in monthly changes in percent, in the form of a chain.

The over-evaluation of the inflation USD exchange rate correlation will be given on the basis of this reasoning. The variables explaining inflation changes will be given in the following:

• Inflation of the previous period,
• USD exchange rate of the previous period (Lek /USD).

During the diagnosis process of a group of samples (the intervention of some reverse lag variables), it was evidenced that two of the most appropriate variables are the above mentioned ones.

Economically and theoretically, this fact already stands. The current inflation is mostly related to that of the previous period and to the exchange rate, with the same lag. It is vitally important to understand that changing effects of exchange rate are reflected in inflation, with lag of time.

Table 7 Inflation dependence on exchange rate

Dependent Variable: CPI_MUSM				
Method: Least Squares				
Sample(adjusted): 1993:04 2001:05				
Included observations: 98 after adjusting endpoints				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.023012	0.059212	0.388644	0.6984
CPI_MUSM(-1)	0.858569	0.041515	20.68097	0.0000
C_USD(-1)	0.060984	0.013997	4.356909	0.0000
R-squared	0.820023	Mean dependent var		0.654973
Adjusted R-squared	0.816234	S.D. dependent var		1.172826
S.E. of regression	0.502766	Akaike info criterion		1.492750
Sum squared resid	24.01350	Schwarz criterion		1.571882
Log likelihood	-70.14476	F-statistic		216.4228
Durbin-Watson stat	1.933047	Prob(F-statistic)		0.000000

As noticed, both variables are statistically important and support the economic theory. Inflation changes for the respective period follow the same trend with those of USD exchange rate in the previous period. The same happens with the previous period inflation. It results out of the sample that it is as decisive as the USD exchange rate to current inflation.

The one-month lag is justified with the fact that it is the preliminary variables which prepare the grounds for inflation performance in the near future.

Exchange rates of other currencies (Euro components) are not statistically important variables of inflation performance in a direct way, but they will be needed to prove its correlation to indirect variables, as for example to REER.

The above model excludes the USD current rate. It results uncorrelated with inflation of the same period (current). It needs a month time to reflect inflationary effects in the economy.

The overall importance of the sample (thus, both variables are important at the same time) is confirmed by the high values of adjusted R-squared coefficient. It indicates that about 82 percent of inflation variance is explained with the presence of two variables with a negative 1- lag in the sample.

On the other side, this sample lacks the multi-co-linearity, i.e., the correlation between both variables. The analytical and the graphical results sustain a complete deficiency of co-linearity of variables. This means that the value of R-squared coefficient nearly at 82 percent is real and is totally dedicated to variables.

Table 8 Correlation matrix

Correlation	CPI_MUSM(-1)	C_USD(-1)
CPI_MUSM(-1)	1.000000	-0.101578
C_USD(-1)	-0.101578	1.000000

Chart 10 The dependence of USD monthly
rate change on monthly inflation
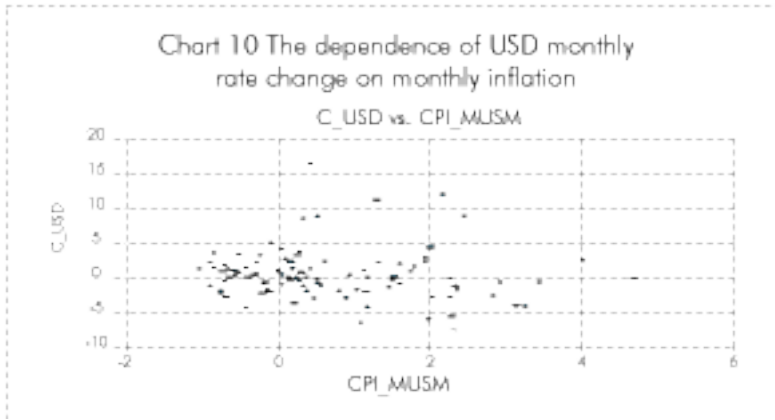
6. DOMESTIC CURRENCY APPRECIATION AND DEPRECIATION AND THEIR IMPACT ON INFLATION

Naturally a question arises: "Is the USD exchange rate (Lek/USD) of the same determining effect, either when the domestic currency appreciates or depreciates?"

To give an answer to this question first of all the most important periods corresponding to Lek appreciation or depreciation must be surveyed, second, given the already assigned correlation in the model of this section, whose results are presented in table 6, the modelling will be realized only by modifying the periods that noticeably evidence appreciation and depreciation phenomena of the domestic currency.

The 1996:02 to 1996:10 and 1997:09 to 1999:03 are regarded as the periods highlighting the domestic currency appreciation tendency, by surveying the monthly data. Whereas the 1995:01 to 1996:02, 1996:10 to 1997:10 and 1999:03 to 2000:12 are the periods highlighting the domestic currency depreciation tendency.

Regression results for both phenomena separately confirm the expected fact theoretically and practically.

Appreciation phenomenon indicates that inflation exchange rate correlation is statistically unimportant, while the reverse happens for depreciation periods. This correlation is utterly important for high levels of confidence, which is indicative of the fact that the speculative factor is robust.

Table 9. Appreciation period

Dependent Variable: CPI_MUSM				
Method: Least Squares				
Sample: 1996:02 1996:10 1997:09 1999:03				
Included observations: 28				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.010998	0.083064	-0.0.132399	0.8957
CPI_MUSM(-1)	0.933176	0.071594	13.03436	0.0000
C_USD(-1)	0.024831	0.017993	1.380016	0.1798
R-squared	0.873412	Mean dependent var		0.829776
Adjusted R-squared	0.863285	S.D. dependent var		0.782471
S.E. of regression	0.289319	Akaike info criterion		0.458382
Sum squared resid	2.092635	Schwarz criterion		0.601118
Log likelihood	-3.417352	F-statistic		86.24546
Durbin-Watson stat	1.396050	Prob(F-statistic)		0.000000

Table 10 Depreciation period

Dependent Variable: CPI_MUSM				
Method: Least Squares				
Sample: 1995:01 1996:02 1996:10 1997:07 1999:03 2000:12				
Included observations: 46				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-0.071310	0.071487	-0.997528	0.3241
CPI_MUSM(-1)	0.785848	0.072664	10.81477	0.0000
C_USD(-1)	0.090192	0.017479	5.159986	0.0000
R-squared	0.828191	Mean dependent var		0.127665
Adjusted R-squared	0.820200	S.D. dependent var		1.081515
S.E. of regression	0.458593	Akaike info criterion		1.341688
Sum squared resid	9.043240	Schwarz criterion		1.460947
Log likelihood	-27.85882	F-statistic		103.6388
Durbin-Watson stat	2.405156	Prob(F-statistic)		0.000000

7. SOME CONCLUSIONS AND PROBLEMS

1.   Studying inflation behaviour in time confirms that it is not an easy path to reach inflation forecast. One of the problems to be taken into account while setting up predictive and explanatory models is the log-likeliness of series. Notwithstanding that at the beginning of this paper a relatively positive evaluation was given related to the size of Albanian time series, it is generally estimated

that the time series of macroeconomic indicators are considered young-aged. In this aspect, inflation series, comprising the subject of this study, suffers from this problem. This is a series that has suffered the largest shocks from the Albanian economy. This fact has made it a series without a sequence. This is one of the reasons why the study on inflation performance, which will be normally intended to find inflation forecasting models, is carried out over the series generated from the monthly or quarterly changes of the CPI. This finding enables that inflation time series and variables explaining it (the USD exchange rate), turn into stationary or stable series, appropriate for analysis and forecasts.

The proposed scenario that studies inflation performance in time, reflects not only its trend, but also may be used for forecasting. This scenario, albeit its good explanatory force, unveils some problems related to the fact that:

- The model (scenario) reflects only inflation dependence on time variable, meaning that it does not take into account other macroeconomic and social indicators, which bear an indisputable impact on inflation. However, the building scope of a similar scenario is more useful for finding the main inflation trend and as such it fits to the quality of a "good" model to its best;
- The other problem, which to some extent depends on the previous one, relates to the fact for how long this model can go with forecasting, i.e., how far does it go in time. Theoretically it can go very far, as far as allowed by the chain of ordinal numbers, i.e., in infinite. Practically, the more we get away from the published values, the further from reality this forecasting model goes. That is why this model is available for short-term forecasts, and with some reserves, even for mid-term ones.

2.   During the last decade, the country and the economy have been faced with political events that have influenced even the inflation indicator. Which of them, in particular, have "hit" it considerably?

The presentation of model results studying this phenomenon indicates that it is the rather tensioned situations the country and the Albanian economy have passed through that have caused shocks (changes) statistically important to inflation. Concretely, we are referring to the 1997 crisis and the spring 1999 Kosovo crisis, whereas the other situations such as the electoral period or referendums have not caused such impacts. The importance of this finding lays in the fact that it is reasonable to exclude these periods (concretely the spring 1997) from future modelling, since they represent shock periods and as such they deform the forecasts and analyses.

3.   Inflation is an indicator closely related to the exchange rate in general and to the USD exchange rate in particular. It is an already verified fact that the explaining power of the USD exchange rate is significantly higher than that of the European currencies or the Euro components.

One of the frequently encountered problems in building the model is the selection of the lag. The model has provided reliable results for lag = (-1) but, the common practice for building such models recognizes a bigger lag. In the case of Albanian reality, the sensitivity against the changing exchange rate of USD is quicker in inflation. It emerges with one month lag.

4.   The phenomenon of domestic currency appreciation indicates that the inflation exchange rate relationship is statistically unimportant, whereas in periods of its depreciation the reverse takes place. This correlation is utterly important for high levels of confidence. In fact cases with strong domestic currency appreciation periods must generate declining inflation and this correlation would turn out to be important, something our data do not verify. This fact confirms our market nature, which is not a price regulator on the descending side, where the speculative element is very strong.

5.   Seasonal adjustment and the levelling (flattening) of series already constitute a very important requirement that must be normally applied in such kind of studies. For all above-

explained reasons this requirement is applied in all variables (mean dependent variables and the reverse) of this paper. Moreover, the European statistics standards are highly requiring the application of a seasonal adjustment of time series, because in this way they are comparable in time and space.

The above treated problems indicate that studying inflation, its behaviour and main determinants is a long way through which models of a high explaining and forecasting power are aimed at. The above study is an effort to clarify some important moments of its behaviour and their explanation is made in an empirical way. In the meantime, it will be followed by the introduction of some other models that would be modestly called as such and would help the central bank forecast inflation, initially for short-term periods.

ANNEX 1

Periods expressed in dummy variables in the model are as follows:

DUMMY 92 – includes the period of January `92 – September `92
DUMMY 94 – includes the period of August `94 – December `94
DUMMY 96 – includes the period of March `96 – December `96
DUMMY 97 – includes the period of April `97 – August `97
DUMMY 98 – includes the period of September `98 – January `99
DUMMY 99 – includes the period of March `99 – June `99
DUMMY 00 – includes the period of August `00 – December `00

NOTES

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[1] Clearing time series from seasonality and rare component is attained through statistical methods included in special softwares i.e. E-views, SPSS, and SAS etc. All analytical processing and graphs included in this paper are processed through E-views.4.0.

[2] From the household budget survey in year 2000, "Food, beverages and tobacco" resulted of 58 percent weight in the consumption of Albanians household budget.

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INDIRECT INSTRUMENTS OF MONETARY POLICY

*Sonila Taçi**

Monetary policy instruments are born and developed together with the establishment and institutional development of the Bank of Albania, to materialize its role as a compiler and further on as an executor of monetary policy in the country.

Monetary policy instruments have a 9-year history in our country, passing through some epochs conditioned by the stage of the Bank of Albania development as policy-maker, the banking system and the Albanian economy development, on the whole. As reflected by many international studies on monetary policy and instruments of its application in the early stages of development, the monetary policy of a country is developed through direct instruments. And gradually, in view of the economic progress and development of a country, its economic policies, financial market development, the birth and creation of new financial institutions, constant knowledge on new financial instruments, it is passed over to the so-called indirect instruments of monetary policy. Monetary policy instruments have also traced the same course of development in the Bank of Albania, getting through four stages, according to knowledge and their application:

- Implementation of monetary policy only through direct instruments

- Knowledge of some indirect instruments;
- Implementation of monetary policy through the combination of direct with indirect instruments and,
- Finally, leaving aside direct instruments and the implementation of monetary policy only through indirect instruments.

In the different stages of this development process, using one or another type of instrument has different dimensions and is made in view of monetary policy and its short and mid-term targets, within limits allowed by the Albanian economy and its institutional development.

In the first part of the article there are mentioned the distinctions between direct and indirect instruments. In the second part, attention is paid to transition from direct to indirect instruments and arguments on monetary policy application totally based on indirect instruments are provided. Whereas in the third part, it is furnished a simple and a headline description of the range of instruments currently used by the Bank of Albania and the Albanian banking system.

FIRST PART

MONETARY POLICY DIRECT AND INDIRECT INSTRUMENTS-THEIR DISTINCTIONS

The Bank of Albania represents the central bank in the country. Through its policies and to serve its duties defined by the Law "On the Bank of Albania", it makes efforts to achieve its final target, i.e., maintaining the consumer price stability or in other words to keeping inflation rate under control. Before drafting with accuracy the policies it must follow, the Bank of Albania fixes final targets and instruments with which it will operate to achieve the targets set.

Through its policies, it strives to reach some targets such as inflation control, promotion of economic growth of the country

and finally achievement of a balanced account of payments. However, it cannot control the achievement of these targets directly. In this process, the Bank of Albania formulates the intermediate targets, such as the growth rate of money supply (monetary aggregates). The final objectives are directly affected by their behavior. As these intermediate objectives are not fully controllable by the Bank of Albania, it sets some operating targets, such as the increase of the money base, which are controllable and may increase or decrease according to instruments selected for monetary policy implementation.

What do we understand by the Bank of Albania's monetary policy instruments?

Bank of Albania's monetary policy instruments represent those means or mechanisms through which it realizes intervention in second-tier banks relationships to ensure that market conditions and the rate of currency in economy are in tune with its final objective, that is maintaining control of consumer prices and the growth rate of economy.

To implement its monetary policy a central bank can act in two manners: directly, using its regulatory power or weight or indirectly through its money market impact as issuer of the so-called "high-powered money"[1] or "reserve money". The direct term is referred to a straight correspondence, one by one, of the respective monetary policy target with the instrument. To illustrate this, it might be mentioned the domestic credit as respective target of the monetary policy with the instrument of credit ceiling.

The distinction between monetary policy direct and indirect instruments can be noticed in two major directions:

- Direct instruments through the respective regulations and guidelines determine or limit the quantity or the price of the monetary aggregates and credit. As the most typical example, it can be mentioned: fixing the minimum interest on Lek deposits, which represents a case of price fixing and

setting of credit ceiling any second-tier bank can serve to the public, which is the case of fixing a limit on the amount or quantity.

- Indirect instruments operate or act through the market, affecting the supply or demand for market funds. Credit ceiling as a monetary policy direct instrument is directly tangible on commercial bank balances, whereas the majority of indirect instruments mostly affect the central bank balance. For example, through applying the credit ceiling, the second tier banks are limited on the range of balance sheet assets under "Credit" item. Whereas related to indirect instruments, the central bank itself determines the range of balance sheet assets under "Loans granted to second-tier banks" or "Repurchase agreements" etc.

The impact on the market conditions does not exclude the possibility for the central bank to set targets related to the range of interest rates or the amount of credit to economy. Instead of direct control, market mechanisms allow money market participants to adapt indirectly to the establishment of these parameters.

Indirect instruments also referred as market-applied instruments generally differ from second-tier bank reserves by bank or non-bank transactions with market prices. Indirect instruments, which are market based, are distinguished from the type of market in which they are applied.

Although these instruments are termed indirect or market based, they contain a minimum regulation base. This is for "governing" in the conditions that realize their functioning such as: transaction parties, the manner or the form of their application (for example the type of auction), the form of realizing payment at the moment of closing transaction, etc. Within this framework, there are the market forces through which monetary policy indirect instruments affect change in the range of high-powered money.

SECOND PART

PASSING FROM MONETARY POLICY DIRECT INTO INDIRECT INSTRUMENTS

Approval of the Law No. 7559 in April 1992 marked the establishment of the Bank of Albania as the central bank of the country, whose principal responsibility was maintaining the domestic currency value through the application of monetary policy; bank licensing and supervision, control, settlement and governing of the payments system. The Bank of Albania establishment was accompanied with the development of the monetary policy framework and its instruments.

The overall statement of the Albanian economy and the developing stage of the financial system in Albania in that time could allow monetary policy drafting almost totally based on direct instruments and monetary control. The nature and characteristics of these instruments matched with the Albanian banking system. From the experience of many developing economies direct instruments have been liable and successful (without any apparent side effect) in the control of credit to economy, its distribution and cost, etc. Direct instruments make it simpler, as it was enough for the central bank to fix limits or restrictions and this operation would be directly transmitted through respective instructions to second-tier banks. Direct instruments make simpler the compilation of the monetary program, as growth rates of monetary aggregates or credit are directly defined or determined by the compilers of the program to follow the achievement of the monetary policy targets. Direct instruments are very suitable for economies with less or undeveloped financial markets as these are not realized through markets. Monetary policy application through indirect instruments requires developed financial markets, tradable instruments, consolidated banks or financial intermediaries. In Albania's conditions, where the institutional framework was undeveloped and tradable instruments (securities) were not yet available when the banking system has just entered under the two-tier system, where banking and financial education was very

low, nothing else could be pretended except for the monetary policy application through direct instruments.

In 1992, the Bank of Albania began to operate through fixing the deposit rate and the credit ceiling. In the same period it began holding the required reserve for second-tier banks and the publication of refinancing rate. In June 1992, it published the first official release on the credit ceiling.

According to it all credit institutions exercising bank activity must respect the Bank of Albania assigned credit ceiling, meaning that they had to extend credits by the Bank of Albania assigned rates for each second-tier bank. The credit ceiling was quarterly assigned for each second-tier bank at the beginning of the year. For some years in succession, the Bank of Albania has made the allocation of the credit ceiling for second-tier banks in accordance with its monetary program targets based on their business-plans, the economy capacity to absorb credits, etc., the credit ceiling continued to apply until November 1999. After this moment, the Bank of Albania applied no restriction on second-tier bank credit to the economy.

In the same year, the required reserve was retained at 10 percent. This meant that second-tier banks would be placing 10 percent of their liabilities against the thirds with their Bank of Albania accounts. To have a flexible, practical and good functioning of this instruments various improvements have been made in the regulatory framework of the required reserve time and again. The most important changes consist in the application of the weekly average in the remuneration of the required reserve and its 5 percent use from second-tier banks. These changes, at the end of 1998 and at the beginning of year 1999 were made with the good purpose of developing this instrument and the provision of some facilities for a fast progress of the banking system. Another important change in the second half of the year was the remuneration of the required reserve, which meant that the second-tier banks would be rewarded for their funds booked in the required reserve account. All the above changes served promoting development of the banking

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system and completing the framework of adequate instruments for the European integration in the future.

In the same year (1992), the Bank of Albania began to decide and publish the obligatory minimum rate on Lek deposits. Bank of Albania's fixing of interest rate has been made mainly based on the inflation rate in economy to ensure a real and positive interest rate, meaning that the Bank of Albania has taken care that household deposits be not corroded from the high range inflation in reverse periods.

Through the interest rate policy, the Bank of Albania has also taken care to serve the promotion of banking system role, the encouragement of real investments in economy, constant macroeconomic improvements, securities market development and the strengthening of the public confidence, especially, in and after year 1997, when the high inflation rate enforced a 37 percent deposit rate. The interest rate applied as instrument continued until September 2000 in which year the Bank of Albania gradually resigned from fixing the interest rate on 6-month and later on 12-month deposits.

With the completion of the regulations, Lombard and refinancing facility took final shape in year 1996. They were widely used in year 1997 and the first half of year 1998, which was a busy period with liquidity problems for the banking system. As the refinancing facility does not exist in the Bank of Albania's framework of instruments, the Lombard facility is deemed to cover long-term needs (quarterly) of banks for liquidity, if the latter (banks) are deprived of any other money market possibility.

In year 1996, repurchase and reverse repurchase agreements were introduced for the first time. Their scope was to settle short-term problems of liquidity deficiencies and surpluses in the banking system. Until July 2002 they have been functioning on bilateral procedures. After this period, repurchase agreements, whose purpose is the transmission of monetary policy signals were completed through auctions, following and approaching the European Central Bank model.

After the overall crisis of 1997, with the total recovery of the Albanian economy and the ensuing macroeconomic stability, with the regaining of public confidence from the banking system, its gradual recovery and development, monetary policy application through direct instruments was no more serving the economic development of the country.

Under these conditions it has been worked for the constant improvement of monetary policy instruments not only with respect of the introduction of the new instruments but also with their ever best functioning as possible. The Bank of Albania policy reached to that point so as to be only applied through indirect instruments, whose complete framework is introduced in the third part of this paper.

What are central bank criteria for fixing a framework of instruments?

One of the main criteria is the instrument capacity to control variables the central bank wants to affect, for example, the range of reserves and money, credit and interest rates. To be successful, the effects of using the instrument must be predictable. The instruments capacity to control can increase if the instrument is flexile which means that its monetary effects can be changed, neutralized, or turn back relatively quick.

The second criterion is related to the side effects of instruments in allocating financial resources. Is it possible that the application of the instrument may interfere with the financial market or cause distortions in the distribution of real resources? Positive. For example, credit ceiling may be very efficient in the control of credit aggregate but this may lead to non-financial intermediation, lag of financial market development and in the distortion in the financial resource appropriation.

The third criterion is generally related to what will be the contribution of a specific instrument or the entire framework to the overall financial development of a country or its financial system stability. For example the Bank of Albania operations in

securities (3- 6-12- month treasury bills) do not only comprise a means for controlling the banking system liquidity but also incite the financial market development, especially that of short-term government securities.

The fourth criterion has to do with the capacity of respective instrument or framework of instruments to be handled in difficult financial situations (shocks) in the system or specific banks, i.e. the shock of liquidity (the massive deposit draw-downs before the due date). In these cases, the refinancing facility has been unsuccessful in dealing with problems of special banks. If we turn back in time, in the end of 1996 and the first half of year 1997, we should remember that the Albanian banks have had many liquidity problems. The framework of direct and indirect instruments used in that period managed to cover the liquidity problems of the system.

In preparing the framework of the Bank of Albania monetary policy instruments, all the above-mentioned criteria have been taken into account. However, the good functioning of this framework requires the coordination of using each of these instruments with the frequency and the using rate of these instruments and their effect on liquidity. In this context it comes out as necessity to program the money reserve, as it ensures the systematic analysis of liquidity users and resources.

THIRD PART

THE COMPLETE DESCRIPTION OF THE BANK OF ALBANIA MONETARY POLICY INSTRUMENTS AND THEIR PRACTICAL IMPLEMENTATION

Currently the Bank of Albania operates only on monetary policy indirect instruments. So, it performs open market operations, offers permanent facilities and requests deposit money corporations to hold their minimum required reserve at their accounts with the Bank of Albania.

What are the Bank of Albania monetary policy instruments?

1. Open market operation
1.1 Reverse operations
1.2 Outright sale-purchase transactions
1.3 Foreign exchange operations (can be understood as part of outright sale-purchase transactions)

2. Auxiliary instruments
2.1 Lombard facility
2.2 Overnight credits
2.3 Overnight deposits

3. Required reserve

1. WHAT ARE OPEN MARKET OPERATIONS?

Open market operations play an important role in the Bank of Albania's monetary policy and are targeted at addressing the behavior of short-term rates, manage the liquidity situations through adding or lessening the market liquidity and signalize its monetary policy. Open market operations can be in the form of reverse transactions including Repurchase Agreements and Reverse Repurchase Agreements and in the form of outright sale-purchase transactions, including securities or foreign exchange operations. It is important to be mentioned that open market operations are initiated by the Bank of Albania, which decides the instruments to be used and the terms of their execution.

1.1 REVERSE TRANSACTIONS

These transactions are termed as such as they represent transactions composed of two operations. Buying represents the first operation/selling the security and the second operation or the reverse is represented by the repurchasing/reselling of the security.

Repurchase Agreements and Reverse Repurchase Agreements

General

Repurchase agreements and reverse repurchase agreements have been market applicable for the first time in year 1996 in the form of bilateral non-periodic agreements between the Bank of Albania and the second-tier banks. From this year to June 2000, these have been used as combined with monetary policy direct instruments, like the credit ceiling, the minimum interest rate on Lek deposits for utterly state-owned banks. Repurchase agreements started functioning through weekly actions organized at the Bank of Albania in July 2000.

The repurchase agreement implies an accord through which the Bank of Albania sells securities and promises to repurchase them in the future according to the preliminary terms and schedules agreed before hand. This is a frequently used instrument to temporary reduce the liquidity in the banking system.

The reverse repurchase agreement implies the agreement through which the Bank of Albania purchases securities and promises to resell them in the future according to the terms and schedules agreed before hand. This is a frequently used instrument to temporarily add the liquidity in the banking system.

Maturity

Based on the maturity term, we distinguish four types of repurchase agreements:

- *Daily (one-day) maturity. These agreements are realized through fast type auctions.*
- *Weekly (7-day) maturity. These agreements are realized through standard type auctions.*
- *Monthly (one-month) maturity. These agreements are realized through a fast type auction.*

- *Quarterly (3-month) maturity. These agreements are realized through fast type auctions.*

Participating amount

For a participating bank in the auction of repurchase agreements, its bidding amount must be minimally Lek 5 (five) million and over this amount, Lek 100 thousand can multiply it.

In multilateral (diversified) price auctions, the Bank of Albania Governor on the proposal of the Monetary Operations Department approves the bidding amount announced in the respective auction. Applications are filled according to the bid amount to participate in the auction. In case that the bidding amount presented by all applications is higher than the proposed amount by the Bank of Albania, then the applications are filled on pro-rata (or partially to a suggested proportion).

In fixed price auctions, applications are filled according to the definite amounts proposed by the second-tier banks to participate in the auction.

The price/interest rate

The Bank of Albania Monetary Operations Department proposes the fixed interest rate for standard auctions on repurchase agreements and the Bank of Albania Supervisory Council approves it. This serves as the maximal/minimal rate for multilateral price auctions.

The interest rate for fast auctions refers to the fixed rate for standard auctions and is approved by the Bank of Albania Governor on the proposal of the Monetary Operations Department.

Collateral assets

As collateral assets to guarantee the obligation of both participating parties in the transaction are used the current

treasury bills on one-year maturity or with no less than 14 days from maturity.

Reverse Repurchase agreements, developed through purchasing auctions, are considered as collateralized loans. In this case, the collateral value is 115 percent, thus 15 percent more than the operating amount.

Other government securities, whether accepted to be used as such by the Bank of Albania Supervisory Council decision, can be used as collateral assets.

The type of auction

Auctions for repurchase agreements can be of some types. The Bank of Albania Governor on the proposal of the Monetary Operations Department approves the type of auction.

By type of agreement, repurchase or reverse repurchase, we distinguish:

- *Selling auction (repurchase agreement). In this auction the Bank of Albania sells securities and promises their repurchase at a later date.*
- *Buying auction (reverse repurchase agreement). In this auction, the Bank of Albania purchases securities and promises to repurchase them at a later date.*

By the offered price in the auction, we distinguish:

- *Fixed price auction. According to this type of auction, applications are filled according to a fixed rate decided and announced by the Bank of Albania in the sequence auction.*
- *Multilateral (diversified) price auctions. Applications are filled according to the interest rate decided by each participant on the condition that the interest rate is no higher than in selling auctions and no lower than in buying auctions from the interest rate announced by the*

Bank of Albania Monetary Operations Department on the respective announcement.

By the time of developing the auction, we distinguish:

- *The standard auction. These auctions are organized within the next day from the announcement of the Bank of Albania Monetary Operations Department on the sequence weekly auction. These weekly auctions are preliminary fixed (in the respective calendar).*
- *The fast auction. Fast type auctions are classified in two subtypes:*
  - *Fast auctions on repurchase agreements of one-day maturity. These auctions are developed two hours from the notification of the Bank of Albania Monetary Operations Department on daily auctions.*
  - *Fast auctions on repurchase agreements of a monthly or quarterly maturity. These auctions are developed four hours from the Monetary Operations Department on monthly/quarterly auctions.*

Reverse from the standard type auctions, fast type auctions are not previously decided and are developed as many times as it is deemed rational from the Bank of Albania. Their organizing scope is mainly the management of liquidity in the banking system.

Applicable penalties in case of transgressing terms of the agreement.

In case one of the parties violates the terms of the agreement, the applicable penalties are based on collateral[2] rules.

Transaction parties

Second-tier banks represent participating parties in repurchase agreements organized by the Bank of Albania.

Procedures for settlement of accounts

Recording operations in auction accounts is of a book-entry[3] form. Based on the principal Delivery Versus Payment, the same time transference of treasury bills (securities) and of the Lek counter value of the transaction is made.

What must be done by a bank to be accepted as a partaker in the auctions of repurchase agreements?

To be accepted as party in any repurchase agreement, second-tier banks must sign a one-year contract with the Bank of Albania at the begging of each calendar year, which precedes the execution of repurchase agreements to be subsequently developed through auctions.

What is the functioning of auctions on repurchase agreements?

The Bank of Albania before organizing auctions on repurchase agreement informs the second-tier banks on the type and terms of auctions through SWIFT, telex, REUTERS, fax or official letter. Through this letter banks are notified of the type of auction, the date and hour of carrying out the auction, the required amount in the action, the interest rate etc. If the auction is of a standard type, it will be periodically developed every week on Wednesday at 14.00 hrs. Bank bids must be submitted to the Monetary Operations Department as to an already prepared application-form at 13:30 on the day of the performing auction. In this application form, banks must write down the name, other additional information on the participating amount in the auction, the interest rate offered in the case of multilateral (diversified) price auctions, etc.

The auction commission examines bank requirements with the beginning of the auction. In case of observing any inconsistencies or if they are not filled according to the standard form, the respective bank is qualified unfit to participate in the auction.

For weekly auctions, the commission is comprised of two members, representatives of Monetary Operations and Research

Department respectively. For monthly or quarterly auctions on repurchase agreements, the commission is comprised of three members, two representatives of Monetary Operations Departments and one from the Research Department.

In multilateral price auctions, application forms are ranked in rising/descending order. All bid forms are automatically notified as winners, if the required amount from the banks is smaller than the one offered from the Bank of Albania. If the required amount from banks is higher than the one offered from the Bank of Albania, then the auction commission has to apply the pro-rata, i.e., the ratio between the amount remaining to be distributed to the sum of bank bids, whose repurchasing interest is equally the same.

After the termination and the proclamation of winners, the auction commission makes the respective notifications on auction results for both participants in the auction and the Bank of Albania managers. The notification of participants in the auctions is made through SWIFT, telex, REUTERS, fax or official paper.

1.2. OUTRIGHT SALE-PURCHASE TRANSACTIONS

General

The peculiarity of outright sale-purchase transactions stays in their permanent effect on the money market. These are not reverse transactions. The selling or buying of securities is not accompanied with the reverse operation of their reselling or repurchasing.

These operations are executed on the Bank of Albania initiative and are aimed at managing the liquidity or interest rates. Transactions may be in the type of purchasing securities, which means that the addition of liquidity in the banking system or the selling of securities from the Bank of Albania implies the attraction of the banking system.

The subject of transactions

In outright sale-purchase transactions, treasury bills of one-year maturity and those of no less than 7 days remaining to maturity may be sold or purchased. Debt securities bearing a high liquidity and credibility and accepted as such on the Bank of Albania Supervisory Council decision can be also sold or purchased in these transactions.

The proposal

Outright sale-purchase transactions are carried on the proposal of the directors of the Research and Monetary Operations Departments and with the approval of the Bank of Albania Governor. The proposal for outright sale-purchase transactions takes advent on the current conditions of money market, based on the Bank of Albania monetary program approved by the Bank of Albania Supervisory Council.

Transaction procedure

Outright sale-purchase transactions may be carried through bilateral procedures or fast auctions. The Bank of Albania Governor approves the transaction procedure based on the suggested proposal from the Monetary Operations Department.

In case of performing outright sale-purchase transactions, the Bank of Albania informs the second tier bank it wants to operate through SWIFT, fax, telex or REUTERS. If this bank accepts to take part in the transaction, the Bank of Albania sends immediately its confirmation to the Bank of Albania. After this operation, both parties define the conditions and the terms of transaction.

In the case of performing transactions through fast auction procedures, the Bank of Albania informs all second-tier banks till at 10:00 hrs., through SWIFT, telex, faxed message or REUTERS or through official paper. The announcement should contain reference data on the auction and the face value of the treasury

bills offered to exchange, their maturity term etc. In a two-hour interval from the moment of delivering the notification, the second-tier banks must confirm their participation in the auction to the Bank of Albania. The confirmation contains reference data on the auction, the face value of treasury bills required /offered in the auction, their selling/purchasing price, their maturity term, etc. All participants meeting the completion of the nominal value defined by the Bank of Albania are considered winners of the auction. In the case of participants meeting the same terms, the applications are partially filled up according to the pro-rata mechanism.

Immediately after the termination of the auction, the respective commission prepares and delivers notifications on auction results to all participants.

Transaction parties

Second-tier banks holding accounts with the Bank of Albania are considered as counter parties in performing outright sale-purchase transactions with the Bank of Albania.

Accounting techniques

Transaction accounts are settled on the same day with the performing auction or after the termination of bilateral transaction. Shifting the right on the ownership of treasury bills, as well as the transference of funds into banks and the Bank of Albania accounts, is based on the principle of Delivery Versus Payment.

1.3. FOREIGN EXCHANGE OPERATIONS, INTERVENTIONS

The Bank of Albania undertakes full right or swap foreign exchange transactions. Practically the Bank of Albania buys or sells foreign exchange, when it aims at intervening to mostly soothe exchange rate oscillations. Through its government relationships, the Bank of Albania converts the foreign into

domestic currency or sells the government foreign exchange to pay the foreign debts.

2. AUXILIARY INSTRUMENTS

Auxiliary instruments purpose is to temporarily add or lessen the liquidity, to signalize the character of the monetary policy and hinder tremendous oscillations in interest rates. They are always and exclusively carried on the second-tier banks' initiative. The second-tier banks are the only party of the Bank of Albania in these transactions.

2.1. LOMBARD FACILITY

General

The Lombard facility has been the Bank of Albania's monetary policy instrument for a long time. Nevertheless, it has not been used in any case during years 2000 and 2001. Instant changes and improvements of the respective regulation have been according to the developments in the deposit money corporations and money market. That regulation has been reviewed and completed for the last time in February 2001. The purpose of Lombard facility is not to affect the overall statement of liquidity in the banking system but to help second-tier banks overwhelm temporary problems of liquidity. Representing the ceiling rate established by the Bank of Albania, such credit rate serves as guiding to other short-term market rates.

Any second-tier bank can apply for the Lombard facility to the Bank of Albania only after it has previously used all domestic capacities for liquidity or the interbank market or repurchase agreements. The Bank of Albania Governor on the proposal of the Monetary Operations and Research Department approves the Lombard facility to second-tier bank.

Maturity

The maturity of Lombard facility is up to three months. This facility can be quarterly available to second-tier banks.

The maximum amount

Any second-tier bank applying for the Lombard facility in the Bank of Albania is availed to it to a maximum amount between 20 percent of the paid-up capital and the 2 percent of Lek deposits of the applicant bank.

The interest rate

The applicable interest rate on the Lombard facility is 6 percentage points higher than the applicable interest rate on Repo agreements. Currently the applicable interest rate on the Lombard facility is 13 percent (7 percent interest of Repurchase agreements plus 6 percent).

Collateral

All eligible values recognized by the respective regulation "On collateral" serve as collateral means in the case of the Lombard facility:

- Treasury bills of no less maturity than the maturity term of the facility extended by the Bank of Albania,
- Domestic and foreign currency deposits.

Transaction parties

All second-tier banks are Bank of Albania's parties in the Lombard facility.

Penalties

If one of transaction parties branches the taken over obligations, then the forecasted penalties in the regulation "On

collateral means" are applied on it. If the second tier bank does not return the Lombard facility on the due date, it will be prohibited to take any other type of credit in the next quarter.

2.2 OVERNIGHT CREDITS

General

The overnight credit is a totally guaranteed facility, which is extended to aid second-tier banks to resolve overnight liquidity problems. It also helps to ease oscillations of short-term interest rates. The overnight credit is a new instrument approved by the Bank of Albania Supervisory Council in February 2001. The second-tier banks have not felt the need for using this instrument since its access.

Maturity

Such credit facility is matured overnight. The Bank, to which such facility has been extended, must pay it in the next day.

Credit extension by the Bank of Albania

The second-tier banks, which for any reason, lack adequate liquidity for all their payment commitments during a certain working day, shall apply for overnight credits to the Bank of Albania.

The Bank of Albania may automatically extend overnight credits, if the second-tier bank's "Reserve" account of a certain second-tier bank results below the permissive limit of 95 percent, till 5:00 hrs of the current working day.

Maximum amount

A second-tier bank may apply for an unlimited overnight facility, on the condition that the requested amount is totally guaranteed by securities, thus it is utterly collaterized.

Interest rate

The interest rate for overnight credits is 2.5 percent higher than that of the repurchase agreements approved by the Bank of Albania Supervisory Council. The current interest rate for overnight credits is 9.5 percent (Repo rate 7 percent plus 2.5 percent).

Collateral

To guarantee the obligation resulted from the overnight credit serve:

- Treasury bills of no less maturity than the extended loan by the Bank of Albania,
- Domestic and foreign currency securities.

Penalties

If one of the parties violates the duties taken over on this credit, the overall rules provided in the regulation "On collateral means" will be applied.

2.3 OVERNIGHT DEPOSITS

General

Overnight deposits represent a new instrument approved on February 2001. Since its introduction, second-tier banks have constantly improved the use of this instrument. Overnight deposits represent a helpful instrument for second-tier banks to operate with the excessive liquidity, placing it for one day with the Bank of Albania. Overnight deposits also help in the withdrawal of liquidity from the banking system and the lessening of vast oscillations in short-term rates. The interest rate applied on the overnight deposits represents money market floor rate.

Maturity

Overnight deposits are matured within the next day, which is an instrument with an overnight maturity.

The maximum amount

The amount of funds in Lek that a second-tier bank is willing to place with in overnight deposit at the Bank of Albania is unlimited. Nevertheless, the Bank of Albania can refuse the second-tier bank requirement to place overnight deposits without giving any explanations. The Bank of Albania's refusal depends on the market conditions, its monetary program and short-term targets related to money market rates.

Price/Interest rate

The interest payable by the Bank of Albania to the second–tier bank is 2.5 percent annually, lower than the applicable interest rate on repurchase agreements approved with the decision of the Bank of Albania Supervisory Council. If the applicable interest rate on repurchase agreements is 7 percent, the deposit rate is 4.5 percent (7 percent of Repo[4] rate diminished by 2.5 percent).

3. THE REQUIRED RESERVE

General

The Bank of Albania requires all the deposit money corporations to hold the required minimum, either in domestic or foreign currency at the Bank of Albania account. The required reserve as a monetary policy instrument is introduced in year 1992. The required reserve rate on the domestic or foreign currency deposits is unique, at 10 percent on the whole reserve basis. The required reserve system enables the second-tier banks to benefit from the average mechanism, meaning that the completion of the required reserve is made on the weekly average of the

second-tier banks' reserve account for one-month term. The required reserve held at second-tier banks' account by the Bank of Albania is remunerable, meaning that the second-tier banks will receive interests for funds held, as a required reserve, by the Bank of Albania.

- Interest rate stability in the money market

The average mechanism in the framework of the required reserve aims at contributing to the interest rate stability in the money market, giving the second-tier banks the possibility and at the same time the facility to soothe or flatten the effects of temporary oscillations in the liquidity statement. More clearly expressed, the second tier banks can use funds from their required reserve accounts to perform daily transactions on the condition that the weekly average be no smaller than the required minimum.

- Institutions, subject to the minimum required reserve

Banks and foreign bank branches authorized for banking activity in the Republic of Albania conform the respective[5] legislation are subject to hold the required reserve with the Bank of Albania.

- Assigning the minimum of the required reserve

a. Reserve basis

Banks are legally enforced to hold a reserve against Lek or foreign currency deposits, or in other words against the second-tier banks liabilities to the thirds. The required reserve is accounted on the basis of Lek and foreign currency deposits including the securities issued by banks and excluding deposits or current accounts held at one-another (banks) as well as the funds provisioned for the guaranty of credit letters on the condition that these must be closed inside or outside the country.

The second-tier banks report weekly to the Bank of Albania on the accounting data of the required reserve, according

to respective forms. The reserve basis for the month M-1 is assigned in month M, according to the delivered data on the domestic and foreign currency deposits. The required reserve is denominated in the USD or the Euro. Bank liabilities in other foreign currencies than the Euro are converted into the USD and are presented in the reserve basis form.

b. Accounting the minimum required reserve

Second tier banks' minimum required reserve is accounted by applying the rate of the required reserve on the basis of the reserve. The rate of the required reserve is unique for all types of deposits that constitute the reserve basis (in domestic and foreign currencies) at 10 percent. The required reserve in domestic and foreign currency is accounted based on weekly information.

The reserve of month M-1 is accounted as weekly average of the reserves average weighted with the number of calendar days in the month.

Required reserve holdings

a. Holding term of required reserve

The holding term for the required reserve is one month. Its holding term begins from the fifteenth day of the month M to the fourteenth day of M+1 on the account of M-1. For example, the required reserve for January is paid-up on February 15 and is held from February 15 to March 14.

b. Holding the reserve accounts

Second-tier banks hold domestic or foreign currency accounts at the Bank of Albania. The Lek account is labeled "Reserve" account and is comprised of the current and the required reserve account. Banks can make the daily use up to 5 percent of the required reserve account; However, they must replace this use within the week, provided that the weekly average of the reserve account be as much as the required reserve in domestic

currency, accounted by the Bank of Albania on the 15-th of the respective month.

Required reserve remuneration

Second-tier banks' required reserves held by the Bank of Albania are interest repayable from the latter after remuneration.

The remuneration rate for the required reserve denominated in Lek is as much as ½ of the treasury-bill yield on quarterly maturity in the last auction, before the 15-th day of each month when it starts holding the required reserve.

The remuneration rate for the required reserve in foreign currency is as much as ½ of the LIBOR[6] rate on monthly deposits denominated in USD and EURO on 15-th day of the month, when the holding of the required reserve starts. The remuneration is made on the same currency with the required reserve (USD and EURO). The remuneration is performed in the day the required reserve operations are passed into account. For example, on February 15 starts holding of the required reserve for January and the remuneration is payable on the required reserve of December held at the Bank of Albania from January 15 to February 14.

Inconsistencies with holding duties of the required reserve

Any second-tier bank may be found in the situation of not-meeting the required reserve. The bank does not meet the required reserves when:

- After accounting the required reserve, the bank lacks the adequate stock in the foreign currency account to meet an addition of the required reserve. All days to the supply of the required reserve account in foreign currency are considered as due days to this duty. For the required reserve denominated in Lek, the case of the additional reserve does not present a problem as it is held in the "reserve" account including the required reserve and the current account.

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- For the period of withholding reserve in domestic currency, the weekly average of the second-tier bank's required reserve accounted and fixed on the 15th day of the respective month (at 100 percent). In the case the days from the day of falling underneath the 100 percent to the end of the week are considered as due days to this duty.

For not-meeting the required reserve the Bank of Albania applies the following penalties:

- For not-meeting the required reserve in domestic currency, the applicable penalty is for every due day based on the recent treasury bill auction on quarterly maturity plus 2 percent;
- For not-meeting the required reserve in USD and Euro the applicable penalty is accounted in USD for every due date based on the LIBOR rate on the quarterly deposits denominated in USD and the last date of the month for which the required reserve is accounted, plus 2 percent.

For Euro denominated amounts, the conversion is made into US dollars according to the last date exchange rate of the month.

NOTES

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[1] With the term "high-powered money" or "reserve money" it is understood the currency in circulation and the second-tier banks' accounts held in the central bank. That is the money on which the central bank has complete authority that enables the application of monetary policy through indirect instruments of it.

[2] The Regulation no. 111, dated 10.08.1998 "On Collateral assets".

[3] Book-entry system is an accounting system that permits the transference of entitlements (securities) without physically moving the printed papers or documents or equity certificates.

[4] Repo is the abbreviation for Repurchase Agreements.

[5] Law no 8365 dated 02.07. 1998 "On banks in the Republic of Albania".

[6] LIBOR – London Interbank Offered Rate - interest rate offered in London interbank market.

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EURO - THE MOST RECENT CURRENCY

Fatos Ibrahimi*

It is for some years since the name of the Euro has entered in our vocabulary and many of us may think that they know what they need to know about it. However, now that the great moment of change, that of passing from a concept or an abstract currency to a tangible and an obvious currency is approaching, it may be better, perhaps, to look at its early origins.

Euro received the name in the meeting of the European Council held in Madrid in 1995. Its name, as it may be easily understood, derives from the name of the continent this currency belongs to for three years. The symbol is borrowed from the Greek epsilon, whereas the parallel lines that cross the symbol represent the stability of the currency. Although many people may think that Euro's birthday is on January 1, 2002, the idea for establishing such a currency corresponds to a long time ago.

The point here is the Treaty of Rome (1957), where it was announced that the goal of Europe was to establish a common European market. This market would play a tremendous role in the way ahead "to an ever closer unification of all European citizens". The above Treaty was followed by the Act of United Europe (1986), which gave birth to the Economic and Monetary Union, or in other words set the basis for the common European currency.

Although the concept of a similar currency has been accompanying us for more than half a century, the birthday of the long-expected currency is confirmed on January 1, 1999. From that moment, the 11 member countries of EU (12 with Greece accession on January 1, 2001) were engaged in implementing a common monetary policy and adopting a common currency, elements of which were all correspondent currencies to member countries. Although Denmark, Sweden and the Great Britain are EU members, they are not participants in the common European currency, - a proper explanation should be made here. The three countries have the right to follow an independent monetary policy, but they are prohibited to intervene in appointing or practising the monetary policy of the Euro area.

A very good idea might be worthless, if the ways and means for its implementation are not provided right from the moment of conceiving it. In the case of the Euro, the institution that has closely linked its existence with this currency is the European Central Bank established on June 1, 1998. These banks, together with the central banks of EU member states, which have already adopted the Euro, constitute the Euro-system.

The main purpose of the Euro-system is maintaining the consumer price stability, which is attained through assignment and implementation of monetary policy, performing foreign exchange and payments system operations. The Euro-system is directed from the Executive and the Managing Board of the ECB and has taken over the duty of carrying out the monetary policy on the Euro currency from January 1, 1999. At this point, we may briefly depict the stages described by the Economic Monetary Union (EMU) toward the settlement and confirmation of the new currency.

EURO PHASES

In June 1998, the European Council confirmed the target of carrying out the economic unification of Europe and appointed the President of the European Commission, Jacque Delor; the

Chairman of the Commission who would study and propose concrete steps that would lead toward this unification. From the work of this committee it was derived the so-called "Delor Report", which proposed that the economic and monetary unification will be achieved in three distinctive stages:

a) EMU first phase

Based on the above-mentioned report, it was decided that EMU first phase would start on July 1, 1990. This phase ended in December 1993 and was characterized by the displacement of all barriers for free movement of capital among EU countries. During this phase, the Committee of Central Bank Governors of member countries in EU carried the monetary coordination between the European countries.

b) EMU second phase

The second phase began with the establishment of the European Monetary Union (January 1, 1994). EMU was not responsible for the implementation of the monetary policy of the European Union, since it had no competencies to intervene in foreign exchange markets of member countries. Both tasks completed by this institution were: the strengthening of collaboration between the central banks of member countries in EU; as well as the preparations for establishing the European System of central banks for the implementation of a common monetary policy as well as for the creation of a common currency in the third phase.

On May 2, 1998, the Council of the European Union decided unanimously that the 11 member states of the EU had met the necessary conditions for adopting a common European currency at the beginning of the third phase, i.e., starting on January 1, 1999. These countries were Belgium, Germany, Spain, France, Ireland, Italy, Luxembourg, Netherlands, Austria, Portugal and Finland.

c) EMU third phase

EMU third phase is otherwise known as the phase of the irreversible fixing of exchange rates between the corresponding currencies of each member state participating in the Euro basket and the new currency. From this date (January 1, 1999), any of the currencies corresponding to the 11 member states became component of the common currency. This means that 1 DEM or 1 NG is currently exchanged with as much Euros as it was fixed on the above-mentioned date and these exchange rates will be used at the moment when the Euro currency will be introduced to EU countries and broader.

FORECASTING EURO PERFORMANCE FOR COUNTRIES OUTSIDE THE EU

During the period that there were made preparations for the third phase of EMU, many theories and ideas related to the Euro's impact not only on the Euro-area, but also on other countries outside the EU were at the focus of debate. While the advantages of the new currency were numerous, the biggest questions would fall on the role it would play in the countries outside the EU, which continue to have close financial and trade relationships with this area. Taking into account that finding a valuable formula for all the countries was impossible, it was right for economists to conclude that the Euro's impact on any country would largely depend on the country's openness to capital markets internationally and the exchange rate policies followed by that country, besides the intensity of financial and trade relationships with the EU countries.

As trade transactions with the Euro area are believed to play their greatest role through these factors, the positive consequences of implementing the new currency are seen in two directions. First, the unification of the currency between the countries of the Euro area will make them more competitive in the eye of their trade partners outside the Euro area, which will be facing low import costs. Second, the economic growth of the Euro area is expected to follow the implementation of the new currency that will be having noticeable effects on the rest of the world, as well.

At a first phase that the Euro implementation would follow (although not in the type of physical money), thus after January 1, 1999, a gradual weakening of the Euro against the United States and Japanese currency was forecasted. That would take place because the trade transactions between the countries of the Euro area would be no more developed in the form of foreign currency transactions but as exchange between two subdivisions of the same currency. At a later time, the Euro's international role would be enhanced, increasing in this way the use of the currency in international markets. If we made an analysis on the current performance of the European currency compared to the USD, we would really highlight that it has gradually weakened to the "rival" currency during the last two years.

Chart 1 Euro/USD exchange rate during the period, January 1999-September 2001
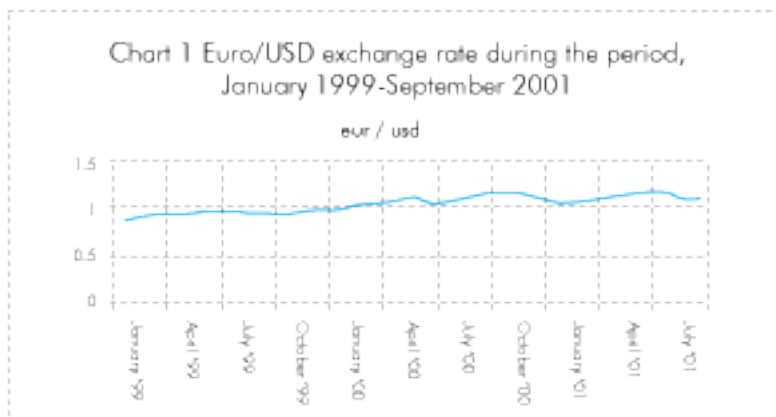
The further performance of the Euro/USD ratio has to be analyzed in the framework of the economy performance supported by each currency. While the European Union and the whole world is preparing for the Euro introduction, economists are trying to find a solution to all the problems they think would emerge immediately after the Euro currency is in the hands of customers.

When the Euro coins or notes become tangible, long queues are expected to be in front of banks and retail shops, while the 302 million Euro citizens will be taken aback in the same way

as tourists' in front of the new currency. Millions of products and services will be renewed of price.

The operation will be effective for companies and countries very remote from the Euro area. According to some estimates, a quantity of about DEM 35 billion circulates outside the EU, mainly in the Eastern Europe.

Montenegro is one of those countries that after the adoption of the DEM as a national currency will be forced to turn to the Euro, once the German currency stops to exist.

PROBLEM (A) - PRICE CHANGES AMONG DIFFERENT AREAS OF THE EURO ZONE

One of the problems thought to arise from the Euro adoption to the Euro zone from January 1, 2002 will be the customers' possibility to compare prices among different areas of the Euro zone. Those gaps that different European currencies could hide will be more obvious from the moment the wages, prices or taxes are accounted in the same currency.

When prices of goods and services are converted into Euro, customers will be massively moving from high price areas to lower price ones to benefit from purchasing cars, petroleum and so forth. What has been scaring the economists today is the reaction of trade unions that may protest against the low wages in certain areas. According to a forecast performed during the first half of this year, economists believe that the costs of conversion and the hesitancy of customers to spend may retard the economic growth of the Euro zone for 2002 by 0.25 percent. This forecast has not taken into account the events of the beginning of September, which means that conversion costs may be higher or their impact on the economic growth rates of the Euro area will be still higher.

However, the conversion is expected to have positive effects that will start to appear as soon as the above-stated area is

recovered from the slowdown noticed during the previous year. Businessmen hope that new coins and notes will facilitate mergers and acquisitions between companies and corporations. The latter ones, under the reign of the multi-currency system, have frequently encountered barriers by the national authorities throughout the above-mentioned processes. It is expected that the financial services sector, which has suffered a lot from the barriers created by regulators, would benefit more from the conversion of the currency.

PROBLEM (B) INFLATION – DERIVED FROM THE UPPER ROUNDING OFF OF PRICES

Among the economists, it is arisen the concern that the new currency adoption will create conditions for inflation rise, monetary policy disorder in Europe, and the Euro depreciation against the USD and the JPY.

Although the prices have been moving on reverse sides in different European countries, in the cases when changes are made in the number of zeros, there exists the fear that the conversion of prices into the euro will provide spaces for upper rounding off of prices.

On the eve of January 2002, what the public expected, as stated by the ECB's director, Vim Dojsenberg, was confidence in the European currency, which is a test that the United Europe is not an abstract and remote idea but something real and dynamic.

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* Fatos Ibrahimi, First Deputy Governor of the Bank of Albania.

EURO AND ITS LEGAL EXCHANGE RATE

Neritan Kallfa*

On January 2002 the Euro coins and notes shall be bearing a legal exchange rate tender in the 12 member countries of EU. Euro concentration is effective not only in EU countries but also in the rest of the countries, inside or outside Europe.

EURO IN EUROPEAN UNION

Two are the principal characteristics that may be picked in this historical process for EU countries.

The first is that Euro shall be introduced physically and not as a convention of various operations. Thus it will be introduced in the form of coins and notes. From January 1, 2002 the Euro has legal tender in coins and notes.

Some member countries in EU began Euro production in July 1999. 11 printing houses accomplish Euro production, today. Two of these printing houses are situated in Germany and each country has a printing house engaged in printing Euro notes, except for Luxembourg. As Greece joined Euro zone on January 1, 2001, its production in the Bank of Greece started in autumn 2000.

Euro production began right after some preparatory phases: approving configuration and technical specifications (1998), printing pilot series (for example, printing small amounts of notes in normal production circumstances) (1998) and raising a qualitative governing system (1999).

The second is its adorning with power. Euro power is termed "exchange rate". Through this power, Euro shall:

- Be accepted from the creditors for the payment of old debts by debtors;
- Have a denominated value in coin and note;
- Be used and received for any exchange operation;
- Be worldwide admitted the right of using from any bearer of it;
- Be fully convertible in every unit to other currencies, and/or in goods or services.

Euro origins stem out from the four major principles of EU. The European Union is set up on these major principles as below:

1. The free movement of goods: through customs and tax institutions;
2. The free movement of goods: quantitative restrictions;
3. The free movement of capital and the monetary and economic unification;
4. The free movement of labour force.

It is the third principle where Euro conception is based on. This principle is composed of two elements as below:

1. The free movement of capital,
2. The monetary and economic union.

It is the second principle, i.e., the monetary and economic union that provided the premises for the application of currency in the European Union.

(First endeavour): The historic development has its origins in year 1969, where the Heads of the Member States decided to

prepare the plan on the Monetary and Economic Union. The Werner Committee, established on this purpose, concluded that the Monetary and Economic Union had two possibilities:

The non-reversible and total conversion of currencies released from exchange rate fluctuations, or

The most preferred would be the exchange in a single currency.

(Second endeavour): Another important step is evidenced in the course of historic development in year 1978 with the establishment of the European Monetary System (EMS). The system institutionalized the Exchange Rate Mechanism (ERM) and the European Monetary Unit (ECU). The exchange rate of ECU was fixed against the basket of the currencies of member countries of European Community. ERM operated through fixing the value of exchange rate to ECU. As long as these values continued to be set on a collective basis, they could not be changed individually. At first, it was fixed the value of the national currency to ECU and after it, it was determined its exchange rate to other currencies of member countries. The value moved normally within the band of 2.25 percent and 5 percent, at maximum. When the value exceeded the forecasted limits, the central banks intervened to normalize the situation.

(Third endeavour): The political commitment undertaken by the Heads of the Member Countries in year 1972 was the cause of re-involving in the agenda of Hanover Summit in 1988, whose consequence was the Council meeting in Madrid in 1989 to decide on this matter. A committee was founded to assist the Council with decision-making. Jacque Delors, the President of the Committee, headed this committee. The Delors Committee proposed the European Monetary Union be established in three phases.

Elements of the first phase consist in the final establishment of the common market, the closest convergence of economies and the membership of all member countries in ERM. In this phase,

the juridical support from the Treaty was inappropriate. In the second phase, it was planned the creation of the European System of Central Banks, (ESCB) so as to coordinate the monetary policies with the formulation of common monetary policies for the Community. The third phase comprised fixing of exchange rates and the delivery of a single European currency, whose governing and management would be confided to the European system of central banks. From that time, the system is conceived as independent, having the achievement and maintainance of consumer price stability as the main object. But, Delors Report also planned a central control on the fiscal policies of these countries, as long as these policies might have impacts and consequences on inflation or interest rates on the rest of the countries.

It was the Treaty of European Union, which set the basis ahead the establishment of the European Monetary Union, fixing the commencement of the second phase on 01.01.1994.

First, drafting economic policies of all member countries altogether through fixing the target inside the common market on the principle of free market economy and free competition. Here is included the conception of a single European currency and the operating object of central bank system, following the economic policy of the European Community.

Second, the duplicated control on the fiscal policy through the commission, requiring the diminution of member countries' deficits at forecasted levels.

The third is the direct arrangement of the fiscal policy by placing provisions in the Treaty. This marked the establishment of the European Monetary Institute (EMI), which was also the forerunner of the European Central Bank (ECB). EMI prepared the preliminary phase of establishing the system, including the preparations for ECU itself (Euro today).

The third phase according to the Treaty starts no later than 01. 01.1999. Besides the preconditions set for the first and the

second phase as assessed from the Commission and EMI, a very important element for passing the third phase was how independent the central banks were and up to what point the convergence of economies in member countries was. Meeting these preconditions would mark Euro release. It consisted of four criteria:

1. Achieving a high standard of consumer price stability (average inflation should not exceed over 1.5 percent above the average rate of the best three member states);
2. Stability in the financial statement of the member country governments (budgetary deficit annual rates be less than 3 percent of GDP);
3. The smooth performance of fluctuation ranges approved from ERM for at least two years;
4. The stability and convergence of economy reflected in the percentages of long-term interests.

The third phase of Euro release is marked with the establishment of the ECB and the legal power of this institution on the monetary policy of European Community.

Euro coins and notes are made official by the following acts:

1. Regulation of the European Council (EC) No 1103/97, June 17,1997;
2. Regulation of the European Council (EC) No.974/98, May 3,1998;
3. Regulation of the European Council (EC), No.2866/98, December 31, 1998.

In the rest of the countries, the Euro is formally conditioned by the monetary law and the contractual right of non-member countries of the European Union.

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* Neritan Kallfa, Adviser to the Bank of Albania's Governor.

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CENTRAL BANKERS

Teuta Baleta*

"Central bank" is a very early used term. Walter Bagheot, editorialist in "The economist", used this term for the first time in 1873. The central bank establishment as an institution dates back still earlier. The first central bank in the world is that of Sweden established in 1668. The aim of establishing this bank was to fund military expenditures. Whereas, the central bank known as activity is an invention of XX[1] century. The above century is otherwise called the central bank century. The central bank number increased significantly from 18 in 1900[2] to 173 in 2001. The world now has more than half a million central bankers (535,115 persons)[3].

Chart 1 Number of Central Bankers (1900-2001)
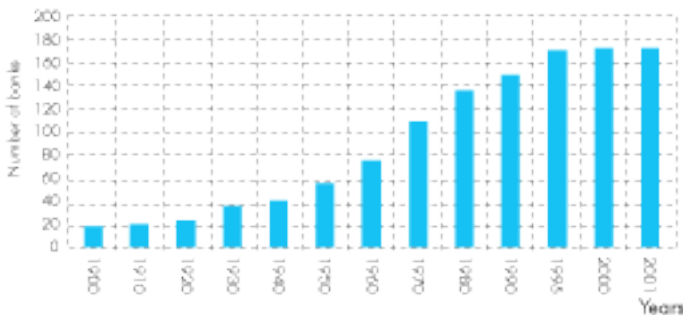
Source: Morgan Stanley Central Bank Directory, 2002

Central banks today are changed into relevant institutions for a country's economy. This has been due to the important role they play in four fields, particularly: instigating consumer price stability, maintaining appropriate functioning of payments systems, supervising the financial sector and managing financial crisis.

All current discussions on the role and central bank functions on monetary policy, bank supervision, models and forecasts, autonomy and responsibility, etc., are aroused from the daily operation of central bankers. Because of this what would be the right number of central bankers in order to successfully and effectively meet central bank duties remains a fashionable dispute. A similar question can be answered directly and not by a single answer. The staff figure is practically an incomparable indicator between central banks of different countries.

The main reason is correlative to the central bank functions. However, on the whole, we note a standardization of core functions of central banks like monetary policy, monetary operations, etc. Also, according to the needs or traditions of countries, central banks perform other duties as well. The most noticeable function is that of banking supervision.

In some countries, this function is under the central bank authority; in some others it is not, having no unique model. The same way, central banks may be engaged in estimating statistical indicators not directly related to monetary policy. Functions of services are resolved problems in different forms, buying services from the third parties or performing them all alone. Or in Bank of Albania' case, where Tirana Stock Exchange is an integral part of the central bank activity, it is almost a unique experience. All these had a direct effect on the staff figure of the central bank. Additionally to that, it is clear that the number of central bankers depends on their efficiency at work. The current changes have evidenced three common trends: the number of central banks is raising and the number of central bankers is in decline, and the governor's term of office is rising.

The number of banks is mostly increased due to the introduction of new states and the establishment of central banks in those states where they have not existed before. Whereas the overall number of central bankers has got a downsizing trend as banks are trying to economize on costs and/or lose some functions. The term of office of governors is rising, as a reflection of endeavors to strengthen the central bank autonomy, especially the real one.

Table 1 Some data provided from Central Banks of some countries

No.	Country	Central bank staff	Staff per 100000 inhabitants	Year of central bank establishment
1	China	150000	11.8	1948
2	Russia	80700	55.5	1990
3	USA	23056	8.3	1914
4	Germany	16074	19.4	1948
5	France	15265	25.6	1800
6	Italy	8515	14.8	1893
7	Turkey	5500	8.3	1931
8	Japan	5415	4.3	1882
9	Spain	3124	7.8	1829
10	Greece	3096	29.1	1927
11	Romania	2444	10.9	1880
12	Belgium	2408	23.5	1850
13	United Kingdom	2344	3.9	1694
14	Argentina	2191	5.9	1935
15	Malaysia	2124	9.6	1958
16	South Africa	2133	4.9	1920
17	South Korea	2078	4.3	1950
18	Netherlands	1842	11.5	1814
19	Portugal	1828	18.2	1846
20	Canada	1539	4.9	1934
21	Czech Republic	1450	14.1	1993
22	Lebanon	1351	37.2	1964
23	Sllovakia	1320	24.4	1993
24	Hungary	1201	11.9	1924
25	Bulgaria	1200	15.6	1879
26	Austria	1121	13.8	1816
27	Poland	1118	2.9	1945
28	ECB	1032		1998
29	Yugoslavia	1000	9.4	1883
30	Australia	977	5.0	1945
31	Ukraina	995	2.0	1991
32	Lithuania	884	24.5	1922
33	Taiwan	876	3.9	
34	Israel	846	14.2	1954
35	Singapore	842	19.6	
36	Kyrguz Republic	834	5.0	1990
37	Jordan	815	15.8	1963
38	Belarus	814	7.9	1990
39	Ireland	720	18.7	1943
40	Finland	702	13.6	1811

41	Latvia	685	28.7	1922
42	Norway	630	14.0	1816
43	Hong Kong	601	8.3	1993
44	Croatia	583	13.5	1991
45	Switzerland	583	8.0	1907
46	Chili	561	3.7	1925
47	Denmark	553	10.3	1818
48	Moldova	496	11.2	1991
49	Sweden	488	5.5	1668
50	Slovenia	384	19.9	1991
51	Malta	300	76.0	1967
52	FYROM	284	13.9	1992
53	Cyprus	273	35.8	1963
54	Estonia	250	17.6	1919
55	Bosnia & Herzegovina	240	6.1	1997
56	New Zealand	199	5.1	1933
57	Luxembourg	180	40.6	1983
58	Island	114	41.0	1961

Source: Morgan Stanley Central Bank Directory, 2002

However, the overall trend of the shrinking number of central bankers is not equally the same for every region. Generally, newly established banks or those that are under the way of institutional development have got the trend to add the staff figure.

The only continent to buck the trend is Africa, where three quarters of the central banks are still expanding. The same may be said for many banks in Eastern Europe and former Soviet Union.

The Central Bank of Bulgaria, which raised the staff figure from 479 in 1992 to 1330 in 1998, has now cut it back to 1200. Similarly, the Bank of Latvia increased the staff figure from 200 in 1993 to 715 in 2000, but it currently employs 685 persons; the Central Bank of Moldova is also a similar case with the first.

The National Bank of Hungary has got a constant downsizing staff since 1993 from 2654 to 1201 persons at present. The Euro system employs 56,000 people; that's more than twice as many as the U.S. Federal Reserve, which serves a larger economy... "But, Europe has too many central bankers and it's time to end the glut."[4]

On the whole, staff figures seem to have got rising trends in the first years of operation, reaching a peak, which begins to cut back later.

I. BANK OF ALBANIA'S STAFF OVER YEARS

A central bank of a country is commonly an autonomous institution from the executive. An element of exercising the right for autonomy is also its exercising autonomy in policies of recruiting central bank personnel. Central banks usually have the goal to attract highly qualified personnel, capable to successively carry out central bank tasks. Euro system's staff collected salaries and benefits for 2001 are nearly at USD 4.2 billion[5].

On the other hand central banks must be sure that their autonomy will not be abused and misused in issues of recruiting personnel. For these reasons, the attention must be focused in increasing the staff efficiency. To all of these, the attention is paid to staff connected aspects and the following of such indicators as the staff figure.

An article of "Central Banking" magazine mentioned the Bank of Albania as a central bank to have significantly increased the staff figure, attracting for the first time the attention on this indicator performance for the period of 1992-January 2002. The Bank of Albania average staff figure for the period of 1992 - January 2001 has been 300 persons a year. Based on the total staff figure, the Bank of Albania is ranked the 125th on the descending scale amongst the banks. However its staff figure is still very low compared to the average staff figure of a central bank of 3148 persons or the median figure of 693 persons. On the whole, the evidenced trend, as expected, has been that of a rising average staff figure by 5 percent annually. Nevertheless, this rise has not been equally the same, but it may be clearly divided into the following periods:

• During 1992-1997, the Bank of Albania had a significant increase of its staff figure from 210 to 317 persons. The

increase in this period is justified by the fact that the central bank was established in 1992 and many of its functions were represented by one person or disclosed as work positions. During this period, there were taken all necessary arrangements to complete the organizing framework, either with functions or the appropriate staff.

- During 1998 and 1999, the central bank staff is reduced, reaching 272 persons. In both years, there have been structural arrangements and staff cuts in the framework of the government program to reduce the number of state administration.
- During years 1999-2002, it is evidenced a repeated scenario of the first period, meaning that there was evidenced a rising staff figure for the Bank of Albania.

Chart 2 Bank of Albania's real staff
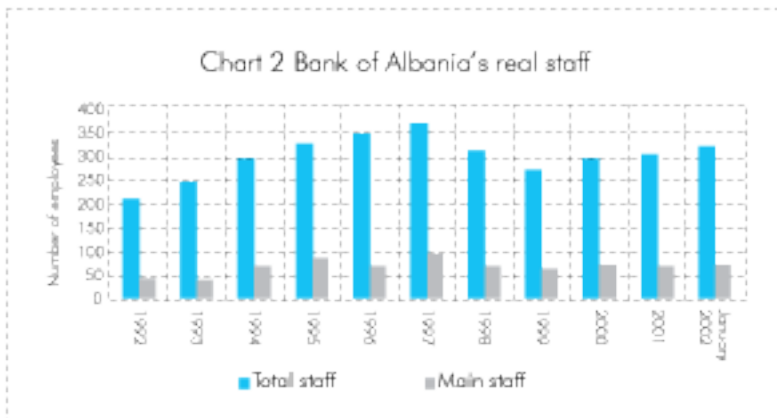
The Bank of Albania's organizational structure, additionally to its dividing into departments, sectors, offices, etc., attributive to staff and employment policies is also divided into the following categories:

- main staff, which includes all persons corresponding to departments fulfilling core functions of the bank as that of monetary policies and research, monetary operations, supervision, etc;
- secondary staff, which includes all those persons corresponding to departments fulfilling secondary functions

and aid with performing core duties, as that of accounting and payments, information technology, legal and human resources, etc; and

- Support staff, which includes all those persons performing service functions to the central bank activity as that of cleaning, secretary, transport, etc. The above three groups represent the central bank staff in the main office. This staff is supplemented by the staff in bank branches located in the districts, the Printing House and the Training Center for bankers which functioned over the period of 1993-1998. Changes in staff figures are caused by changes in all categories.

A typical feature for the central bank staff is the relatively low level of main staff, of that group that fulfills the core function of the bank. The main staff comprised the average of nearly 1/5 (21.5 percent) of Bank of Albania's total staff. From 40 in year 1992, this category currently counts 69 persons, with the largest figure of 93 persons in 1997. The ratio of main and secondary staff records the average of 1 for the total-examined period. The low number of main staff is not necessarily an indicator of efficiency in operation. On the other hand, the large number of secondary and support staff indicates inefficient governing of that part of central bank activity. Additionally to that, measures taken to reduce the staff after 1997 seem to have been more tangible to that category. So, at the end of 1999 compared to the end of 1997, there were 31 persons less from the main staff against:

- 14 persons less from secondary staff
- 12 persons less from support staff
- 19 persons less from central bank subsidiaries established in districts;
- 19 persons less from the printing house staff
- 5 persons less from the Training Center staff, as this unit was cut as a structure.

On the other hand, the rising number of staff at the beginning of 2002 has not taken place only with the main staff category, but with other staff categories as well.

7 persons are added to the main staff category compared to the end of 1999, against:

- 33 persons added as secondary staff;
- 19 persons added as bank branch staff located in the districts
- 8 persons reduced the support staff category.

Chart 3 Annual changing rate of staff figures
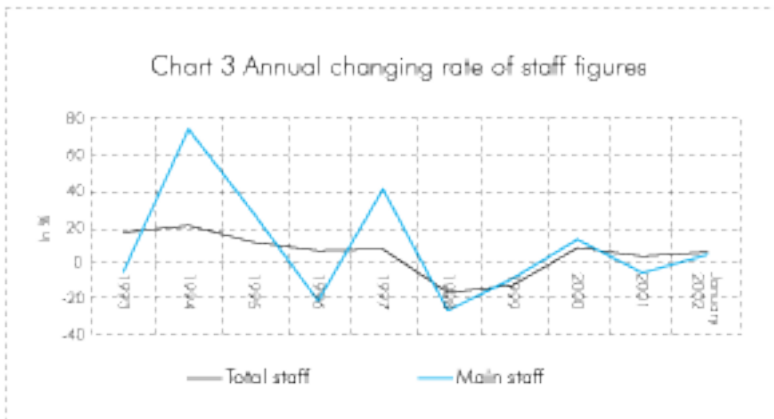
Due to this reason, the Bank of Albania has an average of 9.6 central bank employees per 100000 people, a relatively high figure, but if compared to many developed countries' central banks, it has an average of 2.1 main central bank staff per 100000 people, which is a very low rate.

Chart 4 Bank of Albania effective staff per 100000 inhabitants
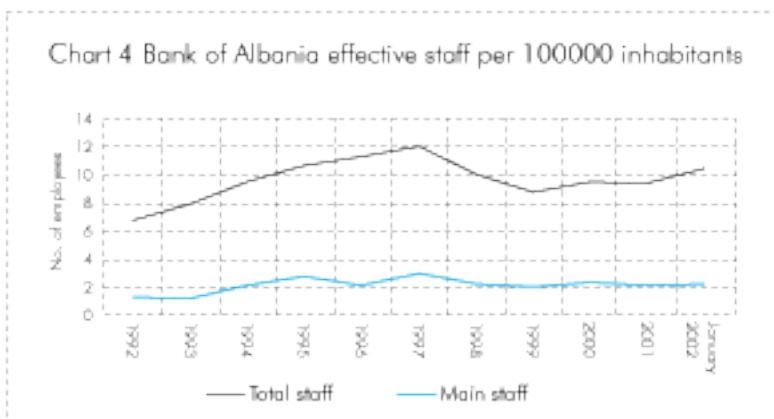
Such a disclosure of figures and performance of central bankers in the Bank of Albania and their classification is very important to determine the midterm strategy in this respect, at least. It is clear that the Bank of Albania's strategy to improve the quality of work must be focused in developing the core functions of central bank activity.

First of all, this requires appropriate supply with staff. On the other side, the Bank of Albania needs to improve its management in other aspects of its activity, aiming at enhancing its efficiency. Given an unchanged central bank structure, the trend for the mid-term at least will be the increase of its staff figure. However, it would be in place to arrange ratios between different categories. So, more persons must be at the service of core functions of the Bank or those functions that are important for the Albanian environment. Practically the concentration of central bankers in the future must be considered in such sectors as research, analysis or statistics.

In the same way "to remove the charge" resulting from non-typical functions of the central bank, it would be advisable to remove many auxiliary services, which may be provided from the third parties or that are not merely adroit to be performed by a central bank.

Banking supervision represents a delicate aspect. Many central banks today are renouncing from banking supervision, confiding it to other agencies and this movement is accompanied with reducing staff. However, it is not advisable that the Bank of Albania be aggressive in this matter and remove this function within a 5-year period, at least. This argument is not the only subject matter of this paper; however, it is helpful to stress that this sector must be succored by rising staff to meet the activity resulted from the rising need for qualitative supervision.

Table 2 Bank of Albania real staff figures

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
I. Main office	113	131	178	221	241	266	229	209	214	238	241
Main staff	40	38	66	84	66	93	68	62	70	66	69

Secondary staff	47	53	55	65	82	76	76	62	64	95	95
Auxiliary staff	26	40	57	72	93	97	85	85	80	77	77
II. Local administration (branches)	63	61	68	57	57	56	39	37	54	56	56
III. Printing House	48	48	45	45	45	45	31	26	26	26	26
IV. Training Center		5	4	5	5	5	1				
Total	224	245	295	328	348	372	300	272	294	320	323

Source: Bank of Albania, Legal and Human Resources Department

II. BANK OF ALBANIA AND SOME BANKS OF THE REGION

If we compare the above indicators with some central banks in the region operating for the same population with that of Albania, we notice that the central Bank of Albania has more advantageous positions, having the smallest staff figure either in absolute value or in relation to the population and a weak rising tendency of this indicator. Such position reflects the fact that the Bank of Albania will have a rising staff figure, even for some years in response to the consolidation of developing functions, especially with regard to their improving quality. The enhancement of efficiency must be sought at a later stage.

Table 3 Bank of Albania and some similiar banks

Country	Population (in milions)	Central bank staff	Staff per 100000	Change of staff in % 1996-2001
Bosnia & Herzegovina	3.9	240	6.1	
Moldova	4.4	496	11.2	16.4
Armenia	3.3	379	11.4	31.6
Croatia	4.3	583	13.5	35.3
FYROM	2.1	284	13.9	45.6
Slovenia	1.9	384	19.9	-3.3
Albania*	3.1	320	9.6	-8.0

Source: Morgan Stanley Central Bank Directory, 2002
* Bank of Albania

III. TERM OF OFFICE OF GOVERNOR

One of the latest trends is a gradual increasing expectation for the term of office of governor. In 2001 there were 23 newly

appointed governors mostly due to the end of the terms of office of previous governors. The average inflow of newly appointed governors from 1997 is 27, whose average increased with a particularly high change in 1999, when there were appointed 37 new governors. A quick calculation indicates that the average expectation for terms of office of central bank governors is nearly 6.5 years, and with a rising trend.[6]

A measuring indicator of central bank real autonomy is the changing rate of governors.

This indicator, measured for the first time in September 1999[7], stated a very low level of the real autonomy. So any governor had 18 months as the average term of office. Based on the stability that the central bank management had after 1997, this indicator evidenced a significant improvement. The average term of office of governors was raised with 24 months. However, according to this indicator, the Bank of Albania is still remote from being really autonomous. The real term of office is 28.6 percent, from 84 months term of office of a governor. Considering the verge that separates the high circulation from the low one of the governor, it takes values in the interval [0.2: 0.25]. In the Bank of Albania's case, the average figure of changing governors in a year is still high, at the rate of 0.5.

Thus, though the current tendency of the rising term of office for governors has been confirmed so far, this term is really and legally as much as 1/3 of the common average. This trend has been influenced, inter alia, by the enhancement of the legal autonomy. Although the real and the legal autonomy are part of the total autonomy, the strengthening of the first provides premises for rise in the second.

For the period under study, in Bank of Albania's case, it may be confirmed that the strengthening of its legal autonomy (measured by the index set up by Cukierman[8]) helped in extending the real autonomy, even significantly (correlation coefficient is 0.7 percent).

Table 4 Correlation between real and legal autonomy

		Real autonomy	Legal autonomy
Legal autonomy	Correlation	0.688	1.000
	Sig. (2-tailed)	0.000	
	N	120	120

Correlation is important at 0.01 (2-tailed).

IV. CONCLUSIONS

The rising role of central banks in economy and their autonomy consequently is evidenced as a common trend, currently making them important institutions for domestic economies and because of this, central banks are increasing their efforts to become more efficient and be mostly focused in their core functions. This common trend is reflected in the number of bankers and their quality.

On the whole, the number of the central bankers is increasing with the establishment and development of the bank that reaches a peak and then begins to cut back with a rising interest to be more efficient and focused in core functions of the bank. As of this, whether the central banks in developed countries are evidenced on downsizing trends of staff figures or low indicator per 100000 people which states their higher profitability and efficiency at work, less developed countries or the developing ones are still on the rising side of the curve. This may be due to their completing with functions or developing functions, which

Chart 5 Bank of Albania's real autonomy and the real term of office of Governor (period April 1992 – March 2002)

may not be part of their normal activity, or due to low technology or staff quality.

It is clear that the Bank of Albania will follow a similar development history. On the whole, at least for the next three years, given that no current function is taken off from the bank, the staff figure shall evidence growth. The target must be that the rising staff might primarily go to those units that have the task to enable the performance of the core functions of the bank, not to support staff.

Nevertheless, it is in the interest of the Bank of Albania and in the succor of its improving management, to be disrobed from secondary activities that could be better ensured as services from the third parties.

NOTES

* Teuta Baleta, Head of Research and Monetary Policy Department.

[1] "The economist", September 25, 2000.

[2] "The economist", November 28, 1998 and February 19, 2000.

[3] Morgan Stanley Central Bank Directory, 2002, London, 2002 pg XI.

[4] Central banks' vital statistics, Central Banking, volume XII, No. 2, November 2001, pg. 10, 11.

[5] Europe's costly surplus of central bankers", Business Week, January 21, 2002

[6] "Central banks' vital statistics", Central Banking, volume XII, No. 2, November 2001, p. 10.

[7] Cani Shkelqim, Baleta T., "Central Bank of Albania: Is it really independent?, Discussion, Paper No. 1/99, September 1999, p. 44-48.

[8] Cani Shkelqim, Baleta T., "Central Bank of Albania: Is it really independent?, Discussion paper, No. 1/99, September 1999, p. 28.

BANK OF ALBANIA'S MONETARY POLICY THROUGH OPEN MARKET OPERATIONS DURING 2001

Suzana Sheqeri*
Arta Pisha

The Bank of Albania's monetary policy to October 2000 was based on the application of direct monetary policy instruments. Found under the situation when the constant executive cuts of interest rates were not followed by commercial banks, the Bank of Albania, at the beginning of the third quarter 2000, deemed it necessary to re-design the operating framework, deciding to base its monetary policy on the application of market instruments. Repo rate already plays the core rate in the economy.

The Bank of Albania has made systematic improvements and changes in the operating framework, pursuing its target achievement during 2001. Concretely in February 2001, the operating framework was completed with permanent facilities (overnight deposits and overnight credits), with auctions of outright sale/purchase transactions and with the fast Repo auctions (daily), as well as there were made improvements in the current market regulations, whereas, in October 2001 a new structural operation, that of monthly and quarterly Repo auctions, was approved. This made the Bank of Albania's operating framework be expanded and based on open market operations, permanent facilities and the required reserves. Improving and completing money market regulations with new elements enhance manoeuvring spaces of the Bank of Albania's policy.

Concretely:

1 Passing from multiple-price auctions to fixed Repo auctions in April helped sending clearer signals to the money market;
2 Using for the first time the overnight facilities provided by the Bank of Albania in withdrawing and injecting excessive reserves from the system. Their application brought interest rate stability in the money market, creating a visionary corridor for their oscillation within the limits established by the Bank of Albania. These interest rates are very important for signalling the monetary policy;
3 Approving and later on intervening for the first time with structural and settlement operations in the market, enabling the sterilization on stable market basis.

All of these helped the Bank of Albania to implement its monetary policy, which changed gradually depending on the performance of macroeconomic indicators retained from the previous year into a neutral and later on to a slight tightening policy.

Until March 2001, Repo agreements were applied as weekly auctions[1] with multiple prices and announced amount. The interest offered by the Bank of Albania was gradually stabilized at 6.5 percent. Through these auctions, the Bank of Albania intended to signalize the market about its easing monetary policy as well as to ensure information about bank assessment on money price in this market.

In the course of these auctions, it was noticed that their systematic frequency helped commercial banks to make a planned management of excessive reserves. However, plans on these investments met with limited possibilities for investing the excessive reserves. This was because banks competed in the auction, either for the amount or the interest rate. The withdrawal of excessive reserves from the system at predetermined limits by the Bank of Albania let out unused funds after the auctions. On the other hand, a feature of the first half of 2001 was the use

by the government of privatization receipts for deficit financing, besides other resources, which lessened the government demand, causing increase of outstanding liquidity in the market. All these made the monthly average of excessive reserves[2] oscillate at about Lek 4.3 billion.

In the situation of prevailing surplus in the market and limited possibilities for investments, commercial banks reduced the market rate, starting with the Repo rates offered in the auction as an effort to win in the auction. The declining average rate in Repo auctions started to be reflected in other money market rates but at different levels of flexibility. So the treasury bills yield demonstrated the highest level of flexibility. This happened because the system's reaction was almost strong and immediate regarding the reduction of government treasury bills yield. Commercial banks Lek deposit rates reflected a declining tendency with a lower degree of elasticity compared to the more delayed treasury bills yield from the moment of transmitting the signal to the market. Although the lending price generally manifested a falling tendency, it was also accompanied by increase in separate[3] months of this period, reflecting the restricted role of lending in domestic currency. The presence of these factors in the market impedes the efficient implementation of monetary policy instruments. The commercial banks' reaction made them gradually reduce the high spreads between the applicable interest rates for lending and interest rates for accepting deposits. So for January - March '01, as a result of the reducing price, the monthly average of the differential accounted for 10.98 percent, from 15.73 percent in the fourth quarter of the year 2000.

What was noticed during this period was the lack of an orienting corridor for interbank market transactions. As a result, the level of interests in these transactions was not stabilized. The level of interest for the same term transactions moved in wide amplitudes, which for daily agreements oscillated around 5.0 – 6.0 percent and for weekly agreements fluctuated around 4.95 – 7.2 percent. Although the application of weekly repo auctions enforced restrictions to commercial banks, it provided

its results in livening-up the interbank activity. A modest increase of the interbank market was noticed for the period. The average monthly volume of transactions amounted to Lek 0.89 billion. The low volume of interbank market transactions was conditioned not only by the market over-supply, but also by its deficiencies for a normal and systematic functioning.

Based on domestic developments of economy, inflation indicators and other monetary developments, the Bank of Albania decided to change its monetary policy attitude from a soothing policy to a neutral stance. This corresponds to April-August 2001. The Bank of Albania continued to apply weekly fixed-price Repo auctions as the main operation of the interbank market. So, to decide the Repo rate, the Bank of Albania was based on the resulted average from multiple price auctions that were lately stabilized at about 6.5 percent. Changing the type of Repo auctions was aimed at stabilizing the market rates and resolving the problems evidenced during the first period.

Also, the Bank of Albania applied for the first time the permanent facilities, overnight deposits and credits. The applicable interest for these facilities is plus 2.5 percent to the Repo rate for overnight credits and minus 2.5 percent to the Repo rate for overnight deposits. The scope of using these facilities was to ensure the withdrawal or injection of daily liquidity by commercial banks, influencing the stabilization of market movements of daily rates, signalizing the overall framework of monetary policy and serving as a corridor for daily rates in the market.

Placing a corridor for market rates recorded end of the period of the lack of stability in interbank market interest rates for various maturities. Right from this period the interest rates in the interbank market were stabilized, having the corridor set forth at the operational framework of the Bank of Albania as a reference. The interest for daily agreements oscillated by 4.25 -4.5 percent and for weekly agreements by 6-6.7 percent.

The changes undertaken by the Bank of Albania created possibilities to commercial banks to invest all their excessive

liquidity planned for weekly maturity, solving the chronic problem of the market. In this period, the commercial banks' requested and accepted amount for weekly Repo auctions amounted to Lek 196.3 billion. Among others, it was noticed that besides excessive reserves of less than 7-day maturity, in some cases banks failed to anticipate the accurate amount of the liquidity to be invested in Repo auctions. This is so because during the weekly Repo auction day there are cases when banks are not notified of the results of the primary market auction.

Chart 1
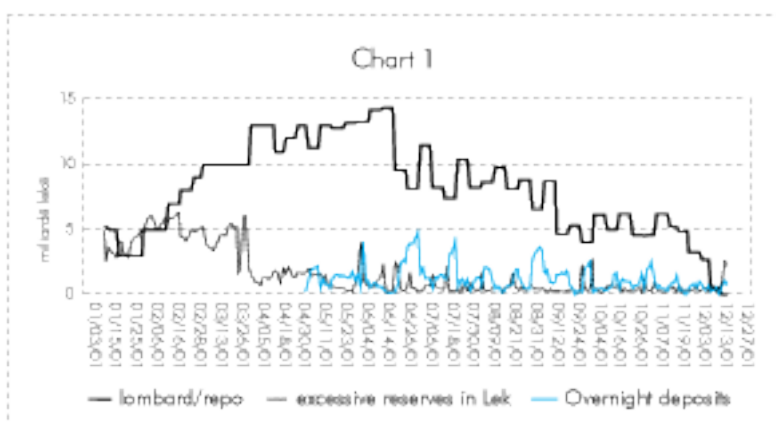
Under these conditions banks used the facility of overnight deposits offered by the Bank of Albania to invest the excessive liquidity, having an interest return of 4.0 percent. This facility offered by the Bank of Albania had a massive application by all banks of the system. The total invested reserves in overnight deposits reached the amount of Lek 191.2 billion. As a result of all these changes, the monthly average of unremunerated excessive reserves decreased to about Lek 0.64 billion.

The withdrawal of all excessive reserves planned by commercial banks to be invested in weekly Repo auctions from the Bank of Albania helped in raising the interbank market activity compared to the first period. The average monthly volume of transactions reached to about Lek 1.6 billion.

The decrease of excessive reserves lessened the pressures for interest rate reductions in the market. Lek deposit rates and the treasury bills yield had an insignificant change, demonstrating the stabilization of these interest rates. In the meantime, the lending price in domestic currency continued to reduce, oscillating from one month to the other. As a result, starting from June 2001 and onward, for the first time the difference between the credit price and deposit rates in domestic currency maintained one-digit figures. This marked the period with the lowest spread from year 1997.

Parallel to investment forms of excessive reserves, commercial banks used the provided possibilities by the Bank of Albania to meet liquidity shortages, either the overnight facility or 5 percent of the required reserves in domestic currency. The overnight credit was applied at a low frequency and in a small amount compared to overnight deposit. The Bank of Albania reached the amount of Lek 4.2 billion, whereas the volume of ALL required reserves used by commercial banks accounts for Lek 5.3 billion.

The change in the Bank of Albania's monetary policy stance, from easing to neutral, the application of new operations and the provision of facilities increased the manoeuvring spaces of second-tier banks. The operating framework let it up to the banks to decide the level of excessive reserves they must retain. Banks lessened the statement of excessive reserves at their desired rate, decreasing the pressures for the reduction of market rates. Parallel to this, establishing a fixed Repo rate brought about stabilization of market rates.

Based on the annual inflation rate during the first 7 months of 2001, its 5.6 percent rate at the end of July, expectations for rising inflation pressures as well as on other macroeconomic factors, the Bank of Albania decided to raise the Repo rate by 0.5 percent (50b.p.) The Bank of Albania transmitted this stance to the market, continuing to use weekly fixed-price Repo auctions as the main operation.

The primary and interbank market reaction was immediate, since interest rate rise was nearly at the same extent with that

signalized by the Bank of Albania. The stability created in the second period remained a typical feature. In the meantime, the increase of deposit rates was gradual and not as obvious as in the above markets. Therefore, our country's largest banks, such as the Savings Bank and the National Commercial Bank maintained unchanged deposit rates, while they raised the treasury bills yield, increasing the spread between the treasury bills yield and the new deposit rates.

Whereas the rest of the system generally reacted in accordance with Bank of Albania's signals, behaving as market competitors. These banks increased Lek deposit rates, besides treasury bills yield rise, maintaining the same interest spreads for domestic currency investments and for new deposits in Lek. In fact each bank's behaviour reflected the place they share in the market.

Chart 2 Market interest rates for the period July 1999 – December 2001
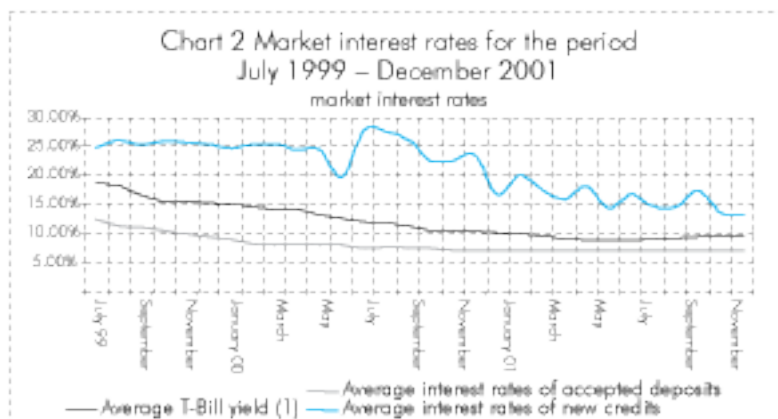
Taking into account the overall system, banks reaction was almost strong and immediate with respect to the rising yield of government treasury bills, feeble and delayed against time deposit rates in Lek and with an unclear effect on the lending price, because of the above-explained reasons. From August 20, 2001 to the end of the year, the banking system maintained low levels of excessive reserves. In the meantime, the end of the year was characterized by a low level of excessive liquidity caused by the increase of the money demand. In December '01,

the level of participation in Repo decreased a lot and moreover, banks did not participate at all in the last auction.

After a long period of non-application, Lombard facility as the last lending resource offered by the Bank of Albania was applied only on 31 December 2001 by two commercial banks.

NEW INSTRUMENTS

An instrument applied by the Bank of Albania for the first time for sterilization, on stable market basis are outright sale/ purchase of securities. The Bank of Albania has performed two treasury bills sales in June and September '01 at the amount of Lek 4.9 billion each. In both cases, the Savings Bank was the buyer. In November 2001, Repo monthly auction was organized for the first time. Lek 2.0 billion was withdrawn from the banking system through it.

The Savings Bank was the winner. Thus, it comes out that the operational framework used by the Bank of Albania has managed to fully transmit its monetary policy to the banking system and influence the interbank market of lending and borrowing either through increasing the trade volume or through the direction of these market interests. Commercial banks have reacted to the Bank of Albania's monetary policy stance. The change of interest rates in the market has been at different levels of flexibility and lag conditioned by the domestic market development, the structure of financial markets, the place occupied by commercial banks, etc.

The restricted role of lending in domestic currency, materialized in the low level of credit market development in domestic currency, makes the monetary policy effect on other economic agents be modest. Repo rates will manage to fully transmit Bank of Albania's decisions to the economy after minimizing the monopoly position of the Savings Bank and rising competition in the market and a better co-ordination of monetary and fiscal authority and developing credit market to economy, and other

similar markets, such as that of securities, of capitals, of fixed assets, etc., as potential and important channels in transmitting the monetary policy decisions to the economy.

NOTES

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[1] Weekly auctions of repuchased agreements are of one week maturity and they are used to withdraw excess liquidity from the banking system.

[2] The average for January '01 – 20 March '01 (until the day when the overnight deposit is used).

[3] Banks that lend the economy in Lek and the interest rates applied on credits depending on their maturity term changes almost every month. This brings high oscillations in the weighted average interest rate of credit in Lek.

CREDIT RISK AND CREDIT RATING AGENCIES

Aida Hysi*

Living in a highly dynamic environment, where markets change per seconds, where the rate of performing operations is very high and the transmission of information is very fast, and competition and rules of the game are very tough, if planned to operate as a financial market investor to enable a positive result for business or manage successfully, this requires, first of all, credit risk awareness and management.

Credit risk appears since the moment of holding a simple deposit and it grows in accordance with the speculative degree taken by the form of investment.

A service offered for knowing and identifying credit risk of banks, of securities or insurance companies, of public finances, of restructured finances, in other words, of the whole financial institutions, but at the same time even of sovereign credit authorities of a country, is a rating service provided by the three biggest international credit rating agencies, i.e., Standard & Poor's, Moody's and Fitch.

These agencies have their first footprints at the beginning of XX Century, offering first elements of credit rating to the investing community. The use of symbols and the terminology entered

for credit rating by these agencies were considered practical right from the beginning of their use and have already taken a wide application, as their range is completed, increased and enriched, being ever more adjusted to new developments of different markets.

Credit rating or classification is realized through using a group of letters or a combination of letters and figures. Knowing the technical language is necessary to read and understand credit ratings provided by these agencies for most of the financial institutions all over the world, being banks, securities or insurance companies or sovereign authorities.

As a manager of international reserve, the Bank of Albania is responsible for the management of foreign reserves. Bank of Albania's Supervisory Council approves "The management policy of the international reserves" through fixing the criteria and conditions for investing debt securities, and the permitted credit risk limits to banks and financial institutions with which it cooperates for investments, either in the money market or in fixed-income debt securities market. One of the conditions for investing in debt securities of banks or financial companies is credit rating by the above three agencies.

Under these conditions, it is necessary to know the symbols and the terminology used by these agencies to understand credit ratings and the risk accompanying an instrument, a debt security, a bank or a financial institution.

WHAT DOES "RATING" MEAN?

The three agencies, the Fitch, Moody's and Standard & Poor's define the credit rating of banks or of various financial companies as an opinion about creditworthiness of the overall solvency of a borrower or of a specific class of financial obligations, or a specific financial program (including ratings on medium term note programs and commercial paper programs). The rating is not a recommendation to purchase, sell or hold a financial

obligation, in as much as it does not comment as to market price or suitability for a particular investor.

PROVIDING A "CREDIT RATING"

Issue credit ratings are based on qualitative and quantitative bases, following a specific methodology in accordance with the criteria and profile or selected statistical, mathematical or computer pattern the agencies use. They go beyond the assessment of reports or indicators expressed in the language of numbers, meaning that a rating assesses at the same time the invisible strengths and weaknesses of banks and other institutions.

The currency in which the payment will be effected is a key factor of analysis. So, the borrower's capacity to settle the obligations in foreign currency is frequently lower than the capacity to repay obligations in local currency, due to the capacity of sovereign government, which is relatively lower for foreign currency debt than for domestic currency debt.

The three credit rating agencies provide their default risk rating in terms of non-repayment capacity of the issue or issuer. Groups of letters or combinations of letters and figures, which contain a well-established denotation, comprise the symbols they use for credit ratings.

TYPES OF CREDIT RATING

Credit ratings can be either long-term or short term. Short-term ratings are done mainly for those obligations or instruments that are considered as short-term in the relevant markets. In the U.S. for example, this means obligations with an original maturity of no more than 365 day- including commercial papers.

Such a rating is done even to long-term obligations or instruments as well (resulting to dual rating), so that debt

assessment be as accurate and coherent as possible, and under constant attention.

Long-term notes are defined through long-term rating.

Below are given the definitions of symbols and terms used by these agencies for credit rating of financial institutions and a summarized table of the various symbols they use.

LONG-TERM ISSUE CREDIT RATINGS

Investing category

AAA or Aaa

The highest credit rating

Rating in "AAA" or "Aaa" category denotes the lowest credit risk. Such a rating is assigned in specific cases, when the capacity to timely meet the financial commitments on an obligation is extremely strong. This category constitutes the best rating assigned by the agencies.

AA or Aa

A very high credit rating

The "AA" rating denotes a very low credit risk. It indicates a very strong capacity to meet the financial commitments in due time. This capacity is not very susceptible to changes in circumstances and economic conditions.

A

High credit rating

"A" rating denotes low credit risk. It denotes a strong capacity to timely meet its financial commitments. However, this

capacity is more susceptible to changes in the circumstances or economic conditions than the capacity mentioned in higher rated categories.

BBB or Baa

Good credit rating

The "BBB" or "Baa" rating denotes that there exists a low degree of credit risk. It indicates a sufficient degree of capacity for the timely payment of financial commitments, but adverse economic conditions or changing circumstances are more likely to affect this capacity. This is regarded as the lowest degree of investing category.

Speculative category

BB or Ba

Speculative

The "BB" or "Ba" indicates that there exists the likelihood of credit risk rise, particularly in the case of adverse economic circumstances over time. However, the business and financial alternatives are likely to enable the fulfilment of financial commitments. This category constantly reflects uncertainty or major exposure to adverse conditions, which may put into question the meeting of commitments.

B

Very speculative

The "B" category denotes that currently there exists a significant degree of credit risk. However, a limited margin of safety remains. Financial commitments are currently being met, but the capacity for continued timely payments is contingent upon a sustained, favourable business and economic environment.

CCC, CC, C or Caa, Ca, C

High degree of nonpayment risk

Nonpayment is currently probable. The capacity to meet its financial commitments is totally dependent upon favourable business, financial and economic conditions. In the event of adverse business, financial or economic conditions, the obligor is not likely to have the capacity to meet its financial commitment on the obligation.

"CCC" or "Caa" rating is CURRENTLY VULNERABLE TO NONPAYMENT; "CC" OR "CA" RATING IS CURRENTLY HIGHLY VULNERABLE TO NON-PAYMENT.

DDD, DD, D

In payment default

The issue or issuer rated in this category is extremely speculative and its value can not exceed the value obtained from any possible liquidation or re-organization process.

So, institutions rated as "DDD" have the highest likelihood to continue the activity and recover, and there can be included or not the possibility of a re-organization process.

The institutions rated as "DD" and "D" are in fact undertaking formal re-organization or liquidation process. The "DD" rating means more likelihood to meet the unsettled obligations to a greater extent, whereas the "D" rating represents the lowest likelihood to re-pay all obligations.

THE EQUIVALENCE OF SYMBOLS FOR LONG-TERM ISSUE CREDIT RATINGS

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
B-	B-	Ba3
B/B+	B/B+	B1
CCC	CCC	Caa
CC	CC	Ca
C	C	C
D	D	D
NR	NR	NR

SHORT-TERM ISSUE CREDIT RATING

Relative to the short-term issuer credit ratings, the three agencies use different symbols to indicate the degree of credit quality.

Standard & Poor's

A-1

An obligor rated 'A-1' has STRONG capacity to meet its financial commitments. It is rated in the highest category by Standard & Poor's.

A-2

An obligor rated 'A-2' is somewhat more susceptible to the adverse effects of changes in circumstances and economic conditions than obligors in higher rating categories. However, the obligor's capacity to meet its financial commitment on the obligation is SATISFACTORY.

A-3

An obligor rated 'A-3' exhibits ADEQUATE capacity to meet its financial obligations. However, adverse economic conditions or changing circumstances are more likely to lead to a weakened

capacity of the obligor to meet its financial commitment on the obligation.

B

An obligor rated 'B' is regarded as VULNERABLE and as having significant speculative characteristics. The obligor currently has the capacity to meet its financial commitments; however, it faces major ongoing uncertainties, which could lead to the obligor's inadequate capacity to meet its financial commitment on the obligation.

C

An obligor rated 'C' is CURRENTLY VULNERABLE to nonpayment and is dependent upon favourable business, financial and economic conditions for the obligor to meet its financial commitment on the obligation.

FITCH

F1

Strong

Indicates THE STRONGEST intrinsic capacity for timely payment of financial commitment on the obligation. This category may be accompanied by "+" to indicate any exceptionally strong credit feature.

F2

Moderately strong

Indicates a SATISFACTORY capacity for timely payment of financial commitment. However, the margin of safety is not as great as in the case of the higher ratings.

F3

Moderate

Indicates an ADEQUATE capacity for the timely payment of financial commitment on the obligation. However, such capacity is more susceptible to near-term adverse changes and could result in a reduction to "vulnerable".

B

Speculative

Indicates MINIMUM capacity to meet short-term obligations and vulnerability to adverse changes in financial and economic conditions

C

High nonpayment risk

Nonpayment of obligation is a real possibility. Capacity to meet financial commitment on the obligation is solely reliant upon a sustained, favourable business and economic environment.

D

In default

Indicates actual or imminent payment default.

Moody's

Moody's uses the Prime Rating System for short-term credit rating.

P-1 (Prime-1)

Issuers rated P-1 (or supporting institutions) have a superior

ability for repayment of short-term debt obligations. It is presented as the highest rating for short-term credit.

P-2 (Prime-2)

Issuers or (supporting institutions) rated Prime2 have a strong ability to repay short-term debt obligations, however to a lesser degree compared to the first category. Earnings trends and coverage ratios, while sound, may be more subject to variation with the passing of time and upon changes of economic conditions.

P-3 (Prime-3)

Issuers or (supporting institutions) rated Prime-3 have an acceptable ability for repayment of short-term debt obligations. The effect of industry characteristics and market compositions may be more pronounced. Variability in earnings and profitability may result in changes in the level of debt-protection measurements and may require relatively high financial leverage.

NP (Not Prime)

Issuers rated Not Prime do not fall within any of the Prime rating categories.

OTHER RATING SYMBOLS AND CATEGORIES

Plus (+) or Minus (-)

The ratings from 'AA' to 'CCC' may be modified by the addition of plus or minus sign to show the relative standing within the major rating categories.

Numerical modifiers - 1, 2, 3

Moody's applies numerical modifiers 1, 2 and 3 in each generic rating classification from "Aa" through "Caa". The

modifier 1 indicates that the issuer is in the higher end of its letter rating category; the modifier 2 indicates a mid-range ranking and the modifier 3 indicates that the issuer is in the lower end of the letter rating category.

R

An obligor rated 'R' is under regulatory supervision owing to its financial condition, a period during which the supervisory regulators may have the power to favour one class of obligations over the others or pay some obligations and not the others.

SD and D

An obligor rated "SD' (Selective Default) or 'D' (Default) has failed to pay one or more of its financial obligations when it/ they came due.

Credit rating agencies assign a 'D' rating when they believe that the default will be a general default and that the obligor will fail to pay all substantially obligations as they come due. 'SD' rating is given when these rating companies believe that the obligor has selectively defaulted on a specific issue or class of obligations but it will continue to meet its payment of obligations on other issues or classes of obligations in a timely manner.

N. R.

An issuer designated N.R is not rated.

'Pi' rating definition

Ratings with "pi" subscript are based on an analysis of an issuer's published financial information as well as additional information in the public domain. They do not, however, reflect in-depth meetings with an issuer's management and are, therefore, based on less comprehensive information than ratings without 'pi' subscript. Ratings with 'pi' subscript are received annually based on a new year's financial statement. Outlooks

are not provided for ratings with a 'pi' subscript, nor are they subject to Potential Credit Watch listings.

Ratings with 'pi' subscript generally are not modified with '+' or '-' designations. However, such designations may be assigned, when the issuer's credit rating is constrained by sovereign risk or the credit quality of a parent company or affiliated group.

Outlook Rating

Rating outlook assesses the potential direction of a long-term credit rating over the intermediate to long term. In determining a rating Outlook, consideration is given to any changes in the economic and/or fundamental business conditions. An outlook is not necessarily a precursor of a rating change or future Credit Watch action.

· Positive means that a rating may be raised.
· Negative means that a rating may be lowered.
· Stable means that a rating is not likely to change.
· Developing means that a rating may be raised or lowered.
· N.M. means not meaningful.

Credit Watch

Credit Watch highlights the potential direction of short- or long-term rating. It focuses on identifiable events and short-term trends that cause ratings to be paced under special surveillance by the analytical staff.

These may include recapitalizations, voter referendums, and regulatory action or anticipated operating developments.

Ratings appear on Credit Watch when such an even or a deviation from an expected trend occurs and additional information is necessary to evaluate the current rating. A listing, however, does not mean a rating change is inevitable and, whenever possible, a range of alternative ratings will be shown. Credit Watch is not intended to include all ratings under review

and rating changes may occur without the ratings having first appeared on Credit Watch.

The 'positive' designation means that a rating may be raised; a 'negative' designation means that a rating may be lowered; and 'developing' means that a rating may be raised, lowered or affiliated.

Dual ratings definitions

Rating agencies assign 'dual' ratings to all debt issues that have a put option or demand feature as part of their structure. The long-term debt rating symbols are used for bonds to denote the long-term maturity and the commercial paper rating symbols for the put option.

'r'

This symbol is attached to the ratings of instruments with significant non-credit risk. It highlights risk to principal or volatility of expected returns, which are not addressed in the credit rating.

Examples include obligations linked or indexed to equities, currencies, or commodities, obligations exposed to severe prepayment risks.

Withdrawn

A rating is considered withdrawn when the agency terms the information submitted for rating as insufficient or in the cases when the obligation is matured, is called (or has a calling feature) or is refinanced.

Rating Alert

Fitch provides a similar rating to that of Standard & Poor's Credit Watch. Ratings are placed on Rating Alert to notify the investors that there is a reasonable probability of a rating change

and the likely direction of such a change. These are designated as:

"Positive", when indicating a potential upgrade;
"Negative' when designating a potential downgrade; or
"Evolving" if ratings may be raised, lowered or maintained.

Rating Alert is typically resolved over a relatively short period. Concluding this introduction and taking into account the Bank of Albania's objectives, the rise in the number and types of instruments where it may invest and the financial institutions it may co-operate to reach this end, is highlighted as a possibility. Knowing this language is necessary to read and understand credit ratings provided by these agencies for the majority of financial institutions worldwide, either banks or security companies. Knowing, using and updating them may be regarded as another possibility for successful management of credit risk relative to the Bank of Albania's managed reserve.

Other correspondent central banks use the services offered by these agencies depending on the criteria and information they require to have under disposal. However, the tendency of these banks is that they use credit rating services from at least two of these agencies.

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BANKING SYSTEM DEPOSITS OVER THE PERIOD OF 1999-2000

Suzana Sheqeri*
Edlira Abazi

The performance analysis of deposits accepted by commercial banks and their composition as to the multiplicity of types, terms and currencies has a specific importance in some aspects. Amongst the most important, we would mention the contribution they give in creating broad money and its component elements, playing an important role in assessing inflation pressures in the economy. On the other hand, broad money structure and its stability comprise an important resource to credit the domestic economy, helping the economic growth of the country. This paper deals with banking system deposit performance over the years 1992-2001, the factors that have influenced deposit performance, the monetary policy followed by the Bank of Albania, deposit structures as per sectors of the economy and the development of deposit market in the banking system.

I. TOTAL DEPOSITS AND THEIR IMPACT ON MONEY SUPPLY

Banking system deposits for years 1992-2002 have recorded a growing trend. This is reflected in the stable growing trend of total deposits to total liabilities of the banking system.

Chart 1 Total deposits to total liabilities
of the system, in percent
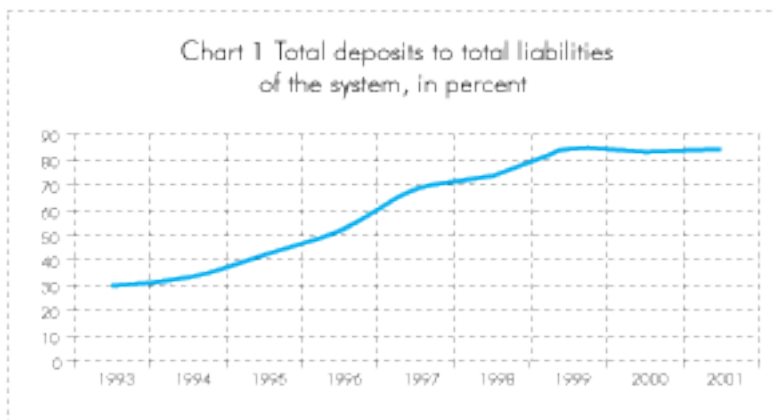
The reasons for the increase in deposits consist in:

- Improved welfare, bringing about more savings opportunities,
- Increased level of bank–depositor cooperation,
- Increased number of banks,
- Provision of more products and advertisements.

Commercial Banks' interest in attracting more savings complies with Bank of Albania's strategy for cash reduction in the economy and banking system expansion.

The fact whether economic agents give more priority to money as currency for transactions or to savings at a certain period, provides the possibility to assess the stability of monetary situation. During the periods of inflationary expectations, economic units tend to hold high liquid money, whereas the improving confidence in Lek stability boosts the motivation for savings, enhancing the time deposit share to money supply.

Changes occurring in allocation of financial assets, in the currency in circulation and in different deposit forms, express the motives determining the money demand. These developments over the time reflect at the same time the effects of the Bank of Albania's policy on the use of instruments for achieving mid-term targets with respect to broad money growth.

The performance analysis of financial assets allocation will be viewed in the framework of monetary aggregates and the contribution they give to the creation of broad money. The basic trend of money supply performance in 1992-2001 is presented in chart 2. The determinant element of money supply growth is mainly focused on ALL time deposits of M2 aggregate.

Chart 2 Monetary aggregates performance over 1992-2001, in billions of Lek
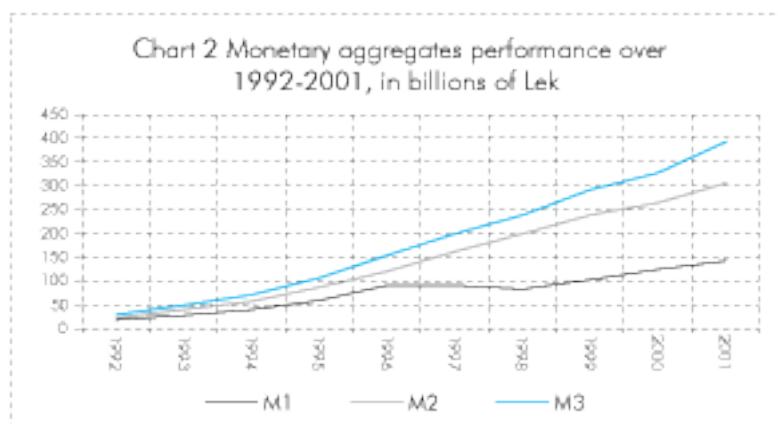
Table 1 Money supply structure in percent

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
CoB	34.39	35.85	39.03	38.99	30.93	36.63	28.52	27.77	30.25	30.26
Demand deposits in Lek	25.28	20.41	15.74	16.15	27.56	9.54	6.43	7.40	7.56	6.10
M1	59.67	56.26	54.78	55.14	58.49	46.17	34.95	35.17	37.81	36.35
Time deposits in Lek	16.55	23.32	26.43	26.17	19.57	35.53	48.24	46.66	42.81	41.23
M2	76.22	79.57	81.20	81.31	78.06	81.70	83.19	81.83	80.62	77.58
Deposits in foreign currency	23.78	20.43	18.80	18.69	21.94	18.30	16.81	18.17	19.38	22.42
M3	100.0	100.00	100.0	100.00	100.0	100.0	100.00	100.0	100.00	100.00
Liquidity indicator	0.25	0.20	0.16	0.16	0.28	0.10	0.06	0.07	0.08	0.06
Deposits in foreign currency/ broad money	0.24	0.20	0.19	0.19	0.22	0.18	0.17	0.18	0.19	0.22

The data in table 1 express more clearly the structural change of broad money over years. Thus:

- 4.13 percentage points reduce the share of currency outside banks from year 1992 to year 2001 compared to

the19.18 percentage points decline of demand deposits for the same period. This has made the liquidity indicator (M1/M3), as a standard estimator of the available liquidity in the economy, from the total of money supply, be downward;

• 24.68 percentage points increase time deposit share in Lek to broad money for the period of 1992-2001;

• Foreign currency deposit share to broad money does not demonstrate any stable trend, due to oscillations presented in different years. After year 1998, however, their share has reflected a growing trend to money supply aggregate. The indicator under analysis is oscillated between 0.17-0.24, recognizing a fall of 0.02 points from year 1992 to year 2001.

Banking system deposit market has generally been upward and with satisfactory paces. These have made money supply developments in Albania for the period of 1992-2001 be characterized by a stable growth of time deposit share to money supply, against the declining trend of time deposits in Lek, excluding year 1996.

The change in the share of time and demand deposits in the broad money has given its effects on the changing structure of money supply, in the favour of less liquid assets, thus reflecting money supply stability over time. The development of relationships between time and demand deposits in domestic or foreign currency,

Chart 3 Structure of money supply over 1992-2001, in percent
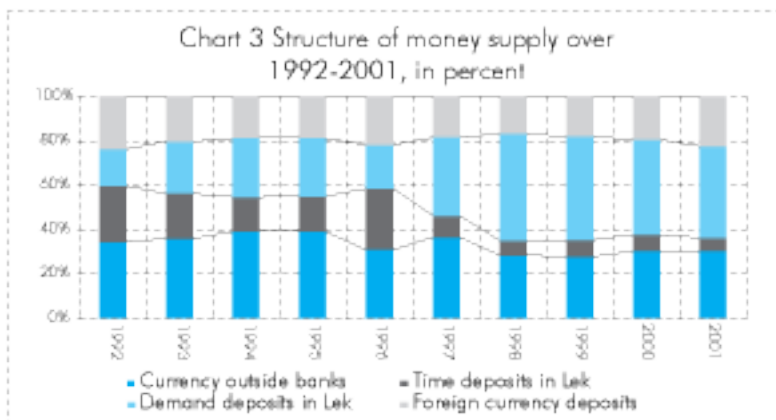
mostly in the favour of Lek deposits, confirms the enhancement of public confidence in Lek's stability and the increased capacity to meet the function of maintaining the Lek's value.

Changes in the ratio between liquid assets against less liquid assets are conditioned by the fact that money is used to meet the needs for transactions in the economy (currency outside banks – demand deposits), for speculative requirements (short-term deposits) and for savings motives (long-term deposits).

With the passing of years, the ratio seems to have undergone changes in the favour of savings, reflecting the rising confidence in the banking system, whereas the currency outside banks and demand deposits in Lek have decreased their share from 59.67 percent in year 1992 to 36 percent in year 2001. The level of this indicator reflects its not too high degree of correlation between the banking sector and the real sector of the economy. Although commercial banks have done a considerable work to attract businesses, figures indicate that the informal market performs a substantial number of transactions. Some businesses or a part of the public do not prefer to place their money with banks, because of the following motives:

- Their willingness to escape duty taxes;
- Avoiding the declaration of their money source at banks;
- Impediments and delays that they may encounter at bank windows, etc.

Chart 4 Lek demand and time deposits share to total deposits, in percent

— Demand deposits in Lek   — Time deposits in Lek
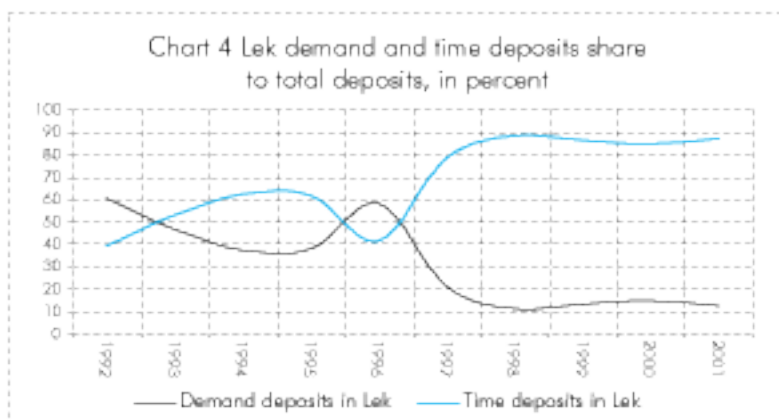
The rising motive to savings is clearly expressed in the time deposits indicator to total gross domestic production. This ratio has increased, from 23 percent in year 1992 to 40 percent in year 2001. Besides the degree of mobilization of savings, this level expresses the increased public confidence in banking institutions.

Bank of Albania's policy related to Lek interest rates has played an important role in the performance of time deposits of the system. Minimum time deposit interest rates are gradually adjusted, following inflation movement and other monetary and economic developments, so that the real interests remain at positive and eligible rates. In this way, household deposits remain protected from inflation movements and real incomes stay at positive rates.

Chart 5 Annual change of real GDP and real average interest rate in percent
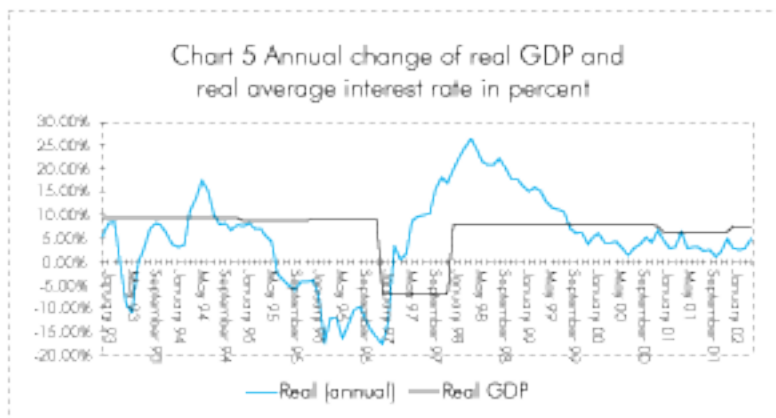
Real interest history is presented with noticeable oscillations. Most noticeable is the period of July '95 - March '97, where real interests remained at negative levels and for the rest of the period, this level has been positive, moving from + 26.5 percent to +1.0 percent. Real interest accounted on average for the whole period is 5.11 percent. Omitting the periods when real interest reaches extremely positive or negative values, its average level accounts for 4.54 percent, whereas GDP real value is increased by the average of 6.8 percent for the period.

Excluding year 1997, which recognized a real negative growth of production, this level accounts for 8.6 percent.

Real interest rate or more precisely real return on deposits has a significant effect on the volume of real financial savings and on the economic growth.

From the comparison of real interest annual average and real growth of domestic production, the effect of the real interest rate on the economic growth seems positive. The policy of maintaining interests at real positive rates is accompanied by the overall growth in domestic production of the country. So, starting from October 1999 and onward, the real interests stay below the real growth of domestic production of the economy, expressing also the Bank of Albania's easing monetary policy concerning interest rates.

Box 1.

In general, the situation in year 1996 was presented with a rising level of deposits in the system and with a low inflation. Under these conditions, increasing minimum rates at 6.5 percent for 3- and 12- month deposits and 6 percent for 6-month deposits was highly eligible under the circumstance in which these changes were made. The situation Albania happened to find itself in the first months of 1997 was unpredictable and it is understandable that in the short-term forecasts of real interests, a year ago no such considerable changes were predicted in the core macroeconomic indicators of the country.

However, fast actions were taken on the level of interests to channel all accumulations released by this market into the banking system to control them, in order to directly serve the main target, i.e. the alleviation of inflation rising rates. In fixing the minimum interests for this period, the main scope was not their real level, but more acceptable levels, which would lead to decrease of inflation rate. Thus, to be stimulated were not only those who had the possibility to accumulate but also the whole population, and mainly its poorest part.

In 1997, 3-month deposit rates underwent more change than 6- and 12- month deposits. So, they were raised 4 times, amounting to 18.5 percent at the beginning of `97, reaching 37 percent in June of this year, to be cut 4 times during the second half of 1997, down to 26 percent at year-end.

After May `97 no more changes took place for 6- and 12-month deposits, because the inflation rate for 1998 was expected to drop in comparison to 1997. Thus, holding unchanged the minimal interest on 12-month deposits, they would gradually pass from the negative to the positive level in real terms.

Quarterly deposits nominal interest rate rise aimed at returning deposits to the banking system, raising the absorbing capacity of financial assets to be released from the distribution of frozen money into accounts of "Populli" and "Xhaferri" funds.

This was also due to the fact that for the moment they comprised the only short-term instrument to respond to the difficult financial situation the banking system was undergoing after the significant decline of time deposits in the first months of 1997. Lek time deposit share to broad money went up from 19.57 percent at the end of 1996 to 35.53 percent at the end of 1997.

After this year, the Bank of Albania policy in cutting the minimum of deposit rates has followed directly the lending cost reduction, helping the recovery and the rise of investments in the economy. Annual inflation rate fell from 42.1 percent at the end of 1997 to 8.7 percent at the end of 1998. Nominal interests underwent five times cut during 1998, reaching respectively at 10 percent, 9.5 percent and 9.5 percent for 3-6-and 12- month deposits.

The increase of monetary stability, the rising of confidence in the Lek's stability and low inflationary expectations served as a basis for further cutting these rates also during 1999 and 2000. Maintaining the horizontal dependence on the time factor, they were cut thrice in the first half of 1999, followed by three other cuts to the end of the year. Banking system average weighted interest rate for 12-month deposits reached 8.30 percent at the end of 2000. The same interest rate for the 3-month deposits accounted for 7.72 percent

at the end of the same year. Nominal interests constantly adjusted to inflation rate throughout the year made real time deposit interest rates fluctuate at reasonable rates.

After October 2000, the Bank of Albania did no longer administratively assign time deposit interest rates in Lek. Repo rates were assigned as a reference for the market rates. To the end of 2001, the Bank of Albania policy related to interest rates has been constantly tightened. At the end of 2001, banking system average interest rates for 3- and 12- month deposits were respectively cut to 7.08 and 6.31 percent.

The rising motive for savings, materialized in time deposits growth, contains a "speculative"[1] element as well. The advantage of keeping money in short-tem customer deposits has changed the structure of time deposits.

The Lek time deposit structure at the Savings Bank[2] encountered significant changes over the period 1992 –2001. In year 1992, the ratio between 3- and 12-month deposits was 1:92 on advantage for 12- month deposits. At the end of 2001, this ratio was displaced to 49.27: 41.77, in favour of 3-month deposits.

Before 1996 the spreads in Lek time deposit rates (3-6-and 12-month term) were not so high as to arouse displacement between maturity terms. In year 1997, allured from high interest returns from time deposits, mainly short-term ones, new time deposits received in domestic currency noticed a terrific increase. Also, demand deposits started a gradual shifting to time deposits, where quarterly ones occupied the main share.

These changes led to the rising costs of newly accepted deposits (time) measured through weighted average rate on time deposits in Lek of the Savings Bank in particular, and of the banking system in general.

The monthly average of time deposit rates of the banking system rose from 16.47 percent in 1996 to 29.77 percent in 1997.

In view of maturity terms, the monthly average rate on 3-month deposits doubled compared to year 1996, reaching 30.33 percent and the average rate on 12-month deposits went up from 16.77 percent to 27.07 percent.

Chart 6 The average weighted rate for 3- and 12-month deposits and the average maturity for the banking system, in percent

■12-month ■3-month ■average maturity
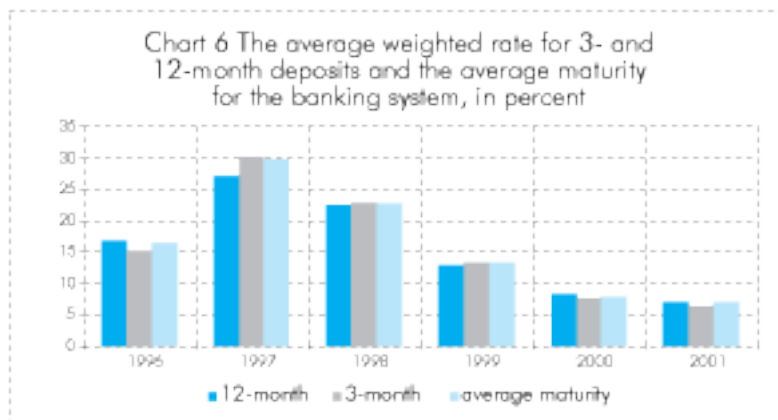
Even during the years 1997 and 1999, the average weighted rate for 3-month deposits was higher than for other maturity terms. Newly accepted deposits of 3- and 12-month term tendency was towards the alleviation of disproportions caused by the elimination of large spreads between short and long term deposit interest rates. In 1999 the average cost of the newly accepted 3- and 12-month deposits accounts for 13.189 and 12.87 percent, being respectively reduced to 6.3 and 7.08 percent for 3- and 12- month deposits in 2001.

Table 2 Performance of deposit structure and average rate of ALL deposits with the Savings Bank, in percentage

	1 month		3 month		6 month		12 month		24 month	
	Share*	Interest**	Share	Interest	Share	Interes	Share	interest	Share	Interest
1992			1.00	18.00	7.00	25.00	92.00	32.00		
1993			0.70	12.00	3.20	18.00	96.00	24.00		
1994			0.50	7.00	2.00	12.00	97.50	14.50		
1995			2.22	10.50	4.70	13.00	93.08	14.20		
1996	0.25	18.00	6.46	15.10	5.03	15.90	88.26	16.60		
1997	0.23	19.00	54.54	33.56	3.25	26.41	41.49	26.90	0.05	
1998	0.21	12.00	53.71	23.08	5.46	23.08	40.19	23.35	0.05	
1999			52.00	14.20	7.00	14.20	41.00	13.80	0.03	
2000			50.87	7.57	7.55	7.85	41.59	8.20		
2001			49.27	6.85	8.96	7.69	41.77	7.60		

*The specific weight in percent of Lek deposits by term to total deposits in Lek
**Average weighted interest rate for deposits held with this bank

The savings motive in economy is significantly influenced by other psychological factors, which have created "panic" situations. These factors of unstable nature have exercised a temporary negative impact on deposit performance of the banking system and have been localized at specific banks. In view of their impact on changing the savings motive of the public, the Bank of Albania changed the level of interest rates with the intention to neutralize the negative impact of these factors and ensure the normal flow of deposits into the system. The banking system has recognized two "panic" situations for the period under study, being caused by different factors.

The first is related to the panic created by the insolvency of pyramid schemes. The total collapse of pyramid schemes was accompanied, besides the destruction of many economic balances, also with social, economic, psychological and political consequences. The crisis of confidence in informal market institutions and the lack of economic and political stability were also felt by formal market institutions. Citizens, under the effect of the "panic" situation, withdrew deposits from commercial banks. Under the situation of a political and economic crisis, to interrupt further outflow of deposits from the banking system, the Bank of Albania intervened by raising time deposit rates in the market.

The second is related to Savings Bank's privatization and the propaganda on the so-called insecurity of deposits placed with this bank at the beginning of 2000. The panic created gave some instant negative impacts on the customers' motive in placing deposits with this bank, reflected in the deposit performance over 2000. The effect was strongest in the first half of the year; however, its influence was also felt during the second half of the year. Time deposit weight to broad money descended by 3.85 percentage points at the end of 2000, while currency in circulation ascended by 2.48 percentage points.

The banking system deposits behaviour in domestic and foreign currency is conditioned, inter alia, even by the maintaining of optimal ratios between the lek deposit interest rates and those in foreign currency.

This behaviour of banking system deposits in domestic and foreign currency comes out more clearly, if we analyse the specific weight of domestic and foreign currency deposits to the total of these deposits.

Table 3 Weight in percent of ALL time deposits and foreign currency deposits to the total of these deposit groups

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Time deposits in Lek	41.03	53.30	58.44	58.34	47.14	66.01	74.16	71.98	68.83	64.78
Deposits in foreign currency	58.97	46.70	41.56	41.66	52.86	33.99	25.84	28.02	31.17	35.22
Total	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00
Average annual rate of lek/usd		102.06	94.62	92.79	104.5	148.93	150.64	137.69	143.88	143.61

At first sight, ALL time deposit weight is presented with a rising trend against the falling trend of foreign currency deposits, compared to the total time deposits. However, the year–on–year performance of ALL time deposit weight always moves on the reverse side to that of foreign currency deposits. More precisely, the reduction of ALL deposit weight in 1996 compared to foreign currency deposits, was an outcome of the influence of informal market and foreign banks expectation to receive more deposits in foreign currency. In 1997 the ratio changed in favour of ALL time deposits, due to their very attractive interests. This ratio was maintained in 1998, to change after 1999. Starting from 1999, other factors, besides the Bank of Albania's easing policy related to interest rates, have also influenced the rising weight of

Chart 7 Time deposit structure in domestic and foreign currency and their trend (in percentage on the left, in Lek on the right)
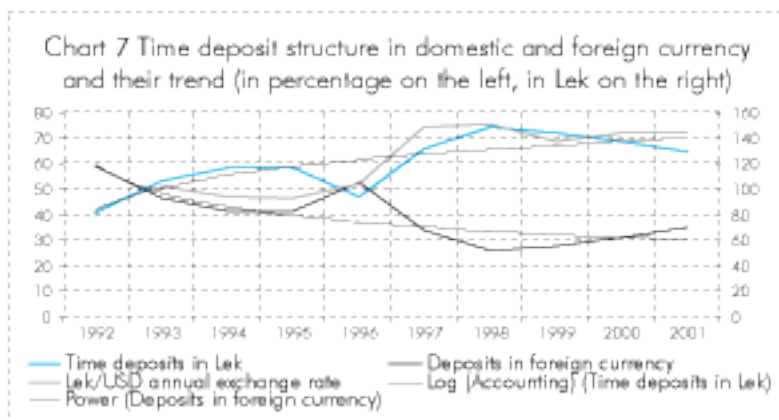
foreign currency time deposits to those in Lek. Such other factors are as follows: More active operation of foreign banks after '96-'97; their greater inclination to take foreign currency deposits; vast foreign exchange inflows during Kosovo crisis (year 1999); commercial banks' marketing for converting EU currencies free of commissions (2000) before the Euro introduction on January 1, 2002.

Chart 8 Lek/USD exchange rate and foreign currency deposits performance

Foreign currency deposits (left-hand scale, in billions of Lek)
Exchange rate (right-hand scale, Lek/USD)
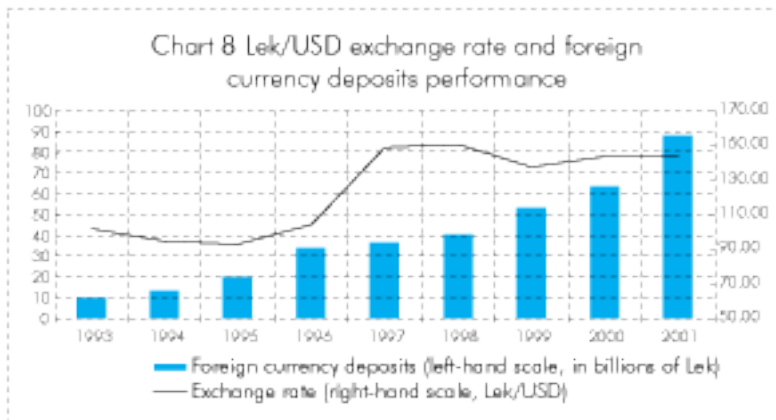
Correlations between deposits in domestic and foreign currency and displacements from one side to another are mainly influenced by the following factors:

- Level of deposit interests in Lek;
- Level of deposit interests in foreign currency;
- The intercession in this spread[3] of the appreciation or depreciation effect of the Lek in the domestic foreign exchange market;
- The degree of monetary stability, mainly related to inflation expectations.

Concretely high interest rates in Lek during 1997 and the appreciation of Lek to the main foreign currencies led to deposit displacement from those in foreign currency to those in Lek. Return on ALL deposit interest rates have been some times higher than on foreign currency deposits. After this year and onwards, the spread

between Lek interest rates and the interest rate according to parity principle was significantly reduced, due to prudential policy of the Bank of Albania on interest rates and the Lek's stability.

Charts 9 and 10 provide a clearer idea on the nominal interest rates of ALL time deposits and on the accrued interest rate of ALL time deposits, after the nominal interest rates of the main currencies are average weighted to Lek appreciation and depreciation coefficients to the main currencies, accounted on annual basis.

Chart 9 Interest rate parity for 12-month maturity in percent

Chart 10 Interest rate parity for 3-month maturity in percent
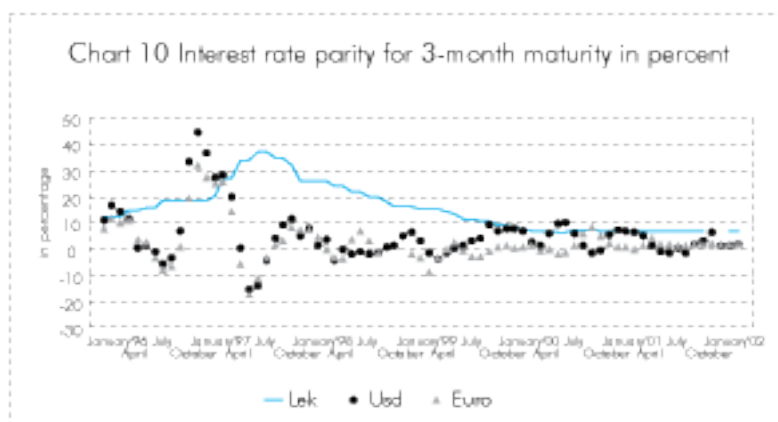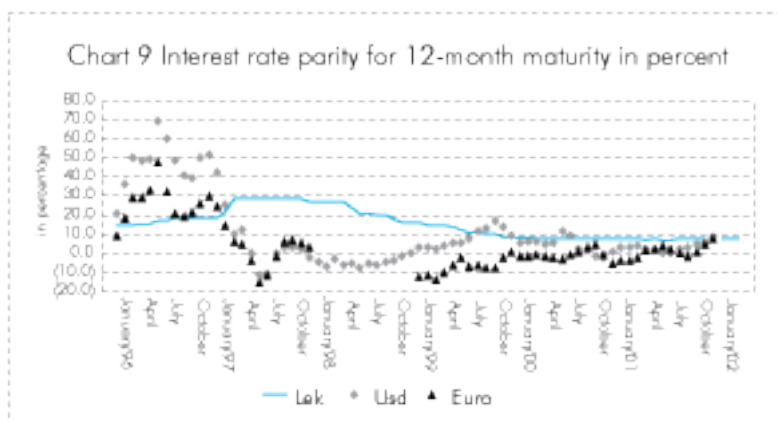
Based on the parity principle of Lek interest rates applied by the banking system and foreign currency interest rates, we have the following situation:

- To the end of 1996, interest rates on 12-month deposits in Lek have almost been under the required level from this principle, presenting the greatest advantage of holding deposits in foreign currency than in Lek;
- During the period of 1997–1998, the level of interest on 3- and 12-month deposits has been higher than required by this principle. The ratio of Lek deposit share to foreign currency deposit share changed from 47.14: 52.86 at end of 1996 to 74.16:25:84 at end of 1998;
- During the period of 1998-2001, the level of Lek time deposit interest rates recorded a constant reduction, being better adjusted to the market conditions and narrowing the spread existing between the nominal rate prevailing in the banking system and the accrued one. The ratio of Lek deposit share to foreign currency deposit share dropped slightly, turning out to be 64.7:35.22 at end of 2001.
- After 2000 and onwards, the spread has been narrowed significantly, reaching low rates that have impacted also on reducing the growth paces of ALL time deposits compared to those of the previous years. In a certain way, this demonstrates the displacement of public preference for holding foreign currency deposits to Lek deposits, implying growth of domestic demand for money and premises for domestic currency depreciation in the domestic foreign exchange market.

II. TOTAL DEPOSIT STRUCTURE PER ECONOMY SECTORS AND THEIR CONTRIBUTION TO DEPOSIT FORMATION

Analyzing the total deposits structure by the contribution of the main sectors of the economy helps the identification of specific characteristics of these sectors in creating deposits, and their contribution to money supply. Statistical data reported by commercial banks have presented a displacement of deposits over 1992-2001 from the public sector to households. The ratio of household deposits to total deposits for 1992-2001 changed, from 35.95 percent to 80.85 percent, while the ratio

of the private sector and the public one to total deposits has changed respectively from 10.91 percent to 12.75 percent and from 53.14 percent to 6.4 percent. Also, the growth rates of deposits in the private sector and in the public one are reduced as well.

A specific development changing the conclusion on the general trend of household deposit influence on the creation of deposits has taken place during 1995-1996. The dynamics of total deposits began to deviate from the growing trend of household deposits towards the growth of those coming from the private sector.

This deviation was caused by the activity of informal market firms. In this period, many citizens withdrew their household savings from the banking system and invested them in informal market firms, which applied higher interest rates. Subsequently in the first months of 1996, the Lek deposits decreased in the banking system for the first time. Upon expansion of activity of these firms, a new phenomenon was noticed, that of ALL time deposit reduction over the last quarter of 1996 and increase of current accounts, mainly on the account of rental firms in the same period of 1996. The falling trend of time deposits was eased to a certain degree by the opening of time deposits on behalf of the presidents of these firms.
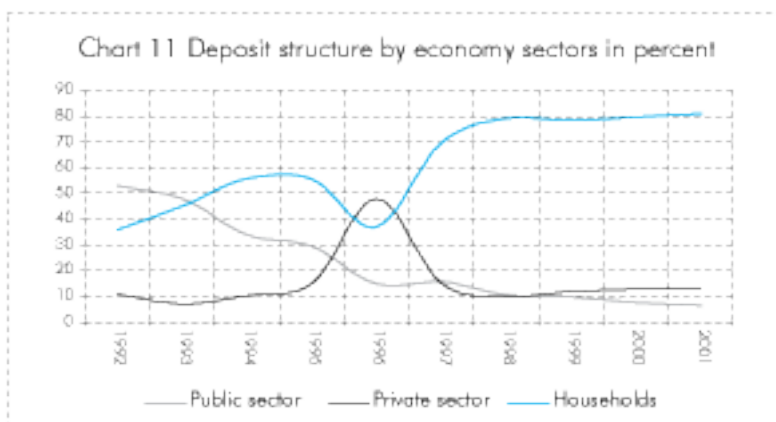

Chart 11 Deposit structure by economy sectors in percent

—— Public sector   —— Private sector   —— Households

Table 4 Deposits by sectors to total deposits in percentage

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Public sector	53.14	47.86	33.8	29.24	14.99	15.71	10.72	9.76	7.60	6.40
Private sector	10.91	7.10	10.45	15.22	47.90	15.09	10.13	11.91	12.80	12.75
Households	35.95	45.04	55.75	55.54	37.11	69.21	79.15	78.34	79.60	80.85

The performance of three types of deposits - demand deposits in Lek, time deposits in Lek and foreign currency deposits - depends above all on the preferences and characteristics of the sector playing a determinant role in their performance by groups.

So, the households play the decisive role in the performance of time deposits and have an important share in foreign currency deposits, whereas the public sector and the private one play an important role in foreign currency deposits and current accounts, occupying a significant share. Therefore, households have a significant effect on determining the time deposits trend, whereas the state and private sectors influence mainly the fluctuations of the liquid part of money.

Table 5 Deposits according to source of creation, in percent

	Demand deposits in Lek			Time deposits in Lek			Deposits in foreign currency		
	Public sector	Private sector	Households	Public sector	Private sector	Households	Public sector	Private sector	Households
1992	28.24	3.21	7.05	1.64	0.49	23.11	23.26	7.21	5.79
1993	25.11	4.23	2.88		0.54	36.29	22.75	2.33	5.87
1994	16.96	5.20	3.10		1.05	43.10	16.90	4.20	9.60
1995	16.64	7.83	1.99		0.70	42.20	12.60	6.69	11.35
1996	8.53	29.33	2.04		2.78	25.55	6.46	15.79	9.51
1997	8.53	6.69	0.50		0.06	56.01	7.18	8.34	13.34
1998	4.70	3.91	0.38	0.07	0.41	67.32	5.94	5.81	11.45
1999	4.69	3.84	0.74	0.13	1.21	63.02	4.94	6.86	14.58
2000	2.80	6.90	1.10	0.40	0.30	60.70	4.40	5.60	17.80
2001	2.30	5.50	0.90	0.30	0.70	58.20	3.80	6.60	21.80

The changeability of sectoral characteristics of deposits performance stems from two factors. First, the different attitudes among individuals and businesses in holding money in accordance with various sectoral functions of the demand for money; and second the needs and facilities to receive credits as additional resources or external resources of various financing.

Households' motive for the addition of money contains either the element of meeting their daily expenditures or the savings element. The use of financial assets in the private or public sector is motivated by transaction purposes and partial coverage of financial needs, mainly by loans.

Household deposits. Based on household deposits structure and their trend, the following is highlighted:

- Time deposits in Lek occupy the main share of household deposits and bear a growing trend. Their share has increased by 7.65 percentage points;
- Foreign currency deposits, given their share, are ranked after Lek deposits and maintain a growing trend (by 10.84 percentage points);
- Demand deposits have been constantly downward (by 18.49 percentage points).

Table 6 Household deposits by term and currency, in percent

Year	Demand deposits in Lek	Time deposits in Lek	Deposits in foreign currency
1992	19.61	64.29	16.10
1993	6.38	80.59	13.03
1994	5.57	77.25	17.18
1995	3.58	75.98	20.43
1996	5.50	68.87	25.63
1997	0.71	80.18	19.10
1998	0.48	85.06	14.46
1999	0.94	80.45	18.61
2000	1.35	76.27	22.37
2001	1.12	71.94	26.94

Chart 12 Households' deposits by maturity term and currency in percent

—— Demand deposits —— Time deposits —— Deposits in foreign currency
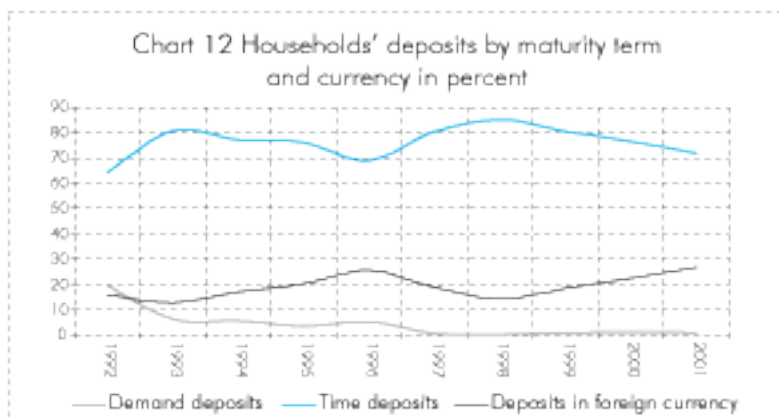
The main changes of shares between household categories over years are given the following explanations:

Household deposits in Lek decreased by 7.11 percentage points in 1996 and increased by 11.31 percentage points in 1997. As above mentioned, the Lek time deposit decline in the system was an outcome of informal market influence, whereas the Lek time deposit growth was a result of the policy of interest rate raises for Lek deposits.

During 1999 the rising share of foreign currency deposits by about 4.0 percentage points to household deposits was affected by increased foreign currency inflows from various organizations carrying out their activity in our country during the Kosovo crisis, and by the downward trend of Lek deposits interest rates. Starting from 2000 interest rates on Lek deposits recognized a constant reduction, reaching the lowest rate in the two-tier banking system history. In the last two years, the foreign currency deposit share to household deposits recognized growth, while the Lek time deposits share had a declining trend. These slight displacements express that citizens have enhanced their preferences for foreign currency deposits. This made the individuals prefer to place their income from emigration, which recognized the highest level over the last two years, in foreign currency deposits.

Chart 13 Annual average inflow of emigrant remittances and the annual average increase of foreign currency deposits placed with the banking system for 1994-2001, in billions of Lek

Annual average inflow of emigrant remittances
Annual average growth of foreign currency deposits

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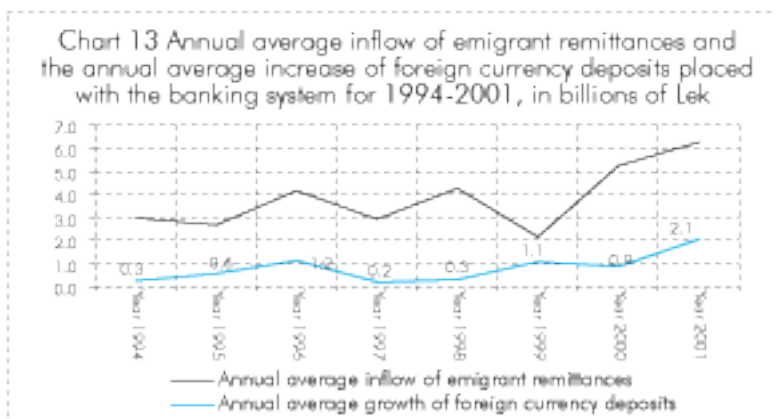
In 2001 foreign currency deposits growth was also affected by depositing the EU countries' currencies free of commissions, upon the Euro introduction on January 1, 2002.

Private sector deposits. Business deposits to total deposits at end of 2001 constitute about 13 percent. The total of money owned by businesses that passes through the banking system is smaller than the financial resources held by households.

Compared to total deposits owned by the private sector, foreign currency deposits held by businesses have presented a high range throughout the whole 10-year period taken under study. At the end of 2001 foreign currency deposits occupy nearly 52 percent of total deposits of the private sector. Also the Lek demand deposits are presented with an upward trend, from 29.5 percent in 1992, to 43.1 percent at end of 2001. Performance of demand deposits for 1992-2001 also displays an unsteady trend and their level is very low compared to time deposits.

Chart 14 Performance of private sector deposits, in percent

—— Demand deposits   —— Time deposits   —— Foreign currency deposits
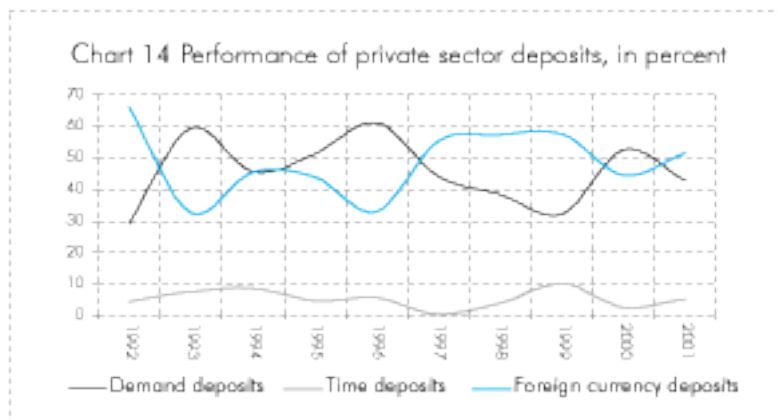
Table 7 Private sector deposit structure, in percent

Years	Demand deposits	Time deposits	Deposits in foreign currency
1992	29.45	4.49	66.06
1993	59.63	7.58	32.8
1994	45.56	8.75	45.69
1995	51.46	4.6	43.94
1996	61.23	5.8	32.96
1997	44.33	0.42	55.26

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1998	38.57	4.05	57.38
1999	32.22	10.13	57.65
2000	52.82	2.51	44.68
2001	43.08	5.28	51.64

Private sector deposits performance over the last 10 years displays the following characteristics:

- Foreign currency deposits have decreased their share at the end of 2001 by 14.42 percentage points compared to 1992;
- Demand deposits share has increased by 13.59 percentage points compared to 1992. Demand deposits recorded the highest share in 1996, by 61 percent, being followed by a declining trend of these sector's deposits after 1996. In 2000 they increased considerably, when lending to businesses was characterized by high paces compared to previous years;
- Time deposits in Lek occupy a small share to the total. After 1997 their share recognized a growing trend as a result of placement of ALL time deposits in quarterly deposits during 1997, when the country's economic activity recorded a drawback and a period of time was needed for its recovery. This made certain amount of money be withdrawn from the economic circulation and part of it was placed at short-term deposits.
- ALL demand deposits share and foreign currency deposits share seem to move on the reverse sides and create the idea that a degree of displacement exists between both groups. However, without excluding this possibility, we stress that demand deposits' share at end of the year may not fully present their right situation. This is so because, due to irregular developments in demand deposits, their volume increases and decreases within a year, being affected by seasonal developments, trade cycle, lending to the economy, etc.

Public sector is presented with a decreased share of deposits in all deposit categories. So, this sector's share has fallen by

25.94 percentage points for ALL demand deposits and by 19.46 percentage points for foreign currency deposits. The constant decline in this sector's deposits and the contribution to total deposits of the banking system are conditioned by some factors. Amongst the most important ones, we would highlight:

- Closing down and privatizing a considerable part of this sector's enterprises in 1992-2001.
- Organizing and functioning mode of the existing enterprises in this sector. Being state-owned, their organizing and functioning mode guided by public policies makes them frequently pass to deficit, becoming businesses on loss accounts (as in the case of Albanian Power Corporation). Subsequently, they influence the reduction of savings in this sector.
- Not so high scale of collecting income from taxes. In many cases this process has been hampered by managerial problems, which may reduce the public sector's savings.

Also, of effect herein are imports and exports, as well as the level of expenditures for external or internal debt.

Cumulative data indicate that deposit developments by sectors change obviously. So:

- Household deposits reflect a stable growing trend. Occupying over 80 percent of total deposits, they bear an important function in establishing the trend of total deposits and money supply.
- Deposit growth in the private and public sector is less stable. This is due to the fact that these sectors bear a high weight in demand deposits. In this way, the role of financial resources of both sectors in shaping the trend of total deposits is presented as smaller compared to the financial resources possessed by households.

From what above dealt with in points 1 and 2, we would highlight that:

Banking system deposits performance has brought about growth of less liquid assets, affecting on the reduction of inflationary pressures in the economy and enhancement of monetary stability.

Deposit structure by maturity terms in favour of those with small maturity presents a not so adequate structure of financial resources of commercial banks' lending activity. On the other hand, a consequence of this structure is also the high volume of interests paid on these deposits. The share of deposit returns invested in new deposits comprises an additional resource in the fast growth of money supply in the economy. Given that short-term deposits have a high share, they affect on reduction of stability over time for this part of money supply.

Various preferences and characteristics of economy sectors play an important role in the developments of deposits, influencing the development dynamics of total deposits. So, household deposits have an important effect on shaping the total deposits' trend and even further, on the money supply and they should be assessed as a stable group. The other two sectors influence mainly the fluctuations of high liquid deposits to total deposits and money supply.

III. DEPOSIT MARKET CHANGES BY COMMERCIAL BANKS

Changes in the absorbing capacity of banks in the system have been parallel to the banking system reforms, initially with the establishment of an adjusted system to market economy in terms of form of functioning and later on in terms of its reformation in many directions, in order to serve the market economy.

Banks' role stands in absorbing capacities of temporary free assets held by the economy thorough banking system channels in Albania. This helps to determine the market size in relation to informal market. Under the conditions when the informal market lacks a standard estimate on its size in Albania, the ratio

of total deposits to gross domestic product helps us to assess the range of banking system financial intermediation. This ratio has increased by 37:47 percent for the period of 1992-2002, expressing the enhancement of financial intermediation of the banking system in the economy. Although lower than in the Euro area (78 percent), this indicator is comparable to countries in transition. Of importance in this system is the savings structure according to banks, for carrying out the intermediary role in the economic development of the country, under the conditions of an improving competition.

The market size is determined by the size of each bank and the role they play in the effective operation of the market. It depends on the number of participants in it, their extension and the level of competitiveness among deposit market participants.

The share of financial resources each bank owns in the system is different for different years and is affected by many factors, highlighting:

- The period during which the bank exercises its activity in the banking system;
- The size and geographical expansion in the country;
- The number of banks in the system;
- The level of competition in the market;
- The quantity and quality of products offered by the bank;
- Facilities in performing different payments conditioned by the level of payments system development;
- Informal market impact, etc.

The calculation of total deposits share per each bank of the system allows us to give considerations related to banks' work for improving the financial potentials with respect to absorbing temporary free assets from the economic circulation. Until 1996 the deposit market was dominated mainly by three state-owned banks. The market was presented as fragmented. The Savings Bank dominated the household deposit market; the National Commercial Bank dominated about 70 percent of the public sector deposits, whereas the Rural Commercial Bank operated in rural areas.

In 1993 the public banks owned about 98 percent of the total deposit market. The total deposit market has noticeably changed after year 1999[4] and onward, due to the rising role of private banks in this market. These banks, being more active in the market either from the intensive or extensive viewpoint, have increased their share, accounting for about 23.47 percentage points.[5]

The panorama of distribution of deposits among banks of the system reflects the dominant position of the Savings Bank in absorbing temporarily free assets owned by the economy.

Deposits concentration has been studies also according to certain categories in:

- Deposits in Lek and in foreign currency;
- Deposits by the degree of liquidity, in time and demand deposits.

Knowing this structure will allow us to evidence the composition of these resources on which banks are based for carrying out their intermediary role.

Table 8 Specific weight of Lek deposits by banks' ownership, in percent

	1993	1994	1995	1996	1997	1998	1999	2000	2001
State-owned banks	99.99	99.89	99.72	99.55	99.24	98.26	96.25	82.98	79.61
Private or Joint venture banks	0.01	0.11	0.28	0.45	0.76	1.74	3.75	17.02	20.39

Chart 15 Structure of deposits by banks' ownership, in percent

■ State-owned banks   ■ Private and Joint venture banks

Chart 16 Lek deposits by banks' ownership, in percent

Public banks ■ Private and JV banks
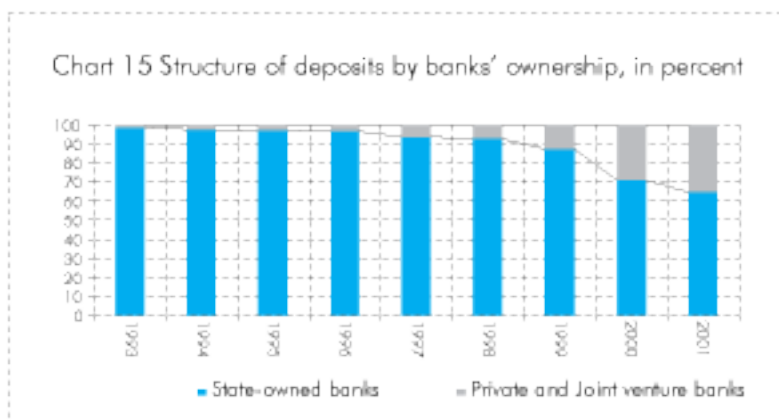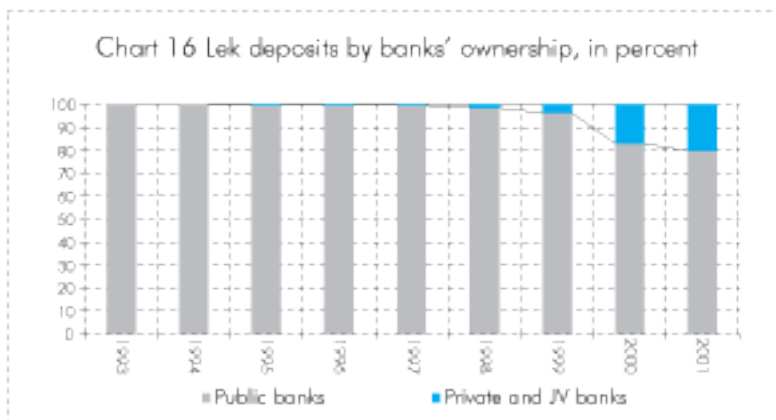
Concerning the period under analysis, we would highlight the following characteristics relating to ALL deposits distribution by banks of the system:

- Public banks own about 80 percent of the ALL savings of the system. This level has had a slight downward trend since the creation of the banking system, when their share reached about 99 percent. The bank owning the majority of ALL deposits in the system is the Savings Bank.[6] It achieved its highest level of ALL deposits at end of 1998, by about 88 percent. Concerning end of 1999 and onward a slight reduction was noticed in their level, down to 79.6 percent at end of 2001;
- Private or joint venture banks have gradually increased their ALL savings share, accounting for about 20 percent in 2001. The highest growth of ALL deposits in this banks group has taken place in 2000-2001, manifesting also the greater interest of these banks in ALL deposit market.

Reverse is the table of foreign currency deposits distribution by banks in the system over the period of 1993-2001.

Table 9 Specific weight of foreign currency deposits by bank ownership, in percent

	1993	1994	1995	1996	1997	1998	1999	2000	2001
State-owned banks	95.98	92.75	91.85	90.75	80.23	74.82	60.35	39.98	34.01
Private and Joint venture banks	4.02	7.25	8.15	9.25	19.77	25.18	39.65	60.02	65.99

Foreign currency deposit market by banks in the system has been characterized by:

- A downward trend of public banks market, against the growth of non-public bank market. The market share owned by public banks has decreased to 61.97 percentage points at the advantage of the rest of the banks in the system, from 1993 to 2001;
- These changes have become more obvious after 1997 and more extended after 1999.

Chart 17 Foreign currency deposits by bank ownership, in percent

■ Public banks   ■ Private and JV banks
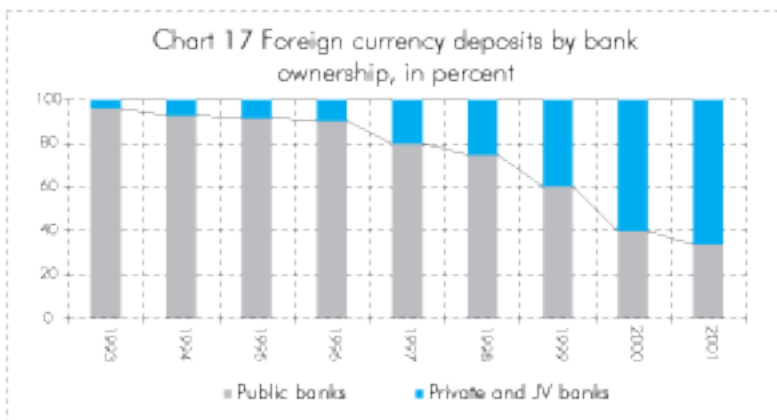
The rising share of foreign currency deposits to the total of foreign currency deposits of the system, owned by private and joint venture banks has mainly come from the growth of demand deposits compared to time deposits. Thus for the period of 1993-2001:

- Demand deposits share has increased by 59.0 percentage points;
- Time deposits share has increased by 6.71 percentage points.

Growing paces of demand deposits with these banks seem to have been some times higher compared to the growing paces of time deposits.

Chart 18 Demand deposits performance by bank ownership, in percent
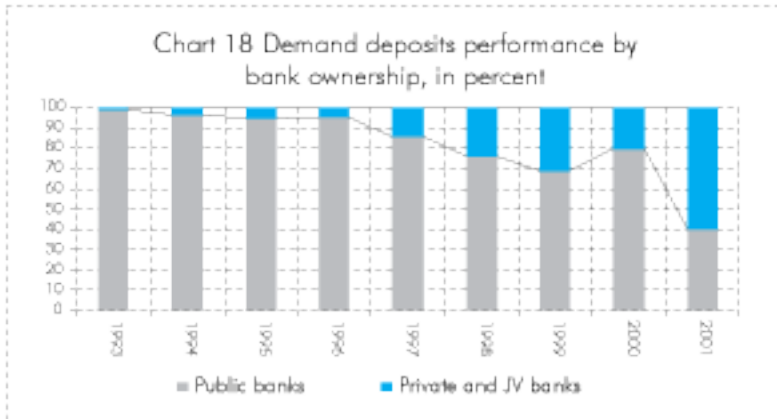
Table 10 Specific weight of demand deposits by bank ownership, in percent

	1993	1994	1995	1996	1997	1998	1999	2000	2001
State-owned banks	99.01	96.33	94.46	95.08	85.86	76.07	68.85	79.39	40.01
Private and Joint venture banks	0.99	3.67	5.54	4.92	14.14	23.93	31.15	20.61	59.99

Table 11 Specific weight of time deposits by bank ownership, in percent

	1993	1994	1995	1996	1997	1998	1999	2000	2001
State-owned banks	98.32	98.98	99.56	99.23	95.81	96.05	91.45	77.57	71.61
Private and Joint venture banks	1.68	1.02	0.44	0.77	4.19	3.95	8.55	22.43	28.39

Chart 19 Time deposits performance by bank ownership, in percent
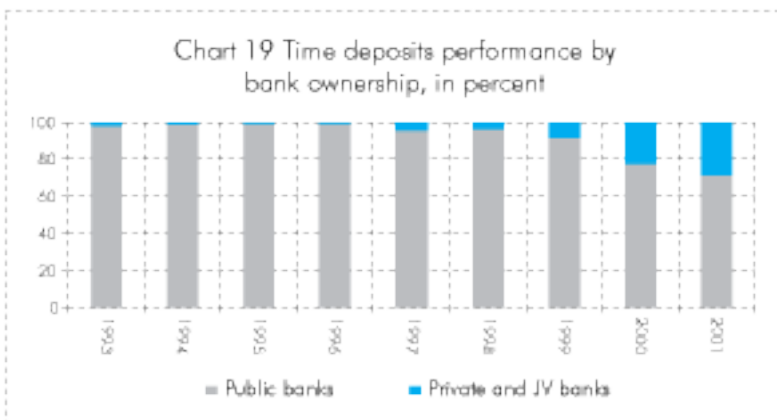
In conclusion, we would stress that as a result of the competition among banks, the trends, structure and customer preferences for the period under analysis have undergone changes.

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The features presented by the deposit market development according to bank ownership, consist in:

- Deposit market share of commercial state-owned banks has been falling in favour of the deposit market expansion of other banks.
- Private banks are presented as more active in foreign currency deposit market, and also with a rising interest in Lek deposit market over the latest years.

Ongoing reforms in the banking system with respect to the Savings Bank's privatization, development of a payments system that will respond to business requirements in the country, implementation of the deposit insurance scheme, larger support of the banking system to credit the economy, attainment of an efficient interbank market, etc., will help in achieving a banking system that will further enhance the level of intermediation in the dynamic development of economy.

III.1. CONCENTRATION IN DEPOSIT ACTIVITY

To measure the phenomenon of concentration of the banking system in the deposit activity and its change over the period of 1992-2001, the concentration ratios and the H index have been calculated. On the whole, it is observed that the real H index value and its optimal value have a year-on year change.

While the optimal value introduces a declining trend, the real H index value seems to have gained a falling trend after 1998, being influenced by the growing number of banks and their intensive and extensive work.

Table 12 H index values calculated for some deposit indicators

Years	Total Dep.	Lek Dep.	FX. Dep.	Time Dep.	Demand Dep.	Household Dep.	Dep. in priv. sect.	Dep. in public sect.	Optimal H-index value 1/no	No. of banks
1992	0.8	0.8	0.8	1.0	1.0	1.3	1.1	1.0	0.33	3
1993	0.4	0.4	0.7	0.7	0.7	0.7	0.7	0.8	0.25	4
1994	0.4	0.5	0.5	0.6	0.6	0.7	0.4	0.8	0.17	6
1995	0.4	0.5	0.5	0.6	0.6	0.7	0.5	0.8	0.17	6
1996	0.5	0.5	0.4	0.5	0.6	0.5	0.7	0.6	0.14	7
1997	0.5	0.7	0.3	0.7	0.4	0.7	0.3	0.5	0.13	8

1998	0.6	0.8	0.3	0.8	0.3	0.8	0.3	0.5	0.10	10
1999	0.6	0.8	0.2	0.7	0.3	0.7	0.3	0.5	0.08	13
2000	0.5	0.7	0.2	0.6	0.3	0.6	0.3	0.4	0.08	13
2001	0.4	0.6	0.2	0.5	0.2	0.5	0.2	0.4	0.08	13

Chart 20 H index performance for the total deposits of the banking system
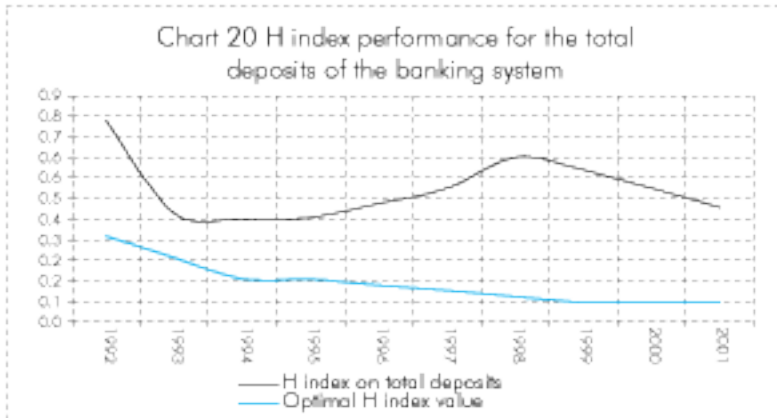
Albanian banking system during the period of 1992-2001 evidenced considerable concentrations in some indicators of depositing activity. Regarding total deposits, demand deposits and private sector deposits, the National Commercial Bank has been in dominant positions to the end of 1993. Whereas, concerning the household deposits and time deposits, the Savings Bank has been in the dominant position.

After 1993, private banks started operation in the Albanian banking market and they increased intensively after 1996. The real values of H-index for Lek deposits indicate that the phenomenon of deposit concentration in Lek is high. The banking system remains concentrated, with a slight downward trend of this concentration. Although the number of private banks has been rising, the Savings Bank has maintained its dominant positions in the Lek deposit activity throughout the whole period. While the real H index value for foreign currency deposits has constantly approached to its optimal value, indicating that no concentration exists in foreign currency deposit market.

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The fact that the Lek deposit market continues to remain concentrated, whereas the foreign currency deposit market is considered as not concentrated, also expresses the greatest interest of joint venture banks to mobilize more foreign currency savings compared to those in Lek.

Chart 21 H index performance for domestic and foreign currency deposits

Chart 22 H index performance for domestic and foreign currency deposits
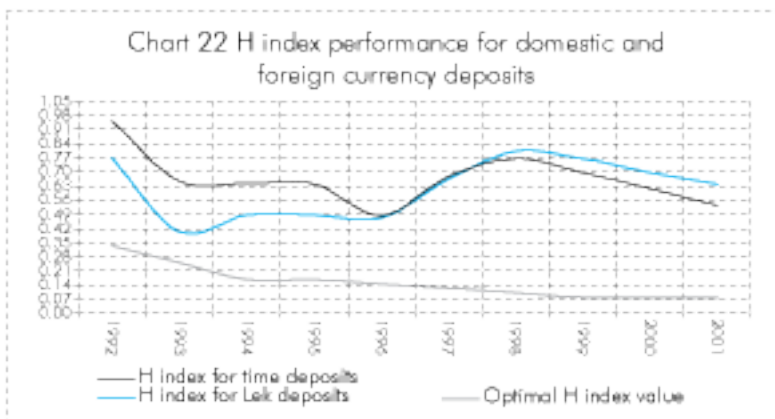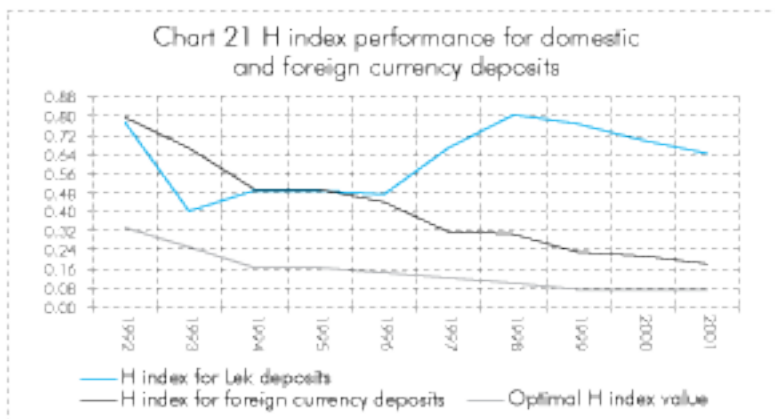
Based on year-on-year values of this index, it results that the trend of concentration phenomenon in depositing activity is being reduced, in spite of reverse side movements of certain deposit indicators for period 1992-2001.

III.2. CONCLUSIONS

Given the above on the deposit activity performance of the banking system for 1992-2001, we are of the opinion that:

- Practically the public banks' privatization (The Savings Bank) has been a slow-moving process, not affecting on the improvement and efficiency of the banking system, reflecting a low level of lending to the private sector of the economy.
- The Albanian banking system has generally improved with respect to the rising motive for savings, the improved deposit structure by terms, and the banks' interest in providing new products to the deposit market. Therefore, banks are providing new forms of services, such as MasterCard, Eurocard to reliable customers. Under the savings account, banks offer deposit certificates, applying a high interest rate, deposits with free life insurance, interests not only by term but also by different amounts within the term. Also, they offer negotiable interests, and not only fixed interests but also indexed ones, etc.
- Private banks' aggressiveness related to deposit growth is generally present also with respect to the expansion of their network in the last two years, from both the intensive and extensive viewpoint.
- Time deposits have generally recorded a considerable effect on the money supply, influencing the stable growth over time of the money supply.
- In general, substitution degree of monetary assets has declined, indicating improved confidence in the national currency due to its stability in the domestic foreign exchange market and the low inflation rate (excluding 1997).

NOTES

[1] Higher preference for three-month deposits is otherwise known with the name "speculation", under the conditions when they are motivated mainly by more attractive interest rates and the time advantage of the profitability of these interest rates against lower interest rates of 12-month deposits.

[2] The deposit structure analysis has been focused on the Savings Bank owning the main part of ALL deposits of the banking system.

[3] It is precisely the spread in percentage between the interest rates of deposits in ALL and those in foreign currency the one that determines the profitability in the alternative chosen between holding deposits in ALL or in foreign currency.

[4] The privatization of the National Commercial Bank has impacted on increasing the share of private banks.

[5] National Commercial Bank is not included.

[6] The Savings Bank, since the creation of the banking system, has maintained the superior position in owning these resources, being the most preferred bank for the public in placing ALL savings deposits. Furthermore, as a state-owned bank, it is regarded as a reliable one. The establishment of other banks in the system increased options for deposit placements.

ISSUES OF HUMAN RESOURCE MANAGEMENT AT THE BANK OF ALBANIA

Ervin Fortuzi*

Human resource management (HRM) is the main direction of work and the reason for the existence of Human Resource Division (HRD) under the Legal and Human Resource Department of the Bank of Albania (LHRD).

There are many definitions on the role, purposes and goals of HRM, on the whole. And many of these definitions will be, naturally, applied without too much theoretical difficulty even in the role they play or should play – in the HRM at the Bank of Albania. A simple and concise definition on the main goal of HRM in the Bank of Albania would be "to ensure that from - staff relations – to the Bank of Albania, both parties earn the possible maximum from each-other".

It is a simple definition for this difficult duty, especially in those numerous cases when the interests of the Bank of Albania and its staff are reverse. For example, the classical contradiction between the employee's interest to work less and be more paid and employer's interest (the Bank) to offer as much more work and pay less is verified in practice that it cannot be effectively resolved only through the legal sanctioning of the 8-hour work, the technical supervising of the bank hours, etc. You can forbid the employees to get outside the Bank edifice during the 8-hour

work (8.00-9.00 to16.00-17.00), denying them from the typical pleasure of Albanians to fill the leisure time with informal talks at a Bank's bar, only through an administrative guideline, but this would make them replace the pleasure of drinking a coffee outside the Bank edifice with playing computer games in the office. What is really needed in this case is a better management of bank working hours from directors, through job descriptions, requiring an 8-hour work coordination into working groups, so that individual's work results be directly dependent on a working group (this sets the employee under the pressure of colleagues connected to terms, quality and the quantity of work), etc., and the association of performance evaluation with the pay, making the employee really interested in working and not simply staying at the old-fashioned and monotonous environments of the Bank.

Naturally in finding a balance between the interest of the Bank and the staff, HRM intends to reach a "golden average", which is never perfect, in fact.

As indicated from the Bank of Albania current practice, the above description on the main purpose for the HRM existence assigns a difficult duty, which could be hardly attainable only through the good knowledge and application of economic science of management and direction, the psychology and ethno-psychology, particularly as one of the many fields of knowledge - and not the only one - that a human resource manager or any other director or chief having other staff subordinate must use to successively perform the duty. HRM has got the employees as subject of its work and it is evermore intended that the HRM establishes personal contacts of managers and directors to every employee. For example, it is very interesting what is recommended by a foreign human resource advisor to the Bank of Albania specialists of this area in particular and the Bank of Albania managers and directors in general. The advisor recommended that when the director addresses to his subordinate for not meeting the tasks appropriately, he/she should begin his conversation with praise for the good deeds, to further fall on criticisms for the weak points observed. Criticisms must be so that the employee gets

the right message of criticism, that he/she must improve work in general and not get, because of lack of tact, the wrong message that the superior is fighting him/her, is prejudicing him/her, etc. One way of expressing it may be "if you do much more of these good things, your job would be much more useful and interesting for the Bank of Albania". This would be gentle and polite and would have a better effect than simply "improve work!" what's worst uttered with a high and arrogant tone.

The Albanian psychology that "the dessert is the last served at a table" which the Bank of Albania superior would instinctively aim to practice in his conversation to his subordinate is mistaken in HRM. "Desserts" in a conversation with the subordinate must be said right from the start so that the employee is provided with a good predisposition to receive well any criticism or suggestion the superior has reserved after "the dessert".

Of course, there is an unlimited number of comparable examples on how a little care on superior's behalf in relations to his subordinate creates such positive effects that otherwise could not be obtained.

HRM good practices are first of all dependent on the good knowledge of economic science and the human resources, particularly. The success of these practices hangs relatively on a large number of criteria, variable from the theoretical knowledge of human resources on such "fine" educational factors such as the group collective or individual "culture" evermore studied and applied at HRM in the West. HRM is evermore evolving from pure economic discipline to an interweaving of different disciplines. HRM is evermore growing, as an area giving a way to fantasy, creative work and unfortunately to speculation - human resource directors). These unlimited opportunities for creative work – but also a speculation – comprise a cause why the HRM is an area that is currently living an explosion in the West.

HRM also has a typical feature that discerns it from other directions of the Bank of Albania operation: HRM can successively meet all the targets, if the Bank of Albania directors

are well-informed and apply good practices of HRM. Therefore, the duty of a human resource manager at the Bank of Albania is to evermore coordinate with other Bank directors to transmit good practices of staff relations to them.

Employee relations to the Bank and colleagues are rather arranged by the regulation "Rules on work relations for the Bank of Albania personnel". This regulation together with the Law "On the Bank of Albania" comprises the main legal basis where LHRD and other Bank departments base their operation. Until now this regulation has reflected a good functioning. However, some recently evidenced ambiguities in this regulation have conducted the need that this regulation be changed or redone. More concretely, Article 33, point 1 b of this regulation stipulates that "When a Bank of Albania employee has completed less than one year of work, his/her paid annual payable leave is determined in ratio to duration of legal work relations". This definition is unclear and serves as a source for contradictions instead of as a solution to them. As it has been written, the clause is much more to the advantage of the employee than the precedent. New bank recruits having less than a year of work in the Bank can receive annual payable leave at no less than 21X/12 days in year (where 21 days is the annual payable leave for him/her who has completed a year of work, X represents the months of work and the formula is worth for $X < 12$) and the given compensation equals a monthly payment (a bonus that must be given at the starting point of the annual payable leave— either partial or complete – is payable). According to the precedent, annual payable leave is totally accorded to those who have completed a year of work. Subsequently, new recruits lose their annual payable leave in the year they have been employed. Otherwise said X days leave in a year is applied for X days leave for every two years indeed. The inconsistency between the legal interpretation and the precedent is sufficient for the LHRD (Legal & Human Resources Department) to undertake the initiative to change the regulation. It is precisely this that must be done in the months to come, so that the LHRD performs its job as perfectly as possible, i.e., the harmonization of bank and staff interests based on clear and honest laws and regulations.

Performance evaluation undertaken once a year is one of the most interesting and the most fruitful directions of HRD job potentially (Human Resource Division). The essence of performance evaluation consists in setting a "mark" to every employee for his duties performed throughout the whole year, based on a number of common criteria for all staff, consolidated in a standard form (performance evaluation is given for every employee by direct superior). Directly depending on "the mark", on clearly defined limits in the respective guideline, the superior proposes an increase of payment for his employee.

Performance evaluation is a relatively new practice applied for every Bank of Albania employee. LHRD has been working very hard for its conception and application, also getting the opinion from relevant Bank departments or individual staff. However, there has been gained a sufficient experience to assess the good and bad aspects of personal valuation in the form it's currently performed at the Bank of Albania. Concretely, based on informal talks and formal remarks (verbal), the majority of staff considers the process of their performance evaluation by their direct superior as subjective. It is interesting to be evidenced that the most voiced criticisms on the performance evaluations arrive not only from those getting a low "mark" and a not-so-high addition of salary, but also from those receiving a good "mark" and a high addition of salary subsequently; they all consider it subjective and excessive anyway.

There are some reasons for what above mentioned. Concretely, the used criteria in the standard form of personal valuation, although creating a higher flexibility in the estimation of staff compared to the existing form, I do think that they are more numerous and more complicated than they should be. Also, performance evaluation is out of the attention of the employee and his superior throughout the year, because the evaluation process is actually carried at the end of the year and only in a few days. The solution? We must work to prepare a simpler, a more straightforward and functional form of performance evaluation. The number of criteria must be reduced. These criteria must be simplified, avoiding scholastic and unpractical criteria, such as

"the capacity to adapt to different situations", etc, criteria which are considered by the HRD as triggering staff's private opinion on performance evaluation as subjective.

The best communication between the superior and his subordinate is the kernel of improving performance evaluation efficiency, the best way to get an improved "image" of staff performance evaluation. More precisely, through contacts with bank managers and directors, the HRD aims to instigate them to improve communication with their subordinates. Performance evaluation form will be filled in by the superior at the presence of the employee in the future. Every criterion will be discussed and there will be also suggestions and proposals. It is a very simple measure on which the HRD has hung hopes for improving efficiency of performance evaluation. It is also intended to put the issue to the attention of the personnel, changing it from "a matter of one day in a year", into the performance evaluation made throughout the year, through discussions of the respective superior to his subordinates, where the dialogue is focused on staff performance along the whole year, based on performance evaluation criteria.

The Bank of Albania centralization decreases performance evaluation efficiency. Moreover, the superior has the right only to propose changes in the salary of his subordinates, based on performance evaluation. The Governor is the authority that changes or approves changes in the salary. Sometimes, the increase of salary approved by the Governor is different from the one proposed by the direct superior based on performance evaluation. This lowers staff confidence in performance evaluations. The solution? The decentralization of competencies on increasing the salary is based on the received performance evaluation. These competencies must be transferred from Governor to the direct superior or it might be considered the possibility of taking consensual decisions between the governor and the direct superior.

There are many recommendations, sometimes even contradictory opinions, on how performance evaluation should

be improved. The British advisor, Mr. Iain Thomson, underlined in a workshop organized on HRM by the Bank of Albania and the FSVC on April 11, 12, 2002, that subjectivism is the most diffused opinion on performance evaluation in the Bank of Albania, and also based on the British experience, it must be removed! At the same time, the American advisor, Mr. David Shanon, was in the opinion and recommended that the performance evaluation should not be removed but, on the contrary, it should be further improved, evermore-relating payment to it.

The above instance indicates that, as to the nature of work itself, there are no academic standards for many problems of HRM. It is the duty of HRD to adapt those solutions for various problems the HRD considers rational and practical.

Ethics is mostly neglected by the LHRD. This department and the HRD particularly have considered - ethic criteria to be met by the Bank of Albania staff until now as a much more legal category than an object of work of HRM, requesting not only legal but also human commitments by HRD managing specialists. The current regulation describes many more duties and restrictions than rights for the Bank of Albania staff. This makes conflicts of various reasons of the Bank of Albania staff, for instance be handled as matters requesting a legal engagement, drafting a detailed material on the conflict from the HRD and its consignment to superior authorities to set the penalty, briefly a solution that does not solve the conflict. In this way, the solution for such cases creates an excessive bureaucracy, loss of time and reduction of work efficiency for all the staff involved.

In the future, it will be worked to 1) prepare rules on Ethics code so that it is more precise and adequate. 2) get the staff as much more aware on the Ethics Code as possible through workshops or round talks 3) study the causes leading to conflicts and the ways to get away from them (a better coordination of work between the different departments will contribute to evading ambiguities about the competencies and duties of every department, ambiguities which frequently lead to conflicts; 4) apply new methods on the solution of conflicts, preferring

individual human contacts between the parties and the solution of conflicts between them, with the intermediation of HRD specialists turning back to administrative penalties required under the regulation, only in extreme cases.

In preparing the new Ethics Code, real ethic problems encountered at the Bank of Albania during its operation should be taken into account. It is very easy to take an Ethics Code from the west, translate and adapt it for the Bank of Albania. However, such a code will be unreal and non-functioning for the Bank of Albania. Thus, in terms of a similar economy to that of Albania, based on cash rather than on bank transactions, the statement of assets (equity) on behalf of Bank of Albania's staff and further depositing the respective forms at the HRD, and the trustworthiness of these statements is, for many reasons, difficult to be verified. For these and other reasons, the new Ethics Code, instead of trying to "keep" in these directions the integrity of the institution through bureaucratic and non functioning practices such as the statement of income (possessions), it should try to find ways on how to discourage the staff shouting in the corridors, etc. Such ethical problems do not exist at the Bundesbank or the Bank of England for instance.

Training with the current ways and procedures followed by the Bank of Albania does not meet the functions it should carry out at a central bank.

HRD has turned into a division that only administers tickets or other similar procedures related to training inside or abroad the country. There are no exact, clear and practical criteria on whose basis the HRD applies a filter and not only that – for the staff and departments' applications for training. There are no accurate and clear procedures to measure the efficiency of training. It is difficult for somebody to contest with arguments the disseminated opinion amongst the bank staff that two or three days trainings abroad are simply tours – in most cases these are considered (short-term trainings abroad) as such by the bank staff.

Not only short-term trainings but also the long-term ones are carried out at the absence of any criterion to measure the efficiency of training. For example, it is actually impossible for the HRD to, based on an elementary logic, forbid an employee, who with the permission or recommendation of his superior, goes for a second or third master, while his superior has got no master degree. Important questions "who goes for training" and "why" are questions actually receiving formal answers, while these questions and many others must be raised at the standards of the adequate clear and honest criteria in the framework of a strategy for training.

HRD has drafted initial proposals to construct a strategy for training. They have been handed out for suggestions or opinion to relevant departments. For the future, it is suggested that based on these initial proposals, a simple and effective strategy be drafted on the basis of a software that will mend the kernel of currently observed deficiencies.

The training strategy will resolve the main part of the problems but not all of them. The training efficiency will mostly depend on the superior-subordinate communication. The simple question, apparently simple, the superior must address to his subordinate after his returning from the latest training is "What changes would you suggest for improving your work at the Bank of Albania, based on the experience you got from training?". It will have more value than any other strategy, whatever sophisticated or academic this training strategy will be. Naturally in the future, the HRD should encourage the bank directors and managers to give more importance to the above communication, so that the Bank of Albania staff would benefit more from the trainings with the homologue institutions in the West.

Naturally, LHRD and HRD as well as other bank divisions or departments function on the basis of a respective long-term strategy. These strategies serve at least theoretically as a guide to the operation of the division or the department over a long-term period. This is actually a very big problem, which is simply under the stage of scrutiny. A lot of work with much more

input is needed from the Bank of Albania managers to fix this problem. The main reason for the need to coordinate different bank departments' strategies is that strategies are fruit of a tremendous creative work and because of lack of coordination among them most of strategies are not applied in practice, a fact that reduces considerably the bank's efficiency. The solution is very simple – frequent contacts and straight communication, group meetings among directors and employees dealing with the compilation of strategies at each division or department.

Every institution functions on the basis of certain standards. The LHRD at HRD, like other Bank departments and divisions, evidences deficiency of appropriate standards and procedures. Subsequently, many employees mostly lose their time with improvising standards that however are temporary and not applied by the rest of the staff. The Bank of Albania must be aware of the unpleasant reality that it is still in the stages of institution building and must take the initiative to remedy this problem. For instance, the standardization of bank papers was an as much important step as it appeared small and insignificant – it avoided chaos in conceiving documents that lowered the work efficiency. But this is only the first step to be followed by many other very important steps. The staff requests for annual leaves, actually taking unnecessary time for employees to compile and for the HRD to process them (because any requirement addressed either from LHRD or other departments' staff is a "composition", in a certain form and style, and even in uneven dialects to one-another) must be standardized. This would relieve the bank staff from extra and unnecessary work, leaving them more time to creative work. The Bank of Albania staff must stop losing time with improvising standards for their daily job at the bank. This is one reason - but not the only one – for the need of standardization and further computerization of bank operation. More laws, standards and regulations, especially adequate, clear, simple and practical laws and regulations do not necessary mean more bureaucracy! On the contrary! It is the constant effort of the Bank's staff to improvise standards that mean creative but unnecessary work, without long-term results, compromising the idea of creative work and thus create more bureaucracy and paperwork.

The solution referring to the above is raising a workgroup to deal with the problems of Bank standardization and computerization. This workgroup must do a great deal of work, especially that of conceiving the job, delegating the implementation of special parts of the project to other bank departments or divisions.

Another way to resolve the above problem would be carrying out an idea that has been circulating at the bank for a long time: the Bank of Albania should establish privileged relationships with a powerful western bank (i.e., Bundesbank, as the champion of the perfect organization and standardization and the foundation of the European Central Bank (ECB) where the Bank of Albania aspires to participate), which should take over Bank of Albania's reorganization according to its own image, observing the specific conditions of Albania. (If the point is for "approach" "twinning" or "patronage" of the Bundesbank for example, this does not depend on Bank of Albania's good will or its maximum commitment to this direction, as it is a condition that must be "sourced" from an agreement between the Government and the EU, that's why the idea can be expressed in another form).

As highlighted by the British specialist in HRM area, Mr. Iain Thompson at the workshop he organized for Bank of Albania directors and administrators, "in the past, many organizations had the tendency to be much more hierarchic, adopting an utterly commanding and supervising stand. Today, organizations are simpler and give more power to the staff. The central bank is not a business firm based on profits and here it differs from commercial banks. Central banks carry out a large number of research type activities, normally exercised by the private sector. However, central banks are much more hierarchic than commercial banks and overcharged with administrative rules and regulations". Such thing bears the risk, which is more evident at the Bank of Albania in fact, that human resource managers - not only – be much more engaged with and be more interested in implementing the procedures and regulations than dealing with the staff and human relations at the bank.

Staff motivation includes a core element of HRM and consequently it comprises, or more accurately it must comprise a core direction of HRD work. It is already known that the main reason - but not the only one (and in a few cases, however interesting, the wage is a secondary reason) – why people go to work is the wage. Since budgetary restrictions of every institution and of the Bank of Albania consequently enforce limits up to where the wage or rewards can be used as monetary motivation for the staff, the non-monetary motivation assumes a great importance. It must be stressed that the non-monetary motivation is one of the main directions of work for the human resource manager, whose success is not so largely dependent on what the manager has studied at school about HRM but moreover on the ability of the human resource manager to know the staff necessities or wills and on his fantasy to conceive and partly implement different programs for non-monetary motivation of employees. Theoretically, these programs may be detached or may be part of a long-term plan / strategy, prepared in advance and approved in details. Drafting a preliminary long-term plan for these activities, which is annually renewed at certain periods of time, is preferred to special and detached programs conceived in a different way each year, because of the preliminary individual time planning for each staff member, as it relieves the work of the LHRD for the management of activities, etc. More concretely, successful practices of developing some cultural-sports activities (such as a football match, for instance), celebration of some holidays (such as the New Year Eve), tour travels to or abroad the country, etc, exist at the Bank of Albania; however, it is an important duty for the future to include these activities in a long-term plan, which is periodically repeated every year, and not improvise similar activities year on year.

The Bank of Albania – and its building located in the envied address "Scanderbeg Square", is as nice from the outside as uninhabited from the inside. Not only its architecture is over 60-years, but also the work conditions in it are unfortunately similar with the work conditions of 60 years ago. As frequently evidenced from foreign visitors at the bank, it (the Bank) resembles a far west American bank of a century ago.

Work conditions comprise a powerful means of motivation or demoralization. Unfortunately, the current work conditions at the Bank of Albania demoralize its staff and this is for 1) the architect conceiving the edifice, not built around the individual and his requirements (the main criteria of modern architecture), but the glorification of a certain ideology of the time that regardless of what it was, it represented an ideology, which raised in cult the group ignoring individual demands; and 2) the amortization of the building. Thus, the current bank building has wide halls – but small workrooms, attractive and impressing facade but dark corridors, all these contradictions deriving from the designing of the building as "glorifying for the community and dispossessing for the individual". The above defects and other deficiencies, such as lack of air-conditioning, non-economic office equipments, elevators, etc., are expected to be partly mended very soon after the complete reconstruction of the bank building.

LHRD role as above mentioned has mainly consisted in delivering opinions about the conception of offices and other bank environments after the reconstruction, suggestions on the need for setting up a restaurant (amid others, with lower prices than those of the market), and other recreation environments, etc., aiming at making the new offices and new bank environments more practical and gratifying. This has been done even after the consultations with the Bank of Albania staff.

Actually the contribution of the LHRD, the legal division, is determinant in the managing procedures that will enable the performance of the complete reconstruction of the bank. HRD contribution is finally reduced in its desirable but not excessive role of the frequent "sensibility" (at the lack of a more precise term), of relevant departments and of the Bank of Albania Administrators for the very high importance of radical improvement of work conditions at the Bank of Albania.

It is a fact that after the powerful and straight intervention of the Bank of Albania Governor, Mr. Cani, the problem of the complete reconstruction of the bank is put under the right way.

The cooperation with Albanian intellectuals that are actually in emigration comprises a new and interesting initiative of the HRD. The project consists in identifying Albanian specialists at relevant fields, currently in emigration, the creation of database with collected data and later on, the use of this database from departments and interested staff at the bank. Work conceiving is already terminated and there are found the ways how this idea can be practically implemented at the bank, aiming that either the bank or its staff be treated of one more opportunity, not one more bureaucracy.

David Shanon, former manager of Human Resources at Fed, visiting Albania on May 2002 to offer his help for the LHRD, when was asked from the Bank of Albania LHRD specialists on the concrete procedures for processing the ample information of the Fed, continuously stressed that "again we have software for that". No bank department, no division and no bank employee can do his job appropriately and reach the maximum efficiency without the help of the Information and Technology Department. Such help has been great so far, but the adding quantity of information to be processed from the LHRD makes necessary bigger assistance to resolve this problem from ITD to LHRD. The rising aid from ITD does not merely mean increasing the number or the quality of PC's currently used as typewriters by bank staff. Naturally, the first to be assisted from the bank is ITD and particularly the LHRD, so that this department has possibilities to assist other bank departments, including the LHRD as well. So the employment of new staff, programmers - not only - (the process where the LHRD has crucial role) would help the ITD with the completion of its role.

Finally, I believe that a considerably high academic potential of the Bank of Albania staff may be used to a greater extent - the main preoccupation of HRD - if the bank a) improves working conditions, b) takes measures to complete computerization of the bank, for the best management and the standardization of the majority of work at the bank currently, asking for more improvisation, spending more time and efforts, discouraging in this way the staff dealing with creative work.

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A CENTRAL BANK COMPENSATION PROGRAM

Zhizela Balla*

1. COMPENSATIONS IDEAL PROGRAM AND ITS COMPONENT ELEMENTS

Compensations ideal program is composed of some component elements closely related to one-another. To make this program work, it is necessary that all elements function appropriately and give the required input to the next element. Therefore, to create a complete image of compensations ideal program, we are first analyzing its components.

1.1. JOB DESCRIPTIONS

Job descriptions represent a summary of information for every work position. This information contains the type, the level of responsibility, knowledge and necessary skills, lines of reporting, the space of operation, main duties per specific work position described in the job description. It is important that these job descriptions be contemporarily adequate, thus reflecting the job performed in the present, neither in the past nor in the future, and not in detail. Every unit must review them periodically once a year, as by rule, and more frequently, when necessary.

Relevant units must prepare new descriptions per every new job and the Human Resource Division must further approve them afterwards. New job descriptions are also needed for new tasks and responsibilities that reflect a significant change.

Job descriptions should not be confused with the regulations or work procedures. Regulations describe rules every employee must apply during his work relations to the bank, thus it is clear that job descriptions are utterly different from the regulations and work procedures as they describe the tasks and responsibilities of a certain work position and not a group of work positions included in an organizational unit.

To further clarify the concept of job descriptions, we are unveiling the contents of a typical job description:

The title of work position – clearly and briefly describes the level and the nature of work, thus identifies the work position.

The level and the current payment structure - presents the class or the payment interval where the actual job is currently included.

The sector / division - the job is part of.

Reporting scale - presents the managerial scale in the managing structure where the assigned person of a certain work position reports.

Summary - gives in a clear and concise mode the scope of the job.

Main duties and goals - describes only those duties occupying at least 5 percent of the working time of the job described. These duties are ranked by priority, the time lines or performance. Generally, in this paragraph, there must be included from four up to ten responsibilities per work position.

The level of necessary factors for performance evaluations- these factors are different for supervisory or non-supervisory

jobs and are used to relatively evaluate the performance before it comes to be classified under the payment structure. Some of the factors that need to be included in this paragraph are:

- The required minimum of knowledge or skills per described job. These requirements must be justified from job assignments.

For non-supervisory positions there must be also included:

- The assigned supervision – the scale of direct or indirect control directly exercised from the superior, the responsibility taken on by the employee and the review per work position;
- The necessary guidance and evaluation from the superior;
- Work complexity-reflects the difficulty and the originality during the working process;
- The effect of work position within the organizational unit either inside or outside the bank;
- The scale and the purpose of personal contacts either inside or outside the bank;
- Physical requirements and work environment giving the risks and different difficulties that may exist;

For supervisory jobs, there must be also included:

- The relative importance of the sector, department, office, program or functions it supervises;
- The level of authority it has been endorsed;
- The level and the scope of personal contacts either inside or outside the bank;
- The scale of supervision exercised by the number of subordinates.

1.2. JOB EVALUATION

Job evaluations consist in setting a relative institutional value to any work position systematically and this is focused

on the characteristics, contents of job and not on the individual performing it.

Stages of job evaluation consist in:

- The formulation of contemporary and suitable job descriptions is the most important stage. On the basis of the information provided by these job descriptions, the analysis and evaluations of work positions is made.
- Analysis per work position consists in analyzing the information submitted in job descriptions, based on evaluation factors per work position, which must be different for supervisory and non-supervisory positions.

Thus, the factors used in analyzing non- supervisory positions consist in:

- Required knowledge to perform the duties in these work positions;
- Allowed supervision on these work positions;
- Necessary management or direction;
- Complexity of charged duties;
- The impact of duties and responsibilities of the work position in the overall performance of the institution;
- Level of personal contacts and purposes;
- Physical requirements;
- Difficulty of tasks.

Factors that might be used in analyzing supervisory positions consist in the following:

- The impact on the organizational unit where these jobs are included;
- The rate of reporting or the ranking of work position in organizing the chart of the institution;
- The given authority to work position;
- Personal contacts and their aim;
- The complexity of supervision allowed to these work positions;

- The level of work positions supervised from the above position;
- The number of subordinates supervised from this position;
- Relative importance of work positions, where for every factor of evaluation, work position analyzed are assigned a number of points. Based on total points collected, a certain wage interval is classified in the wage structure.

1.3. MARKET ANALYSIS

Market analysis consists in setting a price to jobs in the market and in finding completive intervals for payments from our institution in this market. This market analysis must be periodically performed each year, as it is the main source of information over the wages offered by other companies for similar work positions in the industry our institution is part of, in the banking system or other industries for current work positions that exist even at the Bank of Albania.

Job descriptions represent the basis for fixing job similarities for compared salaries. These jobs collected data consist in providing payment intervals offered by other companies. These data are further analyzed and compared to the payments offered by our institution for these work positions. Analyzing the current scale of offered payments from our institution, their competitive capacity in the market is also defined and their review is undertaken, if necessary.

1.4. PAY STRUCTURE

This structure must be the basis for a fair, impartial and competitive compensation for the Bank's staff. It is a combination of the inward hierarchy resulting from the relative importance of work positions and outward market conditions analyzed along the labour market inspection. An ideal pay structure is graphically presented as below:
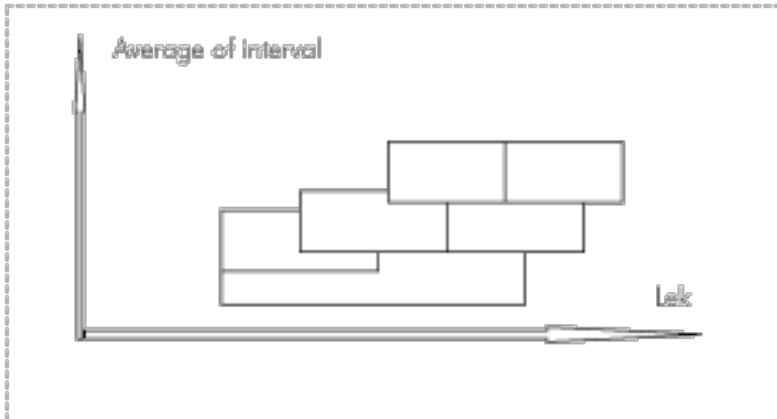
Pay structure is composed of a group of intervals that may intersect one-another. To clearly understand pays (salaries) falling into different intervals, we must first of all clarify the notion "compa-ratio", that is a comparing coefficient calculated with the following formula.

$$\text{Compa-ratio} = \frac{\text{The current payment (salary)}}{\text{Salary}} * 100\%$$

This coefficient serves to define the pay position for an employee or a related group of employees with an average market wage for the same jobs.

Thus 3 major points, minimum, average and maximum, comprise any pay interval in the pay structure.

The minimum pay is the received salary from an employee with an adequate performance.

The average is the pay of a fully trained employee for his/her work position with an adequate performance for a relatively long time. This salary corresponds with the average market salary.

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The maximum is the highest salary for the work positions included in the salary interval.

However, any interval is composed of some other subdivisions, apart of the minimum, the average, and the maximum. These subdivisions have got a special comparative coefficient (compa-ratio) and are based on performance evaluations. Shifting the interval to a higher subdivision, including his/her current salary, is based on his or her performance evaluation, thus the pay rise of employees within a certain interval is different. The pay for new recruits is generally put under the lowest subdivision; in view of his training or experience this payment may be set at higher subdivisions.

The salary rise is based on the performance evaluation. Therefore, any employee receives an extra payment in percent of his/her salary, based on his/her performance evaluation at year-end. This percentage depends totally on performance evaluation; however, indirectly it also takes into account the work experience as the collected increases in percent of the base salary, always based on the performance evaluation, reflecting the work experience and can not exceed the maximum limit of the interval including the salary. The available budget must always be ahead to these increases in percent of the base salary.

Factors conditioning the budget consist in:

- The competitive position of employees in the market;
- The budget of competitive companies for annual increases in percent of the base salary;
- Overall economic conditions;
- The supply and demand for employees with the same experience and skills;
- Financial and budget conditions of the institution.

After approving the total budget for extra payments in percent of the base salary always based on performance evaluation, every unit is availed of a special budget stated in percent of the total fund for staff salaries.

The staff may pass from a salary interval to another as a result of the three processes listed downward:

1.5. CLIMBING THE STEPS OF CAREER

Climbing the steps of career consists in being promoted in career with much more responsibility and a higher salary consequently and this is acceptable only if the employee has got an excellent performance in the previous job. Employees are promoted in office based on an open competition, which might be an interview or analysis of the performance of all employees, candidates to get a promotion at a higher step of career.

1.6. PROMOTION

Promotion implies getting on a higher step of career when a job vacancy exists. The vacancy has got higher duties and responsibilities than the current job. Even this promotion is based on the competition though the candidates considering training, work experience and performance.

1.7. RECLASSIFICATION

Reclassification represents the classification of specific work position to a new grade of career, due to the change of duties and responsibilities of work position. This reclassification may be raised, lowered or remain unchanged in the scale career for the work position, whose characteristics change.

1.8. EXCELLENT PERFORMANCE BONUS PROGRAM

This program must serve as complementary to the increase in percent of the base salary based on performance evaluation at year-end. Bonuses included in this program are accorded for

the very high performance and completed tasks exceeding the work position. There are two ways of according these rewards:

a)   Bonuses in cash

Every individual employed from the institution has the right to receive bonuses in cash for special contributions rendered to the institution, either inside or outside his duties or responsibilities specified for every work position. The superior of the unit, where the employee works, makes the proposal for the reward.

b)   Bonuses for special achievements

A special committee accords these rewards once a year. Directors of all units at the bank propose this committee to reward all the staff (not managerial rank) that has given a special contribution to achieving the mission and the targets of the institution either directly or indirectly.

2. THE BANK OF ALBANIA CURRENT PROGRAM OF COMPENSATIONS AND DEFICIENCIES COMPARED TO THE IDEAL PROGRAM

2.1. JOB DESCRIPTIONS

The current job descriptions of the Bank of Albania do not have the appropriate characteristics and qualities to be the basis for the rest of the stages of compensations program. Frequently they do not appropriately describe the duties and responsibilities of a certain work place. Even their review has not been periodical and based on changed duties and responsibilities of a certain occupation. Consequently, it is necessary that the current job descriptions be analyzed in detail by an "ad-hoc" committee and be prepared in such a way that they be as contemporary as to represent the further basis of the following stages in the program.

2.2. RANKING JOBS BY PAY INTERVALS

This component is totally absent in the Bank of Albania compensation program. Subsequently, any work position relative importance or effect is not yet evaluated or used to classify jobs under certain payments intervals. Thus, matching a certain job with base salary has been arbitrary and not objective until now. One of the main disadvantages of this arbitrary correspondence is the non-acknowledgement of the contribution offered from tasks and responsibilities of different work positions in achieving the Bank of Albania targets, thus discouraging the staff charged with more important tasks and responsibilities to give their maximum to the advantage of the institution.

Finally, it must be stressed that this component should be included and bear proper importance in the compensation program of our institution, regardless of the costs and difficulties that may arise ahead. The development of an evaluation program for work positions will result in acknowledging or the right estimation of the contribution for each work position to the achievement of the Bank of Albania targets, in the adequate classification of occupations in the structure of wages and subsequently in the fair compensation of individuals occupying these work positions.

2.3. LABOR MARKET ANALYSIS

The Bank of Albania compensation program lacks this element as well. In some cases, there have been collected data on salaries offered by the public sector and by commercial banks; however, these have been used simply to create an idea about the Bank of Albania's salary position to the labour market. The comparison of salaries for the same work position has been deficient also as a consequence of inadequate and outdated job descriptions, which restrain us from finding as many comparable work positions as possible. Consequently, the reflection of labour market data in the level of salaries at the Bank of Albania and the definition of its position in this market

have not been accurate and this fact injures remarkably the Bank of Albania's competitive skills to recruit the most capable and the most trained staff.

Again we stress that the labour market analysis must be given appropriate importance. It is necessary that this analysis be periodically performed and its results serve to review the wage structure. Also, the Bank of Albania, after making this analysis, must clearly define its strategic position in the labour market, always with the intention to maintain its competitive capacity in the market.

2.4. PAY STRUCTURE

The Bank of Albania current pay and its components are shown as in the table below:

Base salary	Extra compensation per department classification	Extra compensation per overall work experience	Extra compensation per years of work experience in the banking system	Extra compensation per difficulty of work position	Extra compensation for scientific degree	Extra compensation per performance evaluation	Gross salary
Determined by the Supervisory Council	Each work position takes 20%, 10% or 0% of the base salary on the basis of the relative importance of the department it falls under	0.4% of the base salary for each added year in the overall years of work of the employee. The maximum limit = 10% of the base salary, corresponding to 25 years of work.	1% of the base salary for each added year of work in the banking system. The maximum limit = 20% of the base salary, corresponding to 20 years of work.	10% or 5% of the base salary according to difficulty of work.	1500 lek or 3300 lek for scientific works to the benefit of the institutional performance of the Bank of Albania.	Addition in percentage of the base salary for the annual work evaluation. The maximum limit = 20% of the base salary	Total amount of all components

As observed, this structure is composed of the base salary and six extra payments on the base salary, while an ideal payment structure has only three components: base salary, extra payment per performance evaluation and accorded bonuses for excellent performance. Thus, the current structure of the Bank of Albania is much more complicated than the ideal one. Also, this structure does not base staff compensation on performance evaluation. Other extra payments are based on different criteria and performance evaluation, making compensations as per bank employee be mainly based on other factors and not simply on the contribution they give to achieving institutional targets. As a result, employees are not encouraged for a more qualitative job and high performance.

It is necessary that the criteria for extra payments over the base salary, except that of performance evaluation, be used as the criteria of performance evaluation and their effect should be included in the base salary for these jobs. That simplifies the wage structure but at the same time helps in the right compensation of staff.

Also, the current wage structure at the Bank of Albania also lacks the classification of work positions for different wage intervals. The deficiency of wage intervals has brought about lack of grades in career, so necessary for maintaining the inner motivation of staff, the inducement of further professional trainings and the enhancement of competition amongst the staff for better performance to the advantage of the Bank of Albania interests.

The existence of extra payments for annual work evaluation is a positive feature of the current wage structure, further motivating the staff for the qualitative work. However, its main shortcoming stands in the way of evaluating the work performance and in its association with the wage system.

First, the performance evaluation program must be revised so that the evaluation is as objective as possible and not merely serve the extra payments on the wage.

Second, extra payments must be less centralized and based on preliminary budget plans compiled for every unit.

Finally, it is clear that the Bank of Albania entire compensation program needs a radical change, which is conditioned by the costs and psychological impacts on the staff. Therefore, it is necessary to find intermediate ways, which will   gradually lead to the perfection of this program and its component elements.

Reaching the perfection, the Bank of Albania will have a compensation program that will assist it in meeting the following targets:

- Fairness and impartiality in the compensations of every staff member;
- Attraction, maintenance and motivation of trained staff at any grade of hierarchy;
- Maintenance of the competitive skills in the labour market;
- Elucidation of staff on the existing correlation between the personal performance and the Bank of Albania targets;
- Staff compensation based on their personal performance and the contribution they give to the Bank of Albania.

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ARGUMENTS ON THE LEVEL OF MINIMUM PAID-UP CAPITAL

Erjona Suljoti*

I. WHAT DOES CAPITAL REPRESENT FOR BANKS?

A bank, as other businesses, needs capital to exercise activity. Unlike them, the commercial bank must always retain a certain amount of capital to amortize the unexpected losses. Such obligation derives from the specific nature of the banking activity.

The capital of a bank performs a number of functions. To carry out these functions, it should have structures and size to satisfy the regulatory authorities, shareholders and investors (including depositors).

Among the main functions of capital, we would mention:

First, the capital absorbs bank losses and its potential exposure to various risks it faces during its activity.

Second, it makes other depositors and creditors feel protected not only during normal periods of banking activity but also during hard financial periods. This means that capital is a factor that strengthens the public confidence in any bank and in the whole banking system.

Third, the capital of a bank is a source of long-term funds for fixed assets, for the banking technique and technology. Capital is the main source for financing bank's growth, which is very important to be competitive in the banking environment.

Fourth, capital serves as an instrument of controlling the extension of bank's activity. If a bank's assets have a faster growth than needed, then the bank will receive signals from regulatory authorities to restrain expansion, otherwise augment the capital in accordance with the risks taken over.

Fifth, capital helps the bank be licensed, organized and operate before the deposit flow starts. In the initial period, when the public confidence in the bank is still at a relatively low level, the only financial resource the bank can operate with is the capital.

Referring to all these functions, the initial minimum capital and its amount assume a special significance.

II. WHICH FACTORS MAY INFLUENCE THE INITIAL AMOUNT OF THE REQURED CAPITAL?

- The macroeconomic situation of the country. The more stabilized and healthier this situation, the lower the risk in bank operating environment. This means that banks carry over less risk in their activity. Therefore, such conditions do not constitute encouragement for augmenting the capital amount.
- The need to have or not to have new banks. This relates to the market need to extend the banking system and its services. If the market lacks the competition, lacks banks and banking services, then this may make authorities promote the entry of new banks, operating also through a more liberal capital requirement. Otherwise, a high capital requirement would mean a low return on equity to investors, and vice-verse.
- Business strength (in terms of capital) reflects the actual

possibility of businesses of a country to be able to enter into the banking industry. Frequently, the national authorities are interested in increasing the number of banks with domestic capital in the banking system. To realize this preference, the real business strengths in terms of capital are taken into account. Referring to this criterion, and to the preferences towards banks with domestic capital, at any case, this would not affect on the further augmentation of the capital amount.

- The degree of investors' interest (domestic or foreign) in opening a bank. This factor underlines the idea that the investors' strength (in terms of capital) or power to invest is as important as the interest they show in this activity. The level of interest of domestic or foreign investors is directly related to the profitability indicators (return on equity) and the risk taken over by them. If interest is low, then there will be operated by holding the capital amount at low levels and vice-versa.

The need to meet international standards, for example, different directives from BIS or EU. Many countries of the region, such as Croatia, Rumania, etc., in the framework of signing association agreements to adhere to the EU, have converged the minimum capital amount according to the directive No.12 of 2000. According to this directive, countries signing the association agreement must hold a minimum capital amount of not less than EUR 5 million or USD 4.7 million. Generally, member countries to EU have EUR 18 million or USD 16.5 million as the minimum capital amount.

III. THE HISTORY OF THIS INDICATOR IN ALBANIA OVER YEARS

Currently, the required capital in Albania is Lek 700 million or nearly USD 5 million. The required capital has reflected a rising trend over the recent decade. The EU criterion, USD 16.5 million is 3.3 times higher than the current standard in Albania, nevertheless it meets EU criterion for countries that

would sign the association agreement. Knowing that we aspire to be accessed to the EU, converging legislation with that of EU member countries presents an important step to this and we naturally come to a question: Is it necessary to augment the required capital amount? The answer is positive, as we do not want to step away from the already started integration and moreover, we ensure benefits that accompany the augmentation of capital. The second question is: Is it the due time to augment the capital amount? For this, we are going to analyze some facts.

Table 1 Year on year change of minimum capital in Albania

Years	Amount of minimum capital (in million lek)	No. of banks
After 1998	700	14
02.12.1998	700	10
December 1996	350	8
28.06.1996	200	8
1994	100 – 200*	6

*Note. In 1994 there were two levels of minimum required capital: 100 million leks for Albanian investors and 200 million leks for foreign investors.

From the history of changing the required capital amount, we can directly draw two important characteristics:

I. In Albania, the augmentation of the required capital has not restrained new bank licensing requirements and 4 banks are added since 1998 (when the required minimum went up to Lek 700 million). This means that the interest of investors to open new banks is affected by factors other than the required capital.

II. We notice that the period of changing the minimum required capital amount in Albania is already every two years. There are cases when the required capital has changed twice a year (as in 1996). During this year the change was undertaken to maintain the same rate of the required minimum denominated in USD (USD 2 million). In fact this year we have a noticeable devaluation of the Lek exchange rate to the USD (from 100 Lek /USD to 170 Lek/USD). This devaluation of the Lek enforced the decision on the augmentation of the required capital from Lek 200 to 350 million. In 1998, it was established that for new banks requiring access in the banking system the minimum

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paid-up capital would be no less than Lek 700 million, whereas for existing banks and for those under the licensing approval process, the augmentation was decided to take place in some stages. Initially it was deemed as rational that augmentation be met at the rate of Lek 500 million. Banks would meet this obligation within 18 months and later Lek 700 million would be met for 18 other months. From 1992 until now, we note four changes, implying that these changes have been already undertaken on the average of every two years and a half. However, if we refer to the western countries experience, we will notice that the Basel accord, about capital adequacy criterion in year 1998, specified a date for the application and adjustment of this accord for about 4 years, till 2002, while in our banking system, as above mentioned, the period for changing the capital was 2.5 years.

Conclusion 1: Casting a glance at the history of changing the minimum required capital, it is concluded that the frequency of growing capital has been relatively high. For this reason, it has been assessed that it is still early to change the amount of the required capital, because frequent change sets banks to insecurity and pressure and makes the application of their business-plans difficult.

IV. REQUIRED CAPITAL AMOUNT IN ALBANIA AND IN SOME OTHER COUNTRIES OF THE REGION

Currently the minimum required capital in Albanian is very close to the average of the region, at USD 5.5 million. This indicator conveys the idea that it is not the right moment for changing the amount of the minimum required capital. The share of the required capital as to the total of GDP is higher in Albania than in other countries of the region (like Romania, Bulgaria), implying that in these circumstances, changing the amount of the minimum required capital is inappropriate. Financial leverage is actually low in Albania, meaning that own

capital allotted to total assets is too small. Being the smallest in all the compared countries, this indicator suggests capital amount augmentation. The size of the banking system in Albania is a bit lower than the average of the countries in the region (55.5), which means that the banking system needs to be expanded. This indicator underlines the fact that the augmenting of the required capital would be desirable, so that banks have possibilities for expansion.

Table 2 Comparison of capital indicators for countries in the region

Country	Amount of minimum capital (in millions of USD)	Minimum capital /GDP	Level of financial leverage	Capital adequacy	Size of the banking system*
Albania	5,0	0.05%	6.7	42	50
Macedonia	2,2- 8,3*	0.22%	23.3	36.7	38
Croatia	4,7	0.02%	11.2	21.3	71
Bosnia and Herzegovina	4,1	0.17%	25.7	32	67
Slovenia	4,0	0.02%	14	12.4	79
Bulgaria	5,1	0.04%	11.3	41.3	40
Romania	4,6	0.01%	8.6	23.8	29
Yugoslavia	5,0	1.87%	-	-	-
Turkey			11	-	70
Average	4,8		13.27	25.84	55.5

*Note: In the case of Macedonia there are two levels of required capital for banks. The amount of 2 million USD applies to banks conducting banking business within the territory, while for banks conducting banking business outside the country the required capital amounts to 8 millions USD.
*The size of the banking system implies total assets in the banking system to GDP.
Source: Annual Reports of countries and the IFS Annual Report.

Conclusion 2: Comparing capital indicators, we underline that the required capital amount and the size of the banking system are close to the average standard of the countries in the region; therefore further augmentation of capital is inappropriate. Even capital adequacy, at 1.6 times higher than that of the countries of the region, does not support the augmentation of the minimum capital. On the other hand, the financial leverage level is half the average of the countries in region and far away from the standards of such countries as Croatia and Slovenia (respectively 11.2 and 14 percent), which have a more advanced banking system. This fact props the augmentation of initial capital amount.

V. ANALYZING FACTORS THAT INFLUENCE THE REQUIRED CAPITAL AMOUNT IN ALBANIA

V.1. MACROECONOMIC SITUATION

Comparing the performance of macroeconomic indicators over years, it is clearly evidenced that the macroeconomic environment in Albania has got a stabilizing trend. During the recent four years taken under analysis, Albania disclosed the best positive developments on macroeconomic indicators amongst the compared countries of the region.

Given the macroeconomic developments, Albania resembles more to such countries like FYROM, Romania, Bulgaria, while it has the lowest inflation among these countries. As a share of GDP, investments are lower and the same can be mentioned for GDP per capita. As already known, the Balkan currently attracts a very small percentage of foreign investments and this affects to a certain extent the overall macroeconomic developments and those of the banking system. This has been an aftermath of the extremely aggravated situation with wars and an underlined lack of political stability in the region.

Referring to our problem, it means that it is not yet the moment to augment the capital for such an action would restrain, to a certain extent, the banking system from further growth. If we refer to foreign direct investments per capita, we would see that Albania is ranked the last country in the region. This means that it must create more favourable conditions to attract a larger number of investors, implying that capital amount augmentation is inappropriate. Inflation reflects the lowest rate in the region. Inflation indicators, together with the steady exchange rate, express a more favourable and safer macroeconomic situation, which does not necessarily require more capital.

Table 3 Performance of macroeconomic indicators

Indicators	Years			
	1997	1998	1999	2000
Nominal GDP (in millions of USD)	2,294	3,057	3,676	3,752
GDP per capita (in USD)	684	906	1,081	1,094

GDP growth (change in %)	-7	8	7.3	7.8
FDI (in millions of USD)	47.5	45	41.2	143
Investment to GDP (in %)	2.1	1.5	1.1	3.8
Inflation (in %)	42.1	8.7	-1	4.2
Average exchange rate of ALL/USD	148.9	150.6	137.7	143.7

Conclusion 3: It comes out of the above analysis that the created macroeconomic situation does not necessarily dictate addition of the minimum capital. Also, the low level of foreign investments per capital backs the idea of not changing the capital amount.

V.2. THE NEED TO HAVE OR NOT TO HAVE NEW BANKS

The need to have or not to have new banks is generally determined by:

- The banking system magnitude: It refers to some quantitative indicators, as for example to the number of banks per 1000 km2, presenting the geographic expansion of the banking system; the number of banks per 100 000 citizens, presenting banks' expansion to provide banking services to the population.
- The structure of banking system related to the concentration of banking activity. This fact is underlined in view of an ever more efficient competition of the banking system'. Our country has the lowest number of banks compared to other countries in the region. Should this number be allotted to our country population or its surface area we will get a more real indicator. Even in this case, our country is ranked amongst the last three countries of the region, after Romania and Bulgaria and is generally far off the average of the region as per banks coefficient per 1,000 km2.

Table 4 Macroeconomic data for countries in the region, for 2000

Country	GDP indicators			FDI		Inflation (in %)	Average annual exchange rate to USD
	GDP in millions of USD	GDP/ per capita	Real GDP growth	Total in millions of USD	FDI/ GDP (in %)		
Albania	3,752	1,094	7.8	143	3.8	4.2	143.71
Macedonia	3,800	1,885	5.1	181.6	4.6	10.6	65.904

Croatia	18,977	4,227	3.7	827,9	21.9	6.2	8.3
Bosnia and Herzegovina	4,130.4	1,053	5	117	2.8	8	2.1
Slovenia	18,169	9,413	4.6	133.3	1	8.9	222.7
Bulgaria	11,950	1,459	5.8	999.6	8.4	10.1	2.1
Romania	36,691	1,636	1.6	1036	3	45.7	21,708
Yugoslavia	267	940	7	-	-	85.6	37.5
Turkey	77,484	1150	7.6	112	1.3	55	1644.5

Source: IFS Annual Report for 2000

Conclusion 4: These indicators confirm that the banking system is not oversaturated; therefore we can say that it is appropriate to stimulate the introduction of new banks in the system. From this viewpoint, the augmentation of minimum capital would not help the attraction of investors.

If we refer to the banking system structure, Albania has a banking system concentrated in a single bank. In 2000 the assets of the largest bank in the country share nearly 65 percent of the total assets of the banking system, whereas, in Croatia, the three largest banks of the country share 18.8 percent of the banking system assets.

Conclusion 5: The more concentrated the banking system is the more indispensable the enhancement of competition and the introduction of new banks in the system will be. This fact once more supports the creation of more favourable conditions for the entry of investors in the banking market, thus it does not sustain the idea for the augmentation of the minimum capital.

V.3. DOMESTIC BUSINESS STRENGTH LEVERAGE (IN TERMS OF CAPITAL)

At the first steps of assigning this rate in our country, it was deemed as appropriate to differentiate between the home and foreign investors, assisting the domestic or local investors with half amount of foreign investors (Lek 100 million). This difference was made because at that time, no real possibilities were created for Albanian businesses to invest in the banking system. This indicator was assessed as a stimulus of this activity. Later on it

was deemed reasonable to remove this criterion, though there were other reasons that kept Albanian businesses investments away from the banking activity.

Conclusion 6: Anyway, under the conditions when Albanian businesses are not fully consolidated and do not feel attracted by the banking activity, capital amount augmentation would be untimely.

V.4. ALBANIAN OR FOREIGN INVESTORS' INTEREST IN OPENING A BANK

Currently, Albanian investors (according to some preliminary analysis) do not prefer banking activity as their investment alternative, because of the low and gradual return on assets from this activity.

A bank investment is a long term investment, frequently accompanied with loss in the first years of activity, while such investments as trade or construction harvest their profits since the first years of activity.

There are also other factors along with the above mentioned ones that support the preference of Albanian investors to invest in other economy sectors rather than in the banking system. The attraction of foreign investors would require the creation of favourable conditions with respect to return on assets. Also, the capital amount must be so much as to maintain competition in the region. Establishing a high rate of minimum capital would attract foreign investors, who would invest their assets to countries that offer more facilities.

Conclusion 7: Albania is still in need of new banks and lacks interested investors. From this viewpoint, it must stimulate the entry of new banks and not their restraint. On the other hand, taking into account the performance of public banks' privatization, we notice that there are few interested investors. This reinforces once more the idea that the existing amount of the minimum required capital should not be augmented.

Table 5 Albania and countries in the region in terms of the banking system's size

Country	Number of banks	Number of banks per 1000 km²	Number of banks per 100,000 inhabitants
Albania	13	0.45	0.37
Macedonia	22	0.87	1.08
Croatia	44	0.78	1.02
Bosnia and Herzegovina	63	1.23	1.61
Slovenia	97	4.79	5.03
Bulgaria	35	0.32	0.45
Rumania	40	0.17	0.18
Average	45	1.23	1.39*

*Not included in the average the banks of Turkey and Yugoslavia.

V.5. COUNTRY AND BANKING ACTIVITY RISK

The required capital amount is directly related to the risk rate. Currently, Albania, as some other Balkan countries, is a high-risk country. The banking activity, because of its importance, requires very prudential preliminary measures, which may prevent shocks to the whole banking system and in general to the financial one. If we refer to the performance of banking indicators (credit quality because it's a high-risk activity), we will notice significant improvements year-on-year.

Conclusion 8: Compared to the rest of the Balkan countries, lending indicators state a high-risk position. Such a fact is in the favour of augmenting the principal amount, laying the basis for a sound banking system.

VI. SITUATION IN THE BANKING SYSTEM

The attention should be focused on the banking system performance. The Albanian banking system profitability is at relatively satisfactory levels, somewhat higher than the average of the countries of the region (specified as a simple average among the countries under analysis). Return on equity is the highest in the region (at least, compared to the countries that have available data in this respect), indicating that banks' net profit against shareholders equity is high. For the two other indicators, i.e., return on total assets and net profit to GDP,

Albania indicators are ranked in the second place, again indicating a satisfactory position.

Table 6 Profitability indicators of the banking system for countries in the region

Country	ROE	ROA	Net profit/GDP
Albania	21.06	2.1	1
Macedonia	3.8	0.8	0.3
Croatia	15.6	1.3	0.8
Bosnia and Herzegovina			
Slovenia		0.8	1.3*
Bulgaria	18	2.4	0.9*
Romania	12.5	1.5	0.4
Average	14.2	1.5	0.8

* In the absence of data for 2000 the data for 1999 have been used.

If we consider the historical performance of profitability indicators, we will notice an apparent improvement from one year to the other.

Table 7 Profitability indicators of the Albanian banking system

Indicators	Years			
	1998	1999	2000	2001
ROA	-1.8	-0.56	2.1	1.46
ROE	-82.3	16.4	21.06	21.6
Profit/GDP in %	-0.7	0.3	1.0	0.7

On the other hand, the banking activity quality indicators, compared to other countries of the region, are far from the average. Albania represents the country with the least developed credit to economy (private sector) in the region. Banks do not still prefer lending, though it is already known that this is the main activity of a bank.

Loan portfolio is currently at bad levels and far from the average of the region. The conclusion coming out of this is that further growth of lending activity must be stimulated. Under the conditions when lending is a high-risk activity, it may be accompanied with capital amount augmentation.

Table 8 Indicators of credit quality relative to countries in the region

Country	Non-performing loans to total loans	Credit to economy to GDP	Credit to economy to total assets
Albania	42.8	5.2	10.4
Macedonia	34.8	19.5	33.8
Croatia	9.2	37.5	45.8
Bosnia and Herzegovina		49	73

Slovenia	5	39	53
Bulgaria	8.2	18.3	36.8
Romania	38.3	9.4	32.2
Turkey		22	32.1
Average	23	25	40

Table 9 Performance indicators of the banking system over the years

Indicator (in %)	Years			
	1997	1998	1999	2000
Non-performing loans to total loans	45.0	41.0	32.7	42.8
Credit to economy to GDP	4.5	7.9	8.1	5.2
Credit to economy to total assets	9.2	18	16	10.4
Size of the banking system (assets/GDP)	49.0	44.7	49.3	50.2
Use of financial leverage (own capital/total assets)	6.7	2.8	3.6	6.7
Adequacy capital	-	-1.3	8.2	42

Referring to performance of capital adequacy or financial leverage over years, we would notice that in the previous years these indicators were at very low levels. This has been as a result of high provisions for covering bad loans of the system. After 1999 we notice the transition of bad loans to Loan Recovering Agency and significant improvement of capital account. Capital adequacy indicator is at the highest level in the countries under analysis.

This fact confirms that the banking system is either extremely capitalized compared to the risk taken by banks (there is more capital than necessary) or the banks invest in very low risk activities. Regarding the share of banking system assets to total GDP, it is very close to the average of the countries taken under analysis but far from the developed countries' standards (this ratio is at 250 percent in western countries).

Conclusion 9: Referring to profitability indicators, we can state that they are at favourable levels, highest amongst the region, whereas the banking system performance indicators remain at low rates. The existence of a high risk requires more capital.

Prudence should be shown, because setting a higher capital rate would distract foreign investors, as aforementioned, and would also lead to increased demand for establishing other non-bank financial entities.

VII. ALBANIA AND NEIGHBOR EU MEMBER STATES

In the framework of Albania's accession to the EU, we have referred to the banking system indicators of the EU member states. We have chosen Italy and Greece not only for the fact that they are EU members but also because they are our main partners.

Table 10 Banking system indicators for the EU countries for 2000

Indicator	Italy	Greece
Minimum required capital in USD	16,500,000	16,500,000
Financial leverage (in %)	6.7	12.3
Size of the banking system (in %)	153	128
Number of banks	846	
Capital adequacy	10.3	14.7*
Non-performing loans to total loans	8	
Total loans to total assets	51.3	45%
Total loans to GDP	78	53%
ROA	0.79	
ROE	11.6	

* Data for 1999.

The minimum required capital for both countries is determined by the EU directives, at USD 16.5 million. Financial leverage in Italy is higher than in Greece. The size of the system, reflected in the ratio of the banking system assets to GDP is some times higher than the average of the region and the size of the Albanian banking system. The size of the banking system of these countries is extremely large, confirming a consolidated and advanced banking system.

Bad loans to total credit ratio is low, indicating the good performance of the banking activity.

The above indicators show that the banking system in these countries is highly developed and consolidated, but anyway, they show a higher standard of the required capital compared to regional countries. The reason why we are providing an already known table of the neighbouring countries is to show that we really want to augment the initial capital amount. But, is it just the time to carry out such a change? Is our banking system really

able to support and face this change? Our banking system is still in its infantile stage, therefore it has much to do to reach the banking systems of advanced countries and until conditions are ripe, parallel to changes, the change of the amount of the minimum required capital should also be effected.

VIII. CONCLUSIONS AND RECOMMENDATIONS

Reasons pro capital augmentation	Reasons against capital augmentation
Low level of financial leverage	Frequency of changing the capital amount
Banking system risk, bad quality of banks' portfolio	Capital amount and banking system magnitude are close to the average of the region
Country's risk	Capital adequacy is high
Approximation to the EU criteria	Capital amount is as much as the EU criteria for countries that adhere to EU
	Improved macroeconomic situation
	The need for new banks
	The need for enhancing competition in a concentrated banking system
	Domestic business strength in capital terms
	The need for attracting foreign investors

In conclusion we would stress that the factors, on whose basis is reasoned to set the amount of minimum required capital act on both sides. Anyway, there are many more factors that do not support the augmentation of minimum required capital.

RECOMMENDATIONS

1. Given the above analysis we deem that for the moment, the required capital should remain unchanged.
2. We assess that the operational risk of the banking system must be carefully estimated. If the risk rate is increased, the other categories of capital may be put into operation.

For example, taking into account that our banking system profitability is higher than in other countries of the region, the Bank of Albania may ask for a more conservative policy on the side of banks, in terms of dividend allocation, leaving untouched the principal capital amount.

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2003

Market reaction to monetary policy decisions
Suzana Sheqeri
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March 2003

MARKET REACTION TO MONETARY POLICY DECISIONS

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The Bank of Albania monetary policy decisions on changing the core market rates are decisive for the interest rate behaviour. Based on the Bank of Albania announcement on changing the monetary policy stance, markets ensure the necessary information that serves as a signal for changing the interest rates.

Financial market development in Albania, with the banking sector regarded as the most developed structure, enables the Bank of Albania monetary policy decisions to be mainly effective in money market, thus being limited at a time space of no longer than one year.

The Bank of Albania transmission of monetary policy decisions has its own features, in different years, conditioned by the Bank of Albania instruments to transmit decisions on the money market developments, the structural changes recognized by the banking sector, such as the addition of banks' number, the rising share of private banks to public banks, the addition of the active banks' number in the market, the gradual increase of competition by different markets, etc.

Hereinafter, we will try to analyze the Bank of Albania transmission of monetary policy decisions in the money market

over different periods, to evidence the developments this process has undergone either from the viewpoint of the progress or the obstacles that have restrained the enhancement of efficiency of this transmission.

Table 1 Bank of Albania monetary policy stance for the period of 1997-2002

Monetary policy signal	Core rate changing date	BoA main applicable instrument	Core interest change in p/p	BoA core interest rate
Year 1997, 8 times changed		Time deposit rates for utterly state-owned banks		
Tight policy	January 30	12- month 6- month 3- month	+3.0 +2.5 +2.0	22.0 21.0 20.0
Tight policy	March 5	12- month 6- month 3- month	+6.5 +7.0 +6.5	28.5 28.0 27.0
Tight policy	May 22	3 month	+7.0	34.0
Tight policy	June 27	3 month	+3.0	37.0
Mitigated policy	September18	3 month	-2.0	35.0
Mitigated policy	November 10	3 month	-3.0	32.0
Mitigated policy	November 24	3 month	-2.0	30.0
Mitigated policy	December 3	12- month 6- month 3- month	-1.5 -2.0 -4.0	27.0 26.0 26.0
Year 1998, 5 times changed		Time deposit rates for utterly state-owned banks		
Mitigated policy	May 19	12- month 6- month 3- month	-3.0 -2.0 -2.0	24.0 24.0 24.0
Mitigated policy	June18	12- month 6- month 3- month	-3.0 -2.0 -2.0	21.0 22.0 22.0
Mitigated policy	August 24	12- month 6- month 3- month	-2.0 -2.0 -1.0	20.0 20.0 20.0
Mitigated policy	October 22	12- month 6- month 3- month	-2.0 -2.0 -2.0	18.0 18.0 18.0
Mitigated policy	November 12	12- month 6- month 3- month	-1.5 -1.5 -1.5	16.5 16.5 16.5
Year 1999, 6 times changed		Time deposit rates for utterly state-owned banks		
Mitigated policy	February 17	12- month 6- month 3- month	-1.5 -1.0 -1.0	15.0 15.5 15.5
Mitigated policy	May 27	12- month 6- month 3- month	-1.0 -1.0 -1.0	14.0 14.5 14.5
Mitigated policy	June 2	12- month 6- month 3- month	-1.0 -1.0 -1.0	13.0 13.5 13.5

Mitigated policy	July 7	12- month 6- month 3- month	-2.0 -2.0 -2.0	11.0 11.5 11.5
Mitigated policy	September14	12- month 6- month 3- month	-1.0 -1.0 -1.0	10.0 10.5 10.5
Mitigated policy	November 3	12- month 6- month 3- month	-1.00 -1.25 -1.25	9.00 9.25 9.25
Year 2000, 3 times changed	Liberalisation of time deposit rates for utterly state-owned banks and passing to use of Repo auctions			
Mitigated policy	January 19	12- month 6- month 3- month	-0.50 -1.00 -1.25	8.50 8.25 8.00
Mitigated policy	March 29	12- month 6- month 3- month	-0.50 -0.75 -1.00	8.0 7.5 7.0
Liberalization of 6-month interest	May 17			
Mitigated policy	June 7	12- month 3 month	-0.25 -0.50	7.75 6.50
Liberalisation of 12-month interest	July 19			
Mitigated policy	July 27	Fixed amount and diversified price Repo		9.00
Mitigated policy	August 3	Fixed amount and diversified price Repo	-1.50	7.50
Mitigated policy	August 10	Fixed amount and diversified price Repo	-0.50	7.45
Mitigated policy	August 17	Fixed amount and diversified price Repo	-0.15	7.30
Mitigated policy	August 31	Fixed amount and diversified price Repo	-0.30	7.00
Mitigated policy	September 7	Fixed amount and diversified price Repo	-0.10	6.90
Mitigated policy	October 5	Fixed amount and diversified price Repo	-0.40	6.50
Liberalisation of 3-month interest	October 6			
Year 2001 only once changed	Repo and Reverse Repo weekly auctions			
Mitigated policy	March 1	Fixed amount and diversified price Repo		6.5
Neutral policy	May 2	Fixed price Repo		6.5
Tight policy	August 22	Fixed price Repo	+0.5	7.0
Year 2002, 3 times changed	Repo and Reverse Repo weekly auctions			
Tight policy	March 21	Fixed price Repo (s)	+0.5	7.5

Tight policy	April 10	Reverse Repo on multilateral diversified price	+1.0	8.5
Neutral policy	December 10	Reverse Repo on fixed price		8.5

According to the data of table 1, the Bank of Albania has 26 times signalized the market on the change of the core rate or at 4.3 times as yearly average, over the period of 1997-2002. From these, 22 times or 5.5 times average a year corresponds to the period 1997-2000, in which period, signalizing monetary policy stance in the market was realized through the direct instrument of time deposit rates on public banks or 4 times only or 2 times a year through the indirect instrument of the weekly rates.

The Bank of Albania transmitted market signals have been released for most of the period under study. Years 1997 and 2002 comprise exemptions from this period, during which the Bank of Albania monetary policy signals for most of the period have been tight. The market was 4 times signalized on monetary policy tightening in 1997 and 2 times signalized in 2002. Although the Bank of Albania monetary policy stance has been the same for both periods, there have been changes between them, lying in the way of transmitting monetary policy decisions, the applied instrument, the frequency of transmitted signals in the market, the size of changing core rate, which has been much higher in 1997, compared to 2002, etc.

The Bank of Albania monetary policy stance in both periods has been dictated by shocks of the banking sector in these periods, more precisely by the financial crisis of year 1997 or namely after the fall of the pyramid schemes, helped by the weaknesses of the banking sector and the deposit panic in spring 2002, which was a pure incident of the banking sector. The Bank of Albania was positioned in the role of the insurer of the financial system stability, aiming at returning the public confidence in the banking system.

The aggressive increase of the core interest rates during January-June 1997 indicated that the return of liquidity in the

system was efficient. After the insolvency of the pyramid schemes, which attracted a large part of deposits, banks quickly reacted with the interest rates increase. The applicable instrument conditioned the velocity of reaction, regarding the increase of the time deposit rates in this period, which was administratively obligatory to be applied by public banks. Meantime, other banks of the system were forced to track changes of interest rates by public banks so as to not lose weight in the Lek deposit market, remaining attractive for the broad public.

The data of table 2 indicate that monetary policy tightening was transmitted by the deposit market at 9.5 percentage points on 12-month deposits and 8.5 percentage points on 3-month deposits during January-March or about 77.2 percent on 12-month deposits and about 65.4 percent of 3-month deposits during January-March. In April, it was attained full or 100 percent transmission of it.

Table 2 Reaction in lek time deposits market (in percent)

	12-month deposits interest rates	3-month deposits interest rates
January – March 1997		
Key interest rate change	+9.5	+8.5
Market reaction		
January - March	+6.86	+5.58
January - April	+9.59	+8.51
May - June 1997		
Key interest rate change		+10.0
Market reaction		
May - July		+9.84
September - December 1997		
Key interest rate change	-1.5	-11.0
Market reaction		
September - December	-1.17	-7.99

Worth mentioning for the above period is that deposit market was dominated by public banks, at 93.9 percent. However, this administrative increase of deposit rates in Lek dictated banks raise the costs on new deposits taken. Banks of the system transmitted coverage of the created cost to the primary market of treasury bills, leading to a fast and parallel increase of treasury bills' yield. Increasing the yield as per maturity terms was consistent with the increase of the time deposit rates in Lek for the same maturity terms. It was higher on 3-month treasury bills, from

20.4 percent in January 1997 to 38.22 percent in August[1] (or 17.82 percentage points) and lower for 12-month treasury bills, from 22.5 percent in January 1997 to 35.5 percent in August 1997 (or 13 percentage points).
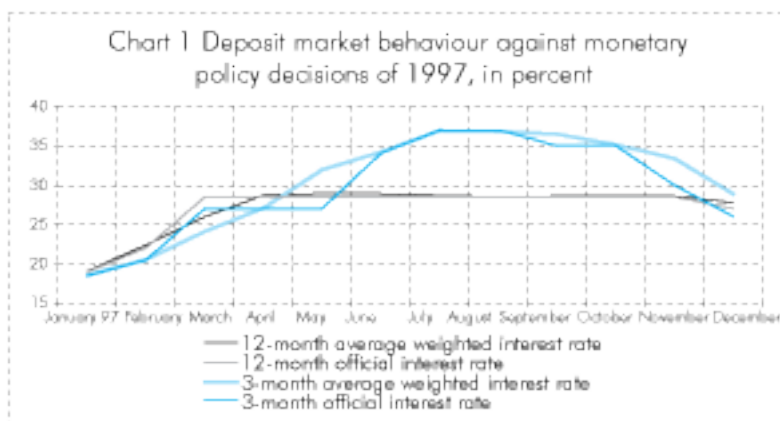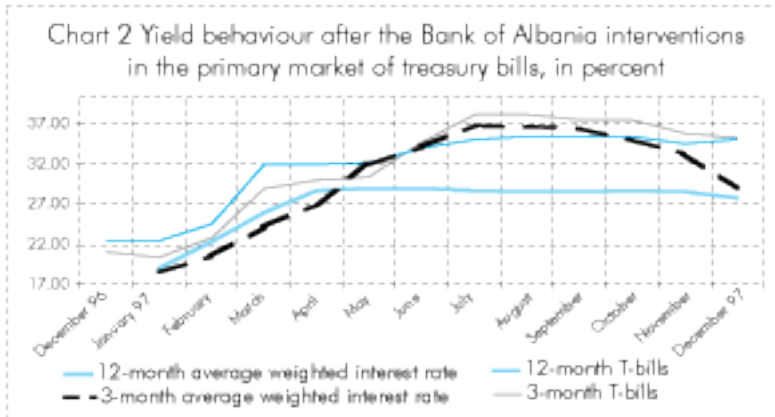

Chart 1 Deposit market behaviour against monetary policy decisions of 1997, in percent

—— 12-month average weighted interest rate
—— 12-month official interest rate
—— 3-month average weighted interest rate
—— 3-month official interest rate

Table 3 Reaction in T-bill market (in percent)

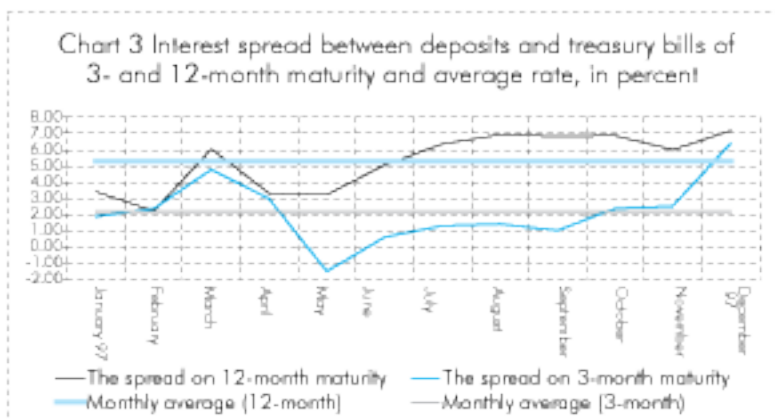|	12-month T-bill yield	3-month T-bill yield
January – March 1997		
Key interest rate change	+9.5	+8.5
Market reaction		
January - March	+9.49	+7.80
January - April	+9.49	+8.92
May - June 1997		
Key interest rate change		+10.0
Market reaction		
May - July		+8.19
September - December 1997		
Key interest rate change	-1.5	-11.0
Market reaction		
September - December	-0.50	-2.92

Unlike the deposit market, the primary market reaction of treasury bills is higher within the period of changing the core rate, indicating a faster transmission of monetary policy tightening to this market. The velocity of deposit market reaction is significantly higher compared to treasury bills' market.

Intertwining these trends under loosened or relaxed circumstance has affected increase of interest spreads by both

Chart 2 Yield behaviour after the Bank of Albania interventions in the primary market of treasury bills, in percent

— 12-month average weighted interest rate   — 12-month T-bills
— - 3-month average weighted interest rate   — 3-month T-bills

markets, respectively. While, the spread between 3-month deposit rates and treasury bill yields is expanded to 4.77 percentage points at the beginning of monetary policy tightening, it demonstrates the same behaviour even during the period of monetary policy mitigation. The flexibility of the monthly average rate is very high this year. Meantime, the spread on 12-month maturity recorded a rising trend, from 3.4 percentage points in January to 7.2 percentage points in December 1997, recoding a monthly average of 5.2 percentage points. The profit margin on this maturity is apparently very high.
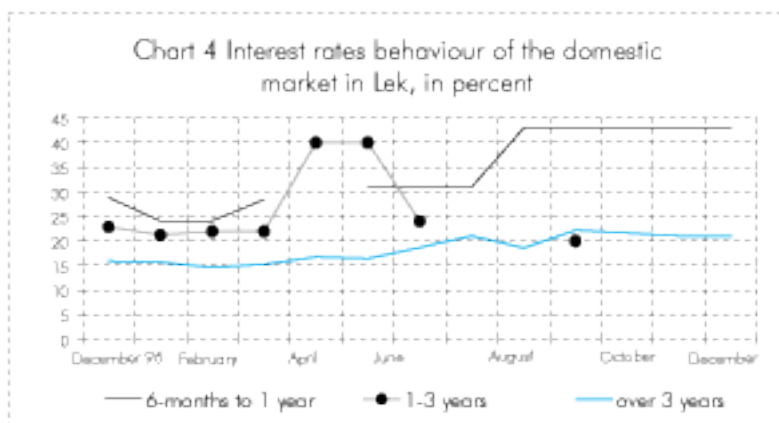
Either the period of monetary policy contraction or alleviation is accompanied with interest spread expansions, disclosing a market with low level of competition and the administrative

Chart 3 Interest spread between deposits and treasury bills of 3- and 12-month maturity and average rate, in percent

—The spread on 12-month maturity   — The spread on 3-month maturity
—Monthly average (12-month)   —Monthly average (3-month)

impact on the level of interest rates by the deposit market, in Lek.

Also, along with the moving spreads on the same maturity in different markets, it is evidenced that profit margin has been higher for long-term maturities against a lower margin on short-term maturities. Maintaining these spreads by profit margin per different maturities comprises unmerited profit for banks, indirectly increasing the budgetary deficit and the domestic debt.

The credit market in Lek displays the same situation, as well. Although the spread between time deposit rates and credit rates, after increasing the deposit rates was high, banks added applicable interests for credits extended in Lek, passing a part of their cost under credit to economy. The applicable interest rate on 6-month to 1-year credits went up from 24 percent in January to 43 percent in December (or 19 percentage points), whereas the applicable interest rate for over 3-year credits extended from 15.7 to 21.02 percent (or 5.32 percentage points).

Chart 4 Interest rates behaviour of the domestic market in Lek, in percent

— 6-months to 1 year   ● 1-3 years   — over 3 years

Higher interest rates on 3-month deposits, compared to the rest of the maturities were accompanied with higher interest rates by short-term maturities, either on the treasury bills or the credit market, dictating a fast increase of the budgetary deficit

and decrease of profit rates for businesses extended for short-term periods.

In general, the Bank of Albania transmission of monetary policy decisions in 1997 is considered fast and complete with one-month lag by all markets and maturities. Interest spreads for the same maturity terms indicate a high fluctuation on one–year maturity during the year. This behaviour indicates banks' propensity to gain high profits, whereas the administrative form of signalizing monetary policy in the deposit market dictates high fluctuation. On the other hand, the Savings Bank dominant position by the deposit market made more difficult the competition of other banks of the system in the play of interests in the primary market of treasury bills and the credit market in Lek.

The second time shock of the banking sector from the unexpected creation of the deposit panic conditioned the Bank of Albania monetary policy decisions in 2002. This situation was accompanied with the extension of the currency outside banks[2], the rise of inflationary pressures[3] and the fluctuation of exchange rates. The created panic among the ranks of depositors created an immediate deficiency of liquidity in the system, which was transmitted by the deposit market, since banks affected by the panic were not disposed of the sufficient liquidity to cover depositor requests in the primary market of treasury bills, as the banking system did not meet the government offered amounts in the primary market[4].

The Bank of Albania intervention was fast and according to a measure plan. In the market, it was utterly intervened with indirect instruments to provide the market with the required liquidity. The Bank of Albania changed the position from liquidity attractor to liquidity injector, enabling weekly injection to the market. Parallel to this, there were used other instruments, such as outright purchases and sales, overnight credit, Lombard facility and monthly Repo(s). Meantime, to increase the cooperation between the banks, the application of overnight deposits was interrupted in the first ten days of April. The primary market of treasury bills

immediately and apparently transmitted the rapid and unexpected shrinkage of the deposits stock by the National Commercial Bank. The market could not fulfil government needs for financing. For the uncovered part of domestic financing, the Bank of Albania extended a direct credit, observing the permitted limits for 2002.

Such market intervention, fulfilling the needs for liquidity, was necessary to guarantee the system stability. For the time ahead, of priority would be the return of the lost public confidence in the banks of the system. The Bank of Albania increased the Repo rate, based on the experience of 1997. The Bank of Albania twice signalized monetary policy tightening to mid-April. Although the Bank of Albania monetary policy signals were tight as in 1997, the comparability of markets' reaction indicates difficulty in some respects. More precisely, interest rates' increase in 2002 was not at the same size with that of 1997 and the transmission of deposit market decisions was indirectly and administratively not obligatory. Other instruments, affecting the level of interest rates and the number of market players had changed. The Bank of Albania monetary policy in 2002 was implemented through indirect instruments only. In the market, there already existed an experience of a market and interbank market oriented corridor of interest rate, although not yet fully formulated.

Chart 5 The Bank of Albania applicable interest rates through indirect instruments, in percent
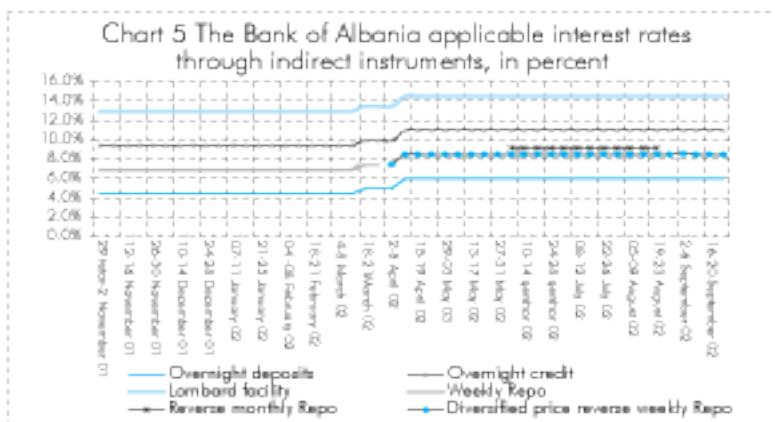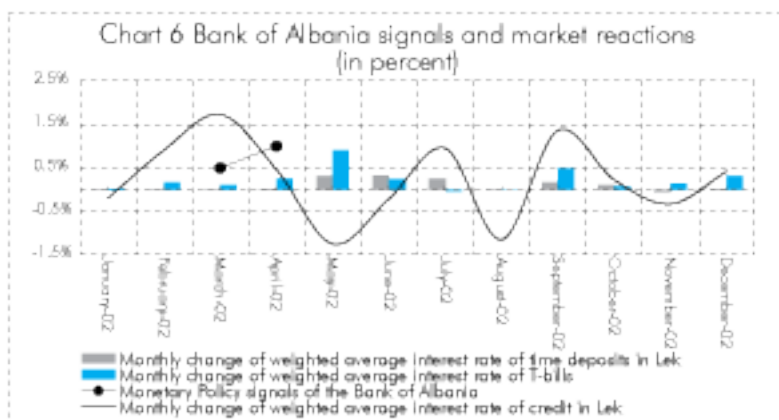
The completely different forms of transmitting monetary policy stance and the flexibility offered by the indirect instruments applied, as compared to the direct ones, dictated another form
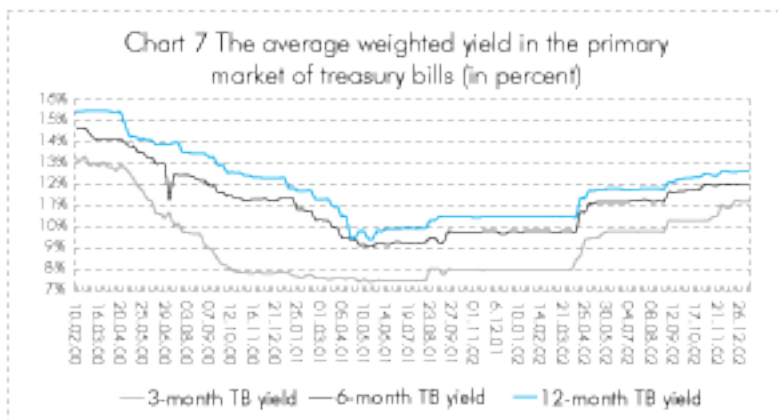
of market behaviour from that of 1997. Meantime, this market demand for liquidity was higher than the supply.

The signalizing of the market for monetary policy contraction, intertwined with the higher budget demand compared to the nominal value of the maturity terms in every auction that took place in the previous year, mainly as a result of non-accomplishment of privatization receipts, affected the acceleration of the increased treasury bills yield for all maturities. Increasing the treasury bills yield was instantaneous, but not complete. Only for April, monetary policy signals were transmitted at 81.3 percent on 12-month treasury bills and at 96.0 percent on 3-month ones. In May, the rise in 3-month maturity exceeded the Bank of Albania increase of core interest rate. The treasury bills yield rise presents their fastest increase for short-term maturities, bringing a flattening of interest rates curve in time, which lasted till August. Generally, within a two-month period, the Bank of Albania managed the full transmission of its monetary policy signal on short-term, 6-month and 12-month treasury bills.

Table 4 Reaction in T-bill market (in percent)

	Repo interest rates	12-month T-bills yield	3-month T-bills yield
March - April 2002			
Key interest rate change	+1.5		
Market reaction			
March - April		+1.22	+1.45
March - May		+1.31	+1.81
March - September		+1.78	+2.31
March - December		+3.21	+2.13

Chart 6 Bank of Albania signals and market reactions (in percent)

Monthly change of weighted average Interest rate of time deposits in Lek
Monthly change of weighted average Interest rate of T-bills
Monetary Policy signals of the Bank of Albania
Monthly change of weighted average Interest rate of credit in Lek

Chart 7 The average weighted yield in the primary market of treasury bills (in percent)

—3-month TB yield —6-month TB yield —12-month TB yield

Treasury bills yields indicated rising trends in September and October, accompanied by stronger increase in September[5]. To the end of the year, the increase of the 12-month treasury bills was two-fold of that of the core rate, whereas the 3-month treasury bills accounted for 1.42 times higher than that of the core rate.

The operation was slower and timely distant from the deposit market in Lek. Banks affected by the phenomenon of deposit withdrawal reacted for the first time in May and at a small percentage. The Savings Bank, increasing the deposit interests to this range, did not deliver the expected effects on broad public reaction. Such a thing dictated a second time interest rate rise in June.

Table 5 Lek deposits market reaction, in percentage points (p/p)

	Repo rates	12-month deposit rate	3-month deposit rate
March - April 2002			
Core interest change	+1.5		
Market reaction			
April		+0.01	+0.06
April-June		+0.88	+0.78
April-July		+0.99	+1.05
April-December		+1.50	+1.07

To the end of July or four months following the delivery of market signals, the deposit market reflected the Bank of Albania signals at a satisfactory level. It is evidenced that the Bank of Albania monetary policy signals to the deposit market

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were transmitted at 66.0 percent on 12- month deposits and 70 percent on 3-month deposits. The Bank of Albania marked full transmission of its monetary policy decisions to the deposit market at the end of the 12- month term or only 8 months later, while it was managed to transmit 71 percent on 3-month deposits.

However, unlike `1997, the spread between deposit rates in Lek and treasury bills yield by respective maturities is apparently lower and demonstrates a small fluctuation. This spread has been steady for the 12- month maturity. Variations of this spread during the year have been generally at lower rates and mainly expanded during the period of monetary policy tightening. In spite of the rising trend throughout the year, it has been moving by narrow rates of 2.7 and 3.3 percentage points, again.

Chart 8 The spread between 3- and 12-month deposit rates and treasury bills yield, and their average rate, in percentage points
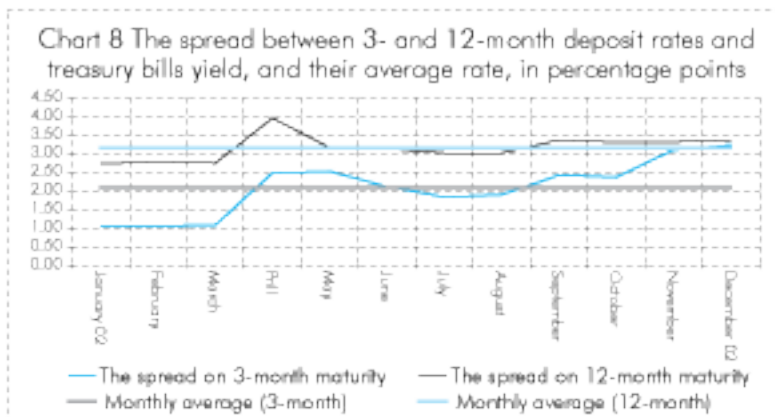
In the meantime, the spread on 3-month maturity is much more expanded compared to 12-month maturity, increasing from 1.06 percentage points in January to 3.23 percentage points in December. Its fluctuations have been higher compared to monthly average rate for 2002, indicating that banks have a tendency to ensure a faster profit under a certain time limit.

The credit market reaction continued to be weak in relation to monetary policy signals. The lack of liquidity in the system was

apparently transmitted to the primary treasury bill market, but did not bear an impact on credit to economy. Besides other factors, such as the changing structure of new credits, the not-so-high competition, and their concentration in foreign currency, mainly, it was conditioned by the fact that banks affected by the shock had a low or an almost zero rate of credits extended in Lek. The transmission at completely different levels of the lack of liquidity to the market was conditioned by a low or an almost zero rate of credits extended in Lek by the banks that were affected by the shock, and also by the fact that 75 percent of credit to economy is in foreign currency.

Empiric assessments of this paper indicate that in the period of monetary policy contraction, markets have got the tendency to have a faster and a higher rate of reaction to profit generating instruments, against more delayed and gradual reaction of cost providing instruments, configuring in the end incomplete and non-uniform reactions, with a different "time sphere".

The transmission of Bank of Albania's monetary policy decisions in 2002 from the viewpoint of percentages of market reaction is later in time than the one realized in 1997. Anyway, as stressed throughout the whole paper, periods are not comparable. The core instrument applied in 2002 did not bear an obligatory administrative character for banks, but signalized the market on the monetary policy stance and each market acts according to free market principles.

Interest rate behaviour in different markets reflected the conditions of each market and the demand-supply level for liquidity. Perhaps, the transmission of market decisions would have been faster and fuller, if the Savings Bank had no dominant position, which though reduced in 2002, constitutes an obstacle for placing all market participants under the same positions.

More precisely in 2002, it was evidenced that this bank was not much interested in high rise of Lek deposit interest rates. Such a thing deferred this bank's reaction, and being the major bank in the deposit market, it impacted on extending the time

for the transmission of monetary policy decisions to the deposit market, in general. Therefore, even in 2002, the competition in this market was not so strong as to make banks more active with respect to the velocity and the size of interest rate rise. This is evidenced as a factor that deteriorated the transmission of monetary policy signals.

The indirect transmission of monetary policy decisions on changing the core rate, intertwined with the use of other instruments that influenced the system's liquidity, has brought about a natural reaction of market rates, indicating improved efficiency, in spite of obstacles. This is reflected in narrowing the spread between deposit rates and treasury bill yields of long-term maturities, from 5.2 percentage points in 1997 to 3.1 percentage points in 2002, while for those of 3-month maturity, this spread has been maintained at the same levels.

Anyway, the improved efficiency of transmitting monetary policy decisions is evidenced in the fact that till the end of 2002 the situation created by deposit panic entirely recovered and the lost confidence in the largest banks of the system was returned. Also, the quantitative targets and the maintaining of price stability were successfully attained. These markets succeeded in transmitting the signals of the Bank of Albania monetary policy decisions.

NOTES

[1] Yields recorded the highest level in August.

[2] March and April were accompanied with a rapid increase of Lek 16.4 billion.

[3] The increase of prices was mainly demonstrated in the level of prices by agricultural products, especially, in the districts of Vlora and Fier, where the phenomenon of deposit withdrawal was more noticeable.

[4] This was an expected phenomenon, as the two banks share included in the deposit withdrawal by the treasury bills portfolio, owned by commercial banks, accounted for nearly 89.9 percent.

[5] Not only as a result of higher increase of the government demand than the market supply but also as a result of the slow regeneration of the liquidity after the massive deposit withdrawals and the cost created by payment of the insurance prime to the Deposit Insurance Agency.

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THE NEW SALARY SYSTEM AT THE BANK OF ALBANIA

*Roland Kajca**

1. INTRODUCTION

This paper dwells on the new salary system of the Bank of Albania. This redesigning outlines in detail the core part of the old salary structure.

The purpose, principles and objectives established by the Bank of Albania Supervisory Council on the salary policy of the Bank of Albania were taken into consideration when designing the new system. The new structure is conceptually based on the theory called "pay for performance".

The new structure managed to:

1. Eliminate at maximum incomes without any work done, presented and accepted.
2. Highly protect and strengthen the rights won by each member of the Bank of Albania's staff, aiming at a full harmonization towards the mutual interests between employees and institution.

The main reason to revise the old salary structure is the continuous orientation given by the Supervisory Council to

design a new salary policy that would take into account the present development rate of Bank of Albania as well as the new realities of the labor market. Various flaws encountered during its application were also a stimulating reason to revise it.

Many of these flaws have been noticed also by foreign advisers to the Human Resources and Legal Department. The recommendations made by them have been reflected in all cases when possible.

The new salary structure established at the Bank of Albania aims at achieving the following goals:

1. Properly appraise the individual efforts and the contribution of the current staff, and link this appraisal with the wage allocated to each one. As a result, competition among staff members and their motivation for a qualified and better professional performance will be higher.[1]
2. Continuously motivate all the staff members and offer them opportunities for a horizontal as well as a vertical career. Everyone would first find itself exactly where he/she can do its best, and second, there will be one more reason to keep everyone interested in staying to work at the Bank of Albania.
3. Keep working with BoA highly skilled and highly qualified employees, through a competitive salary system, being comparable with same or similar job positions of the present labor market.[2]
4. Attract the most skillful specialists in the labor market and then motivate them for their long-term job relationships with the BoA, by offering them employment security, fair compensation and opportunities for professional performance.[3]

2. FLAWS AND PROBLEMS OF THE OLD SALARY STRUCTURE

According to the old salary structure, the general basic salary in the Bank of Albania was composed of the basic salary and some additional elements as illustrated in (Table 1):

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Table 1 Summarized salary table (Basic salary plus bonuses) at the Bank of Albania according to the old structure

Total gross salary →	Gross salary = Basic salary + Bonuses							
Salary components →	Basic salary	Bonuses						
Salary components →	Basic salary	1. Bonus for work experience	2. Bonus for work experience at the Bank of Albania	3. Bonus for department classification	4. Bonus for work performance	5. Bonus for scientific qualification	6. Bonus for job position hardship	7. Bonus for participation in projects
Size of each element →	Depending on work position	0.4% for every year of work experience but not more than 10%	1% for every year of work experience at the Bank but not more than 20%	20% for prime departments, 10% for departments of second importance	Up to 20% for annual work performance	1000 leks for Master degree, 3300 leks for PhD, 3850 leks for Associated Professor, 4400 leks for Professor	10% and 5% for different job positions	Up to 10% for participation in projects

According to this salary structure, all bonuses - at the best case possible - are of a smaller value or equal to the basic salary. However, they hardly reach the level of 50-70% of it. The fourth, fifth and seventh bonuses that concern the job performance are rather insecure. The first, second, third and sixth are automatically received. We underline that only a small number of staff receives the insecure bonuses.

This salary structure has been used for a relatively long period of time and has played an important role in the achievement of the Bank's objectives, but it has not yet succeeded in providing a suitable and differentiated treatment to the Bank's employees.[4]

Albeit interventions and continuous changes, flaws are apparent, some of which might even be considered as essential ones. They are briefly given below with respective arguments.

One obvious flaw of the old salary structure is found in the additional compensation for general work experience (Compensation 1 in Table 1)[5].

First of all, the additional compensation on work experience for a profession different from the one the employee exercises at the BoA, is a non-effective labor cost. It does not present a fair appraisal and reward based on professional skills and qualifications that are essential to the achievement of BoA's objectives.

Here is an example that explains further this point: "Employee X is hired at the BoA as a Human Resources manager. Previously he has worked as a Human Resources manager at a commercial bank, as a financial manager at a private business company, as a book-keeper at a medical institution and as a cashier at the payment department of another commercial bank."

While his experience as Human Resources manager will be helpful to him after being hired at the BoA, the experience gained as a bookkeeper or a cashier would not help him much to perform better in the BoA. Therefore the experience as Human Resources manager should be evaluated as an element related to his job position at the BoA and should be taken into consideration in the analysis of that job position. Since the rest of his work experience is not classified as helpful for a high performance in the BoA, it should not be taken into consideration.

Second, the work experience in the old salary structure is treated as an external motivator and not as an internal one. Meanwhile, real motivators are only the internal ones. Therefore, the external motivators must be turned into internal ones, whenever possible.

Thus, the additional pay taken from such an experience is given "for free" - there was no need to demonstrate any value or work of any kind. Referring to Herzberg's "Dual Factor" Theory, if one gets part of his salary for free (as it occurs with the pay increase because of overall work experience or experience in

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the bank), this could lead to job dissatisfaction (extrinsic factor) and not to job satisfaction (intrinsic factor).

On the contrary, if the work experience is considered part of the job content, for example as an element taken into account in the analysis of a job position and as a criterion for promotion, there will be a new view of motivation. In the second case, this would be converted into and classified as an authentic motivation.

The second flaw of the salary structure in question is found in the additional compensation based on the results of work performance.

These compensations, according to the old salary structure, are given by the Governor based on the propositions made by immediate supervisors and other senior officials of the Bank. Given the large number of the Bank of Albania's employees and the fact that these compensations are allocated based on everyday work, such a method cannot be so efficient. This is due to the fact that the Bank of Albania's senior officials are, first of all, responsible to achieve the Bank's institutional (not departmental) objectives and to guide all the Bank's operations in an unstable environment, such as in the Albanian case. Therefore they should focus on the allocation and the management of all the Bank's resources and delegate more authority to lower management levels.

Allocating the employee's rewards on work performance through delegating the right to managers in charge of departments is one opportunity of giving more authority to the respective managers. In this way, they will become more motivated to determine departmental objectives - arising from institutional objectives - as well as to charge duties to their staff and evaluate properly their efforts for the accomplishment of these duties.

The third flaw of the old salary structure is that it does not provide any chances for a horizontal career, forbidding thus (or even putting at disadvantage), above all, an adequate motivation

of the skilled human resources, which, due to the limited real opportunities for promotion, do not have any chances for a vertical promotion.

In more concrete terms, certain members of the staff, according to the old salary structure, were entitled to a direct pay increase based on their overall work experience and experience in the bank. No matter what the job performance was, one was still entitled to such a right.

If we were to make just a superficial analysis of the whole situation, it would be quite evident that a horizontal career is provided to everyone and no criteria are required thereof. It is enough for an employee to have been paid for a certain period somewhere or in the Bank.

However, a thorough analysis would bring forth the fact that the career we are talking about does neither rely on nor is it explicitly supported by any specific form. It is not difficult to understand that because you have been paid somewhere that does not stand for a virtue to serve as a criterion for a direct annual pay increase. It generates no incomes and it does not affect, in any way, other income sources from which one can get what is paid to the employee. In the same way, formally, it does not help bring incomes to the institution.

In fact, this income is practically considered - under a certain light - as worthless. Accordingly, it is not motivating or it could be even a harming one. This pay increase goes both to the one who has had a high performance and the one of a lower performance and who is not as committed as the first one.

No doubt that such a reward system provides everything but encouragement to the hard-workers, setting thus an unpleasant environment of equality.

This income would make perfect sense only if classified as a social element of salary. In other words, when salaries are very low, additional pay components are provided, so as to justify

their increase at a higher acceptable level. And in such a case, it would make sense. However, salaries at the Bank of Albania are far from being either of a social nature or low. And therefore, there is no reason why such an income should be applied.

Hence, general work experience does not have any value with regard to what we are discussing about. They may be taken into consideration only if associated with other job components (which add new value), however, aiming simply at offering another chance to benefit by comparing everyone's work with that of the others.

A total different meaning must be attached to this increase, which could serve as a powerful lever for the benefit of the institution and people who are interested. First of all, it should aim at: upgrading research works in the bank (being ever more dominant in a central bank); providing real opportunities and impulses to research development oriented people, and enabling a bigger inflow of such skilled human resources from the respective labor market.

The fourth flaw of the existing salary structure is the meaning and evaluation made on the pay increase to the staff members having a scientific qualification.

The old salary structure provided a material reward for the scientific qualification, though symbolic. The sum cash awards benefited is far from being encouraging. In addition, the meaning attached to them does not help a central bank's job.

A fifth flaw (inherited and which stands out even in several recent surveys) of the old salary structure would be the lack of a full regular vertical line in the salary system as well as the relatively low salaries of above positions in particular compared to the same or similar positions in today's labor market.

If we were to draw a comparison between salaries of various managerial positions at the Bank of Albania with those of the same or similar positions outside, however comparable

environments to the Bank of Albania, the differences would put at a disadvantage the Bank of Albania's managers. In fact, it should be the other way round, since the Bank of Albania, apart from being a unique and constitutional institution, is also very important with regard to the object of its activity or the objectives to be achieved.

The Bank of Albania licenses, supervises and examines all commercial banks. Besides this fact, senior staffs of these banks have higher incomes than their counterparts at the Bank of Albania. As a rule, the opposite would be acceptable.

The sixth flaw is the lack of an accurate and full classification of job positions at the Bank of Albania. Such a classification would provide a more accurate allocation of respective incomes in the form of pay rise.

A strange and quite unjustifiable paradox stands out in the old salary structure as far as job classification and relevant pay per job position is concerned. On one hand, there is a unification of those job positions bearing all the central bank's work load (and evidently there is a unification of respective salaries). On the other hand, there are "infinite" job positions of the same or similar importance they represent in accomplishing a central bank's objectives - and what is more, they are not to be compared to the earlier ones - that are treated differently at salary levels. In other words, all the bank's officers (the ones who really perform the day-to-day operations of the bank) are given an equal basic salary no matter the job description they have (being different according to the department profile). Nevertheless, maintenance staff (according to the job description), drivers or even cleaners - being either in the central administration or in the branches - are given a different basic salary.

Being rather more explicit, there is a differentiation for the earlier ones (department classification), in the old salary structure. Certainly, this is not enough to the today's development level of the Bank of Albania, let alone to its near future (considering the Bank's mid-term commitments). Furthermore, it does not

depend on the employee's job description but on the structure he is a member of.

Worth mentioning is the fact that there are almost no criteria under which the present classification takes shape or they are not sufficient to draw adequate conclusions.

Job development level at the Bank of Albania calls for a new classification concept that should change the above-mentioned situation. A thorough classification, which allows for several evaluation criteria (eight from the maximum, two used in the old classification), is being processed and hopefully it will be soon implemented.

3. WHAT WILL BE THE SALARY SCHEME FOLLOWING ITS RESTRUCTURING?

The comprehensive restructuring of the salary system is deemed to be carried out in two stages. This would then depend on working out the above-mentioned problems and on establishing a more flexible system than the previous one.

The final model reflects a lower basic salary and compensation program closely biased by certain work components, recognized as important to enable relevant compensations. According to this model, the overall gross salary has a smaller, secure salary portion and a higher insecure portion (this depends on performance ratings). More specifically, the weight of basic salary and secure compensations will decrease, while the weight of insecure compensations will be increasing. Let us see this transformation in detail:

According to the old salary structure:

Gross salary = Basic salary + bonuses

Basic salary is a fixed amount.

Bonuses in most cases are a fixed amount, not based on performance rating

The same structure will be applied to the new one.

The salary scheme according to the old structure is presented as follows (Scheme 1)[6]:

Scheme 1. Old salary structure at the Bank of Albania.

Gross salary	=	Basic salary	+	Bonuses

From the above scheme, we notice a bigger weight of basic salary in the gross salary (compared to the rest) and the low weight of compensations over it. We recall that all compensations are secure expect one (the performance rating) which is applicable only to a limited number of staff. Relying on the statistical data of the recent years, this compensation bears quite an insignificant weight on the overall salary.

Referring to the new model, the structure now is overturned (i.e. the weight of its components). This is reflected in the following scheme (Scheme 2):

Scheme 2. New salary structure proposed by the Bank of Albania.

Gross salary	=	Basic salary	+	Bonuses

Basic salary is a fixed amount, but ever smaller.

Bonus – is an ever less fixed amount, strongly based on performance rating, bearing thus an ever significant weight on gross salary.

The structure of bonuses is also subject to changes. According to the old structure, bonuses were programmed as follows (Scheme 3):

Scheme 3. Structure aof bonuses on salary and their respective weight in the old model.

Bonuses	=	Secure bonuses	+	Insecure bonuses

From the above scheme, we notice the considerable weight of secure bonuses and the low weight of the insecure ones (practically quite insignificant) based on performance rating.

However, the new structure of bonuses is as follows (Scheme 4):

Scheme 4. Structure of bonuses on salary and their respective weight in the new model.

Bonuses	=	Secure bonuses	+	Partially secure bonuses	+	Insecure bonuses (depending on work performance)

An overturn of the old structure occurs here, too. The weight of the secure bonuses goes down, whereas the weight of insecure ones and performance rating goes up.

Hence, we might say that the basic salary and bonuses ratios are overthrown in the new structure.

And most important, there is an overhaul of the total salary; a downsizing of its secure component and an upgrade of the insecure components based on performance rating.

A diagram of the final structure would be the following (Table 2)[7]:

Table 2 The new salary structure at the Bank of Albania

Total gross salary →	Gross salary = Basic salary + Bonuses							
Salary components →	Basic salary	Bonuses						
Salary components →	Basic salary	1. Bonus for job classification	2. Bonus for job category	3. Bonus for work performance (all employees excluding managers)	4. Bonus for managerial positions (based on work performance and for managers only)	5. Bonus for work performance (for all employees having university degree)	6. Bonus for scientific qualification	7. Bonus for participation in projects, research and activities
Size of each element →	Depending on work position	In process (not in the implementation phase yet)	Depending on the category and basic salary	Up to 20%	0-20% (excluding administrators)	In process (not in the implementation phase yet)	Similar to the old structure (however to be changed)	Up to 10% for participation in projects

According to the above scheme, apart from the reduction of the size and weight of the basic salary in absolute value, there will be an increase of bonuses (to be around 150% and more over the basic salary), and there will be only one secure compensation (job classification bonus), a partially secure bonus that shall be benefited in the same way as the insecure bonuses (category bonus), and five other insecure bonuses. The last six bonuses depend on performance rating.

Most of the new structure is already under implementation. Meanwhile, its second stage is still under process at least from structural outlook, and it aims at giving the new structure its final shape.

4. THE HIGHLIGHTS OF THE NEW SALARY MODEL

The highlights of the new pay model focus on a new classification, leading to the salary structure overhaul and to the proper structure itself.

The salary structure overhaul was first preceded by a classification and realignment of positions and their respective basic salaries. The realignment served only to the structure overhaul. In this context, all the positions were classified under classes, groups and levels. This realignment is the first highlight of the new pay model.

The introduction of class, group and level concepts is made for identification and classification purposes. In the old structure, there was a vertical classification of positions, without providing any single name to a certain number of them while they were given the same basic salary or its other components.

In order to make the identification of same position alignments easier (as to their importance), the "class" concept was introduced. This is a widely used concept for such purposes even in other structures (the present classification in the Albanian public administration is an example of this). Class concept in the new structure stands for one or more positions of the same importance at the Bank of Albania. Class is a vertical classification of job positions. It is related to the basic material evaluation (basic salary) or other evaluations made to the positions or the respective position group.

There are ten classes in the new structure. Eight of them already existed, though not identified through this concept (however, they can be easily identified if paying attention to salaries given according to the old structure). The last two are realignments of the remaining positions of the same type (in total 20 basic salary levels), and they are related to auxiliary activities at the Bank of Albania.

These two classes were divided into 5 groups (vertical subdivision) considering the variety and the big number of auxiliary positions (for this matter even those which are not regarded as crucial for a central bank), as well as their relevant classification (spotted only through the basic salary). This realignment enabled the shifting from 20 basic salary levels of this type to only 5 of them. This quantity justifies also their low significance among all sorts of jobs that are performed in a central bank. Nevertheless, a further reduction of them is not to be excluded.

The introduction of class concept makes the introduction of categories[8] easier. Categories outline a new career style (horizontal career) at the Bank of Albania. This career was not in the old salary structure.

Each class is named either based on the highest position included in it or on the most outstanding features of the job that allows classification.

Thus, the basic salary of all employees is linked to classes and groups. Each class (with no groups) and each group (when available) has a definite basic salary, different from the rest.

A vertical (macro) division is found in the level concept. Different positions are classified under the same level. Though they cannot be classified under a class or group, they do have many features in common that make them stand out in the group from other classifications. For instance, there are many elements that bring about differences between the position of the "Governor" and that of the "Deputy Governor". However, compared to all positions in the Bank of Albania, what links them is much stronger than what sets them apart. Therefore, in many cases these positions are identified under a single term (administrators). The same logic would apply to other groups. "Directors of Departments" and "Deputy Directors" have almost the same authority in managing departments. Also, the elements in common are much stronger than what sets them apart, compared to other groups above and below them. They

stand prominently out of all lower positions. However, they do not have any of the administrators' qualitative features, and consequently cannot be classified under the same level.

In the new structure, there are five (vertical) job position levels. There are two classes in each level.

Levels were mainly introduced - as it was the case of classes or groups -to treat constituent classes of one or each of them as a whole in order to achieve specific objectives of the new salary structure.

The three above-mentioned concepts suggest a vertical division of positions. Thus, they provide the ground for a vertical career at the Bank of Albania. However, this is not possible to all. The higher the hierarchy one wants to reach, the more difficult the climb. The reasons are easily understandable, since there cannot be three directors and eight deputy directors in one department. The job description itself does not permit such a thing.

The introduction of category is thus the second highlight of the new structure. Actually, this is an adoption of a concept under the new organizational structure in the Bank of Albania and not the introduction of a new concept. This is a well-known concept widely recognized by various organizations.

Category is a division or a classification applicable to every position. It allows salary increase after certain periods of time, based on work experience and more particularly, on performance rating. Once one gets the category, the respective salary increase is given through the bonus under the same name. Meanwhile, in case of poor performance, there shall be a downfall in categories or even declassification in any of them.

Such a division eliminates the two aforementioned bonuses (according to the old salary structure) - the one for general work experience and the other for bank work experience. The category is a horizontal division of each class (or group). As such, it does

not offer particular promotion in responsibilities (as it is the case of vertical career); however, it offers professional promotion.

The reason why category concept was introduced is a multiplex one:

- Category excludes totally the two aforementioned bonuses, given for free. Thus, classification turns out to be a real motivation. Nevertheless, attention has been paid to the fact that the sum cash awards benefited from classification should reach almost the same or similar value of what was benefited from the two excluded bonuses. Consequently, the same cash award is not offered for free, but against the work done. This practice is far from being based on the conception of old structure, when this sum cash awards is considered as non-effective cost or as only reducing dissatisfaction.
- Introduction of categories gives space to another type of career that is the horizontal one. This may very well serve as a motivation to stay at (or to approach) the Bank of Albania for all those people who are productive in their job positions.
- The performance condition - set in order to move to a higher category - will stimulate work at all levels. No good performance, no move to a higher category.

Introduction of categories offers an additional right, not only to a certain group of people but also to the Bank of Albania's whole staff. This is the right to make career. The only qualitative criterion of which is: high performance. This reflects also a commitment of the Bank of Albania to upgrading and consolidating opportunities for the development of staff skills.

There is a higher flexibility of the salary system, by "breaking it up" according to performance rating. Hence, we get the salary system overhaul based on the "pay for performance" requirements.

The following diagram presents the new structure and correspondence among levels, classes, groups and categories (Table 3)[9]:

Table 3 Relation between levels, classes and groups in the new salary structure at the Bank of Albania

Level	Class	Group	Categories							
Top management level	Class I	No							1	2
	Class II	No							1	2
Low management level	Class III	No					1	2	3	4
	Class IV	No					1	2	3	4
Professional service level	Class V	No			1	2	3	4	5	6
	Class VI	No	1	2	3	4	5	6	7	8
General service level	Class VII	Group A	1	2	3	4	5	6	7	
		Group B	1	2	3	4	5	6	7	
	Class VIII	Group A	1	2	3	4	5	6	7	
		Group B	1	2	3	4	5	6	7	
		Group C	1	2	3	4	5	6	7	

The third highlight of the new model is only a "return to the origin". This has to do with the reintroduction of the "chief officer" position. The main reason of the introduction of such a position is to offer more opportunities for a vertical career (besides the horizontal one) to those who do not have chances to be nominated in managerial positions and/or have significant professional skills. Another reason of the introduction of this position is also the fact that in departments with a large number of employees it may be necessary to make a rather more detailed classification of staff members depending on the tasks assigned to them.

The three outlined highlights were related to the re-configuration of classification leading to salary system overhaul. The following ones, however, relate to the structure itself.

As we explained above, the salary scheme is the same as the one in the old structure: basic salary plus bonuses. The new structure, however, taking into account mainly the Bank of Albania's environment development or the obligation to accomplish at best duties and responsibilities, (a) reduces the basic salary levels, and (b) eliminates, re-designs or changes bonuses.

In the old structure, there were in total 28 basic salary levels, and bonuses were then added to them.

- (1) General work experience;
- (2) Work experience in the Bank;
- (3) Department classification (or division);
- (4) Job performance;
- (5) Scientific qualification;
- (6) Job position hardship;
- (7) Participation in projects.

The gross salary according to the new structure is made of the basic salary plus the following bonuses (Table 2):

- (1) Job position classification;
- (2) Job category;
- (3) Job performance;
- (4) Management level;
- (5) Job performance (different from the above one);
- (6) Scientific qualification;
- (7) Participation in projects, research works, and activities.

Only the first bonus from all the above ones in the new structure is not based on performance rating, while all the others, in one way or another, are decisively based on it. Hence, we get the salary system overhaul according to the "pay for performance" concept.

We will now briefly dwell upon each of them.

(1) Bonus on job classification is not implemented yet and is still under process. This bonus is based on the classification of all positions at the Bank of Albania, according to the scores one gets in eight criteria considered as adequate to make this classification. This classification includes and substitutes (by entirely improving them) the two bonuses of the old structure: the department classification bonus and general work experience bonus. Such a bonus is a fixed amount and calculated based on the scores of each position. There is a possibility that this bonus

might suppress completely the basic salary and serve itself as a primary criterion in determining the basic salary.

(2) Bonus on job category is the second new bonus, already implemented. This bonus substitutes the two bonuses of the old structure that were obtained naturally and for free. The substitution of these bonuses was actually one of the main problems to be faced with when designing the new structure, since they had quite a considerable weight in the old structure. The bonus on category is a fixed amount for each category, and different categories have different amounts. This bonus is based on job performance.

(3) Bonus on job performance and others of the same nature have undergone significant changes, and their explanations deserve a separate paper. The amount is flexible. The benefited sum for a certain period of time depends only on performance. Below you may just have a brief outline, since it will be dwelt upon in a separate paper.

First, this bonus has a different "content". The content is rather more simplified and straightforward, giving more explicitly and correctly what is going to be achieved. Thus, criteria and requirements to benefit this bonus are divided into two groups. Also, two forms are provided: one for university graduated employees and one for the maintenance staff.

Second, this bonus has a different managing "owner". Under the old structure, this was given by the Governor based on the suggestions made by the heads of departments (direct supervisors). However, under the new structure this is given by the heads of departments themselves (or units of the same levels). The latter have the full authority to determine the bonus amount based mainly on the accomplishment of the work schedule for the performance evaluation period, as well as on other elements included in the form.

Third, this bonus has a new "target". Under the old structure, this bonus was applied to university graduated employees only,

whereas under the new one, it applies to the maintenance staff, too.

Fourth, this bonus has a new "validation period". Under the old structure, it was officially repeated once in twelve months. However, under the new one, it is repeated every six months (the tendency is to actually apply it every month). The purpose is quite simple: anticipate the reflection period when poor performance is observed.

(4) Bonus on managerial levels is a new bonus applied for the first time. It is addressed to all levels of management at the Bank of Albania. This bonus is given by the Governor, in cooperation with administrators, and it is based on work quality. The amount is flexible and based only on performance.

Two were the main reasons for its application.

I. The first is the enlargement of the spectrum of the employees that are entitled to bonus on job performance, from which they are excluded. This seems quite moot as the arguments thereof do not seem to be exclusive (exclusive arguments are those arguments to which one cannot respond with counterarguments of the same qualitative level).

II. The second is the necessary equal consideration of the decentralization put forth as far as bonus on job performance is concerned. It is a matter of delegating to the heads of departments the right to approve it. Such a configuration is more than indispensable to particularly stop the behavior of a manager, who plays the "good one" at the expense of work. Upon verification of such a case, the Governor may penalize/criticize him according to his abusive behavior.

(5) Bonus on performance (different from the above) is a new bonus under process. This bonus shall aim at evaluating the performance of a macro level (under the objectives and tasks of the Bank of Albania). It will be different from the two above-mentioned ones as far as the object of work set to benefit it is in

place. Meanwhile, like the two other bonuses, it will be a fixed amount and will be based only on performance.

(6) Bonus on scientific qualification. There is a diversity of ideas about this bonus and its concept. For the time, the amounts determined by the Supervisory Council decision No. 03, dated 19.01.2000, are still in force. The amounts are fixed and based on performance.

(7) Bonus on participation in projects, research works, and activities. This bonus is the existing one; however, it is designed to better specify its purpose. Thus, its new concept does not limit the variety of activities, which for diverse reasons are not named under the word "projects" (the only name that enabled this bonus). Consequently, every staff member working on a research/study, conference or activities (no matter under what name) that require overtime work (beyond the daily eight-hour) for more than a month, and presenting a specific interest for the institution may obtain this bonus. The purpose it was designed is thus preserved and not restricted to potential interpretations. At the same time, it expands the spectrum of people who can benefit it without putting restrictions with regard to the form, presentation or formal name of the work that enables this benefit. This bonus is also a fixed amount, and it is benefited against the work done.

In the present stage of implementation of the new salary structure, an eighth bonus is also to be applied, called bonus on maintaining the same level of the present salary. This bonus has a purely technical character; however, it is believed to be eliminated once the final model of the new salary structure is approved. The purpose why this was introduced was to equilibrate some aspects of the present stage of implementation of the new salary structure.

5. CONCLUSIONS AND OBJECTIVES

As a conclusion, we might say that the final model of the new salary structure allows achievement in practice of the objective

undertaken. It designs and breaks up the salary based on job performance, as well as on the value attached to each job position in a central bank's hierarchy.

In the future, it's up to us to better arrange the relationship between the basic salary and bonuses, by reducing as much as possible the social part of it "at the expense" of the part based on performance. This fact allows a better and accurate connection of the work done with the salary. By reducing the amount of the secure salary and raising the amount benefited from bonuses (that must be ever more based on traceable objectives of work), there will be a higher commitment to perform a quality work and a higher psychological value of the money benefited through work, too.

A full vertical structure of the salary model remains another task to be fulfilled. This will be done according to the importance attached to each job position in the Bank of Albania's hierarchy and to the pay offered to each of them in the today's labor market. However, the vertical structure we have today is not complete, compared to the respective salary market. Salaries of various managerial positions at the Bank of Albania are lower than those of the same or similar positions outside, however comparable environments to the Bank of Albania. And this non-compliance becomes stronger the higher we go in the hierarchy.

The vertical structure is improved in the new structure. Nevertheless, giving the dynamics of the environment, where comparisons may be drawn, it will continue to be under our focus in the future.

The new salary structure will be based on a compensation system that will aim more and more to a performance driven pay.

NOTES

* Roland Kajca, Head of Division, Legal and Human Resources Department. Mr. Artur Lama and Ms. Eralda Dume have rendered their assistance in preparing and presenting this material for publication.

[1] Taken from recommendations of Mr. David L. Schannon and Mr. Iain Thomson, former advisors of human resources at the Bank of f Albania, sent by the FSVC to assist the Bank of Albania in relation with the development of human resources strategy in the Bank.

[2] Taken from recommendations of foreign advisors.

[3] Recommendations of foreign advisors.

[4] Recommendations of foreign advisors.

[5] The first and second flaw have been taken from recommendations of Mr. David L. Schannon and Mr. Iain Thomson.

[6] In all schemes the size of quadrates almost matches with the share of each component.

[7] Each element of the new structure will be further detailed. The new structure is only partly being implemented.

[8] This concept will be further detailed.

[9] The presentation of categories indicates roughly the time period which conditions the move from one category to the other. It is noticed that the higher one gets vertically (the more vertical career) the fewer are the possibilities to have a horizontal career. During the discussions on the application of categories it was decided that this model be used compared to another which allowed equal career both vertical and horizontal for all job positions. The main reason was that horizontal career as a concept was also introduced as an opportunity or the right to have a career for those employees who could not have a vertical career. The adoption of the other model did not consider this aspect.

BANK OF ALBANIA HEAD OFFICE BUILDING, TIRANA

Niko Shtrepi*

OVERVIEW

Upon the consolidation of the new Albanian state in '20 -'30s, along with the urban planning of cities, particularly of Tirana, the organization and development of public administration started to be applied according to most advanced models of Western Europe.

From this viewpoint, even the Albanian banking system started to be conceived and framed according to the financial model of the Western countries, so as to be ready to precede the financial relations that had arisen and changed rapidly in the state that had won the independence a few years ago. During this period the first banks were built in the main cities of the country, such as in Durrës, Vlorë, Korçë, Elbasan, etc. Such buildings, with their striking architecture and urban position in the very centre of the city, remain to this day the most perfect works in the area of architecture and administrative construction.

From this viewpoint, it was deemed appropriate to locate even the Bank of Albania head office building, due to its importance in the financial and banking system, as a central bank, in the buildings that would format the central square of our capital,

Tirana. The Bank of Albania's building is included in a well-studied urban plan, due to its location. The difference of the Bank's facade from the other buildings of Kavaja street points out the urban environmental variety at the entrance of the central square of the capital, presenting a very important administrative construction.

The building construction terminated in 1938. Vittorio Ballio Morpurgo, a famous Italian architect of that time, designed the building plan. Its architectonic style corresponds to "Rationalism", a trend which flourished in Europe during the first half of the previous century.

This style is distinguished for its enormous volumes and strong lines in the facade. It has been mostly applied in governmental buildings, aiming at expressing the strength and power of Western governments of that time. In this respect, even the Bank of Albania's building is one of the memorable buildings of its kind, at that period.

AN OVERVIEW ON RATIONALISM IN ARCHITECTURE

After the World War I, Europe had to face big problems in reconstruction, accompanied by a demographic boom and, consequently, by a large demand for housing. Therefore, "Protorationalism", which until that time was dedicated to the solution of abstract aesthetic problems, emerged. During this period, representatives of this trend started to deal with the solution of practical problems of production in series, of usage of new construction materials, prefabricated ones, in order to provide competitive and economically advantageous products. This was also the beginning of real "Rationalism", being defined as the rational use of environment based on available resources.

The first experiment in these new architectonic forms, which introduced structural components of glass, steel and concrete, began in industrial constructions and had as a first protagonist Walter Gropius, who was educated at Protorationalist School

of architect P. Behrens. In 1919 Gropius established in Waimar "BAUHAUS", on the basis of rationalist experiences, a school of architecture and applied arts, which not only gathered the famous intellectuals and artists of this epoch such as Kandisky and Klee, but also established the basis of modern design and a center of debate on architecture.

The utopists and architects of abstract architecture such as Tatlin, the neoplasticists such as Rietveld, and the painters represented by Malevic and Mondrian were influenced by the study of formal perfection, chromatic balancing and abstract composition.

Bauhaus participated with much success in prestigious exhibitions of the time, among which "Werkbund" in Stuttgart in 1927, where all rationalists projected the prototype area of future way of living. For the first time the projects of the futurist Sant Wlia were executed, from which complete premises of modern comfort emerged.

The rationalists' ideas through German avanguardists influenced even the Russian architecture of that time (after the October Revolution).

The rationalists' ideas still survived and succeeded in being executed even by Le Corbusier, the famous representative of this architectonic period, who was trained in Bauhaus and who initially was completely a utopist, then he was distinguished as a consequent developer of methodological programs of design.

While Adolf Hitler regards the brilliant experiments of rationalists as a degeneration of art, in Italy the opposite takes place. Upon Mussolini's rise to power, architecture and its developments are put under control. Mussolini launches the thesis that Fascism is a house of glass, where everything is transparent, and on the basis of this principle, almost all the existing architectonic trends enter into competition to select and provide development opportunities to that trend that represents at best his ideas.

For Mussolini the awakening of conscience on golden-years Rome and the construction of a new glorious society on the basis of this bright period were of importance.

In this spirit, it is worth mentioning the establishment of Gruppo 7 in Italy in that period, which was created as a reaction against "Academism". This group, being oriented toward two important epochs of art, antiquity and renaissance, carried out the actualization process with the modern world architecture.

This ethic and aesthetic philosophy is almost the same as Mussolini's ideological philosophy; therefore the modern fascist movement emerged in Italy, which, by absorbing the necessity of something new, ceased from having relationships with former artistic movements regarded as chaotic, was oriented to golden historical periods of Italy and sought the right of absolutism based on totalitarism and universalism. It was accepted immediately by Fascism.

In Casa del Fascio the whole program of the movement is materialized, and it is regarded as the highest stage of the civilization process. Giuseppe Terragni represents and leads the Italian modern trend based on rational architecture. They incorporate the materialization of an individual (Mussolini) with the ideology solidified by matter. Everything is underlined by monumentality and ignorance, by personal incomprehensibility as human individuals connected to ideological system.

BANK OF ALBANIA HEAD OFFICE BUILDING

The location of this building of Rationalism times in the central square of Tirana, with the name of "Skenderbej", our famous warrior of the Middle Ages, has fully justified the respect of the citizens of Tirana and all Albanians.

The building was conceived on a polygonal plan, split in two functional sides: the main arched building, where the Bank's representative function would be exercised and its operating

part. The latter would be constructed on both sides and on the backside of the main building, but its construction was interrupted by the outbreak of the World War II.

The main building structure has been set up in the form of an arch, constrained by its location in the main square of the city. Its main entrance includes a grand portal, supported by strong columns, involving the entire height of the facade and decorated by baked clay mural bas-reliefs in its typical colour, giving the building a very dignified appearance, on the whole. In the organization and operation of the Bank of Albania, the two parts of the building were supposed to be accompanied by an apartment building for the Bank's employees. Its location was planned to be as close as possible to the Bank.

According to the urban study of those years, it was planned that this building, whose the project was designed by Morpurgo, the same architect, would be constructed next to the Albanian Parliament (now the Puppet Theater).

CURRENT SITUATION

Currently, the head office of the Bank of Albania consists of its main building in the form of an arch and two small annexed premises (to be pulled down after reconstruction), being constructed in various subsequent periods to face the increased number of the employed staff.

The big changes that occurred in the beginning of 90s imposed the establishment of prestigious democratic institutions, one of which was the central bank of the country. Therefore, in April 1992, the Bank of Albania was created, to which, just like its sisters all over the world, reliable functions were entrusted for the economic and financial development of the country.

Along with the issuing of the national currency, the Bank of Albania enjoys other privileges, among which the more highlighted are the planning and implementation of monetary

policy and the banking system supervision. Regardless of the above, what is more remarkable is just the fact that over the years the Bank of Albania has been growing professionally, and it is not an exaggeration if one would state that nowadays this institution is one of the avant-garde centres of economic thought and research.

Due to the specific conditions of big restrictions in the area we are facing today, it results that the Bank's daily activity is being faced artificial obstacles, which are impacting, in one way or another, on the Bank of Albania performance. Generalizing the consequences, we would mention:

1 The building, with its existing total area, cannot afford the activity carried out by the central bank.
2 The existing building is amortized, physically almost in all its architectonic elements (mainly in the refining of internal premises), and morally and physically in its installation elements (conditioning-ventilation, information technology, functional system of power supply, etc.).
3 It cannot afford the increased number of employees and the creation of necessary conditions to conduct the Bank's activity according to a typology of updated internal infrastructure.
4 It does not ensure a security level in accordance with the requirements of the time, in certain premises in particular and in the whole building in general.

To solve the above problems, the Bank of Albania, along with the reconstruction of the existing building, has decided to construct a new building as close as possible to the existing one (65 years old).

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BANK OF ALBANIA TRANSPARENCY

Sofika Note*

1. INTRODUCTION

Over the last decade, a tendency of the central banks to be more and more accessible to the public regarding the work and decision-making process is noticeably frequent. Transparency is becoming an essential issue of the central banking, whose importance on the monetary policy is a subject broadly treated in the academic literature of the central banks. It takes on further importance, especially in terms of implementing the inflation targeting. Transparency is broadly considered important for the monetary policy in two main directions: the increase of accountability and efficiency of the monetary policy. However, attention should be given at all times to transparency, so as to avoid its becoming a goal in itself. Transparency is and should remain a means in achieving the final monetary policy target.

Over the last years, the Bank of Albania has estimated the importance of transparency on the monetary policy and has paid attention to the work for improving its level. This paper presents an estimation of the transparency level of the Bank of Albania today, compared to the other central banks and the transparency level of the Bank itself before 1997. This is performed through a transparency index, similar to the independence indexes.

This index shows a considerable increase of transparency for the Bank of Albania compared to the period prior to 1997, and a relatively high level, 8.5 from a total of 15, compared to the other central banks, taking into account the economic development and the financial system standards in Albania.

The paper is structured in the following way: the second section deals with the importance of transparency for the central bank, while the third section deals with the definition of transparency. The fourth section suggests the transparency index calculation for the Bank of Albania. The fifth section deals with the public understanding in Albania, as an important dimension of transparency and the role of mediators in transmitting the information. Finally, the conclusions are given in the sixth section.

2. TRANSPARENCY IMPORTANCE

The economists broadly support the opinion that transparency is important to central banks, for two reasons: the increase of its accountability regarding the independence and the monetary policy efficiency.

2.1 TRANSPARENCY AND ACCOUNTABILITY

Transparency is a factor that contributes to increasing the accountability, under the conditions when the independence level of monetary policy-making is high. Taking into account the politicians' tendency to use monetary policy for their own short-term interests, it becomes more and more evident over the last decades the central banks need a considerable independence degree to effectively perform their duty. Furthermore, this independence should be followed by accountability to the society, or at least to its elected representatives. To ensure the accountability of a central bank, special agreements are established. Nevertheless, whatever these agreements for a democratic accountability of the central bank are, their impact is restricted without transparency, since the information about

the central bank's behaviour is important to argue on its work (Eijffinger, Hoeberichts, 2000). Transparency helps the public to understand what a central bank does, and why not, it gives the public the opportunity to estimate the bank's performance. Thus, a central bank should report on a periodical basis about the past performance and the future plans of the monetary policy. Given its own role in increasing the accountability, transparency should not be a choice of the central bank. The law must establish certain procedures on the explanation of the monetary policy operations by the central bank.

2.2 MONETARY POLICY TRANSPARENCY, CREDIBILITY AND EFFICIENCY

Transparency needs to not derive only from the accountability demand towards an independent bank. Through improving the credibility, transparency raises the monetary policy efficiency (Issing, 2001).

Transparency ensures the wide support of the public in achieving its main goal, making him an ally of the central bank. Hence, it affects the public behaviour on payments and prices, facilitating the achievement of the final monetary policy target.

The importance of both transparency and credibility is justified by the theory of rational expectations. Taking into account the rational expectations, a fully reliable bank might follow a disinflation policy, without originating undesirable costs on employment (Taylor, 1983; Ball, 1991). Transparency reduces the information asymmetry on the economy situation and the perspective of the monetary policy decisions between the central bank and the private sector, thus assisting in the rising of expectations. Most of central banks supervise the short-term interest rates; however, as it is shown by the theory and empiric facts, long-term interest rates are the most important for an economy. Long-term interest rates reflect, inter alia, the expectations on future short-term interest rate as well as the uncertainty prime. The market participants shall improve their

expectations on future interest rates if the monetary authority is more explicit on the factors and conditions that might impact the monetary policy. Also, being well-informed about the monetary policy might reduce the uncertainty prime on the interest rates. Consequently, after publication of information, market movements precede the actions taken on a continuous basis by the central bank and are consistent with them (Freedman, 2002). In this way, transparency shall assist in approaching the long-term interest rates towards the rate targeted by monetary policy-makers.

3. TRANSPARENCY DEFINITION

Transparency is a wide concept not easily to be defined. Many authors give different definitions on transparency; however there are two definitions in the literature of central banking policy: Geraats (2000) defines transparency of a central bank as the degree of providing information on monetary policy process. For the monetary policy performance, the public should possess the same information like the one the central bank makes use of. According to this definition, the more a central bank provides information, the more it becomes transparent. This transparency definition may be considered as rather wide, and anyone making an in-depth study on the transparency issue may realize that providing information and being open to the public might not be enough to have desirable results for the bank.

Winkler (2000) goes further in defining transparency. He defines it as "the degree of understanding the monetary policy process and its decisions by the public". Only providing information is not transparency, states Winkler. When the public gets into the information provided by the central bank, transparency is achieved. Winkler distinguishes three aspects of transparency, authenticity, clarification of information, and equal understanding of information from both the public and the central bank.

Authenticity of information implies that information provided from the central bank to the public should be equal with the

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information that circulates within the central bank itself, without any intentional changes or shortages. This transparency aspect, suggested by Winkler, is to some extent similar to the definition presented by Geraats.

Clear information implies that information should be simplified, structured and transmitted to the public in such a way that it does not lead to misinterpretation. When information is addressed to various audiences, clarification of information becomes particularly important.

Equal understanding of information implies that information provided by the central bank, to become effective, should be understood and construed by the public in equal way as understood and construed by the central bank itself. This requires a certain degree of public education that derives from its own interest or from the bank's activity to encourage this education.

Diagram 1 shows the way of information going out from the central bank to the public in every step of the process of the monetary policy compilation and implementation, as well as its impacts on the public expectations, and consequently on the final results of monetary policy.

Interrupted line arrows represent the information the public gets from the central bank, which, in order to be transparent, must have three aspects: authenticity, clarification and equal understanding. Dotted line arrows show the public expectations and their impact on the achievement of monetary policy. In order that the public expectations are as rational as possible, the public must get information through all the links of monetary policy process. Thus, the targets of the central bank, the strategy of the monetary policy to achieve these targets and how and why the decisions on the bank's activities are taken, must become known by the wide public. The public should have the possibility to acquire even the core information on which the central bank takes its decision. The mediators, mainly the media, carry out the transmission of a great deal of information range from the central bank to the public. Therefore, they have

sometimes a higher impact on the public expectations. The final result is the resultant of the central bank's actions and the public expectations.

Diagram 1
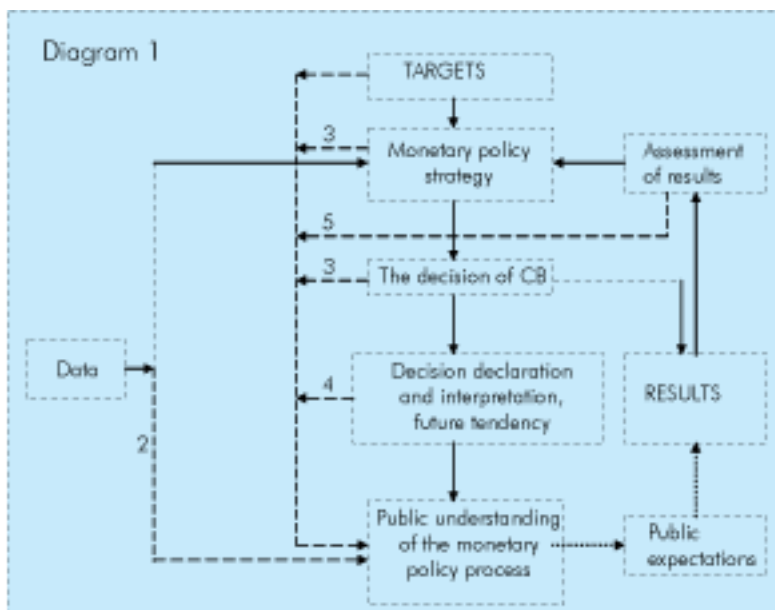
4. TRANSPARENCY INDEX CALCULATION

Central bank transparency is a quantitative concept. It is not so simple to measure it from the quantitative viewpoint. Various economists have tried to quantify transparency through indexes whose calculation is based on some questions and their respective answers by points. Among the authors of these indexes we would mention: Eijffinger, De Haan, Amtenbrink (1999), Gros & Bini-Smaghi (2001), Eijffinger & Geraats (2003), De Haan & Amtenbrink (2003). The index designed by Eijffinger and Geraats (2003) is selected to measure the transparency of the Bank of Albania, since it is more complete and global in dealing with transparency in more aspects, while other authors concentrate on specific aspects or group of aspects.

4.1 METHODOLOGY OF INDEX CALCULATION

In calculating transparency index, Eijffinger and Geraats (2003) see transparency as "extent of information provided by the central bank that relates to the process of compilation and implementation of the monetary policy". The authors identify some types of transparency where each one belongs to a certain link of the monetary policy performance. Consequently, they determine first the different stages of decision-making process of the monetary policy and later the type of transparency pertaining to each stage. From this point of view, the authors define 5 types of transparency: political (target) transparency, data and models transparency, procedural (decision-making) transparency, actions transparency and operational transparency. The difference among the various types of transparency may be seen as an important advantage of the index, leading to further analyses on the role of transparency in the decision–making process of monetary policy.

1. Political (target) transparency relates to the clear expression of the monetary policy targets. It includes the explicit definition of the monetary policy final target, the priority definition in case there are some targets generating conflicts with each other, as well as the quantitative definition of the final target. The political transparency is encouraged by institutional agreements, such are independence of the central bank, its agreements (contracts) and mechanism of leaving out the operations of the central bank, as they minimize the influence or exaggerated political pressures in achieving the target/targets of the monetary policy.
2. Economic data and models transparency relates to the economic information used in designing and implementing the monetary policy. It includes the transparency on the economic data used by the central bank, the models that are used to establish the economic forecasts or assess the impact of its decisions, as well as the internal forecasts the central bank relies on.
3. Procedural (decision-making) transparency relates to the way the monetary policy decisions are made. This type

of transparency is performed through the publications of monetary policy strategy[1], protocol and nominative votes of the decision-making authority.

4. Actions transparency implies the speed of declaration of the monetary policy decisions. In addition to this, it includes the decision interpretation and the monetary policy trend or potential actions to be taken in the future.

5. Operational transparency relates to the implementation of action policies by the central bank. It includes the estimation on the achievement of operational targets of the monetary policy, the information provided on the (unpredictable) macroeconomic volatilities that impact the transmission mechanism of the monetary policy, as well as the assessment of the monetary policy results from the viewpoint of its macroeconomic targets.

The five types of transparency cited above may also be disclosed in Diagram 1, Section 2. To each dotted arrow that represents the information transmission from the central bank to the public, to each link of the monetary policy process, there is a number corresponding with one of the transparency types, described above.

For each of the five aspects of transparency defined above, three questions are raised on the type, quantity and quality of the information intended to be published. 0 point or 1 point is marked, depending on the response. In some cases, there is an intermediate assessment of 0.5 point. In constructing this index, in the case of our central bank, the opinion of some specialists of the Bank of Albania was taken into consideration. The index calculation includes the year 2004 and the period before 1997.[2] Table 1 presents a summary of transparency indexes for the Bank of Albania, including transparency indexes for the other central banks, calculated by Eijffinger and Geraats.

As indicated in this table, the value of transparency index for the Bank of Albania is comparable to the index of the other central banks. If we analyze transparency according to the subdivisions made by the authors, we notice that the Bank of Albania is

estimated as good regarding the information level about the monetary policy targets (political transparency), the decisions and potential actions in the future (actions transparency) and the estimation of the final and operational targets (operational transparency). Meanwhile, information magnitude related to the data, models and forecasts (data transparency) and to the way the monetary policy decisions are made (decision-making transparency) shows lower levels compared to the other central banks.

The definition from the quantitative viewpoint makes possible the comparison among various central banks. To compare transparency of the Bank of Albania with central banks of the countries close to the economic development of Albania would be of great interest, but no transparency indexes of these banks are available at present. However, considering the Bank of Albania's goal towards a close approximation with the models of the central banks of the developed countries, especially with the European Central Bank, the ongoing comparison of transparency of the Bank of Albania with these banks seems to be more important.

Table 1

Transparency of the Central Bank[3]	BoA 1996	BoA 2004	ECB	Canada	Australia	Japan	New Zealand	Sweden	Switzerland	UK	USA
Political Transparency	1	3	3	3	3	1.5	3	3	2.5	3	1
Formal target	0.5	1	1	1	1	0.5	1	1	0.5	1	0.5
Quantitative target	0	1	1	1	1	0	1	1	1	1	0
Institutional agreements	0.5	1	1	1	1	1	1	1	1	1	0.5
Data Transparency	0	0.5	2.5	2.5	2	1.5	3	2	1.5	3	2.5
Economic data	0	0.5	1	1	0.5	1	1	1	1	1	1
Models	0	0	1	1	1	0	1	0	0	1	1
Central Bank forecasts	0	0	0.5	0.5	0.5	0.5	1	1	0.5	1	0.5
Procedural (decision-making) Transparency	0	1	1	1	1	2	3	3	1	3	2
Monetary policy strategy	0	1	1	1	1	0	1	1	1	1	0
Protocol publication	0	0	0	0	0	1	1	1	0	1	1
Votes publication	0	0	0	0	0	1	1	1	0	1	1
Actions Transparency	0	2	2	2	1.5	1.5	3	3	2	1.5	3
Instant declaration of decisions	0	1	1	1	1	1	1	1	1	1	1
Clarification of the applied policy	0	0.5	1	1	0.5	0.5	1	1	0.5	0.5	1
Policy trends	0	0.5	0	0	0	0	1	1	0	0	1
Operational Transparency	1	2	2	2	1.5	1.5	2	3	0.5	2.5	1.5
Operational targets	0.5	1	1	1	1	0.5	1	1	0.5	1	1
Transmission volatilities	0	0.5	0.5	0.5	0.5	0.5	0.5	1	0	1	0
Assessment of final results	0.5	0.5	0.5	0.5	0	0.5	0.5	1	0	0.5	0.5
Total	2	8.5	10.5	10.5	9	8	14	14	7.5	13	10

4.2 INDEX PROBLEMS (RESTRICTIONS IN METHODOLOGY)

While calculating the index of the Bank of Albania transparency, not only general methodological restrictions (valid for all central banks), but also specific problems are highlighted in Albania. So, the Eijffinger and Geraats index, like other similar indexes, assesses the transparency only in terms of quantity of information given and less in terms of its quality/clarity. It does not take into account the understanding of this information on behalf of the public or agents, which is an important aspect of transparency (Winkler, 2000). So, a high value of this index implies a large provision of information, but this does not mean that transparency has assisted at maximum in increasing monetary policy effectiveness or central bank's accountability.

Another drawback of this index is even the inclusion of some aspects of transparency that are currently debatable among central bankers and economists who deal with the publication of nominative votes or minutes of meetings of the decision-makers of monetary policy.[4]

In assessing the Bank of Albania transparency, one of the reasons of the low index value in comparison to some other central banks is even the lack of information which, according to index criteria, should be published. We may provide here the example of some time series, which are not published because they do not exist. Also, in order to publish certain information, a central bank should have a considerable level of confidence in its dependence or accuracy. So, for example, a central bank should achieve a good accuracy of its forecasts prior to their publication, otherwise its credibility might be jeopardized.

Another problem in measuring the transparency by means of this index emerges since it takes into account even the publication of information that currently may not be necessary for the Albanian public. Not all information that is disclosed by a central bank has the same importance to the public of other countries. This is so because of the level of financial system development in Albania and public involvement in it. The assessment of

transparency based only on the quantity of information provided by the Bank of Albania would be incomplete. Therefore, it is necessary to supplement this assessment even by evaluating the public understanding.

5. PUBLIC UNDERSTANDING AND THE ROLE OF MEDIATORS IN PROVIDING INFORMATION

The degree of public understanding of monetary policy and central bank's role in the country's economy is an issue of much importance for the achievement of the main monetary policy objective, i.e., price stability. To analyze the degree of public understanding, it may be grouped in two basic categories: businesses and consumers. It is understandable that these two groups have various levels of interest with regards to what happens in terms of inflation, exchange rate and interest rates. Businesses such as producers/traders, importers, borrowers and investors are interested in the three indicators, thus constituting the more interested group in the country's economy in general and the Bank of Albania activity in particular. On the other hand, the consumers may be interested mainly in inflation, which measures their purchasing power. Çeliku and Nasto (2004), by analyzing a survey established for this purpose, reach the conclusion that the public knowledge on inflation indicators, being listed as the information with more interest on behalf of Albanian consumers, has increased. However, we could not state that the Albanian public is well informed on the Bank of Albania and its work. This is also shown by the results of a survey on October 2003, when approximately half of the surveyed persons did not quite distinguish between the responsibilities of the Bank of Albania, INSTAT and the Ministry of Finance in terms of inflation. These results do not come from the lack of information, but are due to absence of public interest to absorb this information. The lack of public interest is due to non-involvement in issues that have to do with exchange rate, interest rate. The Albanian consumer is not much related with the banking system. Deposits with commercial banks are more a way of saving than a way of profiting, so mortgage

credits, though upward, still remain the choice of a small part of population because of insufficient income. On the other hand, the effect of understanding on behalf of the public is transmitted in monetary policy through expectations, which are not currently reflected as much as appropriate. Maybe, for the moment, they are not so important for the transmission mechanism rather than for the increase the Bank of Albania credibility.

The Bank of Albania has organized lectures and awareness campaigns intending to increase public knowledge on the Bank, the tasks it has and the role it plays in economy. This is something good as long as it is not turned into an end in itself. Besides this, such incentives are fruitful if a public group is chosen, to whom this information may be worth in a near future, otherwise the effect of information looses.

Another important factor impacting on understanding on behalf of the public is even the way of transmitting the information provided by the Bank of Albania. Even if the central bank provides real and clear information, this information may not be transmitted accurately to the public. This is so due to the fact that not always the communication of the central bank with the public is straightforward, but it is realized through mediators, particularly through the media, which, inter alia, is even the leader of public opinion. This increases the risks of distorting the information, thus weakening the positive effects of transparency. As a consequence, it is important to assess how mediators report on the central bank's decisions, because probably they may not reflect accurately the central bank's decisions and the reasoning behind them.

In most cases, the reaction of media on the Bank of Albania has been encouraged by the latter one. Economic articles on central bank are noticed mainly when the Bank of Albania releases any declarations or press conferences. In such cases, the newspapers publish the information given by the Bank, sticking to the material handed out by the spokesman or the speech of bank representative. Also, logical mistakes in explaining the Supervisory Council's decisions do not lack in

these articles. Furthermore, ordinary press mistakes may also be found, bringing about misleading information to the public. This is one of the reasons why the Bank of Albania is committed to organizing the training of journalists on economy. Also, the professional analyses and comments in central banking, though recently increased, still remain infrequent.

Probably, for the current level of public interest, the intermediation quality of media in the central bank's communication with the public may not be a big problem. However, given the increased promotion of the public to understand the role and work of the Bank of Albania, as well as the financial market development and the increased importance of public expectations in monetary policy transmission mechanism, the media's role is turned into a very delicate issue.

6. CONCLUSIONS

Central bank transparency is a topic largely treated over the last decades. Regarded as an element that impacts especially on the rise of accountability and increase of monetary policy effectiveness, much importance is shown to transparency, particularly within the framework of inflation targeting regime. An effort was made in this material to assess the Bank of Albania transparency, including in its concept not only the disclosure of information but also the understanding of this information by the public.

The first aspect of transparency, the quantity of information provided by the Bank of Albania, was measured by the transparency index of Eijffinger and Geraats (2003). The index values for the Bank of Albania calculated for two different periods, before 1997 about 2 points, and at present 8.5 points, indicate obviously the growth of its level in recent years. The transparency index by 8.5 points from 15 is not very low in comparison to other central banks, given that the average index value on other banks is 10.7 points. This index might have been even higher if a part of information had not lacked or

had not been qualified as confidential to the Bank of Albania, information that according to index criteria had to be published. To have a higher index value, inter alia, much work is needed in terms of ensuring more accurate information, whose publication would really provide positive effects.

Public understanding is not a slight, but a qualified evaluation of transparency. Notwithstanding the current level of Albanian public understanding, it remains low because of the level of our country's development in general and the financial system in particular. Public interest in the central bank and its role has been increasing, mainly because of its inclusion in this system. On the other hand, important for public understanding are expectations, which without having where to reflect do not still provide their effect on monetary policy.

ANNEX: CALCULATION OF TRANSPARENCY INDEX FOR THE BANK OF ALBANIA OVER THE PERIOD BEFORE 1997 AND IN 2004

1.a   Is there a formal stipulation of monetary policy objective (objectives), with a clear prioritization in case there are many objectives?

Regarding this criterion, the Bank of Albania is estimated at 1 point, since either the formal objective or the priority objectives are clearly stipulated in the Law No. 8269, Article 3, point 1.[5]

The estimation for the period before 1997 is 0.5 points, since at that time, though a formal defining of monetary policy objectives existed, their priority was not clearly defined.

1.b   Is the main objective quantified?

The Bank of Albania, since 1999 has expressed quantitative limits of the final monetary policy objective and has published it initially in the annual reports. Recently, the expression of price stability objective in quantitative terms is promoted more and more. The final objective is quantitatively defined in the "Mid-term Development Plan of the Bank of Albania", as well as in the monetary policy document drafted at the beginning of each year, which provides the overall monetary policy framework on the current year. Considering that the publication effect of the final objective in quantitative terms is the same, though no legal responsibility is there for its quantitative achievement, we think that the estimate of 1 point should be given for this criterion.

For the period prior to 1997 the estimation is 0 point, since no publication of primary objective was made in quantitative terms.

1.c   Are there clear institutional agreements or contracts between the monetary authority and the government regarding the central bank independence?

The Bank of Albania has a high legal independence. (Cani, Baleta, 2002). Also, though it is deemed that the real independence is lower than the legal one, there has not been any case of its compromise by fiscal policies. As a consequence, it is deemed that the estimation of the Bank of Albania regarding this criterion is complete, that is 1 point.[6]

In the period prior to 1997, the law on the Bank of Albania did not attribute high independence level to it. Therefore, it is deemed to put 0.5 point for this criterion.

2.a Are important economic data on monetary policy published? 5 variables are taken into account: money supply, inflation, GDP, unemployment rate and the use of capacities, on which the time series should be at a frequency of not more than three months.

As concerns to this criterion, the Bank of Albania may be estimated at only 0.5 points. This is so because only for three out of 5 above indicators may be found data, at least quarterly. So, monthly data are provided on money supply, which are published at the Bank of Albania web site. Also, the monthly data on inflation and the quarterly data on unemployment are disclosed either at the BoA web site or at that of INSTAT. We should also stress that the reason of non-disclosure of other data has to do with the fact that these data are not available.

Before 1997 the estimation for this criterion is 0 points, since two out of 5 above variables, inflation and monetary supply were published not more frequently than quarterly.

2.b Does the Bank of Albania report the formal macroeconomic model (models) that it uses in analyzing its policies?

The Bank of Albania is estimated by 0 points for this criterion, since no macroeconomic model is published.

Also, the estimation before 1997is 0 point, since even in that period no macroeconomic model was published, furthermore,

such model might not have exited.

2.c   Does it publish its forecast regularly?

Inflation forecasting is regarded as a confidential information and as such, the Bank of Albania does not publish it. Therefore, the estimation relating to this criterion is 0 point.

Even in the period before 1997 such information was not published, therefore the estimation regarding this criterion is 0 point.

3.a   Does the Bank of Albania publish a clear rule or strategy that describes the monetary policy structure (framework)?

The estimation of the Bank of Albania regarding this criterion is complete, 1 point, since the monetary policy strategy is made public, starting from final, intermediate and operational objectives and how they can be achieved, up to monetary policy instruments.

Before 1997 the clear and complete strategy of monetary policy was not published. Therefore, the estimation for that period is 0 point.

3.b   Does the Bank of Albania publish any detailed report on the discussions of decision-making body (or any detailed report on explanations, in the event of decision-making by one person), within a reasonable time frame?

Regarding this criterion the Bank of Albania is estimated at 0 point, since the minutes of discussions on monetary policy decision-making are not actually published.

The estimation over the period before 1997 is 0 point as well, since even in that time the minutes of discussions on monetary-policy decision-making was not published.

3.c   Does the central bank publish how each decision of the decision-making body on the level of instrument or on the

main operational objective is achieved? (The question relates to disclosure or non-disclosure of votes, and if yes, are they nominative?).

Even about this criterion, the estimation of the Bank of Albania is 0 point, since the votes in the process of making a decision on the level of instrument or on main operational objective are not published.

Even in the period before 1997, the votes in the process of making decisions on the level of instrument and on the main operational objective were not published; as a consequence, the estimation is 0 point.

4.a Are the data of decisions on regulations in instruments or main operational objective published immediately?

The estimation about this criterion is complete, that is 1 point, since the decisions on changes in monetary policy instruments are published on the day the decision is adopted.

Unlike at present, the decisions on changes of monetary policy instrument were not published on the day the decision was made. Therefore, the estimation on this criterion for the period before 1997 is 0 point.

4.b Does the BoA provide explanation when disclosing monetary policy decisions?

Regarding this criterion, it is considered to estimate the Bank of Albania to 0.5 point. The disclosure of monetary policy decisions is almost always done with explanations or assessments, but we can not say that the explanation is always complete and detailed and it is not always associated with an evaluation of the future.

Before 1997, the Bank of Albania did not associate the making of a decision (if it disclosed it to the public) with explanations and reasons leading to decision making. Therefore the estimation over this period is 0 point.

4.c Does the central bank publish a clear monetary policy trend or tendency after each meeting or a clear possible trend on the coming operations (at least, once a quarter)?

As concerns to this criterion, the Bank of Albania may be estimated at 0.5 point. This is so, because, notwithstanding the above improvements in this direction, the providing of monetary policy trend periodically is not compulsory.

The estimation on this criterion for the period before 1977 is 0 point, since at that time no trend or clear tendency of monetary policy was made public.

5.a Does the central bank explain publicly to what extent it has been able to reach its operational objectives?

Currently, the operational objectives of monetary policy are net domestic assets and net foreign reserves of the Bank of Albania. Quantitative limits are applied for these objectives and their achievement is estimated to each periodic document of monetary policy, starting from monthly one, six-month declaration to annual report. Therefore, the Bank of Albania is estimated at 1 point for this criterion.

Even though figures could be given on the achievement of monetary policy operational objectives, a detailed explanation on this issue is lacking. Therefore, the Bank of Albania is estimated at 0.5 point on this criterion for the period before 1997.

5.b Does the BoA provide information regularly on (unexpected) macroeconomic deregulation that impact on monetary policy transmission process?

Information on macroeconomic deregulation, either unexpected or not, is provided at least once a three months in the monetary policy reports. But, since their impact on examining the transmission is not always estimated and the discussions on mistakes in forecasting their deregulation are lacking, the Bank of Albania estimation is to 0.5 point for this criterion.

Before 1997, the above type of information was either missing or infrequent. Therefore, the estimation for this criterion is 0 point.

5.c   Does the Bank of Albania provide a regular estimation of the results of monetary policy from the viewpoint of macroeconomic objectives?

The estimations of monetary policy results from the viewpoint of macroeconomic objectives of the BoA are published regularly, but the contribution of monetary policy to their accomplishment is not explained in a measuring way from the quantitative viewpoint. Therefore, the estimation for this criterion is 0.5 point.

Even for the period before 1997, the Bank of Albania is estimated at 0.5 point, since the explanations have not been as clear as appropriate, and besides this, even the quantitative estimation of monetary policy contribution to achievement of macroeconomic objectives was lacking.

NOTES

* Sofika Note, specialist, Research Department.
[1] By "monetary policy strategy" is meant its general framework: final intermediate and operating targets of the monetary policy and the way of achieving them, as well as the monetary policy instruments.
[2] Index calculation for the Bank of Albania is presented in the Annex hereto attached.
[3] The index for the other central banks, the Bank of Albania excluded, is calculated by Eijffinger and Geraats, in 2002.
[4] Blinder, etc (2001) has presented a more detailed discussion on this issue.
[5] According to the Law no. 8269, Article 3, Point 1, the BoA objective is the maintaining of price stability. Its other objectives are conditioned by the main objective.
[6] Law "On the Bank of Albania" Article 1, Point 3.

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THE ROLE OF PUBLIC RELATIONS IN THE AUDIENCE OF THE BANK OF ALBANIA

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Bledar Striniqi

INTRODUCTION

The term "public relation" is first encountered in the address of Mr. Tomas Jefferson to the American Congress in 1807.

Basically, the term used by him does not imply public relations in itself but international relations. However, since that time concepts on public relations have progressed, covering a vital area in the daily activity of individuals and of the society as well. Edward Bernays held the first lecture on public relations in 1923, at New York University.

Public relations should be understood as the outlined and well-established efforts to build and maintain at an ever high level the relations between the public and the institution, which in this case is the Bank of Albania. In this framework, public relations, carrying out one of the main duties of management, care about a further build-up of Bank of Albania's reputation to the broad public. In this process they determine how and what to state to the public, and what the public feels and says about this institution, thus considerably harmonizing the interests of both parties. In times of crisis for the institution, as was the case of the Savings Bank, when the clients withdrew an amount of

LEK 17 billion within a short period of time, public relations are put in a delicate position. Public relations, in few words, should be perceived as "the science" which deals with the reputation of the Bank of Albania, aiming to ensure good behaviour, understanding and support of the broad public.

Such a perception on the public relations has had a considerable impact on increasing the Bank of Albania credibility.

It is not easy to measure the performance of public relations. Common people, including experts of this field wonder how far the result in this aspect could be measured.

The success of programs, strategies, activities and tactics is related to the measuring of public relations effectiveness, through analyzing the "products" or the "output".

David W. Davenport, referring precisely to the measurement of effectiveness, states: "The major problem in communicating is the illusion that communication is realized". Communication is as important as difficult, mostly if trying to make it effective.

To achieve this mission, the Bank of Albania has continuously made great efforts and it might be said that certain results have been obtained in this respect. Various materials are disclosed at the Bank of Albania website, while different articles are published in the newspapers. This fact leads us to the conclusion that our product is understood by many people, has become a debating subject for many others and has relatively reduced misinterpretations.

To measure the level of communication with the environment and the community and to obtain their assessment and classification, we should take into account:

- What do we do,
- How do we seem,
- What do we state,
- How do we express our statement. (Dale Carnegie, 1982)

The efficient communication with individuals and interested institutions depends on the degree of resolving these issues. Indeed, it sounds strange that bankers, whose main weapon was continuously the secret, speak about communication. In fulfilling this task, the Public Relations Department has transmitted to the broad public the role of banks in managing the national economy and in promoting confidence to investors and consumers. Why is this role so important? It is well-known that the role of the central bank (Bank of Albania) consists in maintaining price stability, aiming at a stable economic growth. The essential issue is to enhance the audience confidence in the bank operations and decisions. To achieve this target the communication level or capacity with the audience should constantly grow.

To improve the work and quality, Investors Relations Offices (IROs) are established in some countries, with the purpose to prompt communication with the public. However, that is not sufficient, because communication with investors (domestic or foreign ones) should be ongoing and consistent. They should be convinced of the macroeconomic stability, lasting for several years from now, since macroeconomic environment is a significant precondition for their promising investments.

Communication instruments must be assessed and improved while dealing with public relations. It is known that various publications or outgoing electronic messages are welcomed by the business community and constitute an important instrument of communication. Albania has a clear vision, a plan to achieve this vision and a group of people capable of following the implementation of this plan. The Bank of Albania must be able to duly respond to the questions of the audience on Albania's economic performance and on the established environment that prioritizes the business and the country's economic growth.

What does the Bank Albania take into account while communicating with the public?

The Bank of Albania tends to reliably communicate about the country's economic reality and without frustrating slogans.

Very few people are interested in listening to explanations in academic terms on various economic phenomena, but it is known that everybody is curious to know about the expectations of the national and world economy. Successful communication with the public is first attributed to the simple language and secondly to institution's credibility in the public.

The Bank of Albania has clear communication targets, aiming to clarify to the public (depending on various groups of interest) the impact of Bank of Albania's decisions on the economy perspectives. In particular, businesses, their owners and managers, knowing the short-term and medium-term impact of different decisions, might react in due time to prevent their negative impacts so as to increase their profit.

How efficient is the Bank of Albania in selecting the communication instruments? Are press releases or educational publications sufficient to inform the public about the role and duties of the Bank of Albania and to transmit to the public its messages on the decisions made?

The principles the work of this institution is based on, encourage us to profoundly know the partners, collaborators and in general the groups of people or communities we are related to, because of our present and future work interests. For this purpose, we should know the origin of each given community, its composition and interests, to further enhance the collaboration values for the benefit of both parties.

The differentiated work performed in public relations field serves to these policies. Thus, the Bank of Albania has implemented various ways of communicating with the public. It has performed a differentiated work with the elite of business, bankers or researchers of economics, politicians and students of economics and the broad public.

To carry out this important activity, specific tasks belong to Public Relations Department. Dealing with communication issues, this Department has focused its efforts on the targeted

audience; on setting a time frame for communication, on selecting the arguments of interest for the audience, and on selecting the proper language and style of communication.

What is our goal and what should we do?

We should first deeply understand what public relations and communication are, and what tasks the specialists or departments acting in this field should perform. And finally, what is their impact on the results of Bank of Albania?

Thus, to explain this point we must be aware of the fact that we will succeed in achieving the targets, if we make the public opinion be with us.

We should perceive Public Relations as constant and outlined efforts to establish and maintain the goodwill and mutual understanding between the institution and its public. Thus, the major issue is to acquire, through an active work the understanding, support and particularly the influence on both, the opinion and the behaviour of the broad public. Establishing relations with the public is a vast and multidimensional task. This can be attained first of all by publishing the news and positive results, in order to enhance the bank's credibility and limit the damages to its reputation, arising in cases of any possible crisis.

Drafting the work stages is important for the public relations and communication. We should first conduct an analysis of the situation and identify the real problems. Further, we should define the objectives, the targeted consumer, messages, strategy, methods and the budget.

Finally, we should carefully estimate the work performance, rightly define the achieved results and come to the conclusions for the future. Management is a primary factor in achieving the results in the public relations field. It is already stated and proved that the secret of a successful program of the public relations consists in the prudential design of the work in implementing

a strategy determined and selected in compliance with the institution interests.

Public relations must always be well-informed about the major issues, making researches in the fields of interest.

Setting the targets in the institution's program is also very important. First, the public of organization, company or institution should be clearly determined and classified. In simple words, who are those that will buy these products, that will benefit from the services or that will play a specific role in the institution's activity? In few words, it is necessary to define the target listener or audience of the public relations program. The messages transmitted by the institution to the broad public, within the designed program, are important too. It is through these messages that the institution succeeds in communicating clearly, briefly and simply with the public or interested communities. Thus, they should be compiled in such a way that the audience keeps them easily in mind.

To carry out a successful achievement of the targets, it is certainly indispensable to work out an overall plan on the institution priorities, which must be implemented.

PUBLIC RELATIONS AND MEDIA

There can be no results in the field of public relations, if between them and the audience, the media as an intermediate significant link, does not function. The public relations program includes also vast cooperative relationships with both the written media and the electronic one. Establishing correct relationships, the institution, i.e., the Bank of Albania, shows what it is, what it can do, what services it can supply to the broad public and finally, what the benefits of this cooperation are.

The cooperation with the media ensures in a very quick and effective time the transmission of messages from the institution to a large number of people, who daily receive these messages

or information through the press, radio or television. These messages are a product of the cooperation between journalists and experts of these fields. Keeping good relations with the journalists and the media in general will prompt the experts to enhance the cooperation with them and consequently to reflect the institution's activity.

The Bank of Albania attaches great importance to communication instruments with the audience and to the internal communication as well. The most adequate communication means are the bulletins, press releases, articles published in the newspapers and magazines, etc. Anyway, they must not be overestimated and we should always be seeking for new ways of communication. This field includes also the media materials, opinions of experts or leaders, who argue and comment the work, the deficiencies and the results of the institution.

It is important to identify the most efficient methods to work with in implementing the designed program related to the links of public relations with the media. Since the planning stage, we should take into consideration not less than three methods or variants, to which we should account the respective costs. We should also take into consideration the fact that not always the lowest cost is required. Most important for us is to make all possible efforts to achieve the targets and not to save money. The money saved where not necessary is wasted money.

We would emphasize that public relations constitute one of the most important aspects of work management. They are considered as a kind of service without a final product, but that support all the operating activities of a business, company or institution. Public relations must be managed by people of high professional skills and are a responsibility of the people occupying a certain position within the organization they work with. It is interesting to note that from a survey conducted at the Business School of Harvard University it resulted that managers of each company, organization or institution spend about 60 per cent of their work time in dealing with public relations. During this lapse of time, they perform such activities as the

transmission of company's message to the media, radio or television, the commitment to communicating directly with the public, presenting the activity of their institution.

PRESS RELEASES, NEWSPAPERS, ARTICLES AND COMMENTS

We already know what the effects of a press release are, its publication and media reaction. If we have published a new announcement, then we should be ready to respond to hundreds of telephone calls and e-mails from the public. Nowadays press releases still remain the simplest and cheapest way of communication with the public.

An announcement in the form of press release is composed of one to two pages and is used to attract public attention. It is sent to the media, requesting its publication at an earliest time possible, otherwise the information loses freshness and the value of events.

Public Relations Department has considerably increased the number of press releases over the period 2002 – 2004. Following and reflecting accurately the major issues of the Bank of Albania, press releases have been quick and have been read and welcomed by the public.

	2004	2003	2002
Press releases	105*	99	50

105*)Forecasts based on the 7-month performance, January-September 2004, 75 press releases.

The media cover a strategic position for each organization or institution, since the information is transmitted through them to the large public.

They have a special impact on the public opinion. Although the time coverage dedicated by the media to a certain issue is restricted, it again transmits messages of high value for both the organization and other interested audiences. We have to

bear in mind that the media operates in a harsh competitiveness environment. The Bank of Albania, taking into account this fact, is trying, through its experts and Public Relations Department, to establish close and correct relations with the journalists and the media in general, creating adequate working conditions and putting at their disposal all the materials they are interested in.

In this framework, the Bank of Albania organizes training workshops with the journalists.

THE WEBSITE AS AN EFFICIENT COMMUNICATION INSTRUMENT

Today, the values of internet and the information that is widely spread through it are regarded to be increasingly of great importance compared to the written and visual media.

Netherlands, along with Japan, Great Britain and India have the highest level of newspapers readability in the world, where 75 percent of families are subscribed in a daily newspaper. Meanwhile, newspapers are listed in the fourth place as means of broadcasting news, after the television, radio and the internet. In these countries 9 percent of people prefer newspapers, 17 percent prefer the internet, and 35 percent prefer the radio, while 39 percent prefer the television. According to a research conducted by the Project for Excellence in Journalism and Columbia School of Journalism, televisions are considerably decreasing compared to the other means of news broadcasting. (Missouri Department of Higher Education's website, http://www.dhe.mo.gov).

People's interest increased due to the acceleration of news broadcasting through internet, its low cost and the diversity of information provided.

Information through internet represents much more interest now, in a world where the media are being more and more concentrated in a limited number of people.

To maintain the credibility as an institution and the credibility of information and its activity, the Bank of Albania has tried and continues to make efforts towards extending information to the external environment (institutions or individuals). It is oriented towards research, collection, analysis and diffusion of information, so that everyone interested has the possibility to be informed about the bank's decisions and activities.

Through the website www.bankofalbania.org initially introduced in 1999 and changed this year, the Bank of Albania successfully communicates with the interested public and each of the targeted groups finds the required information. The Bank of Albania introduced at the end of February 2004 the new website www.bankofalbania.org, which is deemed to further contribute to communicating with the public. Nevertheless, we should try to make it always more attractive.

Analyzing this problem one must start with answering the question: Is the website a good choice for the institution? How and what should we do to have it as diversified and interesting as possible?

Such an analysis and the resulting conclusions will help to establish clear targets regarding the website and to determine what its visitors are looking for.

Months	Number of visitors
January-04	0
February-04	4
March-04	2095
April-04	2653
May-04	3060
June-04	2667
July-04	2691
August-04	2672
September-04	2579

For these reasons, the Bank constantly monitors the visitors of its website, being attentive in identifying them and their respective interests in various kinds of information.

Visits on the new website of the BoA
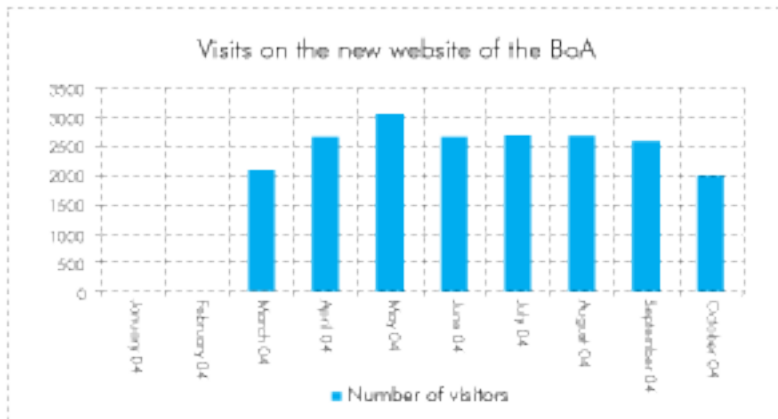
The average daily number of visitors on our website (excluding weekend days) was 258. There is an upward trend towards a stable increase, at an average of more than 20 per month, where 70 percent belong to the visitors abroad and to those requesting information in English. In May, the number of visits to the Bank of Albania website increased to 3060 compared to 2095 in March, thus providing a fact regarding the increased interest in the information the Bank of Albania presents to its website. The highest flow is in the mid-week, and that is related to the nature of the information introduced in our website.

The attention for the part in English, particularly the informing part and that of statistics, has increased recently.

Based on the interest in publications, the Bank of Albania has also projected to issue in a near future a "CD-offline", with its publications and other significant parts from the website.

The analysis of visit duration in this site shows that most of visitors stop a while (67.90 percent of visitors up to 5 minutes), while two significant indicators show visits ranging between 30 and 60 minutes (7.7 percent) and visits more than 1 hour (5.7 percent).

The website www.bankofalbania.org is updated in a programmed way. It is mostly organized in two languages, Albanian and

English, excluding the cases when, due to information speed, it is first published in Albanian. There exists also an ongoing control on the accuracy and updating of the materials published.

Information introduced in the website is of different types and fields. It includes information of a large scale of use, such as the exchange rate, T-bills market interests or T-Bills calendar, and an overall information on the organization and structure of the Bank, the monetary policy developments, main activities and decisions of the Bank of Albania, monthly and yearly statistics of the monetary and real sector, a range of publications of the annual reports and statements of the Bank of Albania, articles, working papers, analyses and surveys, press releases of the Governor, press releases on the Supervisory Council meetings, etc.

ON-LINE PUBLIC RELATIONS

The Bank of Albania pays particular attention to the on-line communication with the public, otherwise known as on-line public relations.

In the rubric "Your opinion on…" of the Bank of Albania website, the visitors have the possibility to give opinions about the content of the site and various needs for further information. The interested individuals may express their opinions also via on-line registration or via e-mail, in the address: public@bankofalbania. org. (20-30 requests arrive everyday and systematically receive a reply). This way of communication provides the rising possibilities of a dialogue between the Bank and the public, helping in the improvement of this site and in the continuous approach with the requirements and necessities of the public.

PUBLIC APPROVAL

Arthur W. Page writes: "…live by the approval of the public… as many approvals you might receive, the better you will live." (Arthur W. Page, 2002.)

To serve these relations, the Bank of Albania has organized the distribution of the questionnaire "Bank of Albania, how deeply does the public know it", aiming to find out how far does the broad public know this institution and how much does it understand the duties and activities of this institution. This questionnaire was distributed to be filled in by certain groups of population, such as small-size and medium-size businesses, big-size businesses, high schools, universities (economics faculties), universities (non-economics faculties), pensioners and occasional passers-by.

About 1000 questionnaires were handed over in Tirana, Lushnja, Gjirokastra, Korça, Elbasan and Shkodra in proportion to their weight vis-à-vis the Albanian population.

The questionnaire contained 16 questions to identify the knowledge degree of the public on the Bank of Albania institution, its functions as well as the public necessity for supplementary information on the banking system and its functioning.

The analysis of the questionnaire results shows that:

- 93.04% have heard something about the Bank of Albania;
- The major part, 77.03% of the interviewed have heard about the Bank of Albania through written or visual media;
- A good part of the interviewed (63.72%) knows the inflation concept, since they correctly construe it. The major part also (52.4%) knows that the Bank of Albania is the responsible authority for control on inflation;
- A considerable part (41.70%) of the interviewed thinks that the Bank of Albania extends loans (its role and functions are not properly known), and the majority does not properly know the organization of the Albanian banking system (51.71%).

The analysis of the questionnaire results shows also that the Bank of Albania is largely known by the Albanian public.

The articles on the issues covered by the Bank of Albania have influenced these results. These articles are prepared by the Bank of Albania specialists or others, who are present almost everyday in the Albanian magazines and newspapers.

About 108 articles of the Governor, managers and specialists of the Bank of Albania were published in the written media over the first half of 2004 on different issues of the Albanian economy and on the explanation of the decisions made by the central bank of Albania.

168 articles closely related with the issues covered by the Bank of Albania were published in the written media over this period by scholars of economics, professors of universities or scientific researchers of the domestic or foreign institutions.

WORD OF MOUTH MARKETING AND ITS IMPORTANCE

"It is merely an illusion that marketing elements are selling your products", states George Silverman, Chairman of "Consulting of Marketing" company and author of Marketing Secrets - through Word of Mouth.

"The reality is that people are coming to you, not because of your marketing activity, but because they have listened about you from other sources…"

The reasoning that "the word of mouth" is much more efficient than the conventional means of the paid marketing is increasingly gaining ground. It remains efficient even in this stage in which communication means and promotional campaigns are developed.

Word of mouth, in Silverman's mind is the communication among people on the products and services, perceived independently of the company itself.

"Word of mouth" is of particular importance independently

of the used terminology. In fact, the best a marketing specialist might do is to find people that speak frequently and favourably to the right intended people.

This process is theoretically based on the skills and qualities of the staff working in public relations. Public relations are mostly related to the dialogue, education and credibility.

Historically, marketing trend has always been "the reference to the experts", as the public is becoming more and more doubtful about the traditional institutions. Many of the supposed "independent" annalists result to be paid by businesses or institutions.

Each individual in the United States spends on average USD 800 a year to cover the spots expenditures that businesses perform, independently of his/her will. American businesses spend USD 200 billion every year for their spots in the media. (http://www.aktuelno.com/MarketingPR). If this sum would be spent for the word of mouth marketing, many of them would be much more efficient.

Many managers of companies and administrators of organizations deem that today surveys and analyses of experts are not so important for the name of the company/organization. Word of mouth is perhaps the best way of communication. People tend to mostly believe the words and rumours than multimillion spots and media comments.

The word of mouth marketing is of a low cost and also the most common way of communication with the public.

Under the current circumstances of a "media shower", a person receives on average about 1000 messages a day. In this multitude of information people are led to believe the words of those people whom they do trust.

They are frustrated by the advertising slogans and promotional campaigns and need to absorb "disclosed" information.

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