BANK OF ALBANIA

ARTICLES PUBLISHED THROUGHOUT A DECADE IN THE ECONOMIC BULLETIN OF THE BANK OF ALBANIA

Volume I

Period

1 9 9 8 - 2 0 0 0

December 2007

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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CURRENT ACCOUNT DEFICIT IN 1992-1997. DOES IT MATTER?

Gramoz Kolasi
Altin Tanku*

1. GENERAL SITUATION

The social, economic and political turmoil that the country experienced during the first half of 1997 is broadly mirrored in the external sector of the economy. The frenetic collapse of the pyramid schemes, the alleviation of the public savings and the social uncertainty led to a decline of consumption, a reduction of trade activity and a contraction of private transfers as well. Consequently, the current account recorded a deficit of USD 264 million or 1.5 times higher compared to the previous year. On the other hand, the disruption of political stability of the country had a strong impact on the inflows of official transfers in hard currencies (the subsidies, credits and direct investments faced a sharp decline). The above developments in the external sector of the economy affected the domestic currency, bringing up the end of the 4-year illusive period of the strong LEK.

In the last five years (referring to the period July 1992 - December 1996), the developments in the balance of payments were characterized by typical developments. In few words they can be summarized as: high trade deficits, high level of current transfers, modest movements in the capital account and finally large scale of indefiniteness for a certain range of illegal and

casual transactions. However the overall position of the balance of payments has been positive and consequently foreign reserves have recorded an increase in absolute value, though their general level remains still low. Generally speaking, this period is characterized by a relatively stable macroeconomic equilibrium, with a high economic growth, with inflation kept under control under the conditions of implementing a tight monetary and fiscal policy initiated in the framework of a series of structural arrangements. However, it would be of interest to deal more with the developments in 1996, which in spite of their diversity ruined everything good that was achieved over the first years of transition.

The first signs of depositing money at different companies (without differentiating whether they were engaged in production activity or not) became evident since 1995, even earlier, whereas the first signs of budget deficit expansion correspond to the second half of 1995. Following the total indifference in considering them, the implementation of tight credit policy, lack of a regulated capital market, inattention towards public savings, etc., the absurdity to invest in these companies surpassed all the limits, by swallowing up hundreds of millions of USD. From the political outlook, the boom of investment schemes coincides with a compressed election campaign, which besides supporting them morally accounted for wasteful expenditures. The interest rates paid were so attractive that not only residents but also emigrants and a considerable number of foreigners fell prey to these schemes. The illusory pyramid schemes made Albanians forget their extreme poverty in the past, creating the hallucination of a non-limit society in consumption. The domestic demand increased considerably, in response to which due to the lack of domestic production capacities, there was an unimaginable flow of imported goods, including luxury goods.

The high increase of the aggregate demand inevitably pushed up the inflationary pressures in the economy. By the end of 1996, inflation was 3 times higher compared to the previous year and presumptions for a further significant acceleration became more and more present. The last month of 1996 outlined the basic

features of the economic and political turmoil that were going to follow in the coming months.

It is worthless to mention again what Albania experienced in the first months of 1997. An unimaginable range of inflexibility, rigidity and many other characteristic reasons initiated in the worst fashion the chaos, the result of which was a total economic, political and financial disaster of the country. Reasonably, the most expensive penalty was paid by the economy, which was very tender even before such a collapse.

Let us highlight the negative events that the domestic economy had to face in the first 9 months of the last year.

Table 1 Balance of Payments (in million of USD, minus sign shows debit)

	1992	1993	1994	1995	1996	1997
Current account	-50,8	14,7	-42,7	-14,6	-107,1	-264.1
Export of goods, fob	70,0	111,7	141,3	204,8	243,7	158.6
Import of goods, fob	-540,5	-601,6	-601,0	-679,8	-922,5	-693.5
Trade balance	-470,5	-489,9	-459,7	-475,0	-678,3	-534.9
Services: credit	20,3	77,5	83,1	97,0	129,3	62.6
Services: debit	-89,2	-162,0	-171,5	-156,3	-189,1	-111.6
Incomes: credit	2,6	64,9	55,6	70,8	83,5	60.3
Incomes: debit	-37,7	-31,0	-41,5	-28,5	-12,0	-6.7
Private transfers	150,0	274,8	374,1	348,9	476,0	235.5
State transfers	373,7	280,4	117,2	128,5	83,4	30.7
Direct investment	20,0	58,0	52,9	70,0	90,0	42.5
Portfolio investment	0,0	0,0	0,0	0,0	0,0	0,0
Other capital	10,7	52,1	11,6	-93,1	-32,5	115.3
Resident official sector	55,0	106,9	119,0	-24,6	67,4	57.5
Commercial banks	-59,6	-43,5	-80,2	-56,9	-110,2	90.7
Other Sectors	15,3	-11,4	-22,3	-11,6	10,5	-33.0
Net Errors and Omissions	44,8	-9,9	33,0	57,1	96,6	137.9
Overall Balance	24,7	114,9	54,8	30,6	47,1	31.6
Reserve	-24,7	-114,9	-54,8	-30,6	-47,1	-43.8
Use of Fund Credit and Loans	13,9	16,6	22,2	11,1	0,0	12.2
Liab. Const. Fng Auth. Reserves	...	...	...	...	...	...
Exceptional Financing	...	...	...	...	...	...

- Restraint of the domestic demand that on the other hand corresponds to a considerable destruction of production

capacities. Such a phenomenon constitutes an essential reason for a possible decline of production in real terms, estimated at 7.3 % recently.

- Loss of public confidence in the banking system concluded to a persistent haemorrhage of money supply, while the decline of demand and foreign currency deposits was inevitable. The compromise of the monetary policy was supported by no more existent public finance. The budget deficit financing with liquidity offered by the Bank of Albania contributed to a considerable expansion of the base money, further accelerating the consumer price rise.
- Significant decline of confidence in the domestic currency. Besides the performance of domestic market, the depreciation of the Albanian LEK to a certain extent reflected the developments in the main foreign exchange markets in the world. It is known that Deutsche Mark, Japanese Yen, Swiss Franc and other currencies lowered their heads in front of the American Dollar, even achieving historical records.
- The drastic fall of public savings. Though no exact information is made public yet, it is reasonable that most of the savings invested in these schemes is not distributed due to inadequate management, wasteful expenses, transfer of most of the capital abroad, abuses of the staff, lack of accurate accounting records, etc.

After creating a general view of the financial-economic performance in Albania in the last 4-5 years, the idea that the developments in the external sector in a regular way have spontaneously taken place. This does not mean that the government had to control, if not everything, most of the transactions of Albania with the world. Simply the concept of a free market economy would exclude such a subject from consideration, but it is known that the regulatory frameworks, policies, etc., are formulated and implemented by the authorities, and in Albania's case too little is done in this respect. Considerable arrangements are made in carrying out current account and capital account transactions. The Law "On foreign investments" was passed and additional improvements are made on the regulation of foreign exchange market. However,

the only manner to finance the great deficit of the current account is confided to spontaneity and illegal operations, while the attempts to promote exports and tourism remained in the framework of promises and negotiations.

Through a more detailed analysis of what occurred during this period with certain elements of the balance of payments and taking into consideration the political aspect of economic development in the recent years, we shall attempt to clear up more convincingly the dynamics and the near future of the balance of payments accounts.

2. CURRENT ACCOUNT AND CAPITAL FLOW

2.1 DEVELOPMENTS IN THE TRADE BALANCE AND SERVICES

Since 1992, time when the current account was liberalized, foreign trade was no more the monopoly of the state. By mid 1992, for the first time, Albania adopted a flexible exchange rate regime, as the most effective way to reduce the imbalances in the overall position of the balance of payments. Concurrently, at early `90s, Albania experienced a new phenomenon, that of a massive immigration, which with the passing of time became one of the key factors for financing.

Chart 1 Volume of Foreign Trade
(In millions of USD, flow during the period)

Transactions volume ——— Trade deficit
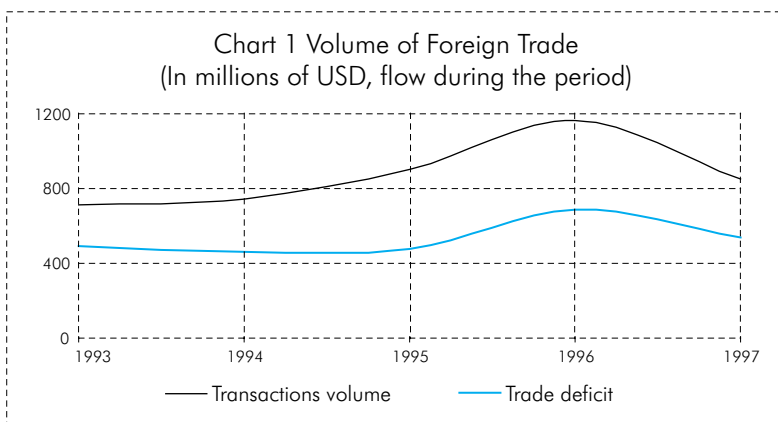
The liberalization of foreign trade appeared in the form of growing contribution of the private sector to imports. In contrary the role of this sector was not at all significant in the traditional sources of exports. While making a careful analysis of the course of imports, one can observe that the import curve was very sensitive to the growing domestic demand. Under such situation, the overflow of imported goods, especially of consumer goods, recorded a boom. Almost everything was imported, such as consumer goods, household equipment, footwear, automobile, etc.

The inherited absence of such household equipment was coming to an end. The dream of the Albanians to have a car or a colour TV set was becoming a reality. In 1992-1996 were imported[1] around 114 thousand refrigerators, 183 thousand TV sets, 80 thousand washing machines, etc. On the other hand, Albania absorbed in the form of credits and investments considerable amounts of foreign capital that entered Albania in the form of machinery and equipment.

Consequently, the value of imports accounted for an increase in each passing year, reaching the climax in 1996 with about USD 1 billion (chart 2).

Quite differently, year 1997 recorded a fall of imports by about USD 230 million or 25 % less than the previous year. Not only the shrinkage of domestic demand for consumer goods but

Chart 2 Export - Import in years
(In millions USD, flow during the period)
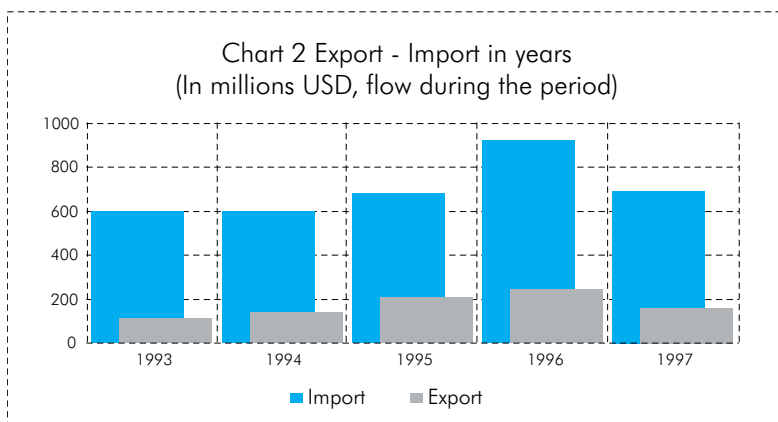
also the shortening of capital inflow in the form of credits and direct investments induced a decline in imports.

Even the exports of USD 85 million (about 35 %) lower as compared to the previous year reflected the overall crisis of 1997. The import/export coverage rate in 1997 further decreased by reaching the level of 23 %, as against 30 % and 26 % respectively in 1995 and 1996. Taking into consideration the low level of export in the past years, the current one needs no comment. In the first months of the year, the wave of devastation did not spare anything, washing even those few capacities of production destined for export. Nevertheless, the figures are significant and cannot be skipped by justifying everything with the ravage of the first months of 1997. During 1993-1996, exports amounted to USD 702 million, at a time when only the imports of 1996 amounted to USD 922 million. Although capital inflow (in all its forms) was higher than the above figures, the strategies of channelling and using it in relation to exports was almost vague or better say it did not exist.

The liberalization of the current transactions gave an impetus to the strengthening of the Albanian exports.

The export growth in absolute value year on year is dedicated to a category of goods that constitute mainly the export of goods produced with the order's material, sporadic foreign investments made in textile and footwear industry that never managed to become a stable basis of the Albanian exports. The traditional exports, that in the `80s were estimated to be 2 times higher than the average year export, stopped during 1992-1997.

While saying that no strategy did exist for the channelling of capital inflow, this does not imply the exchange rate or tariffs policies, because, they would have not exerted any significant impact on increasing the volume of export on the overall Albanian environment. In a framework of limited industrial production, of an agricultural production that does not meet the domestic needs, of an almost worn-out infrastructure for service trading, one cannot speak of successes of foreign exchange and fiscal policies.

Considering the exchange rate, we have to accept that Albania has sold out all its production. Practically the problem does not stand to the price of produced (expressed in foreign currency) goods, but to the very low level of the volume of produced goods. Practice has shown that such policies have not given results even in the most powerful economies of the Eastern Europe. On the other hand, customs barrier existed for a very limited group of goods that are recently converted into a list of two articles due to domestic development policies. Thus, the cause of such a situation is not the great number of customs barriers, but the extremely limited number of goods to be exported.

Even in the case of international sanctions to Yugoslavia, everyone can confirm that for abusive and corruption reasons, embargo was perceived as a theoretical notion. Its conversion into a black trade brought into Albania a considerable amount of foreign currency, leaving behind legal exports. Therefore the real promotional policies to support export would be those that increase the physical volume of production.

In the first years of this decade, during the opening process towards the world, Albania offered competitive advantages such as the free labour force and the natural resources. A possibility to utilize such resources was to attract strategic investors that will be able to offer investments and find markets. Did such a strategy exist? The privatization process brings in light only small proprietors, not capable and not experienced enough to cooperate with foreign partners, because only small and some medium size enterprises were privatized. While the state invested little or not at all in production, the main branches of export were not privatized. Those export sources were crudely exploited, thus bringing about their gradual degradation. Such companies like ALBKROM, KESH, ALBPETROL and ALBBAKER are currently in a critical situation, which is the result of an abusive and non-professional management, of systematic misappropriation and of recent destruction.

The decline of trade activity was reflected in the service account where the expenditures for the transport of goods decreased and

were accompanied by a decline of incomes from portal services. Insecurity in the country had its impact on the decline of incomes from tourism and the transport of passengers, respectively by 64% and 60 %.

The interruption of grants of foreign aid programs brought about the reduction of expenditures for technical assistance to the amount of 68 %. These developments reflected a deficit of services 17% lower than in 1996.

It is estimated that the transport of passengers and goods tracked the growing consumer demand. During the five-year period, these services were fully related to the increase of trade transactions and generally closed in deficit.

The incomes from tourism constitute the main source of foreign currency inflow. These incomes grew from year to year due to an increase in number of tourists and the spontaneous improvement of the family tourism.

Furthermore, during that period, this kind of tourism was transformed into an organized private tourism with the appropriate accommodation infrastructure.

Notwithstanding the above efforts, the incomes from tourism during[2] 1992-1997 were relatively low, about USD 300 million. This figure constitutes only 21 % of the total export of goods and services. The incomes from tourism remained in moderate levels in comparison to the great tourist capacity that Albania offers. Therefore, the period we left behind, and moreover the mid-term future is difficult to offer a general normality that would favour a quality and well-organized tourism. Nevertheless, we must admit that the export of goods and services is a very sensitive phenomenon towards the general political, social and economic environment.

2.2 CURRENT TRANSFERS

Remittances from expatriates in foreign currency, which were of vital importance for the majority of the Albanian population,

became more than a typical phenomenon for Albania in the recent years and one of the main items that financed the great imbalance between the export of goods and the import of services.

Chart 3 Remittances and deposits
(Banking system, in millions of lek, flow during the period)
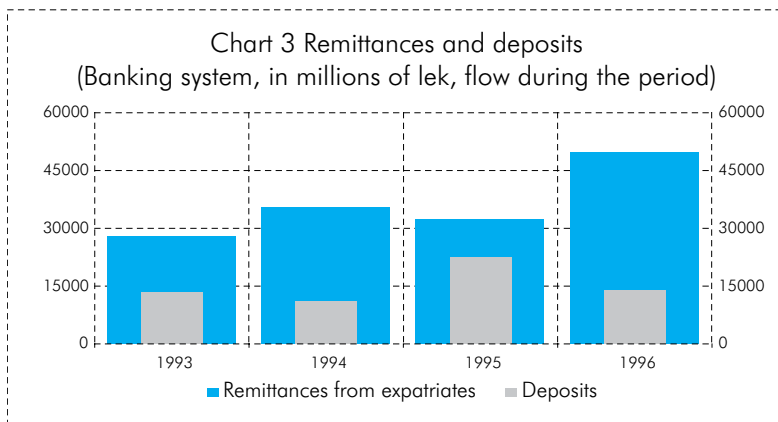
Since 1992, even earlier, these remittances, known as "remittances from expatriates" in the terminology of the balance of payments, became more and more significant along with the high level of state transfers.

It is a well-known fact that the immigration phenomenon on a large scale became evident for the very first time by mid 1990. Since that time and on, the only priority of different categories of population was to leave their country in search of a better future. Though not reliable and correct data are available, it is estimated that there live and work about 400 thousand Albanians[3] in the neighbouring countries, representing all the categories of population.

The Albanian reality of the early `90s and the last year situation, speak for an immigration tendency of the free labour force. Notwithstanding the advantages and disadvantages, such a phenomenon has absorbed the poverty of Albanians to a great extent. The small size of the country made the standard of living, consumption, savings, investments reflect immediately evident improvements on one hand and render possible the external equilibrium of the economy on the other hand.

In the course of 1992-1997, USD 2.8 billion entered in the form of current transfers, of which 1.9 billion are a contribution of the Albanian immigrants. It is estimated that after reaching the climax in 1996, the remittances from expatriates reduced by half in 1997. In spite of that, another recovery of these remittances is expected, in similar conditions as in the course of 1993-1994. The deepening of poverty level and the strong tendency to immigrate may be considered as factors that shall maintain a constant inflow of incomes from immigration and probably a slight growing tendency as against 1997.

2.3 CAPITAL AND FINANCIAL TRANSACTIONS

The chronic current deficit in the course of 1992-1997 was mainly afforded by the high inflow of foreign capital. These funds entered Albania in the form of direct investments and call loans. The total inflow of capital from January 1992 to September 1997 amounted to USD 900 million. Consequently the national debt has continuously increased and according to recent data, the disbursed outstanding debt recorded USD 450 million by the end of September1997.

Chart 4 Direct foreign investments
(In percentage to GDP)
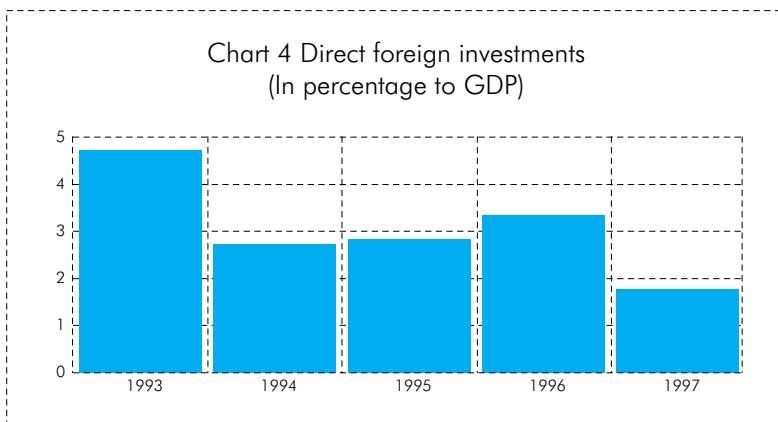
In the absence of other alternatives, of the capital market and initiative, the banking system has found a rest in depositing foreign currency in foreign banks. These funds are foreign currency deposits of the public with the banks.

Table 2 Foreign investments by countries in transition, 1993-1996 (in million USD)

		1993	1994	1995	1996
	Eastern Europe, of which:	3999	3469	9152	7171
1	Albania	58	53	70	90
2	Bulgaria	40	105	90	82
3	Croatia	74	98	81	340
4	Czech Republic	568	862	2562	1428
5	Hungary	2339	1146	4453	1983
6	Poland	580	542	1134	2741
7	Rumania	94	341	419	210
8	Slovakia	134	170	157	119
9	Slovenia	113	128	176	186
10	Former Yugoslav Republic of Macedonia		24	9	6
	In attention:				
1	Albania to total (in percentage)	1.4	1.5	0.8	1.2
2	Albania per capita (in USD)	19	17	23	29

As concerns the division "direct foreign investments", it is observed that they recorded the lowest figure in 1997, in the course of 1993-1997. Compared to 1995 and 1996, they were respectively 39 % and 53 % lower. However, year 1998 recorded a total figure of USD 290 million of direct foreign investments. Referring to Table 2, Albania is ranked last but one, leaving behind solely Macedonia, although part of the listed countries were drown in armed regional conflicts in the referring period.

In the course of 1992-1997, direct foreign investments constituted 9% in the ratio of inflow of current transfers to loans and foreign investments. This figure needs no comment.

We are going to cover further different factors, the lack of which had brought about consequences in the development of foreign investments.

3 CURRENT ACCOUNT SUSTAINIBILITY

3.1 CURRENT DEFICIT. WHEN SHALL IT LEAD TO CRISIS?

Before giving an answer to the above question, let us interpret another problem that is considered by researchers as vital and

imperative to be interpreted. We shall refer to 10 episodes taken from the economic development of 6 developed countries. The most outstanding episode is that of Mexico, which had to face a real foreign currency crisis in the course of 1991-1994. The consequences of such a crisis were reflected in an overall collapse of the national economy and were accompanied by serious effects in the whole region of North America.

The years 1970, 1980 were characterized by a high flow of international capital towards the developing countries of Latin America and East Asia. Such inflows were sufficient to finance the current account permanent deficit in these countries. Consequently these countries, regardless of the implemented policies, did not face foreign currency crisis by that period.

Meanwhile the lack of adequate policies, made a group of countries (3 out of 10 under study) that showed a great and steady deficit, face overall financial crisis, Mexico being the typical case, in the conditions of instant interruption of international capital inflow. On the other hand the implementation of such policies that substituted casual foreign currency inflows with permanent sources, made the other countries ease the fall of foreign capital inflow in the respective economies.

The researchers are mainly dealing with two crucial issues that explain the intricacies that the permanent current deficit causes to internal and external economic stability of a country.

First: If the country is in debt, is it capable of paying it back?

Second: Is the deficit of the current account at a reasonable and adequate level?

A country is able to pay its debts, if it generates in the future sufficient trade surplus. If such is the case, one can say that the national economy is solvent. Nevertheless, this is not the right criterion to define the consequences of the imbalances of the external sector of the national economy.

That is the reason why the researcher refers to the notion of sustainability that openly takes into consideration the will to pay and to lend. Therefore, "a turning point" to meet the solvency and sustainability criteria, is imperative and necessary for a country that finances a new debt with the permanent deficit of the current account and of the trade balance. The problem is whether this turning point shall be reached without bringing about consequences to the economy or it shall be imposed by such economic events as the instant interruption of capital inflows. If the trade deficit gradually becomes a surplus, without constraining authorities to make substantial changes in the existing economic policies, then the deficit is considered sustainable. On the other hand, if this turning point requires drastic modifications of the policies and is accompanied by an instant fall of consumption and economic activity, the deficit is considered as unsustainable and intolerable.

3.2 MACROECONOMIC INDICATORS OF SUSTAINABILITY

The experience of the six countries, which showed a high current deficit in early `80s and `90s, made evident the fact that in three cases (Chili 1979-1981, Mexico 1977-1981 and 1991-1994) the consequences of these deficits brought about financial crisis. After a study of these cases, important relations between a number of macroeconomic indicators and the sustainability of the external position became evident.

3.2.1 Exports to GDP ratio

A nation has to rely on the production of marketable goods as a source of providing foreign currency for the purpose of debt settlement. The countries with a great export sector can pay the external debt more easily, because the debt payment would absorb a small part of total export.

Table 3 Macroeconomic Indicators of Sustainability[4].

	Chili '79-'81 ('82-'83)	Columbia '80-'84 ('85-'88)	Columbia '92-'95	Mexico '77-'81 ('82-'83)	Mexico '91-'94 ('95)	Korea '77-'82 ('83-'88)	Malaysia '91-'95	Thailand '79-'84 ('85-'86)	Thailand '91-'95
Current account	-9.1 (7.6)	-5.1 (0.5)	-3.4	-5.0 (0.3)	-6.7 (-0.3)	-5.4 (2.6)	-5.7	-6.1 (-1.7)	-6.7
Savings	7.4 (5.9)	14.6 (20.5)	16.4	18.7 (22.0)	15.7 (17.9)	25.6 (31.6)	30.0	22.5 (26.9)	34.0
Exports	19.7 (21.3)	12.6 (18.1)	18.3	10.6 (17.2)	12.7 (24.0)	32.5 (36.9)	82.4	23.0 (27.8)	36.6
REER	124.1 (118.5)	135.5 (80.2)	77.6	126.4 (103.5)	113.9 (76.0)	103.6 (92.2)	83.5	115.5 (95)	88.5
Fiscal Balance	2.1 (-3.3)	-3.5 (-1.0)	-0.8	-8.0 (-11.2)	0.4 (0.0)	-2.8 (0.0)	-1.5	-4.3 (-2.8)	3.2
Gross External Debt	48.2 (89.5)	40.8 (43.3)	28.9	31.4 (62.7)	35.5 (65.1)	50.0 (19.6)	35.1	35.9 (35.1)	42.6

The countries we referred to like Korea, Malaysia and Thailand (are considered as countries that were able to correct the chronic imbalances of the current account) significantly increased their exports. The experience of these countries draws out the conclusion that the great imbalances in the current account are less probable to cause external crisis when the economy accounts for a great export.

3.2.2 Real exchange rate

A continuous evaluation of the real exchange rate is led by "fundamental" factors, such as the high growth of productivity of marketable goods or favourable situations of trade instability. Another cause that brings about the evaluation of domestic currency (in real terms) is that the implemented monetary policy is not in harmony with the exchange rate policy. A typical case is the evaluation of the deposit rates. Notwithstanding the factors that induce an evaluation of the domestic currency, the high capital inflows are considered as very important. The developing countries and those of the Eastern Europe, which have undertaken similar structural reforms, have recorded high capital inflows, something that has increased the foreign currency supply, thus inducing an evaluation of the domestic currency.

It is difficult to consider that a real evaluation of the domestic currency reflects the improvement of the fundamental factors and to what extent this evaluation conceals the imbalances in the economy. Nevertheless, the three provided episodes of crisis are characterized by an evaluation of the real exchange rate in the prior crisis periods. The statistical data suggest that the great imbalance in the current account is more potential to generate crisis when accompanied by a relative evaluation of the exchange rate.

3.2.3 Investments and domestic savings

The high level of investments that provides a growth of production capacities constitutes a safe basis for a stable growth in the future. On the other hand, the high rates of investments and savings constitute a safe signal for foreign investors and outline a serious commitment of the country to a stable growth and debt payment in the future. During the three crisis periods the level of savings was low, especially in the developing countries and in those with an average standard of incomes. Quite the opposite was with Korea, Malaysia and Thailand that had high levels of savings.

3.2.4 Fiscal Balance

The observed relations between the budget deficit and the current deficit are stronger in those countries where the role of the state in the financial market is greater. Referring to the events in the six countries under observation (table 3), one draws the following conclusions:

- The lack of fiscal deficit does not mean at all that it will bring about the improvement of the current account;
- Great fiscal imbalances, whether they induce an external crisis or not, require by all means a radical change of policies;
- The external crises are a barrier for the government in the post crisis period.

The conclusions drawn from the observation of the above-mentioned episodes in six countries are real and constitute the main directions on which the Albanian decision making authorities should concentrate their work. In the following, find a sort of response to the questions: Current account deficit in Albania: Is it a potential danger for crisis? Should the financing of the current account be supported by casual and illegal sources? What are the consequences of "super Lek" in the last five years and in the last months of 1998? Are there possibilities for a recovery of the Albanian exports? Can the great tourist capacity of the country be utilized? Should something be reviewed with relation to the implemented policies?

3.3 CURRENT ACCOUNT: THE CASE OF ALBANIA

Let us clarify three important moments and then define what should be corrected.

First, let us define if Albania has a chronic current deficit.

Second, let us clarify if Albania meets the criterion of solvency and finally, we shall juxtapose the current account deficit to the sustainability criterion.

Compared to the absolute value of the current account deficit of the other countries in transition, no doubt the figure is relatively low. Nevertheless, in relation to other indicators like GDP, external debt, foreign reserve, etc., serious figures are obtained. They show that the current account deficit has constantly accompanied Albania and the figures have been relatively high. Mention should be made of the fact that in the last two years such a phenomenon has become alarming.

No doubt the current account deficit in the mid term period shall remain in the current levels (5-6% of GDP), mainly due to an anticipated decline of remittances from expatriates[5, 6]. Although the measures taken shall attempt to appease the trade deficit, it is impossible to restrain the flow of goods without affecting the level of consumption. On the other hand the measures taken

for the recovery of exports belong to mid and long term periods. Therefore, a low level of exports is expected in the next 2-3 years.

In the table below three versions of the current account are provided, of which the most appropriate is the first one. The first version is the one that shows the internal capacity of the Albanian economy to generate sufficient foreign currency in response to the domestic demand for foreign goods and services.

Table 4 Macroeconomic Indicators of Sustainability

		1992	1993	1994	1995	1996	1997
1	Current account/GDP (excluding transfers)	-85,1	-44.2	-27.7	-21.7	-26.1	-24.9
2	Current account/GDP (excluding state transfers)	-62.9	-21.8	-8.3	-6.1	-7.6	-13,2
3	Current account/GDP (excluding private transfers)	-29,7	-21,2	-21,6	-16,1	-22,6	-23,5
4	Current account/GDP	-7,5	1,2	-2,2	-0,6	-4,0	-7,5
5	Export/GDP	10,4	9,1	7.2	8,3	9,0	7,1
6	Savings/GDP	-51.0	-14,9	3,6	11,3	9,0	1.2
7	REER (December 1993=100)		100,0	110,1	113,1	108,0	107,3
8	Fiscal deficit/GDP	-17,0	-10,5	-12,5	-9,4	-12,5	-11,9
9	Total liabilities Const. Fng.Auth.Reserves	78,0	45,9	35,6	13,4	15,1	20,0
10	GDP (in millions of USD)	675,7	1.227,7	1.949,0	2.472,1	2.689,0	2263,5

Note.
1. Current account includes the balance of goods, services and incomes.
2. Includes the above balances plus private transfers.
3. Includes balance of item 1 plus state transfers.
4. Current account that includes balance of goods, services, incomes and current transfers.
5. Includes export of goods.
6. Includes savings of state and private sector and of individuals. IMF estimates.
7. Real Effective Exchange Rate Index. Average Rate for the period.
8. Fiscal Deficit in percentage to GDP.
9. Includes all liabilities of Albania to the rest of the world, in spite of the fact whether the liability is matured or not the external debt. The corresponding figure of 1997 refers to the first nine-month period of the following year.
10 GDP converted to USD. The exchange rate used refers to the average figure of the period. GDP in current prices is an estimation of DEDAC.

It is true that Albania profited great amounts of foreign currency in the form of remittances from expatriates, which

have directly financed that uncovered part of the domestic demand for foreign goods and services (second row). On the other hand their calculation is simply an estimation and as a result it contains in itself a definite percentage of inaccuracy (the method used may include in this figure a category of casual and illegal transactions that cannot be calculated). The more so, this vital source in the past period cannot be considered as a stable source. Furthermore it is quite difficult to restore the confidence of the immigrants to deposit their savings in Albania.

2. If assessing that the criterion of solvency is related to the generation of trade surplus in the future in order to pay the accumulated debt, we may say that Albania does not meet this criterion.

Referring to row 5 and 9 of the above table, two different phenomena are observed. The effect of these two phenomena automatically makes the country unable to pay its past debts in the future. While the ratio of exports to GDP is quite symbolic, 9% on average for the period 1992-1996 and 7% in 1997, liabilities to GDP continuously increased, recording 20% by end 1997[7].

Mention should be made of the fact that up to now we have been referring only to the disbursed outstanding debt. If expected disbursements and new commitments are included (600 million USD for a three-year period), their ratio to GDP shall considerably increase, thus becoming a heavier burden for the Albanian economy.

3. No doubt the most important issue that has recently concerned all researchers is whether the level of current account deficit is sustainable or not. As explained above, this criterion shows if the current level of deficit presumes a turning point that means taking new economic and financial regulatory decisions.

Although the Albanian researchers in the area of economy have studied to little extent or not at all the issues related to

the current account, the existence of real macroeconomic programs (July-December 1992, 1993-1995, October 1997-1998) contains corrective measures in its content, not only for the economy in general but for the external position of the country in particular. Therefore, the engagement of authorities to implementing restrictive monetary and fiscal policies does nothing but restrains the domestic demand that means a lower consumption and as a consequence less import of goods and services.

4. OVERVIEW OF FACTORS CONDITIONING THE DEVELOPMENT OF CURRENT ACCOUNT IN ALBANIA

It should be mentioned that Albania has advantages, such as free labour force, underground resources, a favourable geographical position, tourism capacities, etc.

But actually Albania is facing the total lack of specialized institutions, a destroyed infrastructure, production capacities not yet privatized, quite "original" market forms, unqualified labour force, and total lack of any form of cooperation.

Therefore it is quite difficult to draw the conclusion whether there exists or not an overall favourable, very favourable, or unfavourable macroeconomic environment for all that group of factors that inject or absorb foreign currency in the domestic economy.

Amongst the most important factors that promote such an inflow of foreign currency is the macroeconomic stability, the liberalization of current account transactions, foreign reserve policies, removal of some export tariffs, creation of a favourable environment for foreign investments, the functioning of a normal financial and capital market, establishment of banks and insurance institutes specialized to support with the funds of the export programs, fast and transparent privatization of different sectors of the economy.

4.1 MACROECONOMIC STABILITY

After a total collapse in the early `90s, by the end of 1992 further decline of production was restrained. The following years recorded a general stability that is reflected with a high growth rate, an inflation rate under control and a budget deficit in compliance with the targets. End 1996 and early 1997 reversed everything and as a consequence the economy was thrown into another crisis, though not of the same dimensions as in the previous years.

Nevertheless, unlike the previous crisis, the possibilities to check and re-establish a modest equilibrium in the economy are many. The IMF program constitutes another guarantee to reach a desirable macroeconomic equilibrium.

Since 1992 and on the main characteristic of the macroeconomic programs was the implementation of a tight monetary policy, whose most important instrument was the establishment of a credit limit to the economy. On the other hand, the import of goods and services increased with each passing year. Under the conditions of a total lack of the capital market and the limitations set in the crediting market, it is obvious that the informal market met the needs for financing. The indifference towards this market, the passiveness for its integration, the total disregard towards the volume of transactions performed not in compliance with the program of the authorities, made the collapse inevitable.

The informal market is still present and no doubt it will very soon turn into an absorber of funds. Similar to the period we are referring to, the inefficiency of the capital, money and foreign exchange market and the legal framework have not changed; therefore they are a potential source for disorder and imbalances. The mid-term program to be implemented should consider a new structural arrangement.

4.2 CURRENT AND CAPITAL ACCOUNT LIBERALIZATION

In July 1994, the Bank of Albania approved the "Regulation of the Foreign Exchange Market" that for the first time sanctioned

the total liberalization of payments for goods, services, incomes and current transfers. The repatriation of the initial capital and profits generated by foreign investors was allowed without limitation.

Though this factor stimulated foreign trade, its direct impact on exports is not yet evident. On the other hand, the restrictions with respect to capital account have existed only in a written form, and their abrogation de jure, pursuant to the Bank of Albania Law should have been done earlier.

Nevertheless, the problem of liberalization of capital transactions remains a debatable issue. The question arises: Shall the Bank of Albania use its authority to still put restrictions on the capital account? There are arguments in favour of and against the liberalization of capital transactions. The highest risk involved in this liberalization is the outflow of capital and domestic savings. The experience shows that the liberalization of capital account may continuously influence the exchange rate in response to the changes of the politic-economic environment and macroeconomic destabilization as a result of the short-term fluctuations of capital.

The experience of past years shows that the restrictions imposed on capital account were simply juridical concepts that not only prevented the inflow of capital but also eliminated the use of specialized channels in the inward and outward movement of funds. The movement of funds in both directions de facto is carried out without difficulties, though the risk involved is very high. On the other hand the elimination of restrictions on capital transfers shall convince any individual that it is better to make use of the facilities provided by the banking system than expect from the risky and adventurous undertakings. Although the restrictions are present, the exchange rate fluctuations in other indicators and in the macroeconomic stability are not reduced. It is right to say that the liberalization of current and capital transactions constitutes nothing but an administrative restriction. Probably the size of the Albanian market, the distorted legislation, bad infrastructure, incompetence of administration, etc., are thought

to be factors that lessen the positive effects resulting from the removal of restrictions on the inflow and outflow of goods and monetary values.

Chart 5 Average monthly exchange rate (lekë/1 USD)
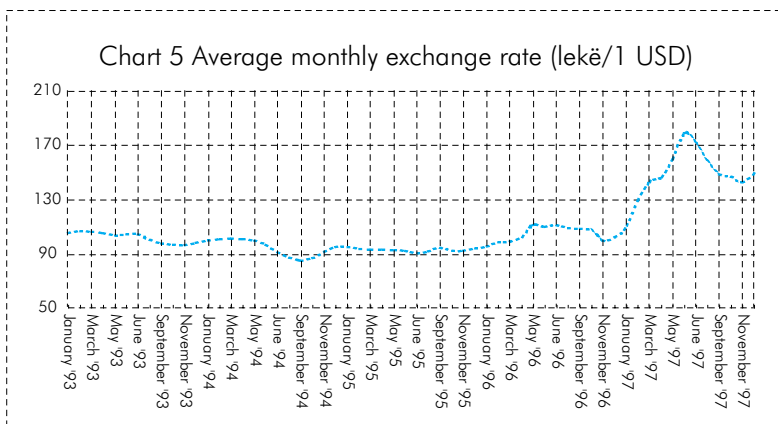
4.3. FOREIGN EXCHANGE POLICY

Since July 1992, a flexible exchange rate regime was used in Albania. The prices of foreign currencies in relation to the Lek were freely fixed depending on the supply and demand. Notwithstanding the reasons that caused the implementation of such a regime, the Lek was characterized by a relatively strange stability.

Although the demand for foreign currency was high, it was compensated by an excess supply. This high supply that rendered possible the establishment and protection of domestic currency stability (mentioning the tight measures of monetary policy applied since July 1992) was not provided by production factors and the inflow of capital, but simply by the spontaneous remittances from expatriates and by casual and illegal activities.

Nevertheless, in the first months of 1997, the four-year stability came to an end and the Lek lost almost 80% of its value not only against the USD but also against other strong currencies. As presented in Chart 6, 1USD was exchanged with 180 Lek.

But this figure was temporary and by November the Lek was exchanged on average by 143 Lek.

Chart 6 Real effective exchange rate
(Index, December 1993 = 100)
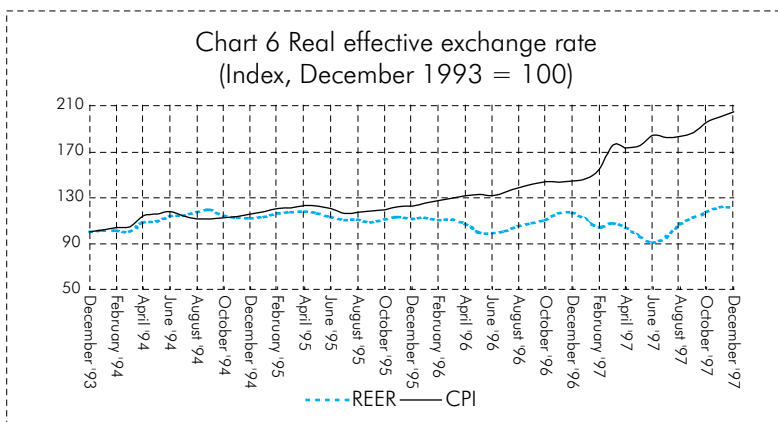
Let us briefly consider the implemented policies and the implications on current account. Although the target regime was that of a fluctuating exchange rate, the price of the domestic currency was freely fixed by the supply and demand. The implementation of such a regime does not imply the intervention of the Monetary Authority and in this framework does not mean that the foreign reserves of the country should be used to keep a fixed exchange rate. The interventions made were few and sporadic, aiming at avoiding market speculations. Though the preference of authorities was to maintain a super Lek (a false dream that should never occur), the arrangements were so as to support a stable Lek, by providing stable foreign currency sources that were very modest and spontaneous.

Amongst the promoters of excess foreign currency supply, we would highlight the flourishing of informal market. The interest rates applied by this market attracted the attention of the Albanian immigrants and of a considerable number of non-residents towards investing a great amount of money in these schemes, thus increasing the inflow of foreign currency sufficient to finance the ever increasing trade and services deficit. On the other hand, a great number of illegal activities, manifested in the form of clear smuggling, provided continuous inflow of

foreign currency. Thus, the main sources of foreign currency supply were identical with the main financing items of the current account deficit and as a consequence the reaction of these sources towards definite political-economic circumstances made the exchange rate and the current account deficit follow the two above mentioned sources.

Therefore, the current level of the two items of the balance of payments (Remittances from expatriates and Errors and Omissions) is the main determinant of the exchange rate. In the meantime, the reverse effect of the current development of the exchange rate shall not condition the increase or decrease of these two figures[8].

On the other hand the exchange rate itself has never played the role of a catalyst with respect to foreign trade, and moreover if we refer to exports. It can't be said that the Albanian traders or producers would prefer to trade abroad instead of trading in the domestic market with a greater amount of Lek in exchange of a foreign unit of money.

The reason for that is that in the period we are referring to, the amount of goods and services produced in general and those produced for export purposes in particular was very low or better say inexistent.

Referring to Table 4, row 7, it is observed that after a fast depreciation in 1993, 1994, 1995, the index of the real effective exchange rate declined rapidly in the last two years, thus recording an appreciation of the Lek, respectively by 4.5 % and 6% in 1996 and 1997.

In spite of what was mentioned above a series of questions arise. Can the exchange rate become an incentive for exports? Is Albania interested in keeping a stable domestic currency, at a time when production capacities are destroyed and financial system is characterized by a series of deficiencies, the elimination of which is very difficult for objective reasons? Although the level of foreign reserve is still low, we are of the opinion that a flexible

exchange rate should be applied. This kind of regime eliminates the deficit or surplus of the balance of payments. The application of a flexible exchange rate regime brings about a deterioration of trading activity, a restraint of investments, great exposure to speculations, high inflation rate in the long run, etc.

Another regime to be applied is the adjusted flexible exchange rate. It is a well known fact that changes of economic factors in different countries impose on-going fluctuations in the exchange rates, in order to avoid deficit or stable surplus and on the other hand, short term fluctuations in the exchange rates tend to disorientate and discourage commercial and financial inflow. That is why the central banks of many countries buy or sell foreign assets to assuage significant and instant fluctuations in the exchange rates.

Actually it seems that the Bank of Albania has implemented such a policy for many years. If considered carefully, the interventions were made for modest purposes and the effect was minimal. In general the interventions tended to restrain the depreciation of the domestic currency and have occurred in special situations of the country, such as electoral campaigns or unstable political and economic situations and in one or two cases they aimed at eliminating the speculations. It should be accepted that they had an instant effect, in spite of the minimum amount of reserves involved.

Chart 7 Domestic Credit in the formal sector.
(In millions of Lek, flow during the period)
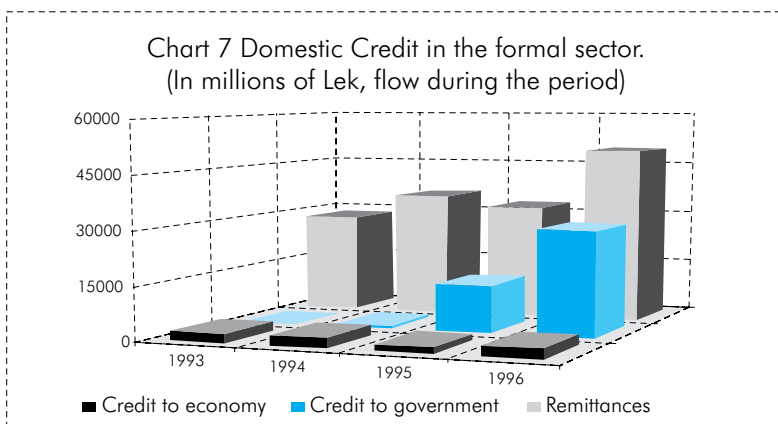
This fact is meaningful, for it shows that the cost of the market orientation is relatively low and the target to contribute to a nominal depreciation of the Lek by 10% every year is easily achievable. This does not mean that the Bank of Albania shall strictly comply with the above figure. In other words this means that in a stable economic, political and financial environment, the Bank of Albania shall attempt to depreciate the Lek by 10%. On the other hand, this does not imply interventions on the part of the Bank of Albania to avoid a depreciation of the domestic currency above this figure, always if stability exists.

The effects of this foreign exchange policy in appeasing the current deficit shall become evident by a gradual decline of trade deficit. It is obvious that imports shall become more expensive because more domestic currency shall be provided in exchange for one exported unit. This does not mean that consumption shall be restrained but this shall serve as an indirect means to stimulate domestic production. A wide range of consumer goods for different reasons is imported though possibilities to be produced in the country do exist. Therefore the moderate depreciation of the Lek shall maintain the competitiveness of the Albanian economy.

On the other hand, because of the psychological effects that such a policy will induce, the expectancy of the public for a better exchange rate in selling shall be increased.

Thus a considerable amount of savings and remittances from expatriates shall remain in abeyance and few free funds shall be available to finance the informal market from this source.

4.4   SAVINGS AND INVESTMENTS

No doubt the period we left behind gave Albania the historic chance to create a general ambitious level of domestic savings. We speak of a general level of savings, because Albania had the great advantage of absorbing a significant amount of funds from the international community and the labour of immigrants besides the incomes generated by making use of the domestic

sources. Therefore there existed all the possibilities to create a general positive position of savings in the public, private and individual sector as well. Albania counted for high sectorial deficit in the early years of this decade. This was reflected with a negative position of the current account in all sectors. The decline of production in 1991, 1992 further deepened the sectorial domestic deficit and increased the external debt that by end of 1992 constituted 78% of GDP. The period following 1992 was characterized by a high growth rate, thus creating real premises for a recovery of the inherited sectorial deficit.

Nevertheless, in the absence of adjustment and orientation policies, every source of incomes was inclined to consumption, which by end 1996 accounted for 1.5 billion USD. Although a considerable amount of incomes generated were invested in different forms, of which investments in construction, services, light industry and a few in food industry were most dominant. Mention should be made of the fact that these investments belonged to the private sector of the economy. A few foreign projects were channelled by the public sector and aimed at improving the national electricity grid, water supply system and telecommunication. However, the high level of incomes generated did not face the old and contemporary mentality of spending money. These valuable resources never faced a right policy of saving and investing that would support the flow of these funds to those branches of production that served export. They did nothing, but promoted consumption and created a wrong idea on investments and the risk involved in them. No doubt, the risk was of the decision-makers.

Without leaving aside the objective obstacles that exist in Albania related to infrastructure, mentality, inherited poverty, lack of legal and institutional framework, the geographic, demographic and market dimensions which to a certain extent serve as justifying arguments, let us mention the following factors:

Firstly, and no doubt the most outstanding factor was the informal market not under control, which finally degenerated

into mere pyramid schemes and the consequences of which need no comment.

Secondly, although the People's Assembly approved the Law "On Protection and Promotion of Foreign Investments" and simultaneously the Agency for the Promotion of Foreign Investments was established, this political engagement was not followed by the establishment de facto of the institutions that would make this engagement a reality. Although the law provided for a non-discriminated treatment on the part of authorities, it is a fact that the institution which would sanction the elimination of the political risk[9] did not exist.

Thirdly, the specialized link of savings and investments did not function. The banking system as the most specialized intermediary did not attempt to play such a role and could not play this role de facto. The fragility of the financial system, the unsatisfactory level of services, the application of restrictions on domestic assets, the lack of specialized financial institutions support the idea that the banking system was not feasible to effectively perform the function of the intermediary. Therefore, money circulated crazily in the informal market which by being introduced as the best means for investment diverted the attention from production and promoted only consumption by increasing import and trade deficit.

Chart 3 significantly illustrates that part of remittances from expatriates[10] that was deposited in the banks in the form of demand and time deposits[11], though represented in Lek or foreign currency. Chart 7 illustrates on one side the high investment potential provided by the remittances from expatriates and on the other side the domestic financing realized by the second tier banks.

Another potential error was the failure to accurately report the needs of the country in the framework of bilateral and multilateral assistance and cooperation and incapacity of the administration to finalize them. This is proved by non-disbursement[12] of 270 million USD out of 520 million promised by the foreign donors, governments and financial institutions.

4.5 PRIVATIZATION

In the early `90s one of the measures taken to decentralize the economy was the privatization of land, a process completed relatively fast. The privatization of land was followed by a global privatization strategy, the stages of which consisted in the privatization of small and medium enterprises and after the completion of the legal framework it was aimed at the massive privatization of big enterprises.

The objectives of this undertaking were ambitious and aimed at transferring state owned property to private business, so that the efficiency and flexibility of this sector would become the promoter of regeneration of production capacities that were totally amortized in the early `90s. Without judging whether the most appropriate way was found for privatization, it is a fact that the end of 1997 made evident the following:

Although the privatization of land was considered as a completed process since 1992, it is a fact that there still exist contradictions in clearly defining the boundaries. On the other hand through these problems are solved in some areas, the buying and selling of arable land is prohibited and no kind of cooperation exists. The movement of population towards the urban areas (especially towards the capital city) was significant, thus lowering the number of population in the rural areas.

Mention should be made of the fact that the pyramid schemes gobbled up not only their savings but the livestock as well that was converted into money. All these factors weakened significantly the privatization process. As a consequence, the agricultural production after the recovery in 1992 -1994 remained at low growth rates, something that induced an increase on the import of agricultural products.

Albania was considered as an agricultural country and the agricultural products were very important for the traditional exports. Perhaps it is the right moment to implement direct and indirect fiscal and financial policies to stimulate different forms

of cooperation, the superiority of which needs no comment. As long as the agricultural economy is divided into thousand pieces, the possibility to utilize the favours and superiority of the technique, biology and finance shall remain an abstract notion. However, being a complicated process it requires the improvement of the legal framework, the priority of which should be the arrangement of the relationship of buying and selling the land.

In the early `90s the Albanian industry was characterized by the existence of a great number of production, service, export-import enterprises, which may be classified as small medium and big enterprises taking into consideration their form and size.

A small number of these enterprises served the Albanian exports, mainly a group of mines located in the north east part of the country.

The rest of enterprises by the end of `80s and the early `90s were transformed into worthless production capacities that were subsidized by the state budget. The privatization to date did nothing but transferred the inefficient group of small and medium enterprises into other hands that proved to be unable to recover them and serve export.

On the other hand these production entities that have traditionally covered the greatest part of the Albanian export were reorganized in a centralized management way (Albkromi, Albbakri, KESH, Albpetroli, etc.), which gradually and systematically degenerated and today are in very difficult economic-financial situations.

Therefore the creation of a new class of small businessmen, who were not effective in the conditions of the lack of technical assistance on one hand and the systematic misuse of the so-called big state owned corporations on the other hand made the contribution of industrial production in the growth of total production be insignificant and consequently even in the growth of export.

Probably in the near future the minimum simplification of the bureaucratic procedures and a series of facilities shall be a priority for at least in the two-three first years, because only like this the strategic investors shall be attracted.

4.6 OUTSTANDING EXTERNAL DEBT

After being released of the outstanding external debt in the third quarter of 1995, Albania became a country without arrears. Nevertheless, as a result of the disbursed credits in the period of 1992 to 1995, the amount of liabilities to non-residents by the end of 1995 accounted for 15% of total production as compared to 40% in the end of 1994. However, the end of 1997 recorded an external debt of USD 500 million, which was a heavy burden for the economy in the mid-term future. Although this amount constitutes soft and long-term loans, adding the commitment of foreign donors (600 million USD in the next 3 years), it is obvious that the recovery of the Albania economy capacities to generate sufficient foreign assets becomes an issue of primarily importance. The logic for that is as follows:

Firstly, the continuous increase of the external debt makes Albania unable to finance the deficit of the external sector with a new debt,

Secondly, the increase of the external debt is associated with an increase of the internal debt that in a way or another consumes the domestic financing resources that are to be used for the payment of the external debt.

Thirdly, under the conditions of the existence of a chronic current deficit, the irrestrainable growth of the external debt becomes a premise for the deepening of the current deficit that may bring about many imbalances.

Fourthly, the apparent inaptitude to promote export growth reinforces the conviction that the potential danger for a foreign crisis is real.

Chart 8 External Outstanding Debt and Export
(In percentage to GDP)

■ External Outstanding Debt in % to GDP   ■ Export in % to GDP
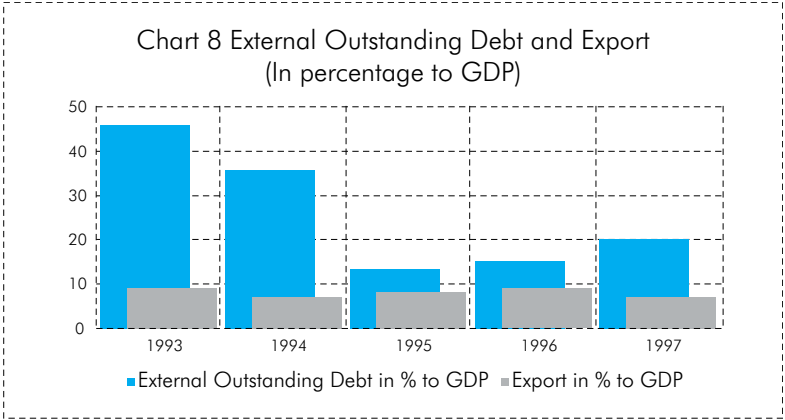
Fifthly, after almost 5 years the current level of foreign currency reserve continues to be modest, in spite of its growth in absolute value. An immediate restraint of the external financing would reduce it simply into a financial concept (see chart 9).

Chart 9 Foreign exchange reserve and Import (In millions of USD)

■ Foreign exchange reserve
■ Average monthly imports — Foreign exchange reserves in months of import (right)
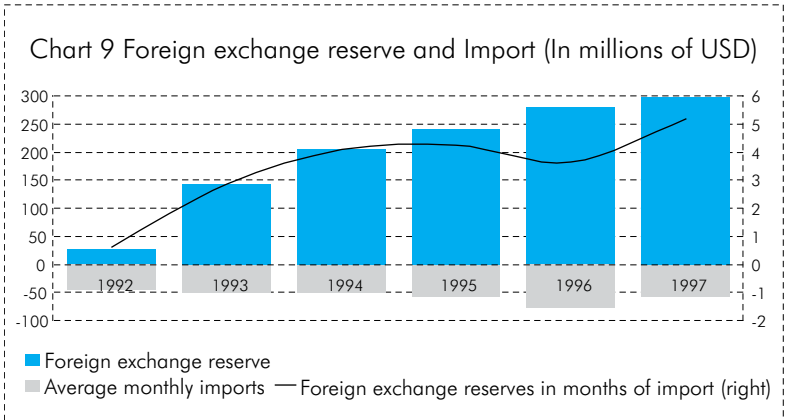
At the above example taken from the events happened in some countries of Latin America and Asia, the solutions presented in the South – East Asia countries are treated as the most successful cases and their economic indicators are considered as satisfactory. However, the experience of the previous year last months, pointed out that these successful economies faced foreign exchange crisis, and as a result of them the capital markets and the foreign exchange ones suffered incredible shocks.

The recent experience of the Asian countries denoted that a country cannot be a never-ending attractive one for the foreign investors. Even though, previously these countries did their best to attenuate the current deficit, at present they could do nothing under the circumstances of the interruption of short-term capital inflows (change of the investors' preferences)[13].Every country, in spite of the level of the ratio of export to GDP or the external debt, may face crisis in the event it does not find ways to absorb foreign assets which on their part should not excessively increase short and mid-term liabilities.

Referring to Table 4, it is observed that such indicators as the current account, export, fiscal deficit, have deteriorated by reaching critical levels in the end of 1997. Considering Chart 8, one draws the conclusion that Albania is not able at present to generate sufficient trade surplus for the future. Under such conditions, the careful treatment of funds flowing in Albania in the form of remittances from expatriates, casual assets and other capital inflows is of primary importance, besides the promotion of the export of goods and services.

The figures of the balance of payments show that these incomes are generally presented with fluctuations by always being at high levels.

Especially during the last two years, illegal activities have provided great amounts of foreign currency. It should be

Chart 10 Overall Outstanding Debt (In percentage to GDP)

■ Domestic outstanding debt in % to GDP ■ External outstanding debt in % to GDP
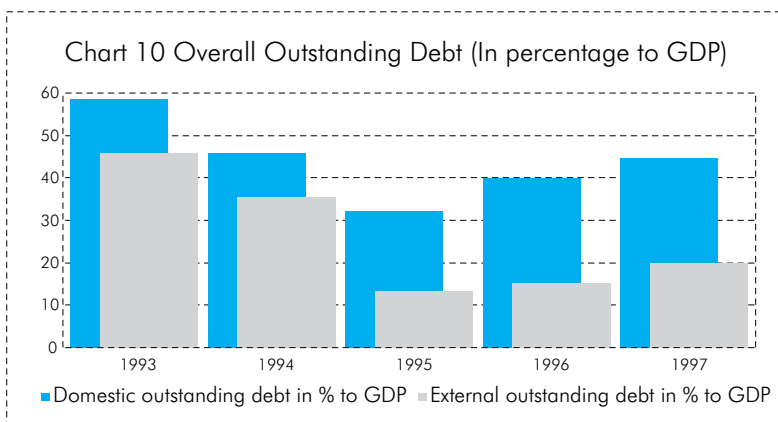
accepted that these two financing factors couldn't be considered as resources for the generation of foreign currency. On the other hand the illegal activities cannot be considered as financing resource by the time the remittances from expatriates are reduced to a minimum level, depending on the will of the immigrants.

In the first part of this paper we proved that for some time (at least in the mid-term period) the current transfers shall play a decisive role, though leaving everything to spontaneity may induce a decline and may be reduced to a minimal means of livelihood. Referring to countries like Turkey, Argentina, etc., for which immigration is a massive phenomenon, we would suggest the implementation of a more attractive policy of interest rates in the international market. This would render possible the inflow of funds (remittances from immigrants sent to keep their families), of investments and the increase of savings deposits in the banks of the countries where they work. In the event fast actions are not taken for the implementation of an appropriate policy, foreign banks established in Albania shall take similar steps and the funds shall outflow. The bilateral agreements between the Bank of Albania and other powerful banks in countries like Italy, Greece, and Germany aim at providing the highest interest rates for the Albanian immigrants, while the cost of such an operation above the market value shall be afforded by the Bank of Albania.

In spite of the relative cost involved in this operation, the vitality of these remittances for our country makes this operation imperative. On the other hand, they are channelled through the banking system, different from the fore running period.

5. CONCLUSIONS

Usually the permanent current deficit has been the main cause for the generation of crisis in the economy. The negative consequences have compelled the authorities to be vigilant to them. In other words, whenever the economy of a country gives signals of crisis, the economic authorities take regulatory measures to avoid the risk involved.

As described above the actual position of the current account in Albania is very complex, with potential possibilities to generate foreign currency crisis, the negative consequences of which would be fatal. The fragility of the political, economic and financial equilibrium of the moment increases the probability that these potential possibilities be converted into a real "shock".

Although it is very difficult to forecast the development of the current deficit in the near and remote future, the priorities to facilitate this forecasting in the future consist mainly in the establishment of a general stable macroeconomic environment. The implementation of restrictive fiscal and monetary policies is an efficient measure to appease the current deficit. It is true that keeping under control the aggregate of the domestic demand means control over consumption and as a consequence control over imports, but on the other hand it means control on investments, which indirectly means less exports. Taking into consideration the current possibilities of the country and the engagement of the international community, it is wholly justifiable to aim at a sensitive reduction of the level of imports for the simple reason that the effects of the structural and institutional arrangements require time, while the current situation should be considered as emergent.

Nevertheless, the question we are faced with is making appropriate legal, institutional and structural arrangements that for at least over a mid term period would render possible the gradual appease of the current account deficit. The impressiveness of carrying out the above is reinforced when in the every day reality we are faced with significant deficiencies in:

- the current situation of production capacities of the country;
- the current level of the national infrastructure;
- the functioning and the structure of the banking system;
- the form of organization, functioning and participation in the markets;
- the small number of investment options;
- the uncompleted legal framework;
- the low level of education.

Given the above, there is reinforced the idea that the basic priority for every country with a current deficit like that of Albania is the indispensability of increasing exports, without which the turning point to generate sufficient current surplus to serve the external debt will never be reached.

The successful achievement of these regulatory measures usually requires a review of the basic policies according to which the national economy functions. Furthermore, quitting the current policies is much easier when the experience shows that the current policies were not in compliance with the targets for which they had been chosen. The liberalization of the current account and the depreciation of the domestic currency are measures to be taken without delay. Such policies, by indirectly influencing the public behaviour, would assist the authorities in stimulating the willingness for saving or consumption.

Although the current account shall continue to be financed in at least over the mid-term period by the savings of the rest of the world, it is obvious that the liabilities in foreign currencies of Albania shall increase, too. The prudential use of these funds remains a priority for the future. Inefficient management of these funds will inevitably induce crisis in the external sector. The external debt figures are such that they do not promise payment of the current debt with a new debt.

The limitation of the borrowing facilities requires the displacement of the current deficit burden from the common loans to other forms of capital attraction like foreign investments, mainly direct investments.

These forms of capital require a capital market of real production capacities[14] that would give potent investors the controlling package of the market. On the other hand the establishment of specialized financial institutions to support with funds and to guarantee them would be a decisive factor in the creation of an appropriate environment, not only for foreign investors but also for the domestic projects that tend to support exports.

The relatively short experience of the transition period shows that the financing of high trade deficit is not provided by the capital inflow but by other current account items (remittances from expatriates).

The foreign assets generated by the labour of immigrants should by all means be supported by a reasonable policy of the monetary authorities. Such a policy, besides the channelling of the current transfers from consumption to investments should aim at absorbing all foreign assets generated by the labour of immigrants, whether they flow into Albania or are placed in saving deposits in the countries where they live.

NOTES

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Altin Tanku, Chief of Statistics and Balance of Payments Sector. December 1998.

[1] The data are taken from the General Directorate of Customs. Nevertheless, the number of this imported group of merchandise as a matter of fact is higher than the one recorded by the customs.

[2] The data for 1997 are an estimation, subject to future review.

[3] There are suppositions that this figure goes up to six hundred thousand persons, more than half of which lives in the neighbouring country of Greece.

[4] Current account, exports, savings and fiscal balance are as a percentage of GDP (average period). RER are average period (RER: average of 1970-95 = 100). Foreign debt is as a percentage of GDP (end of period). Figures in brackets show the periods after arrangements are made. Source: IMF Working Paper 96/110, Current Account Sustainability: Selected East Asian and Latin American Experiences).

[5] Compared to 1995 and 1996.

[6] The fourth row of table 4.

[7] It must be mentioned that the row 9 of the above table includes also the repayments of the disbursed outstanding debt of Albania in 1995. This is the reason why the figure drops from 35 percent of 1994, to 3 percent of 1995.

[8] As already known, the item "Net errors and omissions" is calculated as a deduction, as a result it reflects the level of the transactions with abroad, that cannot be measured.
The major part of this item comes from the illegal activities, known with the term smuggling. It is obvious that their level is not determined by the exchange rate, but by other different factors. Moreover, it is also possible that in the item "Remittances from expatriates" are wrongly included capital inflows from illegal activities.

[9] In this kind of risk are usually included civil wars, civil anarchy, government's decisions that impose unfair and discriminatory exchange rates, government's operations that deny property rights, government's operations to erect customs barrier, etc.

[10] The calculation of remittances from expatriates is an estimation of the Bank of Albania, where are not included the foreign currency supply generated from smuggling activities. This implies that the difference between what was coming in and what was deposited in the banks was greater than what is shown in chart 3.

[11] In order to better represent the difference between remittances and deposits in 1996, the demand deposits of the big enterprises in commercial banks have been deducted.

[12] The data refer to the period January 1995 – October 1997.

[13] However, it should be emphasized that the current crisis of the Asian countries is more complex and it shows a general crisis of the Asian market, which after a relatively long period of unarrested growth, is experiencing a general recession. The multilateral connections of these markets affected them mutually, globalizing in this way the foreign currency crisis over all the South-East Asian countries.

[14] The medium and big enterprises, including the strategic sectors of the economy.

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THE CONSTITUTION AND THE BANK OF ALBANIA

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Keywords
- Bank of Albania - Constitution - Governor -

The Albanian State had for the very first time in 1992 a central bank, whose functions were defined in the Law "On the Bank of Albania". Since the approval of this Law in April 1992, its legal framework has continuously altered, depending on the changes of the Albanian economy and especially of the banking system, not escaping the hairpin bends of the Albanian politics. The amendments made to the Law aimed at defining better than ever the independence of the Bank of Albania.

Pursuant to this idea, it was requested that the new Constitution of the Republic of Albania had included a special article on the Bank of Albania.

Article 161 specifies the main functions of the Bank of Albania:

1. The exclusive right to issue and circulate the Albanian currency;
2. The right to independently implement the monetary policy of the Albanian State.

This right, combined with the primary target of the Bank of Albania, "maintaining price stability" provided for in the Law "On the Bank of Albania", further reinforces its independence.

The strategy adopted by the Bank of Albania to implement its monetary policy is directed towards stability. This makes the Bank of Albania more concerned about the solution of the problems in the long run, by detaching itself from the instant interests and temporarily good solutions.

3. The right to maintain and manage the foreign reserve of the Republic of Albania.

The Article clearly and definitely states for the management form of the Bank of Albania and the term during which the governor, the number one of this institution, shall hold his position. We consider this as very important, under the conditions when Governors' tenure has been short. Each Governor has run the Bank of Albania for a period of 16 months on average, out of 84 months of the mandate.[1]

The inclusion of this Article in the fundamental Law of the State bears witness for a positive step taken towards the strengthening of the Bank of Albania independence. Nevertheless, we are of the opinion that the law would have been amply clear in its objective to sanction the independence of the Bank of Albania in the event it contained even a single sentence - "The Bank of Albania is an institution independent of any power" or "The Bank of Albania is an institution independent of political interventions".

Anyhow, no law can provide for the independence of an institution, being it a monetary authority, if the will to respect it does not exist. In this framework, the first step to be taken is to accept the idea that the law should be respected rigorously.

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CREDIT TO ECONOMY IN THE COURSE OF 1998 AND EXPECTATIONS FOR 1999

Fiqiri Baholli
Edlira Abazi*

The Bank of Albania anticipates in its monetary program an increase of money demand as a result of credit to economy. The support of the economy with credit is one of the main tasks of the banking system closely related to the specific conditions of our country, such as:

- Backward level of technology and information;
- New requirements put forward by the transition;
- Natural resources available and the lack of activities to make use of them;
- New elements of capitalism in business and foreign competition.

In order to check expansion of money through the credit to economy[1], the Bank of Albania has used the credit instrument[2] since the start of its operation as the central bank of the country. For this purpose, in compliance with the main objectives of the economic programs, the increase of the banking system credit is defined at the very beginning of the year.

Credit ceiling to economy anticipated in the monetary program of 1998 was primarily defined Lek 6 billion and later was reviewed and defined 2.5 million.

By early 1998, credit of the second tier banks was as follows:

(In millions of Lek)

	State - owned banks +Dardania Bank	Private Banks
Total of outstanding loans	13127.7	2707.3
Short-term loans	4364.3	1953.7
Long-term loans	8763.4	753.6
From which:		
Non-performing loans	9236.7	302.3
Short-term loans	3838.7	185.3
Long-term loans	5398	118

Crediting of the economy was channeled through the private and joint venture banks that perform their activity in our country. State owned banks as the National Commercial Bank, the Savings Bank and the Dardania Bank were exempted from the right to use credit ceiling.

Year 1998 highlights the following progress of the domestic credit, in its both categories:

- credit to government,
- credit to economy.

The percentage of credit toward domestic credit:

				1998
	Dec. '97	Q 1	Q 2	Q 3	Q 4
Credit to government	91.3	90.9	91.1	91.3	91.5
Credit to economy	8.7	9.1	8.9	8.7	8.5

It is observed that credit to government has the greatest share in the stock of domestic credit.

That is the reason why the budget deficit was the main source of expansion of money demand.

The fact that the public sector constitutes on average 91% of the domestic credit, shows that most of deposits is destined to finance the expenditures of the public sector. The investment in treasury bills by the second tier banks is a minimum risk investment.

But on the other hand the existence of the above ratios of the domestic credit may lead to economy imbalances in the future.

The changes that occurred in the stock of credit, its tendencies from one quarter to the other, compared to end 1997 are as follows:

Banking system	Dec. '97	March '98	Jun. '98	Sep. '98	Dec. '98
Stock of credit in millions of Lek	15835	16418	16892	17397	17692
Change of stock of credit in millions of Lek		583	1057	1562	1857
As % to stock of credit in 1997		3.6	6.6	9.9	12

The increased stock of credit to economy as observed in the above table, did not reach the levels anticipated by the monetary program.

Until the end of the year, the stock of credit increased by Lek 1.8 billion.

The new credit allocated in 1998 accounted for Lek 5.8 billion and the receipts from credit were Lek 4.2 billion. The settlement/ usage ratio is estimated at 72.4 % for the whole year, indicating that the credits extended during 1998 have been regularly settled. The receipts and the use of new credits in 1998 by the state-owned and private banks were as follows:

	Use + rescheduling	Receipts
State-owned banks	905.5	1827.1
Private banks	4857.7	2403.6

Credit in Lek constituted 69.4% of the credit stock in 1998, whereas in 1997 it had constituted only 77% of the stock.

Credit in foreign currency was a preference of the private banks by reaching to 41.6% of the total credit stock. In 1997, it comprised only 23%.

43% of the credit structure of the banking system was short-term credits, whereas 59.8% were non-performing loans.

As concerns foreign private and joint venture banks, short-term credit constituted 73% of the credit stock by end 1998. In the state-owned banks, this figure was 22.1% and that of non-performing loans was 79.8% (National Commercial Bank, Savings Bank, Rural Commercial Bank).

Credit portfolio of the banking system was Lek 12 607 million, which is the credit outstanding in the state-owned banks, and Lek 5 085 million, which is the credit outstanding in the private and joint-venture banks.

It is observed that the private and foreign banks have supported with credits the branches of the economy, such as, trade, silviculture, construction, fishery, tourism, repair of vehicles and electrical appliances etc., which have not affected the increase of GDP indicator.

The increase of credit stock by banks in 1998 was as follows:

Banks	Stock of credit Dec.'97	Stock of credit Dec.'98	Increase of credit stock
NCB*	2079.8	1525.3	(554.5)
SB*	9454.3	9704.7	250.4
Dardania Bank	220.5	159.1	(61.4)
Italian Albanian Bank	2520	3674	1154
Tirana Bank	159.1	743.5	584.4
National Bank of Greece	0	0	-
International Commercial Bank of Malaysia	28.3	210.5	182.2
Alpha Credit Bank	0	297.8	297.8

*Credit to the Housing Entity is transferred from the NCB to the SB.

The Italian Albanian Bank is the bank that has recorded the highest increase of credit stock as compared to other banks in Albania. The credit portfolio by the end of 1998 constituted only 42% of the total assets and 68% of the total deposits.

The Tirana Bank has used 48% of the credit ceiling.

The International Commercial Bank has used about 82% of the allocated credit ceiling.

The Alpha Credit Bank, although started to extend credit in the second quarter of 1998, realised 62% of the credit ceiling.

The National Bank of Greece has not extended credit in the course of 1998.

Hence, we may draw the following conclusions for 1998:

- Credit ceiling defined by the Bank of Albania in the monetary program for the year was sufficient and did not become an obstacle for the credit to the economy by the banking system.
- Private banks have preferred to extend credit in foreign currency, though the exchange rate of Lek against other foreign currencies was stable.
- Short-term credit has dominated the credit to the economy, indicating that lending has supported small businesses and not important projects for investments in key branches of the Albanian economy.
- The low level of utilization of credit ceiling reflects the safe investments of money in TB and deposits in foreign currency.
- There exists a contradiction between the bankers and businessmen with respect to the extension of credit. The reasons, according to bankers, are the business plans that have many weaknesses.
- Another important element for crediting by the private banks is the history of customer-bank relations. It is important that a client, who applies for a loan has an account with the bank.
- We are of the opinion that all foreign private banks had low figures of extended loans, because they were more interested in saving money for the future strategy, minimizing the risk as much as possible.
- Another problem is the non-extension of branches of foreign private banks to the whole territory of Albania. The lack of infrastructure and the events of September negatively affected the confidence of investors in the lending activity of the banks.

- The money generated from smuggling or different traffics, is invested without passing through in Albania. This reduces the demand for credit to a certain extent.
- The stabilization of the situation in the country and in the region would increase the confidence of private banks to extend their crediting activity.

The Bank of Albania has planned in its monetary program of 1999 a credit ceiling of Lek 8 billion, allocated as follows:

(In millions of Lek)

Banks	Q 1	Q 2	Q 3	Q 4	Annual
Italian-Albanian Bank	580	720	870	720	2890
Dardania Bank	0	70	80	70	220
Tirana Bank	380	470	570	470	1890
National Commercial Bank of Greece	70	290	340	290	990
Alpha-Credit Bank	200	250	300	250	1000
International Commercial Bank	90	110	140	110	450
Albanian-American Bank	280	90	100	90	560
Total	1600	2000	2400	2000	8000

Based on this allocation, the Monetary Policy Department addressed a letter to the above banks on 18.02.1999, requesting them to provide, within 26.02.1999, the BoA with information about their possibilities to utilize credit ceiling for 1999, about their goals, their problems and difficulties they may face in realizing it.

All the banks were of the opinion that the purpose of their activity was not only to create a clientele that had deposits and made transfers with them, but to develop a crediting activity as well. This was contrary to their risk policy.

All the banks that have the right to use the credit ceiling allocated by the BoA for 1999, in spite of their objectives to realize this credit ceiling, raised some problems and concerns they encounter in the lending process.

- Political insecurity towards which the private business is very sensitive. Taking into consideration the importance of the political and economic stability, it is the task of the Albanian state that all the political forces in the country should establish a safe climate for investments.

- Albania is lacking a modern payment system. The transfer of money takes almost 20 days and payments are made in cash.
- Businessmen are not well educated to work with banks. They rarely turn to the banks while their relation with them should be constant.
- The difficulty to evaluate the collateral is another obstacle for crediting the private business. There is another difficulty related to the real estate guarantee and property registration. No preliminary evaluation of properties exists, but they are evaluated only at the moment the loan is extended.
- Banks do not trust their clients. The lack of stable activities does not give them security to extend loans.
- There are no laws for defining the collateral, evaluating the guarantee and executing them. The drafting of a legal framework is imperative.
- Corruption in the juridical system creates difficulties in the solution of problems the banks encounter. The private banks that started their lending activity in 1998 had not created their loan portfolio and are still working to meet their needs for loan officers.

On the other hand, it is not only the capital of the banks that covers the needs of businessmen for loans. Different financing projects that are not included in the credit ceiling are also channeled through banks and different foundations operating in Albania.

The Bank of Albania and the Institute of Statistics do not posses complete data on this activity. Therefore, in 1999 the collection of such data pursuant to the recommendations of the multi-sector mission of the national statistics shall start. Mention should be made of the fact that in the course of 1998, FEFAD that by the end of the year had a portfolio of Lek 615 million (an accumulated turnover of Lek 1.3 billion) extended loans. This institution was licensed as a bank during this year and shall continue to make loans with the KFW funds and with its own funds. Other projects that support the businesses are: GTZ,

World Bank Agency IFC, SME project, SOROS Foundation, etc.

In the course of 1999 the banking system shall perform the delivery of many foreign loans extended to the Albanian Government for which agreements have been signed. Besides the loans treated by the state-owned banks, agreements have been made with the private banks on: the loan of the Greek Government (GRD 5 billion or Lek 2.5 billion) at an annual rate of 9%, maturity 10 years and the grace period is two years; EBRD loan, of which so far Lek 145 million have been extended. There are also other projects that support the small and medium business, as well as programs for supporting big businesses, such as the one of the International Financial Corporation.

Remittances from expatriates are other sources of financing businesses.

Considering the data of the Balance of Payments, these remittances accounted for USD 521 million, while the deposits with the banking system in foreign currency have increased only by USD 28 million. About USD 350 million are anticipated figures for remittances of 1999. This amount of money circulates in addition to money generated from illegal activities (drugs, clandestine, prostitution, etc).

Taking into consideration the above reasons and the barriers created by the situation of short-term loans portfolio at the end of 1998 (private banks Lek 3615 million, state-owned banks and Dardania Bank Lek 4015 million), we are of the opinion that credit ceiling allocated for 1999 is relatively high. Therefore, the banks that shall credit the economy will not increase their stock of credit from depositors' fund by Lek 8 billion.

NOTES

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[1] The term "Credit to economy" will be used for banking system credit, not credit to the government.

[2] Credit instrument, expressed in the monetary program language is the "credit ceiling".

THE ROLE OF FISCAL INCENTIVES IN PROMOTING PRIVATE BUSINESS

*Selami Xhepa**

1. INTRODUCTION

As a country with an economy under transition, Albania aims at industrial restructuring, by improving the technology and adopting new privatisation programs for all the sectors of the economy. The attraction of private capital and especially of the direct foreign investments constitutes an important element in the success of these attempts.

The increase of competition in the capital market has made different countries make use of certain instruments to attract private investments, where the financial and non- financial incentives play a certain role. In this framework, the drafting of a platform or an action strategy, based not only on the competition among promotion instruments but also on other elements of the strategy, such as consumers, investors, investment market strengths and weaknesses, are an issue of primary importance.

The incentive for writing this paper on the necessity of granting fiscal facilities for private entrepreneurs results from the projects offered by the Government and debated recently in the press, with respect to the removal of facilities granted up to now.

2. OTHER ARGUMENTS PRO AND AGAINST THE USE OF FISCAL INCENTIVES

Generally speaking, the fiscal and financial authorities are against the use of incentives. Their classical argument is that *"the use of these incentives distorts the economic activity because of the deviation from the standards of earnings before and after tax and consequently brings about a different distribution of economic resources from the one generated by the market equilibrium"*.

Nevertheless, this argument that refers to the consolidated markets is applied even in the transition economies and is a debatable[1] issue. Another argument used is that *"taxation and financing schemes developed by governmental organisations have an insignificant effect in the selection of an investment project"*. Stability of the system of taxes and their predictability in a mid term period are regarded as the most important factors.

On the other hand development agencies and the private business make "lobbing" to the decision-making authorities for influencing the granting of incentives. The arguments used by them in such a case are different:

First, incentives are considered as an instrument to improve competition in economy, by improving its capacities to attract floating international capital[2].

Second, they are correctors of "market failures". This may result in conditions of lacking information on the market opportunities for investments, something that may lead to a smaller number of investments than in the conditions of a well-informed market.

Third, the arguments in the favour of incentives are based on macroeconomic considerations. In this case they are used to address such problems as cyclic or structural changes of unemployment, balance of payments deficit and corrections made because of high inflation rates or their effects on taxes.

Finally, their use is considered as a "compensation for the

disadvantages of establishing a project" that result from poor infrastructure, inefficient administration, high costs of business service, etc.

Why does an evident contradiction between two opinions and attitudes towards the use of incentives exist?

An explanation may be found in the definition of incentives used by the governments and the business. The broad meaning of this term includes *"any actions of the Government, that return on investments above such levels in the event such actions were not undertaken, or that reduce investment risks"*.

Taking into consideration such a broad concept, it is clear that incentives affect investments, including direct foreign investments. For example, commercial barriers that increase return on investments and reduce risks are considered as positive factors in attracting foreign investments.

The generally most accepted concept is that *"incentives are fiscal measures, such as the reduction of taxes or other financial facilities offered for investment projects"*.

3. EXPERIENCE OF DIFFERENT COUNTRIES

The EU spends about 1/3 of its year budget (EURO 30 billion) for four structural funds, that constitute the basis of subsidising the regions or sectors that are considered to be in difficult conditions. One of them, the European Investment Fund co-finances small businesses with about Euro 2 million, mainly through investment funds.

The following table gives a view of the allocation of these funds through the member countries:

Countries	Population[3] in %	Maximum of grants as a % to capital expenditures of an investment[4]
Belgium	33	30
Denmark	20	25

France	42	25
Germany	42.8	23
Greece	100	75
Ireland	100	75
Italy	49	65
Luxembourg	80	25
Netherlands	16.6	25
Portugal	100	75
Spain	58.3	75
United Kingdom:		
Great Britain	34	30
Northern Ireland	100	75

Source: Financial Times, 27 September 1997

The funds for regional development constitute 20% of the total amount of grant, whereas assistance funds for the development of production sector constitute about 50% of the total.

Therefore, (financial) incentives are widely used by the EU countries to promote the industrial development. Following the example of the developed countries, the transition economies began to adopt special programs to attract investments, where incentives are being and will be widely used. The stimulating programs for the development of the private business and the attraction of foreign capital adopted by the Albanian authorities since early 1993 were based on these experiences.

4. THE EXPERIENCE OF ALBANIA

The principles of setting up the incentives system offered by the Albanian legislation were based on the simplicity of their implementation by tax authorities and were oriented towards stimulating the creation of new businesses (excluding the new businesses from taxes for a period of four years), and the investment process in new technologies (exempting machinery and equipment from custom duties). This last measure was applied until mid 1995 and later was removed (except in tourism sector). The only encouraging measure for foreign capital is the reimbursement of the paid tax on profit, in the event the earnings were not repatriated in the country of origin but were reinvested there. Some of the most important effects resulting from the application of such measures were:

- Exports increased from 50% in 1994 to 80% in 1996. The number of private companies (foreign and domestic) that took advantage of such facilities increased to 1800 by the end of 1997;
- Import of machinery and equipment reached on average USD 100 million per year, until the moment they were exempted from taxes. After the removal of this measure, their import dropped by 30% on average.
- Their contribution to employment is significant. (The Italian Investors Association has declared to have employed 60 thousand labour forces). The argument used for the removal of fiscal facilities is the losses that the state budget may incur. The analysis of tax authorities observes only the losses, without taking into consideration the realised profits. Nevertheless, let us cast an eye on the following indicators.

	'93	'94	'95	'96	'97
Tax revenues (as % to GDP)	16.6	16.0	13.2	10.7	9.8
Customs revenues (as % to GDP)	2.9	3.4	2.7	2.7	2.6
VAT revenues (as % to GDP)	4.0	2.7	2.4	3.2	4.6
Budget deficit (as % to GDP)	9.27	8.95	6.76	10.25	10.82

Source: Fiscal Statistics, Ministry of Finance, June 1998

As observed from the table, the budget revenues from customs decreased after the tax levied on capital goods (August 1995), thus remaining 48% lower than their average figure of the period 1993-1994. Their decline, in spite of the raised customs duty from 0% to 7%, reflects a contraction of the investment activity because of the increased cost of capital.

On the other hand, additional revenues realised by the state budget are not spent in production activities. On the contrary, capital expenditures decreased by 7% during this period.

Another estimate made by tax authorities is the loss of about Lek 9.6 billion (about USD 65 million) incurred due to the exemption of businesses investing in tourism from the tax on profit and customs duties. Real estimate might have been provided, in the event it was anticipated how many of these projects would

be realized if such incentives had not been offered. It resulted out of a survey related to this fact that 80% of the interviewed businesses[5] answered "no" to the question: "Would you invest if incentives were not offered to you?" Taking into consideration these facts, the calculations on the lacking profit of the state budget do not seem to be real. Moreover, the calculations do not take into consideration the budget revenues generated from other national and local taxes, the multiplying effects and the subcontracting.

5. RECOMMENDATIONS FOR IMPROVING THE INCENTIVES SCHEME

Incentives cannot eliminate the negative effects of the political, legal and economic climate. Therefore, the decision to invest is a complex process, where the analysis of such factors as the political situation, the security, macroeconomic situation, legal and institutional framework, etc. of the country, is of primary importance.

Exemption from tax on profit is a measure that is not much related to investment but to promotion of establishing new businesses. In that sense, the decision to remove this incentive is recommended, so that the already established and operating businesses in the country are stimulated with measures related to investment itself. As such, the exemption from customs duties of the import of technologies and materials (that actually do not distort the market competition because they are produced or found in the domestic market) is recommended. This would significantly affect on cutting cost of investments and would counterbalance, to a certain extent, even the effects of the tight monetary policy. Vis-à-vis other types of incentives used, this one offers the simplicity of application by tax authorities. The results elaborated from the questionnaire with the private sector, about ranking incentives by their importance, are as follows:

Ranking	Type of incentives
1	Exemption from customs duties
2	Reduction of the standard level of tax on profit
3	Accelerated depreciation
4	Exemption from tax on profit
5	Discount for investment/re-investment
6	Discount from social security contribution
7	Specific discount from gross incomes, for taxation purposes
8	Non-fiscal incentives

The Asian experience and that of many transition economies have indicated that such an incentive has proved to be more successful.

Besides, preventing the exemption from tax on profit may be also associated with:

- Extending the term of the right of companies to carry over the loss, from three years to more than five years;
- Reviewing the depreciation rate and the application of standard rates of OECD, etc.

Exempting excise tax payment liability for businesses operating in tourism seems to have no sense and as such it may be removed. (Let the tourist drink Whiskey with excise tax included!).

Finally, the most important and real incentive for the private business is the provision of a fair competition, where taxation authorities ensure observance of the rules of the game by all the subjects. Increasing taxes cannot be a solution for the state budget supply.

There is always an end to such increase. Tax authorities should be concerned for the fiscal evasion (illegal outflows), whose dimensions are higher, rather than for the state budget outflows created from fiscal facilities (which are legal outflows).

NOTES

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[1] The investment regime adopted in Albania is based on the principle of equal treatment of foreign investors. In this framework, all offered incentives have been available not only to foreign investors but to domestic businesses as well. This paper has frequently referred to foreign private investments only for the purpose of highlighting their importance as an additional factor to attract foreign savings to the economy, and not to differentiate with respect to facilities that should be offered to the private business.

[2] Movable capital is considered all the investment projects for all the sectors of the economy with the exception of the strategic sectors.

[3] As a % to the population number of the country.

[4] Maximum of grants allowed as a % to the capital expenses of an investment.

[5] 150 foreign companies and representatives of all the sectors of the economy are interviewed, at a rate of 10% of answering the questionnaires.

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OPINIONS ON THE FOREIGN SECTOR DEVELOPMENTS, 1992 – 1998

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In these 8 years of economic transition, the balance of payments statistics have played an important role in describing and predicting the progress of the Albanian economy in the foreign position. This statistical category has reflected in significant details the international transactions of the trade of goods and services as well as the capital flows. Balance of payments has played a considerable role also in describing the developments in Albania's financial position. Within the disturbed economic environment, the balance of payments statistics have served the authorities as an important useful indicator in determining the monetary policy to be followed and the interventions to be made on the exchange rates.

Apart from describing the foreign position development of an economy, the balance of payments role extends further to an important indicator of the economic situation, especially where an independent monetary policy[1] is being applied, serving as a test on how effectively the policies are applied within the domestic economy.

When presenting the income and services balance sheets in transactions among residents and non – residents, the balance of payments determines at the same time, the performance in

time of the liabilities and interests towards the rest of the world. The balance of payments reflects the decisions of residents or non-residents, their behavior regarding investments, savings, consumption, fiscal position, demographic factors, etc. The results of current transactions and capital flows may as well be good indicators of the foreign investors' expectations on the future of the economy in general and of specific branches in particular. Balance of payments flows and performance are very much related and at the same time serve as indicators on all market components' expectations and operations in an open economy. The most frequently - used indicator of the balance of payments is the balance of current accounts. Especially in the past two – three years it has turned into an alarm-detector of the unpleasant economic situations. The sustainability and solvency of the balance of current accounts, the cases when it may pose a risk and the signs of the appearance of this risk have become focus of the attention of the financial institutions.

These high current deficits need to be financed by either an increased liability towards the world or a reduction of foreign assets. That is why the position of the capital and financial account is an as much important indicator as the current balance. The nature and composition of liabilities and assets as well as their flow, make also an important indicator of the expected economic performance. Developments in this category are the initiators of problematic deficit transformations in real financial crisis.

The South Asian experience is the most typical case. These two factors or their combination may lead into a further aggravation of the current deficit. This combination of the current account with the financial account often leads into a destabilizing situation where the current deficit will aggravate continuously and therefore force the economic policies or any variable to change (i.e. the exchange rates - great and immediate devaluation) in order to prevent it from going further.

The international sector crisis that our economy had to face at the end of the 80's, which reached the peak in 1992, is the perfect example that may be used to illustrate this phenomenon.

The purpose of this article is not to explain whether the international position of current deficit poses a risk to Albania or to deal with factors that define the degree of exposure to this risk. This article aims – through a careful analysis of the events and foreign position of Albania – to briefly describe what the development of the balance of payments means to other macroeconomic statistics, making use of its (the balance of payments) relations with these variables. In other words, this article will attempt to give an idea on these elements, which are currently underestimated, and specifically on the international investments position and on the balance of savings and investments. The Bank of Albania will therefore give its opinion on what stands behind high current and trade deficits, capital flows and the very high figures in "errors and omissions".

MAIN DEVELOPMENTS IN THE BALANCE OF PAYMENTS DURING TRANSITION

Albania has been under the most conservatory model of centralized economy and the slogan of relying only upon one's own forces. That is why the policy that has been followed in the foreign sector of the economy until the end of 80's tended to be a policy of balanced developments, in whose function the balances of goods and services trade had to be zero. After 1985, Albania's foreign position aggravated and this showed at the exports' decrease as well as the increase in the demand for imported goods. 1990 – 1992 political and economical reforms – that later on led to the transition period – were followed by a greater pressure for increasing imports, which resulted in the increase of the current deficit both – in convertible currency and rubles. Deficits in the balance of payments were financed by the use of almost all the foreign currency reserve (gold included), foreign loans, overdue liabilities, inter-banking loans and in non-execution of Forex contracts. Albania therefore, found itself facing a relatively great foreign debt.

In this situation, while economic policies were changing and the economy was slowly transforming itself, the reforming of the

foreign sector began. As economic programs started, changes were concentrated mainly in cutting the legal restrictions for loans and investment entries from abroad and from a partial liberalization to begin with – complete only later – of the foreign trade (apart from a limited list of goods whose trade needs special license) as well as foreign currency exchange.

Years 1992-1998 that followed these changes had an alternated current account, high trade deficit in goods and services that increased in the following years as a result of the domestic demand encouraged by the economic growth. The turning point during 1992 economic development (where economic decline came at a halt), was consolidated during 1993 that through imports increase brought about an immediate expansion of the foreign trade as well as important changes in its structure. The trade deficit reached USD 490 million. As a share of GDP, this deficit, followed by the current one (besides government transactions), reflected descending tendencies up to year 1995. After this year, both, trade deficit and current deficit rose significantly as a result of formal market developments (application of a more liberal fiscal policy than it was originally planned) as well as informal markets that bloomed in 1996 beyond every logic and expectation. At the end of 1996 the trade transaction deficit reached USD 678 million.

During 1997 social and political developments hit badly the foreign sector. The economic and trade exchanges with the world fell significantly and were reflected in the decline of trade deficit down to USD 535 million. Differently from the previous years, the decline in the trade deficit was not followed at the same time by a current deficit reduction, which amounted to USD 254 million.

The current deficit situation improved during 1998 - a year which has the main characteristics of an inflation period. It may be generally stated that the determining role in the current transactions has been played during this period by the high trade deficits and emigration entries in foreign currencies (cash mainly).

Table 1 Balance of payments in USD (millions)

	1992	1993	1994	1995	1996	1997	1998
Current account	-50.8	14.7	31.2	36.6	-62.4	-253.7	-45.2
Current account without state transfers	-405.6	-223.7	-87.5	-100.0	-158.7	-286.5	-133.1
Export, fob	70.0	111.7	141.3	2048	243.7	158.6	208.0
Import, fob	-540.5	-601.6	-601.0	-679.8	-922.0	-693.5	-811.7
Trade Balance	-470.5	-489.9	-459.7	-475.0	-678.3	-534.9	-603.6
Services: credit	20.3	77.5	83.1	98.2	127.3	67.9	94.6
Services: debit	-89.2	-162.0	-97.6	-106.4	-142.3	-101.1	-133.7
Income: credit	2.6	64.9	55.6	70.8	83.5	61.6	86.1
Income: debit	-37.7	-31.0	-41.5	-28.5	-12.0	-11.9	-8.7
Private transfers	150.0	274.8	374.1	348.9	476.0	235.7	437.7
Official transfers	373.7	280.4	117.2	128.5	83.4	29.0	82.5
Direct investments	20.0	58.0	52.9	70.0	90.1	47.5	45.0
Portfolio investments	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other resources	10.7	52.1	-7.0	-95.0	-35.6	95.3	0.6
Net errors and omissions	44.8	-9.9	44.5	-7.9	-54.9	-142.4	55.0
Overall Balance	24.7	114.9	54.8	30.6	47.0	43.8	63.3
Reserves and other related items							
Reserves	-24.7	-114.9	-54.8	-30.6	-47.0	-43.8	-63.3
Use of IMF credit and loans	13.9	16.6	22.2	11.1	0.0	12.2	7.9

These have enabled the financing of some parts of the high trade deficit, becoming at the same time the main encouragement for the increase of consumption and consequently of imports.

Financing current deficit has been made possible by the capital inflows mainly in the form of foreign investment. An important part of the foreign financing until 1995 had been the increase of the overdue liabilities part of which was liquidated at the third part of 1995. Usually at the end of each year, the capital account has concluded with positive figures, which means that Albania has imported more capital than has exported.

The capital inflows have played a decisive role in foreign currency reserves that have only increased from 1992 until the first quarter of 1999. This increase appears to have been led by two main objectives. Up to 1995 foreign currency reserve increased in order to liquidate the overdue liabilities and later on, the increase of the foreign currency reserve has aimed at the creation of a foreign currency stock able to face and surpass the emergent needs in case of a foreign sector crisis. In order to follow this policy a floor limit has been requested for the indicator of

foreign currency expressed in monthly imports at the end of each year. To serve this indicator that is determined as one of the main targets of the macroeconomic program, the Bank of Albania has accumulated behind the Albanian Government all the foreign currency assets that had flowed each year in the country. (Here we consider credit disbursements and aids in cash only).

BALANCE OF PAYMENTS AND THE INTERNATIONAL INVESTMENTS POSITION

International Investments Position (IIP) analyses the development as well as the tendencies of the economic performance towards world economy within a certain time. The net investment position shows what does an economy own as well as what are its debts to the rest of the world. International Investments Position statistics are not yet calculated in Albania. The only reason for this is the non-existence of exact data on the situation of the assets and liabilities. Actually apart from assets and liabilities derived from deposits transactions and the public foreign debt relationship, there is very little or no information upon the changes in value of the means for other investment categories. The absence of this information renders impossible the calculation of the differences that derive from exchange rate fluctuations and price changes of these assets and liabilities.

In spite of the absence of this statistical category, by following the balance of payments developments, something may be said about the International Investments Position. As mentioned above, high trade deficits financing by means of foreign capital inflows in the form of investments and foreign loans was the main characteristic of this period. Naturally, Albanian residents have exported significant amounts of capital towards other economies (here are considered the foreign bank system interests and the population savings in foreign currency, within the banking system or outside it, in the hands of the public).

The continuous growth of foreign currency reserve of the Monetary Authority was another distinguishing trend of the period.

This growth has in all cases been comparable with all changes in the assets and liabilities of the financial accounts. Therefore, though the financial transactions are followed by increase in liabilities, as a general trend of the period, moreover even in those cases when current balances are terminated positively, the net result of financial transaction, Monetary Authorities included, has turned out sometimes in favor of the liabilities increase and some other times in favor of the increase of assets[2].

The Albanian economy has inherited a high foreign debt from the late 80's crisis. Part of it, about USD 500 million was liquidated at the third part of 1995, lowering significantly the overdue liabilities on the part that consisted in the foreign debt payments. However, according to our evaluations which are based on IMF statistics, the amount of overdue liabilities (non-negotiated debt) remains considerably above USD 250 million even after 1995.

Considering the debt liabilities and adding to it the financial result of capital transactions, it is not difficult to come to the conclusion that at each year end Albania's liabilities towards the world have been greater than its claims (financial assets) to the rest of the world (see table 2).

Table 2 Change in Assets and Liabilities

	1992	1993	1994	1995	1996	1997	1998
Financial Account	30.7	110.2	47.8	-403.3	49.6	152.9	22.5
Change in liabilities	103.9	188.8	155.6	-305.3	190.3	95.9	152.3
Change in assets	-73.2	-78.8	-107.7	-98.0	-140.7	57.1	-129.8
Change in reserves	-24.7	-114.9	-54.9	-30.6	-47	-43.8	-63.3
Net result of transactions	6.0	-4.7	-7.1	-434	2.6	109.1	-40.8

Consequently, the International Investments Position might have been closed continuously with a negative sign.

Other changes included in the calculation of International Investments Position must not play any significant role. The change of the assets and liabilities value, as an effect of the change in prices must be limited, because other elements distinguished for strong price fluctuations (mainly investment in assets) are zero, according to the balance of payments statistics.

The capital market is also non-existent. Hence, in Albania's case, differences in the price of investments are limited by the change in the price of fixed assets of direct investment enterprises (machinery and equipment and buildings), which differ only because of accounting records (amortization, re-evaluation, etc.).

The changes that derive from the exchange rates (chart on the value of the main currencies) have generally influenced the aggravation of the International Investments Position. From the beginning of the transition period, the Albanian Lek (referring to the exchange rates as of December 31 of each year) has depreciated continuously until the end of 1997, to appreciate again in year 1998. This means that the liabilities, which in absolute value are higher than the assets, have increased also because of the Lek's depreciation effect, whereas assets have decreased because of the same reason.

This situation is overthrown for year 1998 only. In spite of the Lek's appreciation or depreciation, these changes may not have had a determining value considering the high level of financial liabilities (debt included).

The increase of liabilities has been mainly due to foreign loans, that is debt liabilities (including the new debt as well as the debt inherited from earlier than 1992) and direct investment means that have entered in Albania before the transition period. Consequently, the liabilities of the Albanian economy are made in great part by the foreign debt and foreign investments. The trade credit and deposits of non-residents make the rest of liabilities in the Albanian banking system. On the other hand, the assets (Albanians' liabilities) consist mainly in Albanian bank system's deposits with the non-resident financial institutions and assets in foreign currency the population owns. There may also be other assets unrecorded in official statistics. The statistics of the partner countries, which report direct investments of Albanian residents, are a good indicator for this purpose.

One of the main characteristics of the balance of payments

in Albania's case is the absence of registrations of portfolio investment transactions or other short-term investment flows (the short-term debt). Generally, the Albanian economy liabilities are mainly long-term ones and its main creditors have been and continue to be institutions such as the World Bank, the IMF, the European Community or different governments[3]. Though actually the liabilities of our economy remain near alarming limits and their treatment needs to be cautious, the net liabilities position contains positive elements.

By this we mean precisely the lack of portfolio investments and short term financial liabilities (foreign investments and debt). The 1997 crisis of the successful South-East Asian economies, showed that the short term investment means are risky and depending upon change in behavior, preferences and foreign investors expectations may well become detonators of financial crisis.

Referring to the same experience, the crisis in these countries showed that the inclusion of the banking system in foreign borrowing is a dangerous precedent of the crisis. From this point of view, the distribution by sectors of the liabilities stock puts to evidence another positive trend of our liabilities. Statistics show that in spite of the high liabilities scale that Albania has, a great part (about 94%) are Government and Monetary Authority liabilities; therefore other sectors (5%) and what is more important, the financial system has very little or no financial liabilities towards the world. This does not mean that we are out of danger or that through this "intelligent" distribution (since it is a Government debt) we are eliminating the danger.

This only shows that in the list of precedents that may cause a financial crisis, we have one less element and this is not insignificant; it may well be considered important.

The relation between the balance of payments and the developments of the domestic economy may be expressed through equality that exists between the changes in the current accounts balance (consequently in the net capital flow) and

the difference between gross savings and investments in the economy. In other words, the current account deficit reflects the savings and investments behavior in the domestic economy. Referring to this relationship, it is not difficult to understand from the balance of payments that the Albanian economy is more inclined towards investments or better say it rather prefers expenditures to savings.

The balance of payments statistics (referring mainly to the current balance, Government transactions excluded) show clearly that generally Albanians spend more than their income resources.

Chart 1 Current account and fiscal balance as a percentage to GDP
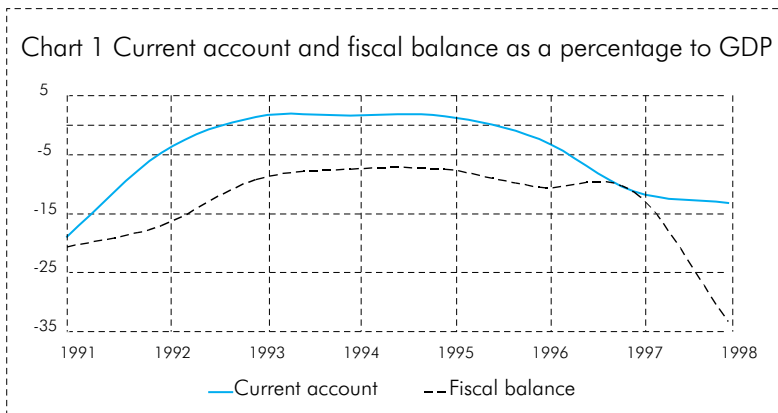
Starting from 1993, which marked the end of the crisis and the beginning of the economic growth, supplementary income has flowed into Albanian Economy that has been absorbed by it. According to statistics, during the high-income years, expenditures have been high also. In fact it is difficult to make a detailed analysis, using the macroeconomic equations that relate the balance of payments to the other variables, since economic factors behavior each year has been affected by unusual phenomena also, which have been generated by the political factor or the informal economy.

Something more about the behavior of the Albanian economy towards income and consumption, however, may be said on the

basis of balance of trade's (of goods and services) developments and the capital inflows from abroad. Foreign trade statistics show that the annually growing capital inflows have been oriented more and more towards the increase of goods and services import (balance of income included).

The import of consumer goods, including those that are consumed in the short term and medium term, makes up the greatest group of real imports (excluding imports that go for active processing). This group of imports has been annually increasing in considerable amounts. Therefore, generally it may be stated that during these years the overall expectation of the Albanian economy has been towards consumption growth.

However, we have to be careful. It is true that generally all income resources have been oriented towards growth of consumption, but this does not mean that the Albanian residents have not used the high foreign currency inflows in order to increase their level of savings. According to the Bank of Albania's opinion, there are indicators in the balance of payments statistics, which show that during the transition years a good part of revenues from the foreign sector have been savings-oriented.

One of the main characteristics of the balance of payments has been the existence of high positive figures, which in analyses are frequently referred to as indefinite or illegal activities. High inaccurate positive figures, especially for years 1996 – 1997 may serve as an indicator that show that these savings have existed and may be far from having an insignificant value.

Balance of payments registrations include all those transactions that have been accompanied by an increase of foreign assets within the banking system (consequently, including the foreign currency assets of the pyramidal schemes, which represented public foreign currency savings). On the other hand, however, their decline within the private or individual sector could not be registered. What really happened during this period may be explained as transfer savings to foreign currency assets of the household and private sector, from the "mattress" to the banking

system, while the statistics have recorded only the increase of the foreign currency assets with banks. The same phenomenon, but in the opposite direction, might have happened during 1997, causing the increase of "net errors and omissions" item. This does not mean that the figures in "errors and omissions" represent totally and obligatorily the publics' foreign currency savings, which were invested in the pyramid schemes, but to our opinion they mostly represent this phenomenon.

The relation between the domestic and foreign sectors of the economy may be seen in more detail by pinpointing the difference between the state and private sectors, which leads to another important conclusion.

The balance of current accounts may be also expressed as the sum of the balance of private sector (savings-investments) and of the state sector. This logic suggests that the private sector in Albania, during the whole transition period has always been positive. This means that incomes in this sector have regularly been higher than expenditures.

To these conclusions lead the high budget deficits of the time (graph1). In all these years, from the foreign sector viewpoint, the fiscal policy has "consumed" the positive balances that have been generated by the private sector and what is worse, has oriented them towards consumption – (budget expenditure structure where investments are low).

In analyzing the current position changes, it is important to understand the way these developments have reflected the changes in public behavior relating to savings and investments. The economic adjustment policies, either monetary or fiscal, during 92-98 period have aimed to hold the domestic demand and supply within the domestic resources and foreign financing limits – without hindering the growth of the domestic production. High trade deficits and the increasing current ones, show that it has been difficult for the authorities to orient, the balanced behavior of the economy in relation to savings and expenditure by means of economic policies.

Therefore, holding consumption to sufficient levels, in order to prevent it from prevailing on savings, has been a difficult objective to accomplish. This is also due to the fact that during these eight years, economic reforms and programs have been accompanied by phenomena that remain out of the framework of monetary policies such as informal markets and parallel ones, illegal trade and above all the pyramidal schemes that have modified the consumers' behavior.

NOTES

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[1] An independent monetary policy means all those monetary policies that are not conditioned by the related or fixed exchange rates.

[2] The most positive moment for the IIP was verified in the third part of 1995 and relates to the partial settlement of the overdue liabilities of foreign debt. From this derived the reduction of the liabilities by around USD 306 million. The result of financial transactions at the end of this year showed that the fall of liabilities and the rise of residents' claims were combined in a financial account that consisted of USD – 435 million.

[3] Private creditors are not listed in the creditors' list.

BRIEFLY THE ALBANIAN BANKING SYSTEM IN 1998

Teuta Baleta*

This article shall introduce a revision of the profit and loss account, balance sheet and capital adequacy of the Albanian banking system, emphasizing the 1998 developments and comparing these developments with those of a year ago.

1. GENERAL CHARACTERISTICS OF THE ALBANIAN BANKING SYSTEM IN 1998

Year 1998 was characterized by the increased number of banks that conduct their operations in the Republic of Albania. The total number of banks at the end of 1998 was 10. Two new banks, representative of the foreign capital, named American Bank of Albania and Branch of Alpha Credit Bank in Tirana started their operations after getting the licence by the Bank of Albania; in the meantime the licence of the state-owned Rural Commercial Bank was revoked. Further more, three banks, also representative of the foreign capital, got their preliminary licence, determining in this way the increase and expansion tendency of the banking system through the increased number of banks[1] for the year 1999.

Each year, at least from the year 1996, the banking system is expanded with new foreign capital banks (which we will refer to

as foreign banks[2]). During the 1996 Tirana Bank and the Branch[3] of the National Bank of Greece started their operations, and in 1997 the International Commercial Bank started the operation. Thus, year 1998 could not be considered as an exception or a particular one, but as a continuation of a two-year tendency for the expansion of the banking system with foreign banks. In general, year 1998 was characterized by the reformation of the banking system structure. On the one hand, we have an increased presence of foreign banks and on the other hand a reduction of the state-owned banks and their preparation for privatization. This has led to reduced share of state-owned banks in the banking system operations, whose gap is partially covered and is expected to be used by the foreign bank group. These developments give a clear tendency of the Albanian banking system at the beginning of the third millennium: a banking system fully (or approximately) private, where the foreign capital shall be dominant.

But, despite these quantitative changes, which we may freely consider as positive, there were no changes in geographic shifting of the banking network. Banks are still concentrated in Tirana city, without any extension in other cities. The branches of state-owned banks carry out banking services in those cities. This network, starting from the end of 1997, is shrunk up. At the end of 1998, the banking system has in its composition 45 branches, out of which only two belonged to the Tirana Bank (private bank with foreign capital); while the others belong to the National Commercial Bank (10) and the Savings Bank (33).

In the wide-ranging macroeconomic framework, year 1998 is considered as a starting year of economic recovery and stabilization of the country, after the crises faced in 1997. This general stabilization was expected to influence the conduct of the normal banking operations. (It should be kept in mind that the banks in Albania during 1997, particularly during its second half, had no possibility to carry out their services). Aiming at promoting lending by the banking system and based also on the monetary developments, on consumer price behaviour and on foreign exchange rates, the Bank of Albania reduced

several times the minimum interest rates for time deposits with state-owned banks. The Bank of Albania also approved a more liberal credit ceiling (the credit ceiling approved for 1998 was three times higher than the one of 1997 and twice higher than that of 1996)[4].

Table 1 The calendar of changes of the minimum interest rates for time deposits with the state-owned banks in 1998

Decision date	Deposit Maturity (interest rate in %)		
	Three-month	Six-month	Twelve-month
- before 19th of May 1998	26.0	26.0	27.0
- 19th of May	24.0	24.0	24.0
- 18th June	22.0	22.0	21.0
- 24th August	20.0	20.0	20.0
- 22nd October	18.0	18.0	18.0
- 12th November	16.5	16.5	16.5

This action of the Bank of Albania was associated with:

• Reduction of the average deposit rates, from 27.8 (end of 1997) to 16.5 (end of 1998);
• Reduction of the rates for short-term loans, from 43 (end of 1997) to 25 percent (end of 1998).

Nevertheless, the actions undertaken by the central bank did not give the desired effect on banks' lending. Thus, the credit ceiling approved at the beginning of the year was reduced from Lek 6 billion to Lek 2.5 billion. The general reasons that should be mentioned for this level of credit are as follows:

• High risk of credit in Albania influenced by either the economic background or lack of effectiveness of the law institutions;
• Low readiness of private banks to expand their activity in this area;
• Prevention of state-owned banks to grant loans. This decision was taken as a result of the bad quality of their loan portfolio and preparations for privatization;
• High rates of return generated from treasury bills. At the end of 1998, the average yield of treasury bills of one-year maturity was 23 percent. Therefore, the difference of expected profitability was only 2 points for both different

types of investments, which from the risk point of view stand in two different poles[5].

During 1998, the twelve-month increase of credit outstanding has been negative (0.7 percent)[6] making the assets structure of the banking system loan portfolio amount to 7.8 percent and 10.3 percent at the end of 1998 and 1997 respectively.

In general, an intensification of the competition is expected in the Albanian banking system, in the coming years. This should be a result of the entry of new banks and their need to earn money; structural regulations being undertaken, which lead to the destruction of monopolies existing currently in the banking market; as well as the measures that the Bank of Albania is taking in this direction.

Competition enhancement is considered as favourable from the viewpoint of banking activity improvement in Albania, its geographic extension, and provision of new products as a need for attracting clients. Above all, increased competition in the banking system brings benefits to clients in terms of decreasing the cost of banking services.

2. BANKING SYSTEM STRUCTURE

Whenever discussing about the Albanian banking system structure, a division into three groups by the origin of their capital is made:

- Commercial banks with state-owned capital (two banks);
- Commercial banks with joint stock capital. The Albanian share capital is again state-owned, amounting to 40 percent in each bank (two banks);
- Other banks, representing the group of foreign banks (six banks at the end of 1998 and eight as of September 1999).

If banks within the same group are compared to one-another, it is noticed that they have other similar characteristics as well.

The first group is composed of the banks with state-owned capital. Here are included the largest banks of the Albanian banking system, from the viewpoint of total of assets, the level of current accounts and deposits, total credit outstanding, investments in treasury bills, etc.. The origin of these banks is the same. They were established from the conversion of the banks existing before 1992 (which is considered as the starting year of reforms in the banking system), banks that were specialized in a particular sector of the economy (agriculture or foreign trade, etc.) and universal banks. These banks had to operate in a new background, managed by a new philosophy, under the conditions of lack of skills and continuous interventions of the government (as the single owner). This fact changed them soon enough into banks with problems.

Their major problem was and still is the loan portfolio. The level of their bad loans reached very high levels thus reducing their profitability and consequently eroding their capital. Those problems are getting worse if we add the lack of the service quality, new products introduction, continuous changes of the staff (both managers and usual employees).

However, they did not lose their monopoly position in the banking system, thus reducing the effectiveness and causing problems for the entire banking system.

At the end of 1998 this group represented 85 percent of the total assets of the banking system; 91 percent of the deposits and 69 percent of the total loans of the banking system, whose figures have been over 95 percent in 1994. Therefore, in the four year period, the tendency was to reduce the share of those banks as a result of the changes in their number, but also to limit their operations (e.g. the state owned banks are not allowed to grant loans). This tendency is expected to continue even in the future and it is considered as a positive one.

The second group is composed of commercial banks with joint stock capital. In these banks, the state ownes 40 percent of the shares. Until now the state is represented by the National

Commercial Bank, but after the recent decisions for its privatization, the direct shareholder is the Ministry of Finance. The banks of this group were established almost at the same time. The expectations were that this group, by having foreign capital in its composition, (representatives of well known banks, Italian and Arab) would be the one to lead the banking system with respect to quality service, extension of the banking system and introduction of new banking products.

As a matter of fact, it did not happen so. For several years, banks of this group were satisfied with a limited number of clients, mostly business people or foreign citizens, co-patriots of the capital of the bank, and were concentrated on secondary banking operations, such as payment services mostly outside the country and foreign exchanges. Only during the last two years (1997 and 1998) the share of this group started to be significant.

The last group comprises all the banks that are not classified in the first two groups. These are generally new banks, in a sense that they have entered the banking market recently (in 1996 and on). They are representative of foreign, private, and state capital. In general, they are branches or affiliates of foreign banks. Thus, the expansion of this group shows to a certain extent the interest of foreign investors in the Albanian banking market. As new banks, they are still considered "small" from the viewpoint of total of assets and their share in the banking system. Unlike the banks with joint stock capital, they were more aggressive in the market since the very first moments of establishment and are expected to be the group that "would lead" the banking system[7].

It is worth mentioning that during 1998 their share to the total of the banking system increased from 3.6 percent (end of 1997) to 8.9 percent, or the total of loans in the same periods of time were 2.5 and 8.7 percent. Such a banking market structure is not a peculiarity only for Albania. In all Eastern and Central European Countries the high concentration level of the banking market is the result of the way the two-tier banking system was

established. As a general rule, the two-tier banking system was established by splitting up the existing banks into one level system, which were specialized from the point of view of their operation. Thus, in the major part of the Eastern and Central European region, the banking market is introduced excessively concentrated, indicating the domination of state-owned banks. We may point out the Hungarian case, one of former socialist countries most successful in the economic reform.

Since the beginning of the financial system reform in 1987 the number of banks increased from 8 to 30 in 1990 and the share of four major commercial banks was reduced from 58 to 48 percent[8] as a result of the establishment of new banks as well as the conversion of the small specialized financial institutions into commercial banks.

It's obvious that the concentration of the Albanian banking system is actually even bigger, where only two banks hold over 85 percent of the total assets.

As mentioned above, the brief presentation of the banking system structure has its importance, because many phenomena observed in the banking operations are explained through it.

3. FINANCIAL PERFORMANCE

Net financial position as at end 1998 did go beyond the tendency observed since 1994. The Albanian banking system continued to operate with losses, therefore performing as an inefficient system.

The declared loss at the end of 1998 was about Lek 3.1 billion (0.7 percent of GDP). However, as compared to a year ago (Lek 7.9 billion ore 2.3 percent of GDP), the loss has been reduced to 61 percent. In consequence, both indicators of profitability, respectively return on assets (ROA) and return on equity (ROE) decreased significantly. These indicators of the banking system in 1998 fell by -1.7 percent and -77.6 percent, from -5.9

percent and -84.9 percent that were at end 1997. But, does the "improvement" of the profitability indicators represent a real improvement of the efficiency of the banking operations during 1998? Generally speaking, no. It should be born in mind that high losses incurred during 1997 were due to the situation of that year, particularly during the first half. Therefore, losses of 1997, more than a consequence of the ability of banks, were influenced by the extraordinary situation in the country.

The result of the banking system in Albania was affected by two factors:

- The performance of the financial result in the group of state-owned banks.
- The performance in the net income from interests, expenditures for reserve funds to cover loan losses (provisions) and operational expenditures.

A. FINANCIAL RESULT OF THE GROUP OF STATE-OWNED BANKS

Income and expenditure level of this group consists of 93.3 percent and 93.9 percent of the total of profit and expenditure of the banking system.

This concentration is due to almost particular items of the profit and expenditures.

Table 3 Income, expenditures and financial result for 1998 (in millions of ALL)

	Income	Expenditure	Financial result
1. Banking system	36 728	39 819	-3 091
2. First group	34 257	37 384	-3 127

It is clearly seen that losses incurred by both state-owned banks reduce the profitability of the whole banking system. But, the main reason of the incurred losses in each of the state-owned banks is different. About 51.5 percent of the National Commercial Bank loss was caused by the negative net profit from interests. The Savings Bank generated in 1998 a positive

net profit from interests, but bad quality of its loan portfolio and high level of expenditures for provisions turned the result from financial intermediation to negative (about Lek 2 billion losses)[9].

It is observed that both banks have not a good investment quality, from which they do not generate sufficient profits to cover the expenses and are obliged to have high additional expenses in the form of provisions.

B. IMPACT OF PARTICULAR ITEMS OF INCOME AND EXPENDITURES

• The Interests

Net interest income at the end of 1998 was about Lek 200 millions (0.1 of the average assets), from being negative at about Lek 235 million at the end of 1997 (-0.16 percent of the average assets). This level of interest income is considered to be relatively low to cover the operational expenditures and provisions for covering loss loans (referred to as provision expenses for simplicity of writing). Over the years, the Albanian banking system has been in a position to provide a sufficient income level from interests for covering expenditures and making profits.

These incomes are influenced by sides, interest expenses and total interest income. But, during 1998, it is observed that a net income is accumulated from the positive interests. Which side has influenced such a level?

During these years the interests paid for current accounts and time deposits caused the only interest expense. Therefore, the level of these expenses will depend on the change of the deposits surplus and their interest rate applied.

The interest incomes are under the influence of more items, because they are provided from several sources: placements with

banks (mainly with foreign banks in the form of current accounts and deposits), investments on treasury bills and granted loans. The change of the interest rates for this side is less flexible in comparison with the changes of the interest rate for time deposit and continuously a big difference is maintained between active and passive interests.

Therefore, the investment structure or concentration on certain investments has more influence on the level of interest incomes. Greater investments with no risk or low risk on assets result in low efficiency. The bad quality of loan portfolio also reduces the incomes from this investment and on the other hand it burdens the banking system with high provision expenses.

How have the above-described elements acted during 1998?

During 1998 the Bank of Albania continuously decreased the minimum interest rate for time deposits at state-owned banks (see table 1). All banks accompanied this with a reduction of interest on deposits, the average lending rate, and treasury bills yield. It is estimated that this interest rate reduction had its positive impact on both sides.

It is understandable that the reduction of the interest rate decreases the quantity of interests to be paid, that is the deposit cost. But, this reduction is positive even on the side of incomes, due to two reasons:

Firstly, the difference between active and passive interests is great, therefore active interests did not reduce at the same level or with the same pace, creating room for reducing the margin (active interests differ more slowly), and

Secondly, the difference between assets and liabilities, sensitive to the change of banking system interest rate, is negative. In other words, interest earning assets (which are sensitive to interest) are less than interest payable liabilities. This means that interest rate cut brings a bigger reduction to costs rather than to

incomes. Furthermore, this negative difference is observed in all banks and in their Lek share of their activity, a share that is more exposed to interest rate change.

Table 4 Assets-Liabilities change to interest rates (in Lek million)

Indicator	1998
1. Total change	-19620
2. Change for the Lek share	-33243

On the other hand, the structure of deposits is estimated as appropriate, that the interest rate reduction could give considerable effects. The interest rate cut can mostly affect the time deposits. This makes up a substantial part of total deposits (about 79.2 percent at end of 1998). Theoretically, the cost of all those deposits is reduced. Even within time deposits, the influence is not the same because the interest rate is related to time deposits only. This group has only a substantial and direct effect, because it comprises 85.6 percent of time deposits or 67.7 percent of total deposits. In total, the cost was reduced for about 70 percent of banking system deposits. The result is estimated as the possible maximum because 98.8 percent of time deposits in Lek are held at state-owned banks, which due to non-satisfactory return have shown immediate reaction by reducing their rates at the lowest permitted level.

Nevertheless, the total cost of deposits has decreased in a smaller amount, because of the increase of Lek time deposits level in the banking system. Despite constant decrease of the interest rate, during 1998 the tendency was to increase placements at state-owned banks. The reason is already known: the lack of other investment alternatives, and the existence of relatively higher level of positive real interest rates, (from being negative in 1997).

Table 5 Interest and inflation rates (in %)

Indicator	1997	1998
Annual inflation rate	42.1	8.7
Minimum rate approved by the Bank of Albania for the 12-month deposits	27.0	16.5
The average deposit rates	27.8	16.5

If we treated separately the effect of average interest reduction for time deposits in Lek by the end of 1997, at the end of 1998[10] we would have the following:

In general, the deposits are increased within a year by 36.8 percent (about Lek45.9 billion); for time deposits and Lek time deposits the growth rate is higher, 47.1 percent and 63.4 percent respectively.

The growth of Lek time deposits by 44 844 million during 1998 has given an effect of Lek 7399 million on the growth of interest expenses (quantitative factor). The interest rate reduction (the average rate is taken for calculation) by 11.3 basis points, has given an effect of Lek 7988 million in the reduction of interest expenses (qualitative factor). As a total, the effect has been on the reduction of interest expenses by Lek 589 million.

For that reason, on the whole the interest expenses increased by 20 points less than interest income did, ensuring a net result from positive interests.

- Expense provisions

Year 1998 underwent the same general tendency as in those years, when the result from interests further deteriorated under the effect of provision expenses and operational expenses.

The provision expenses amounted to Lek 3.3 billion, from Lek 4.1 billion in 1997. They are 16.3 times higher than net interest income or 1.8 percent of the average assets of the banking system. In other words, it could be said that the banking system is granting loans to incur losses.

Easily, it is drawn the conclusion that the banking system realizes an inefficient financial intermediation. This high level of provision expenses is directly caused by bad loan portfolio.

These expenditures for the group of state-owned banks represent 92.9 percent of the banking system provision expenses.

Therefore, it is the quality of lending at state-owned banks the one that keeps "hostage" the banking system profitability.

However, as compared to a year ago it is observed that those expenditures have reduced by Lek 0.8 billion or 20.5 percent as a consequence of freezing the lending activity of the state-owned banks, writing off from the balance sheet of a part of loss loans, as well as the revocation of the licence of the Rural Commercial Bank, whose loan portfolio moved to the Loan Restructuring Agency. The level of the provisions for 1998 also increased as a result of the changes of regulations on calculating provisions for covering loss loans. Pursuant to new regulations adopted in 1998, provisions will be calculated also for standard loans. This is a more conservative position adopted by the Bank of Albania in considering credits to foresee the highest economic risk background in Albania.

- Operational Expenses

The operational expenses, about Lek 2.7 billion at the end of 1998 increased by 7.8 percent as compared to the end of 1997. The entrance into the market of two new banks caused this increase and it's known that the operational expenses from their nature are mostly fixed expenditure. However, compared to the average assets, the level of these expenditures has fallen from 1.7 percent at the end of 1997 to 1.5 percent at the end of 1998. Therefore, their increase is accompanied with a bigger extension of the banking activity. In general, such a level of operational expenses is acceptable.

The level of operational expenses in different banking groups represents directly the extension of the banks in the country and the automation of the banking processes and the remuneration of employees.

The group of state-owned banks has about 63 percent of the operational expenses of the banking system. But, this does not mean that those banks have high and unjustifiable level of such expenditures. These banks have an excessive network

of branches, work with minor clients and the process is not automated. As compared to the total of expenditures, this item represents only 4.5 percent or 1 percent of the average assets.

Two other groups have a high level of operational expenses. Moreover, in some banks these expenses are the main reason of the negative result of banks. In proportion to total expenditure, the operational expenses are 53.9 and 35.5 percent respectively in the second and third group. Though these banks do not have an extended network or number of employees, the wage level (significantly higher than in state-owned banks), and relatively high investments in working places and technology lead to higher expenses.

Furthermore, such expenditures are expected to increase as compared to the average assets in the coming years, because of two reasons:

- Entrance of new banks into the market. It is interesting to see that the operational expenses of the third group from 17.6 percent in the total of the operational expenses at the end of 1997, accounted for about 23.6 percent in 1998.
- The privatization of the state-owned banks, which should be accompanied with investments in technology and increase of employee's remuneration in order to cope with the market competition.

In general, it could be said from the income and expenditure structure of the banking system that improvements may be made in two main elements:

- Increase of net interest income;
- Reduction of provision expenses for covering loss loans.

The main factor that affects on improvement of profitability is the quality of lending, which has a double negative effect on the statement of income and expenditure. The net interest income could be improved through the increase of interest income. On the expenditure side, there are fewer possibilities

for the interests "to move". They will depend on the reaction of depositors against the banks and the interest rate.

4. BALANCE SHEET OF BANKS, ASSETS QUALITY AND CAPITAL

Characteristic of the Albanian banking system is the low lending level. Loan portfolio represents only 7.8 percent of the total assets, while placements with banks (in the form of current accounts and time deposits) as well as on the treasury bills investments of the Albanian Government for the end of 1998 come out as main investments, occupying respectively 35.3 and 43.3 percent of the total of assets.

The structure of the banking system has not changed since 1997. As the main groups even during this year are the placements with banks and treasury bills. The only thing that has changed is further reduction of credit weight during 1998, which is replaced by an increase of investments in treasury bills (at the end of 1997 the share of this item was 34.5 percent, while the placements with banks have remained at the level of 35.8 percent of the total assets).

This structure is not the same in the three groups of banks. The first group (as explained above, even the whole banking system) has treasury bill investments as the main group, which at the end of 1998 amounted to 50 percent of the total of assets. The other two groups of banks place their funds mainly at foreign banks, in the form of time deposits and current accounts (see table 6). From the risk point of view, it is observed that most of the banking assets have been focused on risk-free or low risk assets.

Table 6 Main groups of assets (in percentage to the total)

Item	Group I		Group II		Group III	
	1997	1998	1997	1998	1997	1998
1. Treasury bills	38.4	50.0	0.2	3.8	0.9	5.4
2. Loans	9.5	6.3	23.1	30.6	6.7	7.4
3. Placements with banks	33.2	30.4	50.5	40.5	70.7	77.5

The liability structure has also remained unchanged. The main item of the liabilities is composed of customer accounts, specifically time deposits. As mentioned above, the increase of time deposits in Lek during 1998 has led to an increase of the entire share of deposits, from 78.2 percent (end of 1997) to 81.6 percent (end of 1998). The contrary happened with its own funds. Although, the entry of new banks means more paid in capital, the capital share has fallen for the same period, from 7.1 percent to 1.2 percent. This was mainly as a result of the inclusion of losses incurred in 1997 in the items of own funds. This factor explains the further deterioration of capital adequacy ratio, from 5.5 percent to -8.9 percent.

Table 7 Main liabilities groups (in percentage to total of the balance sheet)

Item	Group I		Group II		Group III	
	1997	1998	1997	1998	1997	1998
1. Total deposits	80.7	87.6	51.0	49.8	67.3	45.5
out of which: Time Deposits	61.7	72.8	19.0	9.7	28.4	22.2
2. Own funds	3.4	-2.5	43.2	37.8	30.4	12.8

As a total, despite its favourable assets structure, the banking system is introduced as a non-capitalized one. The capital adequacy ratio for the banking system at the end of 1998 is -8.9 percent from 5.5 percent at end of 1997. The principal reason of the lack of capital is its erosion as a result of continuous losses incurred by the banking system, mostly by the first group of banks. It comes out of the banking structure that the state-owned banks have a substantial lack of capital (the adequacy ratio is 57.7 percent at end of 1998[11]). They have incurred significant losses. In the meantime, the other two group of banks are extremely capitalized (the adequacy ratio is 76.8 percent and 43. 6 percent respectively for the second and third bank groups).

Since the first group of banks is under the privatization process, the lack of capital in those banks implies also a capital injection cost, which up to the end of 1998 amounted to about Lek 11.2 billion, and it is growing due to losses incurred continuously.

Although, the credit has a relatively limited share to the total of the balance sheet, it is important to consider its quality. The Albanian banking system indicates in general a loan portfolio with bad quality compared to the high level of overdue loans. This leads to increased provision expenses, worsening of the profitability and losses incurred.

For the banking system as a whole, 57 percent of the loan portfolio is classified as consisting of overdue loans. This high level of overdue loans is observed only in the first bank group (about 77 percent), while in two other bank groups, the figure is 8.9 and 17.3 percent respectively.

This is a result mainly of the freezing of new loan extension by state-owned banks and the changing of the existing portfolio to non-performing loans. In the two other bank groups, more care is shown to loan extension. Even more concerning is the fact that the banking system and the first bank group in particular, has a high level of bad loans (loans classified as doubtful and lost, with a very low repayment probability). Their level is 46.7 percent and 63.9 percent respectively.

This bad quality level of the portfolio, which is present for some years, has found out several measures to be taken by the Bank of Albania. Thus, a more conservative regulation relating to loan classification and calculation of reserve fund for covering loan losses was adopted. The portfolio is classified in four loan categories of non-performing loans compared to three previous categories. It is added the "pursued loans" category where according to the previous criterion they were classified in standard loans.

They are classified in this category due to the risk of turning into non-performing loan. It is required that the reserve funds to be created not only for the "pursued loans" category, but also for standard loans one. On the other hand, the Bank of Albania took the decision for not granting new loans by the banks whose portfolio have loans not paid back on time for 30 days and over 20 percent. Despite of the objections about

it, this decision resulted to be a right measure taken for the moment. It was created the possibility through this decision to freeze granting further loans with low quality by reducing future losses in the form of the creation of new problem loans and their consequences.

Table 8 Loan portfolio quality (in percentage against total credit outstanding)

Item	Group I		Group II		Group III	
	1997	1998	1997	1998	1997	1998
1. Non-performing loans	64.6	77.0	14.3	8.9	46.6	17.3
2. Bad loans	46.5	63.9	6.8	7.6	33.0	11.1

5. OTHER ISSUES

Considering the so-far progress of the Albanian banking system from the point of view of bank's capital origin and expected privatization of the state-owned banks, when the goal stated in the privatization strategy is to find strategic foreign investors, one draws the conclusion that there will be no "Albanian owners of banks" in the near future (2-3 years).

The permission given to foreign banks to enter the Albanian market is a good strategy for the recovery and development of the banking system. This strategy has already given its results even in other Eastern and Central European countries, Nevertheless, today those countries are expressing the concern whether the foreigners "will rule" the banking systems of their countries. In Poland[12] half of the capital is owned by foreigners, in Slovakia about 35 percent[13]. In Hungary during 1994-1998 the foreign ownership increased in banking sector, from 15 to 60 percent[14]. In Albania, the presence of the foreign capital in the banking system is 47 percent at the end of 1998, increasing substantially within a year (at the end of 1997 this figure was 37 percent). The share of the foreign capital is expected to increase in the coming years.

It is interesting to observe the number of banks operating in a certain country. In Poland, a country with a population of about 38.6 million of inhabitants[15], 70 banks (or a bank

for about 552 thousand inhabitants) are competing and one out of five polish has an account with the bank[16] (in Western Europe such a ratio is 4:5). In the meantime, Croatia has about 62 banks and 33 saving banks. The Governor of the Central Bank of Slovakia has stated that a sufficient number of banks are operating in Slovakia and has opposed the Government's intention to promote competition in the banking sector through a liberal licensing policy. According to him, the only thing to be done is the improvement of financial institutions' quality[17]. The same thing has been declared by the Czech Republic. Many observers have pointed out that 40 banks are too much for a country with the Czech Republic size[18] (or a bank for about 257 thousand inhabitants).

The second tendency highlighted is the limiting of licensing and expanding of efforts for the consolidation and quality improvement of the existing banking institutions. If we compare the number of banks in Albania to the population, it seems that we are a country "overpopulated" with banks. There were 10 banks in operation at the end of 1998, with a population of 3.3 million of inhabitants or one bank for 336 thousand of inhabitants; if we refer to September 1999 when the number of banks is 12, a bank is serving to a lower number of inhabitants (280 thousand of inhabitants)[19].

Such a figure would be considered as quiet normal if Albania would have been a country with a banking heritage and the people (both individuals and company owners) should have had established relations with banks.

The reality is different. We may not say how many Albanians have active relations with banks (because such figure is not available), but it is estimated as not high.

This does not mean that actions should be undertaken either to reduce the number of the existing banks or suspend or limit the licensing process. The number of banks will eventually depend on the space the market gives to them to survive and be successful. This is a figure, which shows that the Albanian banking system

overcame the stage of "hunger" for new banks and foreign capital. At this moment, the licensing philosophy adopted by the Bank of Albania and the policies pursued in the banking system should be changed. The Bank of Albania has no need to simply promote "entrance of new banks into the market", but it should aim at the entering of new qualitative banks.

This means the entrance of new banks that promise and include in their business plans the conduct of such operations that are not currently carried out by the banking system. Such banks should be the ones that promise to use new products in the payments system, investments in securities market, provision of bank services outside Tirana territory and what is most important are "more willing" to lend, particularly to Albanian citizens. It is a known fact that some of the licensed banks recently have not started lending activities or have expanded at a very low pace in this direction. The most significant figure is the non-fulfilment of credit ceiling for several years. Also one of the well-known reasons that explain the non-lending by the banking system is "high risk economic background and a society or businesses that do not know how to make a business plan and that are not bank clients". This reason is more than true.

Nevertheless, without wanting to upset anyone, this reason seems convenient enough to cover, to a certain extent, the willingness not to lend. The Albanian economic background has high risk, is unsteady and de-regulated. Besides other things, it is also affected by domestic and foreign crises. On the other hand, this "risky" economic background was not established over a night. It is classified as such for almost a decade. In this way, new banks that have started their activities recently, are assumed to have known and studied its positive and negative aspects, and based on this study they have taken the decision to enter into the Albanian banking market. Moreover, they have made their appropriate business plans, through which they have ensured the obtaining of the license.

Also, the fact that Albanian businesses are not bank clients is not a new one. It is clear that the businesses that have less than 8

years of activity, without any relationship culture with banks, can not approach them and are not able to make business plans. In such cases, banks are interested to function as normal ones and promote policies to attract clients. Therefore a bank, having observed such gap in the economic culture, may quite well carry out a new activity, the one of offering consulting services to new businesses.

Thus, it is not only business or the Albanian client to be blamed. As a first step, the licensing policy should be re-modelled by the Bank of Albania.

As a second step, the supervision function of the central bank should be enriched with a new element, i.e., the assessment of feasibility of the business plans submitted with the application for a licence. It should be born in mind that the licence is obtained based even on the promises made in the business plan form, according to which the applicant is classified as appropriate for opening a bank. The whole or partial non-achievability of this plan, even when under extremely specific factors (because such plans are studied under the assumption that the applicant has information and has studied the Albanian market), shall decrease the applicant's suitability for banking activity.

Another step, that is already carried out by the Bank of Albania is the strengthening of the licensing requirements, and initially the increase of the minimum required capital for establishing a bank. This makes the selection process more qualitative.

Another principle that should be included in the licensing process is the diversification of foreign bank capital origin. This has two positive impacts. Firstly, it brings about different banking cultures, with interests in different areas of the Albanian economy or different segments of the clients market. Secondly, it diminishes the exposure of the Albanian banking system to a single economy, reducing the possibility of undergoing external shocks in case the economy of that country faces problems.

The latter may be considered as paradoxical, under the situation when the Albanian economy is not integrated with other

economies and its internal problems conceal the problems of other economies. But, it will not be always like this.

Another factor may be even the increase of transparency on the licensing process. The licensing transparency is not only the declaration made to the media for the issued licenses. Such a thing should be made public, right from the moment of submitting the application to get a license to the Bank of Albania. It is obvious that the information should not include the one classified as confidential. On the other hand, making the information public shall help the Bank of Albania to get the opinion first from the economists and feedback from different business groups. Naturally this will help taking right decisions.

We emphasize this, taking into consideration the experience with some pyramidal schemes, which submitted to the Bank of Albania their application to get a bank license. Only upon their submission of applications to be licensed as banks, an additional element was created, making the population have confidence in such schemes. Immediately, the information "X firm shall become also a bank" was spread out. This might have been impeded, if the Bank of Albania should have explained through the media that submission of application is not enough for obtaining a license. The effect would have been even greater, if the Bank of Albania had made known the fact that their application for a bank licence was turned down (since the first half of 1996), explaining the respective reasons, or making known the fact that other firms withdraw from this process as soon as they were faced with the list of requirements. The Bank of Albania never made public the licence rejections (and there have existed such cases).

In the meantime, the continuation of the policy for licensing foreign banks seems to be suitable for the moment. Due to their experience and expertise, foreign banks have clearer strategy and efficient management, particularly in risk management. They are more prepared as regards the performance of retail banking operations[20], which seems a possible way for attracting Albanian population to banks.

The presence of foreign banks in a country, particularly in transition economies, insures long term benefits in the form of additional pressure exercised on the national (domestic) banks with regards to undertaking appropriate risks; expertise and technology transfer, promotion of competition, etc. Foreign banks can influence even on improvement of the regulatory process of a country because the authorities of their countries regulate them (always when these banks come from developed countries)[21].

They could successfully confront the internal shocks because they have more diversified investment portfolios (may be affiliates or branches of foreign banks with an extension of activity in other countries, or banks from countries with a different economic structure). But, the effect of this impact might be significantly reduced, if the foreign banks come from the same country or region or from countries with similar production structure.

Under the current situation of the Albanian banking system, the entry of new foreign banks into the market is still a valid policy, but the quality of their selection process should be increased.

NOTES

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[1] These banks are: Tirana Branch of First Investment Bank, FEFAD Bank, and Black Sea International Commercial Bank. Until September 1999, two of them have started their operations during the first half of 1999, while the request for the extension of starting the operations of the Black Sea International Commercial Bank was approved.

[2] The term "foreign banks" or "banks with foreign capital" does not mean that from the Albanian legislation point of view those banks are nonresident. The definition is given to distinguish the origin of the capital.

[3] Whenever in the denomination of a bank is used the term "branch" it would be taken into consideration from the Albanian legislation point of view and especially the regulatory requirements that there is no any distinction or differentiated treatment between a bank and a branch. They are in the same positions.

[4] See "Annual Report, 1998" of the Bank of Albania, page 37.

[5] According to the rules issued by the Bank of Albania, generally Treasury Bill investments are regarded as zero risk investments (risk free), while credits are regarded as highest risk assets (coefficient 1).

[6] Credit outstanding at end of 1997 and 1998 is respectively Lek 16.4 and 16.3 billion.

[7] For detailed data regarding the share of each bank group in the banking system, please refer to the heading "Supervision data" of the Economic Bulletin.

[8] Source: Entering the 21st century, world Development Report 1999/2000. The World Bank. Chapter 8: Case studies recommendations, Hungary".

[9] The net result from financial intermediations is found by subtracting from the net result of interests the expenses for provisions.

[10] These calculations have not taken into consideration the foreign exchange deposits level, current accounts in Lek for which interest is paid and their rate has not changed. The structure of time deposits and the average twelve-month deposit rate changed several times during 1998. These elements are not taken into account for calculation simplicity and the reason is to show the positive background made for the banks to reduce the interest expenses.

[11] The minimum allowed for the capital adequacy ratio of a bank is 12 percent.

[12] Weekly magazine "Business Week", 2 August 1999, page 18.

[13] According to the Slovakia Central Bank Governor, quoted by the newspaper "New Europe", 29 November- 5 December 1998.

[14] Source: "Entering the 21-st century", World Development Report 1999/2000. The World Bank. Chapter 8: Case studies and recommendations. Reforming

weak banking system: Hungary", page 161.

[15] CIA World Factbook, 1999 (estimations for July 1999).

[16] Weekly magazine "Business Week", 2 August 1999, page 18.

[17] According to the Slovakia Central Bank Governor, quoted by the newspaper "New Europe", 29 November- 5 December 1998.

[18] According to the magazine "European banker", "Private banks takes slice pie" no. 165, April 1999, page 11.

[19] If we take into consideration only Tirana city (about 700.000 inhabitants), where banks are located, the figure should be 70 thousand of inhabitants, and 58 thousands of inhabitants, respectively for the end of 1998 and as at September 1999.

[20] Retail banking: "Dictionary of Banking" of the author Jerry M. Rosenberg, 1993 gives the following definition: banking services offered to the public, including commercial companies, consumers and small business.

"Dictionary of Modern Economics" of the author David W. Pearce, 1989 gives the following definition: the term that is used for traditional banking operations carried out by the banks that operate as centers for clearing the relations and always by the banks involved in the trustee activity and others, through their networks of branches with the public. As it is implied, retail banking activity involves a great number of transactions, depositing and withdrawing money (cash), check payments, granting loans with uncover accounts and granting other loans-in small amounts.

"Encyclopedic Dictionary of Finance" of the authors Dean Paxson and Douglas Wood, 1998 is explaining the following: The retail banking activity historically is a relatively simple business. Commercial banks that operate mostly through a network of branches, accepted consumer deposits, which at that time were frequently used to grant loans, in most of the countries in the form of loan with uncovered account, for the corporation sector. For the deposits kept in current accounts, banks offered free transaction services, mainly through the use of checks in the most developed economies. Individual consumer loans were also made available, but they were not a considerable part of the bank loan portfolio. There were not, or there was a little segmentation of the consumer market.

By the end of years '60, personal electronic products were at their beginning, the automatic money machine network (ATM) was undeveloped and financing with credits was treated as a peripheral (second hand) product and to a certain extend unpleasant. The role of the branch was to offer a full range of services for all categories of clients. The branch manager was considered even as administrator, credit officer (within narrow limits), and having skills for the internal services offered by the bank. The international services usually were offered by the specialists working at the international branch (department). The system was based on papers, attempted to be negative against the attitude and concentration of the client, slow, expensive and had serious deficiencies in their

efforts for marketing and sale (see Channon, 1998).

[21] In the World Bank edition entitled "Entering the 21st Century", World Development Report 1999/2000, it is observed from a recent study on the effects of the foreign banks in the banking system of 80 countries, and it has resulted that the domestic banks have a lower level of expenditures and this participation attempts to improve their result.

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BANKING SUPERVISION AND STANDARD REPORT OF EXAMINATION

Arian Kraja*

I. BANKING SUPERVISION

I.1 WHAT IS BANKING SUPERVISION'?

Banking supervision is the regulatory process of monitoring the condition of an individual bank within the banking system, as well as the system as a whole.

It begins with the establishment of licensing standards and their implementation; it continues with evaluation and assessment of a bank's activity and performance; and when necessary, includes the taking of remedial measures and application of penalties to ensure that laws and sound industry practices are followed. These remedial measures may ultimately include revoking the bank's license.

I.2 WHY IS BANKING SUPERVISION NEEDED?

Banks and their activities are subject to much closer official supervision than other kinds of businesses, because of their role in the economic and financial life of a country. Banks accept

deposits from the public and government. By doing so they assume a role of major trust for society's financial assets.

They occupy a central place in the payments mechanism for households, businesses and government. They also play a major role in the allocation of financial resources of a country, mediating between deposits of surplus funds and would-be borrowers, on the basis of active judgments as to the latter ability to repay.

This stands in marked contrast to the practice under conditions of central planning, where banks would typically act merely as passive conduits for the distribution of funds without the necessity to make credit decisions.

Because of the special role banks play, the primary justification for banking supervision is to limit the risk of loss of depositors, and by so doing to maintain public confidence in the system as a whole.

I.3 WHAT IS THE SUPERVISORY PROCESS?

Banking supervision is an ongoing process that begins with licensing. It is precisely at this time when the individuals and/judicial persons are evaluated, as to their acceptability for being granted permission to commence banking business.

Standards regarding initial capitalization, qualifications of management and appropriateness of the bank's proposed business and strategic plans must be met.

Supervision continues with reporting requirements, which are reviewed and evaluated on an "off-site" basis. Inspectors from the Bank of Albania will also visit the bank to conduct "on-site" inspections.

These "on-site" inspections are designed to verify information provided by the bank and to review first hand operations and performance of the bank.

The latter inspections may be general in their scope (full scope inspections), or may be focused in a particular area (partial inspections).

The findings and recommendations on each on-site inspection are presented on a written format that is called the Report of Examination.

Banks engaged in unsafe and unsound practices will be required to cease such operations and develop and implement corrective actions.

Likewise, deficiencies, identified during the supervisory process - whether from an off-site inspection, - are required to be corrected.

Article 44 of the banking law (Law No. 8365) provides for several means by which the Bank of Albania may deal with a bank's failure to comply with the supervisory requirements.

II. THE REPORT OF EXAMINATION

II.1 WHAT IS THE REPORT OF EXAMINATION?

Report of Examination is the written communication used to present to the administrators of the Bank of Albania, and the Board of the examined bank the most significant findings, conclusions and the recommended corrective actions, drawn by an on-site inspection.

Since the Report of Examination communicates significant findings and recommendations, it bears a key role in the overall supervisory process. The Report of Examination in almost all cases serves as a justifiable document for all corrective measures undertaking.

To ensure uniformity in the presentation of inspection findings, their smooth reading and immediate identification of main

matters and conclusions, a standardized Report of Examination format has been adopted.

This format begins with a front page listing overall conclusions on the most significant findings. This in turn is followed by another page where the most significant matters, deserving Board attention of the inspected bank are listed.

Afterwards, summary comments are rendered on each element of CAMELS' system[1] as well as other matters deemed necessary.

These pages are associated with tables and other data intending confirmation of conclusions listed at the front of the report.

II.2 THE STRUCTURE OF THE REPORT OF EXAMINATION

The report of examination is composed of 4 main components:

1- CONCLUSIONS AND RECOMMENDATIONS
2- EVALUATION
3- ADDITIONAL INFORMATION
4- CONFIDENTIAL SECTION

II.2.1 Component 1: Conclusions and recommendations

This component is evaluated as one of the most significant parts of the report of examination which gives a brief and concise account of:

A. Main examination findings and conclusions;
B. Matters requiring Board's attention of the examined bank;
C. Violations of current laws and regulations.

In the heading *"Main examination findings"*, the financial condition of the bank, the capital, assets quality, the loans and investment portfolio, the overall framework of policies and

practices, profitability, liquidity, etc., are evaluated in accordance with "CAMELS" system and the quality and tendency of each component is explained.

Therefore, any significant change or future tendency deemed necessary is explained. This heading is signed by the Chief Inspector and the Director of the Supervision Department.

Matters requiring Board's attention are presented under the heading, "Matters requiring Board's attention", listing them according to the constituent elements of the CAMELS system in view of Board's measures for improving examination findings, i.e., policies drafting, approval of regulations and instructions, drafting necessary programs, or undertaking administrative measures for infringements redress or improvement of the financial condition of the bank; and problems marked during examination and cited in the final report of examination.

Each member participating in the Board of the bank under inspection is responsible for full analysis of the entire Report of Examination.

Each member of the Board should sign the page under "Signatures of the members participating in the Board of Directors" in order to confirm that each of them has thoroughly reviewed the report.

(The table has the following outline)

Name, Surname	The function in the board of directors	Date	Signature

Violations of laws and regulations, found for the bank under examination are included under the heading "Violations of laws and regulations" where the first ranked are law violations followed by violations of regulations and violations according to their risk exposures of the bank.

II.2.2 Component 2: Evaluation

This part is composed of 6 elements of the CAMELS system.

This section presents the evaluation for the financial condition of the bank reviewed in all its aspects. Supposing that the normal order of the CAMELS system was followed, then evaluation would begin with capitalization. But, considering the overall significance and influence borne by management, this evaluation is good to begin with management and administration.

A - Management / Administration

Management is estimated on account of all indispensable factors for the safe and sound administering of the institution in compliance to all accepted practices. The attention should be focused on the technical competence, leadership and administrative capabilities; compatibility with regulations and statute; capability to plan and react to the changing conditions; effectiveness of systems used for managing information; adequacy and applicability of domestic policies; the response against recommendations made by inspectors and supervisory authorities; and management quality. More concretely this section deals with:

- Management assessment, in view of the daily routine of bank administration as well as in the long-term;
- Judgment on board's policy in view of basic function of the bank (deposits, credits, securities, etc);
- Matters deserving the board's attention;
- Implementation or non-implementation of the internal and external audit recommendations and nominally indicating managers' explanations;
- Evaluation on adequacy of policies of the bank;
- Judgment on the identification and evaluation of risks exposures from management;
- Judgment on the bank's assets dealing with internal related groups of people.

B - Capital adequacy

The capital adequacy is evaluated with respect to the regulations in effect on regulatory capital and own funds

adequacy; as well as on the overall financial stock; the nature, tendencies and the volume of assets classified as substandard; intangible assets, off-balance sheet items and profit; growth rates, etc.

Thereto, basing on the capital necessities, considerations are rendered on: bank profit; overall risk of interest rate; reasonability of paid out dividends; as well as on plans regarding capital maintenance at adequate range, or on undertaking appropriate corrective measures. To pass a judgment on capital level and its adequacy, the following ratios are to be studied:

Capital ratio and tendencies

RATIOS	Current examination (Date)	Previous examination (Date)	Previous examination (Date)
The total of doubtful – substandard own funds items Base capital assets total Own – funds assets aggregate Base capital corrected assets			
	Current examination (Date)	Previous examination (Date)	Previous examination (Date)
Dividend/net income The growing rate of assets Profit/previous years loss/the average of share holding capital			

Further, it is briefly commented on capital quality with respect to assets quality, profits, assets growth as well as management philosophy on capital position.

C - Assets growth

The assets growth is evaluated with respect to the level, distribution, tendency as well as classification of non-performing assets. The current concept relates to the level, composition and tendency of matured assets, which are:

Ratios on assets growth and tendencies

RATIOS	Current examination (Date)	Previous examination (Date)	Previous examination (Date)
Classified assets/the total of assets Classified loans/the total of assets Classified loans/credit aggregate Classified loans/own funds Loans substandard & doubtful/ own funds			

These ratios enable:

- evaluation on the overall financial stock and volume of classified assets.
- Assets structure.
- The structure of loan portfolio in domestic and foreign currency according to their maturity;
- The structure of investment portfolio, etc.

D - Incomes

Income quality and quantity is evaluated in connection with the capacity to support present Indicators and tendencies.

RATIOS	Period (Date)	Period (Date)	Period (Date)
Net income after tax/average assets Net income after tax/own funds average Operation expenditure / gross operational income			

Besides accounting the above indicators, the current section deals with:

- Evaluation of the profits level and their effect on capital;
- Evaluation of expenditures, especially for the most exceptional ones, past due and suspended in interest reckoning; capability to demonstrate, identify, administer and recover/collect non-performing loans.

Thereto, it is also evaluated the investment quality on securities; the adequacy of investment policies, investment risk,

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etc., or the efficiency of lending policies and practices of loans administration; and the future operations, coverage of losses and maintaining of capital adequacy, level and tendency of profitability; profits structure and quality; net spread interest; as well as profit exposure to interest rates change.

Therefore, it should be also taken account of expenditure adequacy for reserve funds in covering losses from loans (provisions); share of exceptional items, bonds transactions, tax effects on net income and dividend payments, etc.

Evaluation of profits plan and the would-be factors influencing it in the future. Judgment on the adequacy level of provisions for credits.

Analysis on income composition (incomes from dealings with other banks, incomes from customer's dealings and clients' lending.)

E - Assets / Liabilities Liquidity and Management

Assets and liabilities liquidity and management is evaluated with respect to deposits structure and stability; level and tendency of support on short-term and largely liquid fund resources; difficulties in funds provision; and forecasted liquidity from securities and other assets.

Besides this, it is also taken account of the adequacy of liquidity, funds practices and policies including provisions on fund alternative resources, management of the interest rate risk; or nature, tendency, and volume of off-balance sheet assets.

Special importance should be attached to the implementation of Bank of Albania's regulation "On Banks' Liquidity". Concerning this element, the following is defined:

- The quality of fund resources for meeting credits demands and deposits withdrawal.
- The bank's manner of calculating the liquidity ratio Deposit

structure in domestic and foreign currency and comments made on it.
- Existence of the committee for managing assets and liabilities (ALCO) and its operating efficiency.

F - Sensitivity to Market Risk

The sensitivity to market risk component reflects the degree in which changes in the interest rates, foreign exchange rates or consumer prices and share-holdings influence the capital base and profits of the institution.

While evaluating this component, it should be taken account of: the managing capacity to identify, measure, monitor and control the market risk; size of the institution; nature and complexity of own assets; as well as own profits and capital adequacy regarding banks' exposure to market risk. Concerning this issue, there is made:

1. Evaluation of factors affecting the interest and foreign exchange rates.
2. Evaluation of the managing system used to monitor and control these factors.
3. Commenting on their influence on the institution's profits.

G - Risk Management

The following points help the examiner for the assessment of risk and indicate the way bank directors are supposed to deal with risk management.

1. Evaluate the risk managing program of the institution, comment on how the management identifies, measures, controls and monitors the risk formally and informally.

This item requires a broader assessment of risk management and of monitoring practices. This does not necessarily require detailed descriptions of each practice and policy.

On the contrary, it is proposed to define the adequacy of mechanisms to identify internal and external risks exposures that the bank is going to take over and the way they are measured, etc. When referring to the adequacy mechanisms used to identify internal and external resources of risks, we should take into account that:

a) External resources of risks - are risks that the management can not control. They include technological changes, economic competition and political events. The management has the task to identify and then respond to impacts of these resources.

b) Internal resources of risks - are controllable because they derive from management decisions such as strategic planning and allocation of resources. For example, in case the strategic plan specifies growth in a certain area, does the institution possess appropriate human resources to stand up to these objectives? Is the information system of the institution capable of dealing with these changes?

This element defines whether the practices and risk line for each function of the bank (credits, deposits, and securities) coordinate to the overall strategic plan.

2. Evaluate written practices of the institution and credit management, including documentation, approval and report requirements. Evaluate the lending policies and practices, as well as those of credit payment, taking into account lending complexity and portfolio composition.

Concerning this element, comment is made on the policy of lending and credit management regarding their completeness and appropriateness.

3. Evaluate the process of reviewing loans and the internal rating system. Evaluate the institution's methodology in deciding the adequacy of provisions for covering losses from the loans.

4. Evaluate policies and practices of asset and liability management. Evaluate investments recommendations, the strategy of funds, the objectives on liquidity targets and interest rate risk management.

Concerning this element, comment is made specifically on bank liquidity, funds management and interest rate risk exposure.

5. Evaluate the internal control and management information system. Evaluate the independence, inspection and frequency of internal and external audit. Comment on the application of recommendations provided by internal audit.

6. Evaluate the institution's policy with respect to transactions with its own employees or conflicts of interest. Comment on other issues regarding administration, supervision and audit from directors and management.

7. Evaluate management's knowledge and the tendency to behave in conformity with the laws and regulations.

Concerning this element, the violations of laws and regulations are highlighted.

8. Identify any individual or interest controlling the institution, the degree and method of controlling.

II.2.3 Component 3: Additional information

The heading "Additional information" provides detailed statements of the bank's financial position, as follows:

In million Lek

	31/12/19xx	31/12/19xx
Assets[2] Cash Transactions with the Central Bank Other bank transactions Loans Investment on securities, etc….		
The total of assets		
Liabilities Deposits Other liabilities Etc….. Total liabilities Share holding capital Total of liabilities and total share holding capital Off balance sheet items		

It is noticed that putting management at the beginning reflects the importance of operations or non-operations of bank managers, under general financial conditions of the bank or of the financial institution.

Summary of items subject to classification and special attention

Categories	Classified items			
	Substandard	Doubtful	Lost	TOTAL
Loans and leasing Securities Other real estates Other assets (e.x "Debtors for accrual interests and past due income")				
Total as at 31/12/19xx Total as at 31/12/19xx-1 Total as at 31/12/19xx-2 Total as at 31/12/19xx-3				
The sum, description and commentary	CATEGORIES			
	Substandard	Doubtful		Lost
1. 2. 3.				

Items subject of classification include assets and off-balance sheet items specified under the following categories.

Substandard assets represent assets which are insufficiently safeguarded from the current sound equity and from the repaying capacity of the debtor, or of collateral pledged, if there is any. The asset classified according to this method might have a well defined invalidity or that risks the debt repayment. They are characterized by a definite probability that the institution will retain losses, if the deficiencies are not corrected. Doubtful assets bear all transmissible deficiencies like substandard assets with supplementary characteristics.

- Describe and comment in detail all the categories of assets classified as above.

Loan loss provisions reconcilation

	31/12/19XX	31/12/19XX	31/12/19XX
The balance sheet at beginning Gross loss from loans Recoveries Provisions for loss loans			
The balance sheet at the end of the period			

This part also includes the coordination of management assessment with the evaluation of other constituent elements of CAMELS, which in the long run indicates the financial condition and management of the bank.

Profit analysis

Comerative table of income and expendures

	31/12/19XX	31/12/19XX	31/12/19XX
Income from interests Expenditures for interests			
Income from interests Income from non interests Expenditures for non interests Provisions for loss loans and the leasing Profits (Loss) from securities Loss /Profit from foreign exchange operations			
Net operational income (before tax) Applicable tax on incomes			
Net operational income (after tax)			
Net income			
Divident payment The net change in the account of share holding capital			

The additional information is logically placed after the evaluation component, grouped according to the CAMELS system, needed to back up the comments made under the section of evaluation, or conclusions and recommendations.

The ratios of profitability components and tendencies

RATIOS	31/12/19xx	31/12/19xx	31/12/19xx
Net income from interests/ average profitability The total of expenditures for non interests/ average assets Net income/average capital Net loss/average total of loans			

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Of significance is the risk management phase, which should be taken into account and requires from the inspector to evaluate the level of tolerance for the overall risk management, as well as the assessment of the local economy, its impact on the bank and how well the management monitors this impact.

NOTES

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[1] CAMELS is a standard evaluation system on second-tier banks. Each letter stands for an element on which the bank is evaluated. C- Capital; A- Assets; M- Management; E-Earning; L- Liquidity; S- Sensivity. The evaluation provided on each element scales from 1 up to 5 where 1 represents the best evaluation and 5 the poorest evaluation.

[2] Assets and liabilities on this table are introduced according to the balance-sheet of the bank under examination.

THE STRATEGY OF THE MEDIUM-TERM DEVELOPMENT OF THE BANK OF ALBANIA, AN IMPORTANT DOCUMENT FOR THE BANK AND ECONOMIC POLICY IN ALBANIA

*Marta Muço**

The development strategy of the Bank of Albania in the medium term was approved by the decision of the Supervisory Council, No. 111, dated 17.11,1999[1].

The first draft of the strategy was proposed a year ago and was reviewed and discussed by all officials of the Bank of Albania. It was approved on principle by the Supervisory Council on February 1999, allowing a period of time of almost 10 months to be discussed, tested and improved furthermore by all Bank structures. This was conducive to the argument that the Bank of Albania, for the first time, drafted a written paper of this nature and attempted to provide an example of enhancing institution's transparency and communication inside it.

On the other hand, we were convinced that the definition of this strategy did not only require listing of some ideas, but also deeper studies on its special aspects, taking into account a number of influential factors operating inside and outside the institution.

In the framework of lack of a national development strategy, the Bank of Albania undertook the initiative to fill up the vacuum in this area. The Bank of Albania formulates and implements

the monetary policy of the country, one of the most important orientations of the economic policy. From this view point, the draft of the Development Strategy of the institution defines the objectives for the short-term implementation of the monetary policy.

The legitimate ambitions of integration in the European processes and broader, dictated the need for anticipating the process with well defined strategies. While drafting this document, the regional events aroused the necessity for reflecting in our work the changes dictated by the new conditions and admission of the Stability Pact.

THE SCOPE AND IMPORTANCE OF THE STRATEGY

The scope of formulating this document is:

1. The drafting scope of the Development Strategy for the Bank of Albania is to define the short-term and medium-term objectives;
2. This document is aimed at appraising the attained level of the institutional development and indicating the ways traversed to drive up to the current state;
3. This strategy is aimed at fixing schedules for achieving these objectives;
4. This strategy, by determining the way ahead, decides the priorities and the way they are achieved in the medium-term.

The drafting of this document is of importance because:

1. It provides transparency on the development goals of the Bank of Albania, introducing them listed and analyzed not only for the public but also for the institution itself;
2. It avoids casual occurrences of the institution and better coordinates the operation among the departments;
3. It practically determines the course for achieving the objectives and Bank functions specified by law.

CONTENTS OF DEVELOPMENT STRATEGY OF THE BANK
OF ALBANIA IN THE MEDIUM-TERM

The document approved by the Supervisory Council is made
up of 5 parts.

It begins with an introduction, presenting the scope and
importance of writing this paper.

The second part presents an historic overview on the banking
system, the statement and development goals for the Bank of
Albania and the banking system in the short-term. It also gives
an account of the Albanian banking system up to nowadays
and the two-tier reorganization after 1992. This part provides
a brief account on the Bank functions and its statement after
reorganization. The condition and goals of ESAF 1 and 2 as well
as the results attained so far are also described in this part.

The third part deals with the overall development strategy of
the Bank. This part, which represents the basement on which the
whole document is set up, defines the institutional model to be
followed by the Bank of Albania in the process of improvement
and approach to international standard. The strategy defines that
the model, by which the Bank of Albania should be gradually
oriented to is that of the European Central Bank. The reasons
accounting for this choice are backed up by the geographical
position, tradition of economic transactions and shares in import
and export structures of Albania.

This model is also deemed as containing compromising
elements, favourable for a central bank like the Bank of Albania.
On the other hand, the operating area of the euro covers a great
deal of the countries considered as the main economic partners
of the country at present and in the future. This part underlines
the idea that the long and complex process of compliance to
the European standards will impose changes, beginning from
elements of monetary policy up to the adopted structure of the
Bank, infrastructure and policies of employment and training
as well as information technology and organization, etc. This

process will be carried out by stages, establishing the conditions for the long-term membership of Albania to the European institutions and broader.

Bank's independence constitutes another approach of the medium-term development of the institution. This matter is viewed under two points: First, interpreting the notion of independence within the competencies sanctioned by law and showing why it is essential; Second, pointing out the de facto achievement of this independence specified by law. The latter is viewed as Bank's increasing creditability, openness, information and transparency to the public, especially with respect to monetary policy.

Applying the legal and regulatory framework, as well as the public awareness are two other concerns to be regarded as priorities of the medium-term development of the Bank of Albania. The later is especially viewed under the approved strategy as an important element of the work in the future. The considering of the public as a natural bank alley in front of the challenges of economic development and reforms will be achieved through extending communication inside and outside the bank, increasing publications and improvement, expanding information and other measures concerning relationship with homologues in the world wide.

The monetary policy and financial markets cover the most important area in this part of the overall strategy of the Bank. Achieving and maintaining price stability constitutes the main objective of the Bank, specified by law and detailed in the monetary program and ESAF.

Pursuance of inflation performance and analysis, treated in a special section of the strategy, is forecasted to be carried out by achieving intermediary quantitative objective, such as money supply growth when the monetary base may be regarded as an appropriate intermediate objective.

On the other hand, broader monetary aggregates would be more suitable indicators for drafting the monetary policy in

the future. The strategic objectives for using monetary policy instruments as well as the gradual passing from direct into indirect instruments in the medium term are also discussed under the same section. The abrogation of credit ceiling is considered as the first step in this direction. The development of financial markets, such as the monetary market, foreign exchange market and the capital market, through forecasting and concrete planning of the steps to be undertaken for their further promotion, are part of the development strategy of the Bank of Albania in the medium term. Under the conditions of continuous implementation of a flexible regime of foreign exchange rates, foreign assets management will be improved, aiming at decreasing the government's foreign debt and supporting imports, when necessary.

The fourth part of this document describes the strategic developments and other functions of the Bank. Improving bank supervision as one of the most important duties of the Bank of Albania is treated in detail under this strategy. The duties to be accomplished in the medium term and Bank's objectives for approaching to international supervision standards are viewed in four main directions: a - Supervising the process of new banks' entry; b - Regulatory framework and supervision on second-tier banks; c – Supervising the financial performance of the bank; d- Supervising the process of dealing with problem atic banks.

Statistics development and research strengthening make up a priority for the medium-term development of the Bank of Albania. Statistics development and strengthening based on international standards is very important for the Bank of Albania. This standardization will be achieved through the effort for participating in two standard systems of data dissemination, the GDDS and SODS in the medium term.

Improving data quality and information sharing inside the Bank, as well as its absorption from other alternative sources are defined as other leading duties of the Bank. Their achievement will be enabled through foreign technical assistance, paying attention to the prudence and accuracy of data processing.

Developing research skills is considered as one of the long-term objectives to be implemented by stages. Necessary training of human resources, strengthening of research function of respective units, and preparing analysis for Bank authorities and the public are defined as essential directions that will enhance the quality of economic estimates made by the Bank, along with realization of forecasting and programming.

Living in an evermore computerized and organized world, the development of Information Technology for a relatively new bank, like the Bank of Albania is considered as an important step for achieving better international standards and practices.

Being aware that we are in the initial steps of developing information technology and knowing its indispensability for Bank's development, our focus will be: expanding knowledge and experience, a better organization of human resources, extension of automation, implementation of information systems, and development of the information system of reporting and statistics.

Improving systems of payments and accounting are constituent parts of the medium-term strategy of the Bank. Since the Bank of Albania represents the supervisory authority of the payments system in Albania and the responsible institution for its smooth functioning, the strategic objective for the improvement of this system is to increase currency circulation through the banking system, thus reducing cash use. This will be achieved by improving the system of inter-bank payments and other small amount payments in collaboration with second-tier banks. The strategy for improving inter-bank payments will be attained by implementing a RTGS system. On the other hand, the automation of the clearing system will be achieved through increasing Bank's collaboration with second-tier banks. These efforts will be affected by the improvement of the legal and regulatory framework of the payments system.

The accounting system, as a means serving the needs for internal management, will keep improving in the medium-term,

following the strategic objective of communicating necessary and transparent information to the public, or as a means for monitoring Bank's activity. Pursuing this strategic objective, upgrading the accounting system and its compliance with the international standards will be aimed at in the medium term.

In compliance with the central bank functions, the Bank of Albania holds the exclusivity for issuing the national currency. Regarding this function, the strategy determines the main directions of issuing national currency in the future.

The successful development of the institution in the medium-term depends on the level of skills and training of the human resources. That is why this important area is introduced in the strategy by analyzing the priorities of managing and training of human resources. Therefore this process will aim at harmonizing the current and perspective interests of the Bank and of its employees concerning their training and professional career. Job assessment and motivation of own employees will be achieved by planning optimal conditions, not only for work but also for recreation and relax.

All these strategic tasks can not be fulfilled without developing the Bank of Albania infrastructure. That is why issues of improving working conditions, Bank's safety and safeguarding, as well as improvement of the organizational structure also occupy a modest place in this strategy.

The fifth, the last part of the Strategy for the medium-term development of the Bank of Albania treats in the form of conclusive notes the connection between the achievement of the strategic tasks and the Albanian economic environment. Separate elements of joint action between the economic environment and the Bank of Albania are included in the economic programs of national development, especially in both ESAF programs. Nonetheless, the strategy lays emphasis on some separate indicators, such as the economic growth, budget deficit, structural reform and privatization, democratization of the society, membership in international organizations, etc.,

constituting preliminaries for the successful implementation of this paper in the medium term.

Since the Strategy for the medium-term development of the Bank of Albania is also considered as a self-assessment document, for the first time attempts are made for determining its strong and weak points. Bank of Albania strategy is the first effort for an objective analysis with well-defined duties for a broad spectrum of Bank sectors according to the international standards. This is a coherent and realistic program based on the achievements, which also takes into account even the difficulties. We appreciate it as a modern program, seeking support in theoretic and practical elements of contemporary management of banking.

However, we are also aware of its breakable parts. The lack of complete statistical analysis makes the strategy relatively hard to be conceived as a concrete program. This makes it assume the casual appearance of a measures plan, especially for the main functions of the Bank. On the other hand, specifying the real realization costs makes up another difficulty, partly dependent on us. The knowledge on some matters concerning integration into the European systems and broader, is limited. It should not be neglected that the drafting of this document is made under the conditions when the stability of institutional and economic development of the country is still followed by elements of insecurity.

IMPLEMENTING THE STRATEGY

The Bank of Albania's commitment to fulfil this paper is at maximum. But, the implementation of the development strategy of the Bank of Albania does not constitute a detached act only dependent on the banking system developments or the institution's good will for accomplishing medium-term duties. It will be accomplished in the background of the necessary reform for the overall economic institutional and political transformations of the country. Consequently, various segments of this transitory

process will reciprocally interfere in the achievement of this target, leaving own tracks on it.

An engagement program was designed to ensure a follow-up of the performance for implementing a stage distribution and actualization of the principles under this strategy paper. It will be constantly pursued by all bank structures, making the necessary adjustments, included even those dictated by the time. Establishing fully defined schedules and charging appropriate structural units make the engagement for implementing this document more responsible and convincing.

During its implementation, there should be considered the reflection of accomplished duties, following the recommendations and instructions left by the IMF missions after discussing the monetary program with Bank of Albania; reflection of recent knowledge in the areas of monetary operational policy; supervision; payments accounting; research and statistics realized with the assistance of IMF, WB, USAID missions, etc.; and reflection of the current problems encountered during implementation; as well as the positive institutional developments.

The Bank of Albania has full confidence in and appropriate commitment to implementing this document.

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* Marta Muço, Head of Governor's office.
[1] The full text of this document is published in the Official Bulletin of the Bank of Albania, no. 17, December 1999.

CREDIT CEILING

Fiqiri Baholli*

I. OVERALL FEATURES OF APPLICATION IN VARIOUS COUNTRIES

The credit ceiling is a direct instrument used by a central bank for monetary control. Different countries use it, as a temporary instrument of monetary policy to control money demand, or as a means to monitor the aggregate credit during all the time.

The credit ceiling imposed on second-tier banks on crediting the economy was defined by the Bank of Albania as growth of credit stock in the balance-sheet up to an appropriate range.

Experiences of credit ceiling in different countries have varied to a great extent concerning the monetary objectives and specific application of the instrument.

Credit ceiling is used due to:

- Facility to apply;
- Accurate transmission of monetary targets and credits;
- It is believed to be the most effective monetary instrument under the conditions of undeveloped financial markets or/

and under the conditions of restricted technical potentialities of monetary authorities;
• An effective means for managing funds resources in most "favourite" sectors.

Taking into account different development ranges of financial markets, a brief overview in the countries having used the credit ceilings shows that this instrument was used under the conditions of:

• Non-competitive banking structures;
• Undeveloped or slightly developed markets;
• Government securities;
• High cost transactions;
• Restrictions capital outflow.

The non-competitive banking systems are characterized by a high mediating cost and a large difference of interests in the deposit credit ratio, something that damages the transmission mechanism of monetary policy onto the economy and open market operations. Moreover, in countries with few banks, concentration in few hands led to ineffective auctions of securities.

The OECD countries have used the credit ceiling as an emergency instrument in different incompatibility periods of maturity of assets and liabilities.

Certain developing countries have used credit ceilings to "favour" various sectors of the economy, as for example the agriculture.

In the 90-ties, some of the Eastern and Central European countries in transition used credit ceilings to control the monetary aggregates throughout the transition stage from the planned economy into the market-based economy (such as Albania, Bulgaria, Czechoslovakia, Poland, Romania and FYROM).

The credit ceiling experiences from different countries point out their advantages and disadvantages.

Advantages:

- A more confident control on credit aggregates;
- It may result as the only practical monetary instrument under the conditions of small or unsuccessful markets;
- They are easily applied when the number of banks is restricted;
- They are easily determined and attached to the monetary program items;
- They are riot affected by the regime of foreign exchange rates.

Disadvantages:

- They can not be used for improving short-term liquidity management;
- They tend to segment the credit market, in spite of the competition among banks; or
- Restrict the competition among banks, by damaging the monetary market development;
- They may lead to the micromanagement of credits distribution by the central bank;
- They may be difficult to monitor, since the credit may be granted in types uncovered by the credit ceiling;
- They may lead to the multiplication of direct control and financial restrictions;
- Application in countries with a large banking system may become difficult;
- The intermediation between formal and informal sectors may disintegrate.

In conclusion:

The credit ceiling may serve as an effective instrument under certain circumstances, when the relationships of monetary aggregates are unstable, or under transition stages, when financial markets are undeveloped and indirect instruments can not be used. As the time goes by, when the market orientation of monetary control becomes more present, the central bank

should be gradually passing onto the indirect instruments for achieving the monetary and inflation targets. (Anyway, this instrument exists in the central bank arsenal and serves as a turn over in difficult situations.)

II. APPLYING CREDIT CEILING BY THE BANK OF ALBANIA

In the framework of credit ceiling application by the Bank of Albania, some main elements are worth mentioning:

1. At the beginning of each year, the monetary program, as an integrated part of the whole economic program, forecasted credit growth to the economy at the balance sheets of second tier banks. This growth may be otherwise described as use of domestic resources of the banking system for the development of the economy in accordance with the main objective of maintaining consumer prices stability.
2. Distribution among the banks was made on quarterly basis, observing the performances of placements with domestic and foreign currency; performing and non-performing loans, as well as the performance of the paid up capital, for every banking institution licensed by the Bank of Albania;
3. Attending the credit ceiling accomplishment was made on quarterly basis, according to the information received by second tier banks for using, repaying and changing stock at the beginning and ending of the period.
4. Like any compulsory instrument, the exceeding of the allowed amount of credits from the banks had penalizing measures to the banks and their administrators. By applying the credit ceiling, the Bank of Albania aimed at encouraging economic growth and credit extension from the banks that were more successful in lending activity.

To this end, requests for extending credit ceilings at certain periods have been permitted and admitted based on credit ceiling indication among the institutions and own redistribution during the year. Meantime, the diversification of credit portfolio

(according to the schedule) would provide increase of lending potentialities from the banks during the year. The credit ceiling, applying rates, lending, as well as the distribution in currency, schedules and sectors for the period of 1993 to end of September 1999 are presented as follows:

	1993	1994	1995	1996	1997	1998	1998[1]	Sept. '99
Credit ceiling (bill lek)	7.4	3.7	2.9	3.1	2.3	6	2.5	8
Accomplishment	39.4	64	60.1	95	75	30	72	11
Recent Credit (bill lek)	10.3	7.4	6.7	7.4	3.98	5.8	5.8	5.5
Issued: (in %)								
Domestic credit		90	86.5	63	37	20	20	25.5
Short term loans	74	54	61	50	65.5	67.2	67.2	73
Credit to private sector	53	74	70	83	98	100	100	100

According to the monetary program for 1999, the credit share to the economy in Net Domestic Assets (money demand) was envisaged to increase by Lek 8 billion. With the decision of the Supervisory Council, this credit ceiling was spread according to quarters, for the banks permitted to lend in our country.

	Q1	Q2	Q3	Q4	Year
Total	1600	2000	2400	2000	8000

Since December 1998, separating the private from the state-owned banks, according to the monetary data, the credit stock appears as follows:

Credit growth forecast from 6 to 2,5 miliards of lek	Dec '98	Q 2 '99	Q3 '99	Credit ctock change in Dec '98 Q3'99
Private banks	5084.9	6864.5	7529.6	2444.7
State owned banks	11230	9953.4	9656.3	-1574
Banking system	17691.3	18195.4	18563	871.7
Official sector	2830.3	1913.4	2056.8	-872.3
Private sector	14862	16282	1958	1743
Lek	12065.3	10372.4	10343	-1722.3
Foreign currency	5626	7823	8220	2594
Accounting indicators (the exchange rate)	140.58	136.9	134.1	

Up to the end of the third quarter of 1999, Lek 5.5 billion was extended and Lek 4.3 billion was collected. Loans in domestic currency had a declining trend, while lending in foreign currency continued increasing, constituting 44 per cent of the credit stock of the banking system, from 32 per cent in December 1998. According to the lending data, private banks continued extending foreign exchange loans, in spite of the stable trend of the domestic currency compared to the foreign exchanges.

State-owned banks recorded decrease of credit stock due to their exclusion from lending activity.

Credit to the economy was represented by the sectors of agriculture, trade, construction, processing industry, extracting industry and production, as well as distribution and supply of electric energy and water.

Considering the credit ceiling a helpful instrument for controlling the monetary demand of a certain situation, its application in our country was preliminary conditioned by the restricted number of banks, undeveloped markets of securities and the lack of supervisory standards for examining second-tier banks.

The application of credit ceiling for second tier banks was not carried out in the last two years, though banking institutions licensed by the Bank of Albania increased. Meantime, the government security market extended with respect to participants and operations. Thus, the legal and regulatory framework was completed by establishing credit portfolio rates, concentration of capital, etc.

On the proposal of the monetary policy and supervisory departments, the Supervisory Council of the Bank of Albania decided on revocation of the credit ceiling to second-tier banks. Further strengthening of bank supervision and drafting of various regulations by the Bank of Albania enabled indirect control of credit demand.

In the current stage of state-owned banks, upon the decision of the Supervisory Council, the second-tier banks with more than 20 per cent of non-performing loans were not allowed to exercise lending activity.

III. THE ROLE OF BANKING SUPERVISION AFTER THE REVOCATION OF CREDIT CEILING

In the framework of objectives for the optimal functioning of the banking system based on market principles, the Bank of Albania has undertaken appropriate steps for the supervisory functions, through the regulatory system and on-site examinations.

On-site examinations are gradually challenging contemporary standards by monitoring high risk areas, such as credit. The staff of this sector has increased and has been constantly trained. Respective Reports for "The overall statement of the bank "and "On-site examinations" are quarterly drafted according to the CAMELS system.

On-site examinations increased for 1999. Therefore, from 4 on-site examinations planned, there will be accomplished 7. Lending examinations occupy a significant space among 18 partial examinations accomplished. Regarding full scope examinations for 2000, it is envisaged that every bank will be subject to full scope examinations once in 12 months. It is envisaged to carry out 10 – 11 full-scope examinations during this year.

In view of the regulatory framework, one of the indirect instruments for monitoring bank liquidity that substitutes the direct instrument such as that of credit ceiling is the liquidity ratio defined in the regulation "On liquidity ratio" approved by the decision no. 71, date, 02.06.1999 of the Supervisory Council of the Bank of Albania.

The purpose of accounting the liquidity ratio is:

- To constantly control and pursue banks' liquidity for short-term liabilities, such as those of up to one month maturity or without maturity due, but that have a statistical probability to liquidate within the month.
- To restrict the risk of transformation of short-term resources.

The regulation "On monitoring significant risks", approved by the Supervisory Council of the Bank of Albania on decision No. 78, dated 07.07.1999 is aimed at: measuring and controlling risk concentration on the same beneficiary, to avoid the negative financial effects of the bank resulting from the superfluous concentration of the risk on the same beneficiary. This goal can be achieved through permanent and simultaneous observance of:

- a maximum ratio of 20 per cent through entirety of risks undertaken by the bank during its operations on every beneficiary and the regulatory capital of the bank itself;
- a maximum ratio of 700 per cent through the amount of significant risks and the regulatory capital of the bank itself, identifying as significant risk all the risks taken over by the bank throughout its operation with the same beneficiary, when their ratio to the regulatory capital is higher than 10 per cent.

The regulation "On loans rating and provision of reserve funds for covering loss loans", approved by the decision of the Supervisory Council of the Bank of Albania, No. 50, dated 22.04.1999, defines the rules, criteria and rating approaches for bank assets, as well as the basis for provision of reserve funds appropriate for covering loan losses. To restrain the credit risk, banks analyze their credit stock and other similar assets. Loans are classified periodically according to the criteria specified in this regulation. At any case, banks have in their disposal reserve funds for covering loan losses, created in accordance with this regulation.

NOTES

* Fiqiri Baholli, Head of Monetary Policy Department.
[1] In the monetary program of 1998, assessing the program performance at the end of the nine-month period, the credit growth forecast was reviewed from ALL 6 to 2.5 billion.

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THE WORLD ECONOMY IN THE LAST DECADE OF THE CENTURY

*Selami Xhepa**

1. INTRODUCTION

The financial crises that seized most countries of the world[1] in the eve of the new millennium laid before the international authorities the need for international financial system reform in order to maintain the economic stability of the world. The 90-ies will be considered by the economic analysts as periods of great toppling in the monetary crisis theories. There were born on an imperceptive speed the generations of new models of crises[2] explaining.

The reformation emergency of the world financial system increased significantly, considering the extensive global developments of the international financial markets and the active participation of the developing economies. This led to an unstable increase of global financial markets, thus becoming a source of frequent crises. Consequently the prospects of the world economy developments are markedly compromised. The global integration effects and the relationship stability amidst the capital markets of the Eastern and the developing countries are becoming dubious.

2. WHAT HAS CHANGED IN THE WORLD ECONOMY DURING THIS DECADE?

The global conditions of the economy up to the early 90-ies were utterly different from the landscape presented by the ending century decade. With the termination of the Second World War, the economic policies were directed in establishing a world economic system, which would accelerate its development and the social welfare. The architect of the financial system of the world economy acknowledged as the Bretton Woods System was Keynes and his viewpoints dominated the establishment of international structures as the IMF and the World Bank. This system was entirely based on the role of American leadership in the global economy backed by the fact that only the American economy emerged powerful and on appropriate financial capacities to play such an after world role.

The world finance was based on the USD, while the economic development programs were based on Keynes views: on lowering taxes and increasing government expenditures, i.e. the constant growth of government debts. Of course the source of these debts were the American banks and the Federal Reserve, creating tremendous inflation of USD outside the country. Considering the geo-political background of the time[3] many financings were not related directly to the economic projects. Signs of disintegrating control on the currency made their distinct appearance precisely at the beginning of 70-ies and they could be symbolically related to the decision of the American administration in the year 1973 to abrogate the relationship of USD to gold. This period marks the end to the economic policies of Keynes applied by the United States, Europe and Japan. The decision on abolishing the monetary system based on the USD was accelerated by the beginning of the energetic crisis after the decision of the OPEC countries on reducing the production rates and increasing oil prices. These developments dealt an immediate blow to the main American, European and Japanese petrochemical, cars, and mechanical industries, which were the pillars of the economic growth of the Triad (USA, Europe and Japan). The world began to experience a newly economic

phenomenon, unknown to that time the *stagflation* characterized by a negative economic growth or zero and a 15 per cent rate of inflation. The "*Golden Epoch*" came to an end.

This economic fall had a long effect on decreasing exports and deterioration of the mercantile conditions for many developing economies. On the other hand, the need for controlling inflation led to a high increase of interest rates of the principal financial markets, which hardened the charge of the external debt on the developing countries. The 90-ies view appears totally different. The developing economies were characterized by decreasing rates of inflation and low interests. The decrease of interest rates in their security markets made the markets of these developing countries attractive. Another important development was the decrease of price value in the stock markets, by underlining a higher tolerance to risk, or a decreasing perception of it.

These two periods recorded change in the structure of the capital in circulation. In the 90-ies, the private capital had a higher growth than the official capital. While the official (state-owned) capital in the developing countries represented 49.5 per cent of the total of capital inflows in the years '70-'80, in the years '90-'96 they occupied only 9.5 per cent. The net total inflows of the capital in the developing countries during the first half of '90 figured over USD 1 trillion.

Even the economic development strategies are different from one another.

Most countries followed the policies of imports substitution, sustained by high import taxes and policies of low interest rates, increasing the credit to certain sectors of the economy. To impede the outflow of resident capitals, the authorities used to exert strong monitoring on capital movement. Foreign loan was only restricted to the public sector (including the state-owned banks).

Years '80 verified the deficiency of these policies. Consequently, the early '90-ies recorded a vigorous movement to economic liberalization, including the liberalization of financial

and commercial transactions, the structural reforms which were targeted at the flexibility increase of domestic markets and the role extension of the private sector.

The sophistication of financial markets and the access by developing countries due to the liberalization of capital accounts and their extension with inexperienced players from developed countries, high transactions volume as well as the high range of integrated markets led to a considerable increase of sensitiveness of the world's financial system. The probable failure in one financial market would expose and extend its negative effects over the entire financial system of the world.

The debt crises of the 80-ies encouraged mergers and acquisitions among corporations (and several failures), bringing into light a new generation of powerful financial groups, a tendency further extended on the Wall Street crises of 1987. Consequently, the financial markets provided a large concentration of powers, institutional investors that frequently dictate the destiny of the listed market companies.

Table 1 The capital inflows of developing countries, in billions of LEK

	1990	1991	1992	1993	1994	1995	1996	1997
Total net inflows of private capital	31	126.9	120.9	164.7	160.5	192	240.8	173.7
Inflows by Government creditors	22.2	25.7	17.6	18.7	-2.5	34.9	-9.7	29
Total net inflows	53.2	152.7	138.5	183.4	158	226.9	231.1	202.7

Source: IMF/EBS/ 1998/121;1998

The daily circulated currency in the international market that drives at USD 1300 billion (1995) exceeds the range of the world's international reserves (estimated at USD 1202 billion). In this sense, under the label of safeguarding the value of the domestic currency, central banks transferred in the hands of private individuals not only the foreign exchange, but also the power.

In the context of such developments, from 1998 the efforts of financial authorities, the IMF, and the World Bank are intensified in outlining a new structure of world finances.

3. THE NEW STRUCTURE OF GLOBAL FINANCES

3.1 INSTITUTIONAL ORGANIZATION

The recent crises drove in the focus of the critique of scholastic and political circles, the role of international financial organizations and particularly that of the IMF to prevent crises and to avoid the diffusion of their effects on other countries. The critiques core is concentrated in the role and function of this institution, reappearing, after the 90-ies developments, on the same revising necessity as in the years of the energy crisis. One of the most disputable problems is that of the *"lender of the last resort"*, which means that IMF should assume the role of an international central bank (i.e. IMF should hold reserves and issue its currency - a proposal made by Keynes with the foundation of this institution). The need for a *"lender of the last resort"* comes up with the exchange rate oscillations and a panic venture, which hazard not only the country in crisis but the entire financial system of the world.

If IMF will not play this role, the main opinion is to shape another mechanism world wide accepted to deal with rescheduling countries on no financial potentialities and bankruptcy. This led to a debate stimulation on a super chapter (*Super Chapter 11)* on IMF statute on bankruptcy, because if this is an acknowledged phenomenon on a company and is regulated by the national legislation, the nations are considered sovereign and bankruptcy is not acknowledged as a legal act. In the meantime, there are established some new mechanisms inside the IMF to assist countries in emergency or their prevention such as "Emergency Financing Mechanisms" (applied in the event of the Korean emergency when the credit line was delivered within 2 weeks), the Facility of the Supplementary Reserve etc. It is being discussed the idea of increasing the capital rate of the IMF from the current USD 45 billion into USD 88 billion. The opponents of the IMF role in resolving crises, extensively developed the theory of the "moral hasard" where the certainty to rescue a country in emergency encourages the investors to undertake higher risks in search of higher earning rates.

Besides the rearrangement of the IMF role, there are also established two more institutions: The Forum on the Financial Stability and G-20. This Forum scope is the data collection and the development of early signalizing indicators. In the composition of this organization, there are the finance ministers of G-7 and their respective central bank governors, the IMF and the World Bank, the Basel Committee, the World Organization of Securities markets and the Worlds Supervisory Association of Assurances. The role of this organization, charged with the supervision and arrangement of institutions and financial markets, is considered as essential in the impediment of future crisis.

The introduction into the economic stage of the world of some large economies from developing countries requires a better coordination of policies among developed countries of this group country. For this reason, in September 1999, the establishment of a new international economic group was launched, denominated G-20, which includes besides the G-8 countries even such giants as India and China[4].

3.2 THE AGENDA

The already fixed agenda on reformation includes five principal areas:

- Transparency, standards and supervision
- Consolidation of financial systems
- Regulated integration of international financial markets
- Inclusion of the private sector in the financial crisis prevention and resolution; and
- Systemic aspects

In the transperancy area, the principal objective involves the consolidation of decision-making and the best economic achievements, by improving the transperancy of domestic economic policies and practices. The specific proposals with this respect consist in issuing more data on the application

of economic policies and their efficiency, the extension of consultations with poor and high indebted countries to a comprehensive deliberation of IMF policies and practices.

The target of standards adaptation consists in strengthening standards on economic and financial activity and business. The arrangements will principally approach such issues as accounting procedures, bankruptcy, companies and corporate management, the arrangement of assurances and payments systems, the arrangement of securities markets etc.

The strengthening of supervision is targeted at rules consolidation for monitoring financial businesses based on international standards.

Improving systems for monitoring the movements of short-term capitals would serve as principal instrument in the range fixing of a country's sensitiveness to an external *"shock"*.

The strengthening of the financial systems requires from the national authorities the periodic supervising review of the financial system of the country, especially of the institutions on high debts or largely exposed to potential risks. Therefore a more prudent analysis of the macroeconomic policies to the financial statement of the banking system would help the consolidation of the financial system of the country.

There are held discussions related to the potentiality of applying these instruments.

- The increase of exchange rates flexibility. For this, the countries may be asked not to peg their currencies to other strong currencies.
- The participation of the private sector in the debt reorganization, allowing debt exchange with ownership securities or new funds issuing in crisis event.
- Changes are proposed in the bonds contacts, to allow a better coordination among the issuers and their holders. One idea is that to change the payment terms, the qualified

majority of the voters of bonds holders should be applied, instead of the customary unanimity.

- The reserves growth of the banks issuing credits to developing countries (affecting increase of financial cost on borrowing economies).
- Establishing an emergency mechanism based on private financing to extend new credits in case of crisis or insolvency.

4. MONITORING CAPITAL FLOWS

The liberalization of transactions and capital accounts had a strong influence on capital flows to developing countries. According to a survey[5] on financial market liberalization, the financial liberalization includes six dimensions:

- Avoidance of credit monitoring,
- Liberalization of interest rates,
- Free access to banking industry and the financial service industry in general,
- Bank autonomy (non-intrusion in the daily operations or their management),
- Privatization and private ownership on banks and,
- Access allowance to international capital inflows.

If at the beginning of this decade, the governments of poor countries were merely passive observers of the global financial crisis, currently they are faced with dilemmas to take appropriate decisions to affect the economic structure of the world in the next century. There must be decided whether to proceed to the full liberalization of capital accounts (to benefit from foreign financing) or increase the barriers to foreign capital (to safeguard the domestic economy from external shocks). This perplexity has involved the Latin America, Asia, and Eastern Europe (in reality, the Latin America has an old story of 150-years "on-off love" to foreign capital). Considerable amounts of foreign capital enter these countries, but they can not be productively absorbed. Therefore, Chile applied strict rules on monitoring capitals until 1991. This control involved the size and maturity of short term

capital inflows, imposing (30 per cent) taxation over this capital category.

The big trouble encountered by these countries is how to defend from leaving investors and how to convince them to return[6].

On the other hand, there are two risk sources, bothering foreign investors: a) an enormous and a sudden depreciation of foreign currencies, or high inflation which would bring about loss in the real value of securities issued in domestic currency; and b) creditors (the government or the private sector) which would fail to pay the foreign debt service (as Russia).

Experience of some countries in capital monitoring

Brazil: In the six month period of 1994, Brazil was confronted to an annual inflation rate of 2000 per cent and implemented a stability plan on inflation (Real Plan), pegging the domestic currency to the USD. It was precisely this strengthening of monetary policy, the inflation decrease and the nominal exchange rate stability that led to extension of foreign capital inflows. To control the deficit of capital account and to influence the maturity structure of capital inflows, the authorities adopted a tax package on foreign capital inflows, as:

- *The tax on domestic business issuing debt securities outside the country increased from 3 per cent to 7 per cent;*
- *A tax of 1 per cent began to be applied over foreign companies investing in the domestic stock exchange.*
- *The foreigner's tax on purchasing fixed investments of the country increased from 5 to 9 per cent.*

Parallel to the application of these measures, the sterilizing policies of the central bank of Brazil resulted to a significant increase of interest rates (from 7.1 per cent in 1993 to 26 per cent in 1995 and 1996]. Such high interest rates were still very attractive to the foreign capital even after the deduction of taxes, and encouraged extension of foreign capital inflows. Consequently, the balance of the capital account (to GDP) grew from 2.5 per cent in 1994 to 4.7 per cent in 1994.

Based on these considerations, many analysts conclude that the restrictive policies on foreign capital inflows adopted by Brazil were not effective. The blame has to be laid on sterilizing policies adopted by the central bank and the low rate of the applicable tax.

Chile: Upset by the growth of foreign capital inflows at the beginning of the 90-ies and to protect the value of the domestic currency, the central bank of Chile began the application of sterilizing operations in the foreign exchange markets. The wide scope of this operation brought about significant growth of interest rates which further encouraged the foreign capital inflows. The balance of capital accounts resulted 10 per cent of GDP, where inflows of short maturity figured 1/3 on the total of inflows.

In June 1991, the authorities applied a 20 per cent rate, as unremunerated required reserve the companies had to hold at the central bank. Simultaneously, the central bank began to reduce the sterilizing policies.

Therefore, the balance of capital accounts was reduced from 10 per cent into 2.4 per cent of GDP in 1991, while the short term inflows turned negative (-0.7 per cent of GDP). The reserve requirement increased to 30 per cent in May 1992, which is still effective. Many authors believe that the Chile's success is precisely related to this tax application and the reduction of sterilizing operations of the central bank. Columbia applied the same policy (but with a higher tax).

The Czech Republic: Encouraged by the considerable difference of domestic rates to the foreign exchange and an expected appreciation of Corona, the foreign capital inflows recorded significant increase on the balance of capital accounts, from 6.6 per cent of GDP in 1994 to 16.7 per cent in 1995.

The first response in counteraction were the sterilizing policies of the central bank followed by a tax application of 2.5 per cent on foreign currency transactions (April 1995) as well as administrative requirements to approve transactions on foreign loans. Consequently, the capital account was reduced to 3.5 per cent of GDP.

Malaysia was one of the first countries which experienced considerable inflows of foreign capital since 1989. Disturbed by their

5. RESPONSES OF MACROECONOMIC POLICIES TO FINANCIAL DESTABILIZATION

The principal measure on restriction of short capital inflows applied by the developing countries was: allowing the exchange rates oscillation to respond to these inflows pressures. The countries that applied fixed or managing rates made first interventions to reduce such pressures on currency appreciation.

Reviewing the application efficiency of these sterilizing policies, several scholars arrived at the conclusion that they may not be very effective on a fixed basis and may be accompanied by problems in terms of economic adjustments to the capital inflows on a wide range, because:

- The authorities have been unable to reduce the pressures despite extensive intervention into the foreign exchange market.
- The short term interests tend to increase (when the authorities start sterilizing efforts), encouraging more inflows.

In the meantime, the exchange rate appreciation has priority:

- In allowing currency appreciation, in particular, which helps the economy to be protected from domestic monetary supply deriving from the expansion of capital inflows. Therefore, if the economy is damaged by the real appreciation of the exchange rate, its adjustment will rather derive from the adjustment of the foreign exchange rate than from higher inflation levels.

Instability due to the growing oscillation of currency would impose higher costs on the economy. Moreover, if the country has not availed of protective instruments, the flexibility of exchange rates could also discourage the medium term inflows.

Another response to the limitation of short-term capital inflows may be the fiscal restrictions to reduce the pressures on the growing aggregate supply and restrain the inflationary effect of such inflows.

6. DEBTS OF DEVELOPING COUNTRIES

The financial crises have provided large impact on the whole world economy, but especially on poor countries. About three years ago, the developed countries approved on principle the

agreement on reducing the debt of developing countries as the first stage of this global initiative. The G-7 summit in Keln, on June 1999 gave a new impetus to this process, stimulating at the same time the public debate around it[7]. "What is that all about?"

The problem of the third world debts has been durable over a long period of time, at least from year 1982, when Mexico forewarned the incapacity of its banks to pay the received debts, delivering awful signals to the world banking industry. Countries like Mexico and Brazil hold such debt levels to Western banks, especially to the American banks, that their nonpayment will likely collapse many banks of these countries.

Persuaded by low interest rates at the beginning of 70-ies and convinced by the increase of their goods prices in the international markets, these countries constantly accumulated debts from bilateral donors, international institutions of finances and the Western private banks.

But at the end of the 70-ies, the goods prices by the international markets had a significant decrease, while the interest rates increased.

The debt service expenditures increased, providing a spiral in their economic development, which continues up to nowadays. Between the years 1983-1990, the developing countries managed to pay USD 1.5 trillion for the external debt service. In the meantime, their external debt is currently estimated at USD 3 trillion. The G-7 summit of Keln reviewed the problem of debt enlargement of the highly indebted countries (HIPC), including 42 countries mainly from the Sub-Saharan Africa.

These countries are mentioned for a total debt of USD[8] 310 billion borrowed from the developed countries, while the debt erasure framework includes USD 42 billion or 13.5 per cent of their total debt.

But the Keln summit left opened the issue on future financing of this program. The financing of this package of USD 42 billion

was on the top agenda of the Paris and Washington summits during September and October.

One of the proposals was the 10 per cent selling of its gold reserves by the IMF (300 ton), which is expected to amount to USD 4.2 billion. This proposal was rejected by the gold producing countries, including the African states, which are mostly gold producing countries. After selling a part of the gold reserves by the Bank of England, this commodity price (June 1999) reached the lowest level over 20 years. This proposal is more likely to be refused by the American Congress, since it would be a blow to the American industry of gold mines, which is one of the biggest in the world.

On the other hand, providing this program was financed by the aids programs supplied by the developed countries to this group of countries, this would mean maximum restriction of the assistance for the economic development of the region.

> *The debts share is:*
> *50 per cent to the Western governments (Europe, North America and Japan)*
> *35 per cent to the international institutions; and*
> *15 per cent to private lending institutions (banks*

7. DEMOCRACY AND CRISIS

The crisis of this end century led to the stimulation of a broader debate on the stability of democratic values in the developing countries. Is the so-called "Asiatic path" to economic prosperity toward political freedom the real crisis effect?" Are democracy and free market appropriate solutions? The rapprochement of viewpoints on this problem, almost settled in the framework of a global discussion (mainly from the developing countries), makes up one of the most interesting areas for economists, politicians and physiologists.

According to Amartya Sen (the winner of the Nobel Prize in economics, 1989), the most important phenomenon of the XX Century is "the prime of democracy". Democracy was established as a normal form of government, to which each nation has the right to be availed. We should not start from the very beginning each time this or that country is "ready for democracy", but we must almost take it "as granted" – argues Sen.

Actually, many scholars like Sen underline that "the recent problems of the Eastern and Southeastern Asia are a penalty to the non-democratic government. " The political and the civil rights of the society provide the possibility to forcefully attract the attention to the general needs and ask for public action".

Even the American scientist of political matters *Francis Fukuyama* pronounces the Western liberalization together with its representative principals on democracy, the legal state, the human rights as well as the free enterprise as triumphant after the Cold War in the book *"The end of the History and the Last Man"*. The Asian autocracy suffered from turns back from the Suhartoes falling to Mahatir troubles. The people, in the autocratic China enriched or impoverished by the economic reforms, are searching further extension of their rights. However, most scholars remain doubtful on the issue whether China would enjoy the same prosperity if the Tienanmen brought the political plurality. On the recent ten-year developments, it is unfortunately accepted that the autocratic regime of China issued more positive results than the democratic system of Russia.

Kim Dae Young (President of the South Korea) underlines that: "Addressing the rare economic resources in some limited regions and restraining the social conflicts, the autocratic systems seem very efficient on a short term.... But, the problem of moral injury, the bureaucratic stiffness, the political cornices as well as the disparity among regions, social classes and industries - are becoming more serious.

Nakasone (former Prime Minister of Japan) attracts the attention to the drastic movement towards liberalization. "The

accentuation of democracy holds the risk of leading the country to the loss of control and chaos establishment; whereas the emphasis of the market economy to efficiency may be destructive on a national culture. After having achieved the economic prosperity, democracy should substitute the autocracy".

Whereas, *Pei Minxin,* professor of political sciences of Princeton, using the regression analysis in examining the relations between democracy, growing incomes and economic liberalization of the government on one side and some countries data on the other, concludes that "There does not exist an explicit witness that democratic governments promote a better development than the autocratic ones. Hence, even the increase of political liberty does not improve the governance type.

On the contrary, corruption in the recent democracies tends growing". Pei concludes that democracy attorneys should issue priority to economic reforms- opposing the Western style, which made first appeals and encouraged political rights that were frequently accompanied by economic sanctions, obstructing and harmful to the private enterprise. "Unfortunately, - concludes Pei - to educate the American Congress on this issue is more difficult than find reformers in non-democracy countries.

Consolidating the opinion, Ramos (former President of Philippines) emphasizes that "while the economic growth can initiate without democracy, democracy is only enabled by the market economy which helps the establishment of the private right or otherwise nominated the civil society - which empowers the bloom of social and political liberty.

CONCLUSION

Whether the crises help the establishment of a new social spirit world wide, the agony experienced by our society would be more useful in this agenda of opened problems to solution.

NOTES

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[1] After Japan and the Asian countries, the crisis swept Russia, the countries of Latin America, especially Brazil and Venezuela on more acute signs.

[2] The first model of monetary crises nominated "the model of speculating attack" was constructed by Krugman (1979) as well as Flood & Garber (1984). This model explains the monetary crises based on the loss of the central bank control on foreign reserves due to the expansionist monetary and fiscal policies. The efficiency of this model became questionable on the monetary crises of the European Monetary System in the year 1992-1993, where there were distinguished no signs of the expansionist monetary and fiscal policies either by UK or France. This gave an impetus to the scholars to construct another model "of the exclusive clause" (which is frequently termed as the model of the second generation). According to this model, the authorities base their decisions on keeping a prerequisite pegged exchange rate of the currency (which means as long as its advantages as inflation decrease and insurance of credibility do not convey considerable costs on the country). The role of economic basis according to this model is more important to the decision-making of the private agents than in the case of the speculating attack. The Asian crisis encouraged many economists to process a third model of explaining monetary crises, titled "the model of the third generation" (by Krugman-Dooley-Sacs, 1999). This model develops a relationship between the monetary and the banking crises and its diffusive effects among countries.

[3] The American efforts to impede the diffusion and the penetration of communism in other world areas, Latin America, Asia and Africa as well as several armed conflicts established in these regions.

[4] The full list of countries joining G-20 is: Argentina, Australia, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Korea, Mexico, Russia, Saudi Arabia, South Africa, Turkey, England, USA, and the presidency of EU. This group of countries occupies 86.7 per cent of GDP and 65.4 per cent of the world population.

[5] J. Williamson, M. Makar "A survey of financial liberalization" cit. The Economist, May 1999.

[6] The debt crisis of Latin America in the 80-ies allowed access to foreign investors only at the beginning of the 90-ies (they left Mexico due to the forex crisis in 1994).

[7] A world-wide movement acknowledged as "Jubilation of 2000" has found many supporters, including important personalities of the economic science as Barro, Sachs, or the rock star groups as U2, etc..

[8] Every person in the developing countries is indebted of USD 250 to the developed countries.

DEVELOPMENT OF TRANSPORT CORRIDORS IN CENTRAL AND EASTERN EUROPE AND THE BALKANS

*Selami Xhepa**

The overthrowing of Berlin's wall symbolized the reunification of the continent which, for ideological motives, remained divided into two parts for decades. But the continent continues to be separated in reality. Differences of economic development especially in structures, technology, and moreover the accentuated mismatch in infrastructure continue to serve as difficult barriers to a harmonized development among the people of the continent.

I. INITIATIVES

The Pan European Conference of transport, under the support and coordination of the European Commission came precisely as a need to connect countries in the continent on the basis of their national interests in the region. Convoked for the first time in Prague (1991), it defined the main guidelines of the project for the development of the Pan European transport network. Three years later (1994), the second meeting held in Crete defined the strategic outline of the projects, the so-called "Pan European Corridors" which are 10 in reality.

The use of "corridor" term is connected with the fact building transport infrastructure and it does not merely entangle the road

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network but also the railway, airline and portal networks, as well as the systems of control and navigation. Realizing that the established network of corridors was highly schematic, the third summit held in Helsinki in 1997 expanded the scheme of transport corridors by adding the connection of road corridors (nominated "the main line") to some joint lines (called "branches") to those regions, which were on a more economic backwardness.

To finance the project study of the road corridors, the commission made available a part of financings through PHARE and TACIS program. In order to activate such funds, interested countries should sign the interest protocol (the Memorandum of Understanding) of the corridor including them. The needs assessment of the Central and Eastern European countries for transport network financing was confided and is completed by TINA (Transport Infrastructure Needs Assessment). TINA report estimates that the transport network completion would nearly cost ECU 90 billion and would be accomplished until 2015. Annex 1 provides a presentation of 10 Pan European corridors accompanied by a map.

Box 1 Assessments of TINA report

The Pan European network of transport is identified as part of the process of transport infrastructure needs assessment (TINA), with secretary in Vienna. This process is participated by 26 countries from EU and Central and Eastern Europe, which all together have identified the following transport network which entangles about:

18,000 km road
20,000 km railway
38 airports
13 sea ports
49 river harbours

The accomplishing cost on the whole network until 2015 is estimated at ECU 90 billion.

The study on the Balkans network provides a good example and includes the strategic assessment of over 100 projects, involving roads, railways, mixed transport and the portal development of Albania, Bulgaria, FYROM, Hungary, Romania and Slovenia. The study resulted in drafting a development program, reaching the assessment of financial needs at ECU 105 billion.

The study on the Balkans transport was completed in 1997, identifying a number of project prospects for every country.

For Albania the study estimates the prospect needs for investments in road infrastructure together with the development of Durrës Port. Corridor VIII East-West was of special emphasis in the study. This corridor connects Durrës Port with Tirana and FYROM.

Source: Web site of EU/Phare Programme.

In this analysis, we have specifically dwelled on Corridor VIII, which has recently become a dispute of a wide public debate (frequently and in a speculative manner) mainly guided by politicians.

II. CORRIDOR VIII (ADRIATIC SEA - BLACK SEA)

Corridor VIII is part of the 10 transport corridors established by the Pan European Conference of Transport. Italy is charged coordinator of this project.

This project is developed in the principal line: the Italian ports of Bari/ Brindisi towards Durrës/Vlora- Tirana - Pogradec - Scopje - Sofia - Plovdiv - Burgas/ Varna. This corridor incipience by Italian ports, deviating by what was determined in the Pan European Conference of Transport (where Durrës Port was defined) concurs with GD VII of European Commission on the expectancy of a formal approval in the next date of the Pan European Conference.

This corridor concerns Greece and Turkey. Greece interests are related to the fact that it is building the Egnatia road, a road axis running parallel to Corridor VIII entirely on Greek territory, with Igumenice as portal terminal. Egnatia road joins prospect projects (one of the 14 admitted projects) determined by the European Council Summit in Essen (1994) and is financially supported by community funds destined for the European transport networks, (decision 2236/95).

Turkish interests lie in the fact that Corridor VIII intercepts with Corridor IV in Plodiv (Bulgaria) to Istanbul. For this reason both countries, Greece and Turkey have required to sign the Memorandum of Understanding.

The length of the Corridor (Durrës - Varna) is nearly 1100 km road network. The road condition is relatively good in Bulgaria and FYROM and is aggravated in Albania. The railway network displays two intersections in the border line Fyrom - Bulgaria (55 km). With the elimination of these intersections, the length of the railway network is nearly 1200 km.

The total cost for an "efficient functioning" of Corridor VIII is nearly estimated at USD 2.5 billion (or ITL 5000 billion) for the next 5/6 years. If strategic exigencies of the all the principal Western players (mainly Italy and Greece) coordinate with each-other, the financing cost will not be considered as a difficult barrier.

III. CURRENT PROJECT CONDITION

The text of the Memorandum of Understanding is prepared but it is not signed yet: interest divergence among involved countries seem to have turned insuperable.

On its side, the European Commission has strongly recommended Greece's commitment to drafting the Memorandum of Understanding, intending to match as much as possible "the main line" proposal of Corridor VIII with the

project of Egnatia road. In reverse case, the underwriting of the Memorandum by the European Commissioner of Transports will be delayed and would enable its financing by community funds (as was lingered the underwriting of the Corridor V Memorandum, because of the Austrian objections).

Under this situation, the draft of the Memorandum of Understanding prepared for months remains blocked, despite of the appeals made by some member governments at the EU Commission authorities.

Currently, regarded as a project of regional relevance, it has been included in the prospect projects to be developed in the framework of the initiative of international community for the Stability Pact in South-Eastern Europe.

IV. CORRIDOR VIII IN ALBANIA

Since the corridor conception at Crete Conference in 1994, the presidents of Albania, FYROM, Bulgaria and Turkey signed in USA the Memorandum of Understanding, which opened the way to financing of the feasibility studies and the initial financing of the first stage of this project.

Known as East-West Corridor, its total length is 247 km, whereas the road connection to Corridor VIII has a total length of 154 km and roadwork procedures have commenced by certain road segments of the first stage, (in 67 per cent of the total corridor, which based on accomplishment delays may conclude in 2003).

The first stage includes rehabilitation procedure of the existing road network.

Box 2   East-West Corridor

Roadwork procedures have commenced in:

- *Durrës-Rrogozhinë (39 km): financed by PHARE; contractors "S&F" (a Greek-Italian enterprise of Sarandopullos – Falcione). Roadwork procedures commenced on 19.01.1998, time duration 27 months. Delay: 9 months.*
- *Rrogozhinë-Elbasan (44 km): financed by ? ; Contractors Behase (Turkey). Work procedures started on 1.09.1998; time duration 24 months. Delay 20 months?*
- *Librazhd-Qukës (21 km): financed by WB; contractors Mavrovo (FYROM). Roadwork procedures started on 4.1.1999; time duration 24 months. Delay 6 months.*
- *Korçë-Kapshticë (32 km): financed by Phare; contractors Granit (FYROM). Roadwork procedures started on 1.06.1999; time duration 24 months. It is not part of Corridor VIII.*

Roadwork procedures have not commenced yet in:

- *Elbasan-Librazhd (30.5 km): financed by IBRD.*
- *Qukës-Qafë Thanë (19.6 km): financed by Kuwait.*
- *Qafë Thanë – Pogradec (21 km). It is not part of Corridor VIII.*
- *Pogradec-Korçë (40 km): financed by PHARE. It is not part of Corridor VIII.*

North – South Corridor. Length 374 km (extended from Hani i Hotit to Gjirokastra).

Roadwork procedures have commenced in:

- *Milot-Lezhë (12 km); financed by WB; contractors Falcione (Italy). Roadwork started on 11.08.1998, time duration 20 months. Delay 24 months.*
- *Mamurras-Milot (12.8 km): financed by Italian Government; contractors Sarandopullos (Greece); handed but not functioning.*
- *Fushë Krujë-Mamurras (12 km): financed by WB; contractors Mak-Albania (Arabian company). Roadwork procedures started on 16.11.1998; time duration 7 months. Delay 4 months.*
- *Vorë-Sukth (14.2 km); financed by PHARE; contractors Ital-Strade*

(Italy). Roadwork procedures commenced on 11.01.1999; time duration 22 months.

- *Sukth-Durrës (8.7 km): contractors Ruscala (Italy). Roadwork procedures started on 4.1.1999; time duration 18 months.*
- *Rrogozhinë-Lushnjë (18 km): financed by PHARE; contractors Graniti (FYROM). Roadwork procedures started on 4.1.999, time duration 22 months.*
- *Kakavijë-Gjirokastër (23 km): financed by PHARE; contractors Step-Metin (Greece). Raodwork procedures started on 1.6.1999; time duration 18 months. It is not part of Corridor VIII.*

Roadwork procedures have not commenced in:

- *Shkodër-Han i Hotit (35 km): financed by Italian Government.*
- *Lezhë-Shkodër (40 km): financed by Italian Government.*
- *Mat Bridge-Drin Bridge-Tapizë-Fushë Krujë (7 km): financed by WB.*
- *Lushnjë-Fier (32 km): financed by Italian Government.*
- *Fier-Vlorë (35 km): without financing.*
- *Fier-Tepelenë (85 km): without financing.*
- *Tepelenë-Gjirokastër (30 km): financed by PHARE.*

Source: Koha Jonë, 2000-03-14

V. GEO-STRATEGIC INTERESTS

The scenario of domestic economic difficulties of the Balkan countries is appended on the highly complex economic and political interests of big powers.

On the one hand, the USA seemed passive in showing their interests in the Balkans. However, they do not forget that their long-term strategic plans and the tendency of Mediterranean developments goes beyond protection of own alleys in the region, of Turkey and Israel.

This seems to dictate its long-term military presence in the Balkans. On the other hand, Europe seems to be more

concerned with its internal problems. Financial instruments made available to the region prove totally incapable to cover its recovery exigencies.

The other side of the play, reflected in the brittle domestic balances of the regional countries, whose border lines have been subject to permanent changes throughout history, is to control their connecting network to the energetic resources (gas and oil) from the Caspic and Black Sea.

Because of their considerable investment claims, the new oil networks and gas pipelines under study impose transition on "safe" territories, while the safety in this region is currently small.

On the other hand, Russia seeks to maintain its control: upon Chechenian developments, Moscow seems to hesitate repairing of the oil pipeline emerging in the Black Sea (in Novosimbirsk) from Azerbaijan and is designing a new gas pipeline to come out in the Georgian port of Suspa. Other hypotheses face other matters: Iran seems to be not favoured (viewing the ratios of its transactions with USA and the West), whereas the established consortium called "Central Asia Gas Pipeline" (where all countries participate on principal interests) expressed its willingness to invest USD 2 billion to build a gas pipeline of 1400 km from Turkmenistan through Afghanistan to Karachi (Pakistan).

It is hard to say which of these projects will be realized: but it is almost evident that for their relevance they are destined to highly influence projects of European Transport Corridors and their financing feasibility.

Box 3   *Energetic projects*

After the proclamation of independence by ex-Soviet Union, the Central Asia republics entered in the focus of the "Big play" of the world superpowers. The reason is well-known: the highly excessive underground reserve especially of gas and oil.

Central Asia and Azerbaijan covering a surface of 3,937,600 km2; (Kazakhstan 2,717,000 km2; Uzbekistan 447,400 km2; Turkmenistan 488,100 km2; Kyrgys Republic 195,500 km2 and Azerbaijan 86,600 km2). This surface is almost 2/3 of the whole European Continent.

Azerbaijan, Kazakhstan and Turkmenistan together rank third in the world for holding oil reserves after Middle East and Siberia. Central Asia republics of Turkmensitan, Kazakhstan and Uzbekistan hold nearly half of the world acknowledged gas reserves. In addition to gas and oil, this region is also rich in strategic resources as uranium, gold and non-ferrous ores.

That's why the region has become the centre of the world diplomacy attention.

Owing to the historical, ethnic and cultural relations, Turkey is totally involved in this game by projects of transport lines of energetic supplies and their introduction in the international market. If realized, the oil and gas pipelines planned for Baku- Ceyan; Tengiz (Kazakhstan)-Caspic Sea-Ceyan; and Turkmenistan-Iran-Ceyan will issue Turkey a highly strategic position to control the energetic lines coming out from Central Asia toward Europe and Mediterranean.

In view of exploitation of oil and gas sources of Caspic Sea, "the legal status of Caspic Sea" is attracting the attention of big powers. The final agreement through Kazakhstan and the Russian Federation, which admits "Caspic" as a "sea", has contributed to the growing ambiguity of disagreement amongst the five countries, where Iran declared to not recognize the concluded contract between the Russian Federation and Kazakhstan.

In the meantime, the American administration announced its support for an energetic corridor (on oil and gas) from the Caspic Sea region to Turkey.

Bewilderment and divergence of the world and regional diplomacy on this issue continue to hold pledge the oil and gas pipeline projects of the country. The project studied by AMBO company (a consortium of Albania, FYROM and Bulgaria) can not be referred as finally determined.

VI GREECE POSITION IN RELATION TO CORRIDOR VIII

In the summit of European states' heads in Essen (December 1994), Greece earned two projects from the prospect projects of European transport: the project of Egnatia road and PATHE.

PATHE project (an abbreviation for Patras-Athens-Thessaloniki) as suggested by the name, makes the connection of Patras to Athens and furthermore to Thessaloniki. The project includes a road length (rehabilitation of the existing road network) of 860 km at a total expense of ECU 3880 million and its completion is planned for 2002.

Egnatia road, length 780 km, total cost of ECU 280 million, was planned to be completed within 2002. It makes the connection of Igumenice Port and travels through the whole Northern Greece up to Alexandropouli (the border line to Turkey) and extends on own branches to Bulgaria, Skopje (part of Pan European corridors). It stands in southern parallel to Corridor VIII and is expected to traverse our country on further orientation to Skopje, Varna/Burgas.

As it is noticed, both projects will terminate within a shorter period of time than the expected completion of road segments of Albanian corridor East- West, which has not yet started in many road segments and does not have the required financing.

Main road axes of Greek network consist in:

- The Western Axis: on orientation to Patras/Igumenice - Italy - Austria - Germany.
- The Central Axis: on orientation to Central/ Northern Greece - FYROM – the Former Yugoslavia - Croatia - Slovenia - Austria - Germany (through Corridor X); and
- The Eastern Axis: on orientation to Greece-Bulgaria-Romania-Moldavia/ Ukraine -Russia (through Corridor IV and V).

This means that the development of Igumenice Port will displace the whole trade transactions expected to traverse "the Adriatic bridge" from Durrës Port, ensuring instant exit to Turkey.

On the other hand, the insistence (or concession) of Skopje for exit on Corridor X to Follorina and Thessaloniki and its joining with Egnatia road ensures "the safety valve" in case something happens in the relationships with Tirana.

In additional, the decision on the Corridor V extension from Sofia to Thessaloniki undoubtedly sets the Port of Thessaloniki on more privileged positions in the crossroads of the goods traffic.

In this sense, the connection or disconnection of Albania (the linking road from Pogradec to Florina joining with Corridor X on Thessaloniki exit) to Thessaloniki is believed to effect no changes in this port's position to other transport corridors.

From the political viewpoint, a similar connection would serve as a counterbalance of Skopje decision, whereas on the economic viewpoint this connection would serve as another alternative choice for the transport of goods.

(While the decisions on corridors' construction are more guided by political considerations, their choice and exploitation is subject to advantages offered by private operators).

Based on these considerations we deem that, unlike the so-far propaganda, the Port of Thessaloniki is not a competitor of the Albanian ports of Durrës / Vlora. We believe that the competition will mainly derive from the ports of Igumenice and Patras.

In essence, Greece connections through Corridor X and IV to Egnatia Road practically make Albania "a pocket" of all countries in the region.

Perhaps, even the strategic interests of Italy will not be so persistent as long as its own bridge on the Adriatic Sea may be channelled North through the Ports of Rieka and Cooper and South by Igumenice.

In this case, the argument could be backed up by the fact that the farthest distance of transport would be surpassed by the reduction of delay in the transport of goods.

So, Western cargoes destined to East (Turkey and beyond) in this case will pass only through two customs houses (entrance-exit in Greece and entrance-exit Turkey), while the goods transition from Vlora to Durrës would require more customs procedures, which at any case had better been avoided by any subjects.

For the same reasons, even for the transit of goods through Albanian ports, the interests of private subjects (always for transit to East) would be more likely to displace further to Thessaloniki than via Skopje, Bulgaria and then in Turkey and beyond.

On the other hand, pressures for issuing the status of "free zone" to the ports of Igumenice and Patras (in addition to Pireu ports, three other ports enjoying this status) have been intensified by various domestic groups of interest in Greece. This would make up another additional factor for increasing the competitive position of these two ports in relation to the ports of Durrës and Vlora "as linking bridges" of the Adriatic Sea.

VII. ITALIAN POSITION

Italian interests on Corridor VIII are believed to be based on two layouts:

First, on the involvement of Bari/Brindisi (not Durrës/Vlora) as starting points of this corridor. In this framework, this implies earning financing for both ports' projects, as linking bridges of the Adriatic. In this way, Italy ensures powerful channels of exit to East (Koper, Rieka, Durrës and Patras/ Igumenice).

Second, Italian financing by some road segments of Corridor North-South seems to pronounce its geo-strategic interests for a presence in the Balkans, especially in Albanian territories. Albanian ports would ensure it a sooner and easier exit in Albania and Kosova. In addition to this, Vlora port might be the major terminal for the transition of oil pipelines from Burgas to Italy and furthermore to West.

Based on the above analysis on the position of these two neighbouring countries in relation to this corridor, I believe that we should take into account the following facts:

The Bulgarian objection to include Greece in the road segments of Corridor VIII points out the Bulgarian intention to hold its privileged position in goods traffic through Albanian ports to Russian market, but the proposed solution does not seem to be financially rational.

First, the Corridor VIII would serve the goods transition mainly to Turkey and furthermore to Central Asia, (not Russia). Looking at the corridor map, it is clearly observed that the connection of Northern and Central Europe with Russian market is fully ensured by other Pan European corridors.

It is hard to believe that the economic rationality of private operators could exploit a North European transition for exit in the Russian market through Corridor VIII. So, it is principally the expected trade activity to Asia, which props the idea of this corridor. In the meantime, Bulgaria has ensured an extension of the corridor to its border line to Turkey for Alexandropoulos (a setting point for the gas line terminal coming from Burgas).

But, if the Bulgarian objection is rational from the economic and competitive viewpoint, how about Albania's the attitude?

In addition to the political considerations stated in this article, I think that there are some other economic problems that should be taken into account.

The extension of Corridor VIII to Thessaloniki means additional length with new segments of the road network by about 80 km and nearly the same investments in USD millions. This means more economic opportunities for this area.

VIII. PARTICIPATION OF EUROPEAN FINANCIAL ORGANIZATIONS IN PAN-EUROPEAN CORRIDORS

Financing of Pan European corridors (IV, V, VIII and X) by EBRD:

From all the corridors, the VIII one is noticed to absorb nearly 5 per cent of the total financing (ECU 103.1 million), while the Corridor IV has been the main priority of the EBRD financing (by ECU 725.7 million or 36 per cent of the total financing of corridors); Corridor V (by ECU 620.7 million or 31 per cent) and Corridor X (by ECU 585.2 million or 29 per cent).

From ECU 1021 million issued (1993-1999) to the countries engaged in appropriate corridors, financing according to states has been as follows:

States	Total financing (1993-1999), in millions of Eur	In percentage
Albania	10	1
Bosnia-Herzegovina	32.7	3.2
Bulgaria	84.1	8.2
Croatia	88.7	8.7
Czech Republic	17.8	1.7
Hungary	329.4	32.2
FYROM	9	0.9
Rumania	279.4	27.4
Slovakia	15	1.5
Slovenia	74	7.2
Ucraine	80.9	7.9
Total	1021	100

Source: Estimated according to the data published by EST-OVEST, NR.6, 1999

It is noticed that the EBRD financing is more concentrated in:

• The Corridor IV, passing mainly through Central Europe (exiting from the Czech Republic, Hungary, Rumania to

Bulgaria, deviating to Turkey and Greece);
- Corridor V, which goes through the Northern states to our country (from Croatia, Slovenia, Bosnia, with direction to Budapest and then to Ukraine); and
- Corridor X, going downward from Austria/ Hungary to Former Yugoslavia territory and exit to Greece, joining Egnatia road.

EIB financing of Pan European corridors, 1990-1999 In millions of ECU in %

	In millions of Eur	In percentage
Corridor I	50	1
Corridor II	590	12
Corridor III	525	10
Corridor IV	1746	34
Corridor V	914	18
Corridor VI	400	8
Corridor VII	0	0
Corridor VIII	181	4
Corridor IX	54	1
Corridor X	641	13
TOTAL	5101	100

EIB financing for transports by countries: in millions of ECU, in per cent, for years 1990-1999

	In millions of Eur	In percentage
Estonia	76	1.4
Latvia	62	1.2
Lithuania	124	2.3
Poland	1265	23.7
Czech Republic	1160	21.7
Slovakia	322	6
Hungary	297	5.6
Slovenia	615	11.5
Rumania	845	15.9
Bulgaria	381	7.2
Albania	51	0.96
FYROM	130	2.44
TOTAL	5328	100

Source: Estimated according to the data published by EST-OVEST, NR.6, 1999

It is highlighted that even in EIB financing, the financing of corridors IV, V and X is of priority.

But there is generally noticed a very slow activity of our country with the financial European organizations. From both institutions, our country has not withdrawn more than 1 per cent of their total financing planned for Eastern and Central European countries included in these corridors.

IX SOME TENTATIVE CONCLUSIONS

- The current economic development of the world made the competition extend not only through different countries or states, but also through regions. In this sense, development can not be merely achieved in the framework of slogans and political challenges or/and only in the national political pragmatism, but also by a careful study of the competitive range of the country or region. Only on this basis, political pragmatism can be better oriented to serve the national interests of a country.

From this viewpoint, the "swelling" of the domestic opinion, on the basis of national interests seems to contradict the regional initiatives encouraged and sustained by the international community in the framework of the most important initiative until now, the Pact of Stability for South-Eastern Europe. It would be wiser to not embroil the national interests in the press clamour, which gives them the aspect of encouraging the "Albanian nationalism" (which is more false and puffed up).

- Political pragmatism can not intimate orientation of development within a single course "corridor", but a diversity of them. In this sense, the "main line" connection of Corridor VIII through Thessaloniki "branch" does not merely imply our country's displacement or by pass from the above mentioned corridor, but it would serve as a "safety valve" in the political aspect and a diversity of opportunities for connection and communication, offered to economic agents.

How can be otherwise explained, for example the fact that Bulgaria, with its own ports of Varna and Burgas, could

be invincible for exit in the Black Sea, accepts its connection with the port of Thessaloniki through Corridor IV extension; or the fact that Skopje decides for both branches of Corridor X extension in its territory, by joining Egnatia road in Florina and Thessaloniki port. The complexity of communication through Balkan countries becomes an additional factor in the favour of the diversity of linking channels of road networks that will traverse the region.

- The Albanian diplomacy, apart from problem recognition and orientation of economic diplomacy, should strongly feel itself as part of the latter. It would be of significant importance for the Ministry of Foreign Affairs to publicly expose the main lines of the economic geo-policy of the country (as long as it is important to and necessary for the public). This would contribute to clarification of the misty situation covering the corridor subject in particular and orientation of political relations in general. Without finding appropriate balances and compromise among the countries involved in these projects, its financing would continue to further linger, and prove unworthy to our country. The main priority of our country's diplomacy would be finding appropriate solutions and building alleys with countries in the region, in order to surpass the established disagreements.
- The strengthening of economic diplomacy would perhaps intimate either new dimensions of the objectives of the external policy and organization and commitment of the Foreign Affairs Ministry to their accomplishment, or a review of subordination of those charged with economic problems of our embassies' staff outside the country.
- The established confusion about 'the corridor issue' is attributed to the missing of the transparency of the government to the public. The contradictory statements of government members have been of high significance herewith, by naming it once as a main four-lane highway (2+2) and another time as a six lane highway (3+3). The signing of contracts with some of the ministers of the neighbouring countries' governments (Greece, Italy) has

not been reflected and analyzed by official authorities in the daily media, in order to supply the public audiences with the necessary information on such a critic and sensitive matter. Furthermore, the appropriate government structures seem to lack engagement and commitment to adjourn with "the diplomacy" of this problem. So, while the Italian official sources continue to announce that the starting point of Corridor VIII is in Bari/ Brindisi, the official authorities of Albania continue to declare it on Durrës/ Vlora. The deficiency of official sources of information accounts for the main factor of the "smoky situation" of the public opinion and the difficulties encountered by analysts about the clarification of the problem.

- Although declared as the main government priority, the latter seems to have been unskilled in its transactions with financial organizations, something noticed in the low level of ensured financing in relation to all the countries included in the Pan European road networks.

- Even in the ensured financings, the selected firms have demonstrated considerable delays in fulfilling the road segments according to specified schedules. This is under the direct responsibility of the competent state authorities, demonstrating a pointless indifference on their side. The same indifference is manifested in absorbing the promised funds by financial organizations. It is conspicuous the fact that EIB has declared (almost threatening) several times that the Ministry of Transport is not withdrawing the granted funds for Durrës Port. The silence of the respective ministry to such public statements made by press seems very strange.

- If the Albanian Government is not capable of dictating the world and the European diplomacy in the current geo-political realities, it can perform the county's adjustment to these realities in order to hold the competitive position of the country in the region.

In this sense, although the ports of Patras and Igumenice are believed to be eminent competitors of Durrës and Vlora, displacement of public attention versus the "risk" exposed by

Thessaloniki Port will bring no worth to the above-mentioned issue. But, what could be done is issuing a more privileged "economic status" to our ports, as that of free ports.

To be evoked herewith is that vicinity areas have been developed by the application of such policies (ports of Trieste, Malta, etc.), giving them a more favourable position in comparison with our ports.

Certain groups of interests are seeking such status to favour ports of Ecumenical and Patras.

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ANNEX 1

Lines of Pan-European corridors:

Corridor I	Helsinki-Tallin-Riga–Kaunas-Warsaw & Riga- Kaliningrad – Gdansk
Corridor II	Berlin – Warshaw – Minsk – Moskow – Nizhni- Novgorod
Corridor III	Berlin/Dresden-Wriclaw-Lvov-Kiev
Corridor IV	Berlin/Nuremberg/Dresden – Prague- Bratislava- Gyor- Budapest – Arad- Bucharest- Costanca/Craiowa – Sofia – Thessaloniki/Plovdiv – Istambul
Corridor V	Venice-Trieste/Koper – Ljubliana – Budapest – Uzgorod – Lvov+ Bratislava – Zilina – Kosice – Uzgorod+ Ploce – Sarajevo- Osijek – Budapest
Corridor VI	Gdansk – Katowice- Zilina+Torun – Poznan
Corridor VII	Danub: all ports of Danube in EQL
Corridor VIII	Durrës- Tirana – Skopje – Sofia + Plovdiv – Burgas- Varna
Corridor IX	Helsinki –St Petersburg – Moskow/Pskov – Kiev – Ljubasevka – Kichinev- Dimitrovgrad – Aleksandropouli+ Odessa – Ljubevska – Kiev – Minsk – Vilnius – Klaipeda/Kaliningrad
Corridor X	Salzburg – Ljubljana – Zagreb – Beograd – Nish – Sofia – Velesh – Thessaloniki + Budapest – Novi Sad – Beograd - Nish – Sofia – in corridor IV to Istambul + Velesh – Bitola – Follorina – Egnantia road

Network of Pan-European corridors in Central and Eastern Europe

ALBANIAN AGRICULTURE IN TRANSITION PERIOD

Luljeta File*

1. MACROECONOMICS AND POLITICAL FRAMEWORK OF TRANSITION IN ALBANIA

The establishment of pluralism in Albania at early 1990 oriented transition of Albanian economy from a planned economy into a free market.

Three factors could be identified for the deterioration of the living conditions of Albanian population at this moment:

- Rapid growth of food stuff prices, liberalized on August 1, 1992. So, until the end of 1992, consumer prices recorded 7 times growth compared to the end of 1990;

- Total collapse in food-stuff products over the period of 1990-1992 affected the entire production;

- Nearly 380 000 country families, who had recently received the land (represented 46 per cent of Albanian families and 75 per cent of the rural population) had the tendency to produce for personal consumption (not for the market), because of lacking transport and the difficulty to develop agricultural activity.

This period recorded a big shock to the cultivated mentality of the Albanian peasant to be ever addicted to his countryside and land. The paradox of this situation lies in the fact that the Albanian countryside was found desolate especially by its youth, i.e., by the labor force, precisely when peasants became land owners of the land they tilled again.

As any other massive displacement (brusque and not well-organized) of the rural population against urban areas and neighboring countries, even this one had its negative consequences over the rural production, in reducing the working will and in distorting and resigning whole systematized surfaces of land. At this moment, the Albanian Government[1] made a strong appeal to the world community for sustenance. The government applied rather "popular" measures, such as the revocation of government subvention on consumer prices of food stuff articles and earning of social support at 80 per cent wage for the unemployed. To be mentioned among the reasons which dictated the necessity for the application of these measures is the reduction of budget expenditures and the stimulation of private initiative by the rural sector.

2. RURAL SECTOR

2.1 POSITION OF RURAL ECONOMY IN THE NATIONAL ECONOMY

Albania is and will remain for a long period of time a country where agriculture occupies the principal position to the total of GDP.

In the recent decade, the agricultural production to the total of GDP has been oscillating from 39.5 per cent in 1990[2] to 52.9 per cent in 1999.

Table 1

	1993	1995	1996	1997	1998	1999
Agriculture to the total of GDP	57.1	55.8	53.5	58	54.4	52.9

Source: INSTAT, Ministry of Finance; World Bank on 1933 (1994), "Albania Building a new economy".

Chart 1 Agriculture to the total of GDP
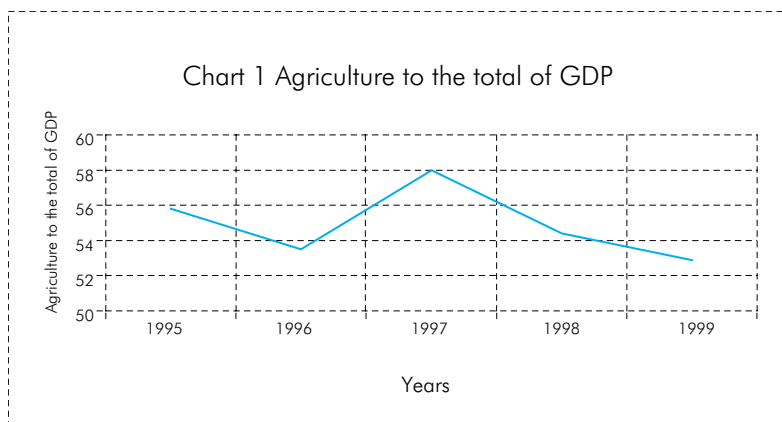
The transition to free market economy and the disintegration of cooperatives and agricultural enterprises required a new regulatory framework. The rural sector, as an important part of the Albanian economy required a rapid transformation of legislation in this area. The structure of rural production registered the following change according to type of ownership:

Table 2

Sectors	1990	1991	1992	1993 and currently
State-owned sector	29	22	9	0
Cooperative sector	50	0	0	0
Private sector	21	78	91	100

Source: Statistical bulletin of MAF

According to the recent statistics of INSTAT (April 2000) only 1.73 per cent of active enterprises belong to the rural sector of Albania.

3. LEGAL FRAMEWORK

3.1 LAND REFORM IN ALBANIA DURING 1990-2000

The land reform of 1991 was the most progressive and decisive of the rural sector and the entire economy, because it sanctioned land ownership and had a very strong effect on agriculture on

the whole. The land reform of 1991 was an outgrowth of the "Law on Land" approved by the Albanian Parliament in June 1991. The basic principles of this aw were:

a) The smelting of cooperative and agricultural enterprises and the equal distribution of their land to country dwellers.
b) This law was lucrative to all peasant families registered as cooperative members or agricultural enterprise workers until 31/07/1990.
c) The land granted to the peasants was free of charge but they did not enjoy full ownership on it because they were restricted in the right to sell, hire or pledge it.
e) Land division was performed by certain commissions comprised of peasants of the village. In vertical line these commissions were connected to the regional commissions and the national commission headquarters.
f) Ex-land holders (recorded as such until 1946, when the agricultural reform was completed) would be recompensed in worth. The type of compensation was postponed to be decided at a latter stage. This law was followed by a chain of amendments for improving land distribution and avoiding as much as possible the problems arising along its application.

Agricultural enterprises were made available for privatization by the implementation of their privatization law on August 1, 1992. This process was accompanied by a chain of problems connected with the compensation of ex-owners or the restricted capacity for land tillage because of the reduced number of mechanical appliances. This brought about a reduction in the rural production of plants, which need the application of mechanical equipment even more. As observed by the following table, the falling production is precisely more rigid by these tillage items.

The following table gives the worth of main agricultural products accounted on 1994 prices:

Table 3

No	Selected items	1992	1993	1994	1995	1996	1997	1998	1999
1	Total in Lek 1000	71602	84927	91985	104157	107224	95634	99027	102384
2	Animal husbandry %	42	45	49	49	48	47	48	49
3	Plants (%)	52	49	45	45	46	46	45	44
4	Fruit growing (%)	6	6	6	6	6	7	7	7

Source: Ministry of Agriculture and Food

Chart 2 Agricultural products accounted on 1994 prices
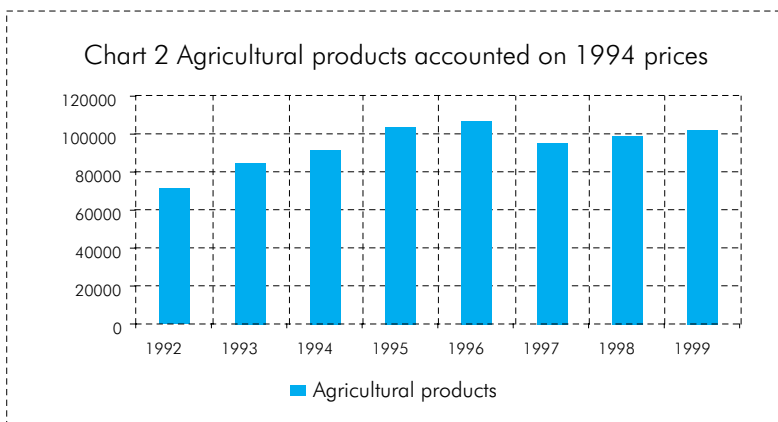
Pursuant to the law on land, the distributed land surface of 375000 hectares of land provided establishment of 400000 small individual farms, varying from 0.6 - 3 hectares per family.

The transition from a very limited number of farming economies managed in a centralized manner into a multitude of excessively small economies managed by farmers themselves was accompanied by series of structural and organizational problems.

For example let's consider the management of irrigation after the transition of 500 big users into a larger number of users (100-1000 times higher). The same problem was encountered in the veterinary service or farming machinery.

A year after the implementation of the land law, nearly 80 per cent of the land surface of agricultural cooperatives was spread. After June 1992, land distribution went on slower rates, mainly

because of the large number of problems created during this period. The main problem during land distribution was that a part of rural population did not accept to receive land surfaces of "on ex-holders", a problem encountered even nowadays.

According to the assessments of the Ministry of Agriculture and Food, nearly 91.5 per cent of land was distributed until August 1993.

The undistributed share was mainly infertile land and the village commissions assessed it as not apt for exploitation by peasant families. The official data state different situations for different country regions.

In April 1999, the Albanian Parliament passed the Law No. 7699 on ex-land holders' compensation.

On 27 June 1995, the law on trading rural land, lawns and pastures was approved. The purpose of this law was the regulatory framework of ownership transfer (buying-selling) on rural land, lawns and pastures.

Nobody believes nowadays that approbation of such law would bring rural exodus and misuse of rural land.

Besides the land problem, division of assets of other cooperatives, SMT (Stations of Machinery and Tractors) and AE (Agricultural Enterprises) constituted a difficult problem to resolve. Small value assets were distributed without difficulty because, according to the law, they were distributed to persons that had used them before. The contrary happened with high value assets, they were even physically destroyed in order not to be acquired by a single person.

On December 21, 1995, the Albanian Parliament approved the law for the legal regulation of transfer of rural land ownership of former state-owned enterprises free of compensation to the families using them.

On April 23, 1998, the law of transferring the ownership on rural land, lawns, pastures and woods was approved, whereas in April 30, 1998 was passed the law on leasing rural land under state ownership to foreigners for 30-99 years use, according to their different investment activities.

Yet, there is no real market for rural purposes in Albania. There is no data related to the surface and the selling price of the rural land. Acts of rural land transactions are currently noticed in the suburban areas of Tirana, access roads to Tirana and tourism areas. The sold surfaces are no more used for rural purposes, but for construction and industrial settlements. The selling price of rural land has been varying from USD 8 to 12 per m2.

There are also noted leasing for agricultural purposes (for production of seeds or intensive cultivation) for periods of 1-3 years, with a payment of USD 150-200 per hectare, according to the land's quality, level of irrigation, etc[3].

The record of land areas under land registry is expected to terminate by the end of 2001.

4. REORGANIZATION OF AGRICULTURAL SERVICES

The new land structure changed the mode of using elements attached to it. Different services as irrigation, veterinary service, hygienic and sanitary checks and rural credits, previously managed in a centralized manner by the state, had to be actually managed individually to serve an excessively fragmentary agricultural economy.

4.1 IRRIGATION

In 1999, before the land structure modification, the total irrigated surface accounted for 423 000 hectares, comprising 60 per cent of the tilled land, contributing by 80 per cent to the rural production of the country.

Many pumping stations and watering channels were destroyed during the tumult period of 1991. Lack of maintenance and the ruin of the irrigation system led to a loss of 89 000 hectares of irrigated land in 1992.

Practically, the establishment of small farms brought forth two main problems:

- Farmers did not have any idea on maintenance and exploitation of watering system;
- The new land structure required an alternative structure for water dissemination.

This situation in the watering system affected decrease of agricultural production in 1992 and 1993.

4.2 MECHANIZATION

Many inputs of agricultural production, such as seeds, soils and pesticides were mainly disseminated by state agencies.

Reorganization of rural sector affected the use of agricultural machinery and equipment, especially the existing mechanical appliance which was in conformity with the vast land areas of agricultural cooperatives or state farms and did not correspond to small farm needs. The heavy agricultural machinery and equipment was manly concentrated in the SMT(s).

When the latter were privatized, machinery and other equipment were transferred under the ownership of their operators. Their repairing and maintaining is actually carried out by private firms.

Since SMT-s were mainly situated in low lands, their geographical distribution was not resolved even after privatization. Evolution of agricultural machinery and equipment in the recent five years is as follows:

Table 4

Machinery & equipment	1995	1996	1997	1998	1999
Chained tractors	1440	1209	1018	1025	1008
Wheeled tractors	7498	7104	6892	7125	7252
Seeding machines	1462	1515	1519	1548	1652
Motto-harvesters	132	129	149	198	294
Harvesting machinery	817	801	783	802	760

Source: MAF, Statistical Bulletin, 1999.

4.3 TECHNICAL ASSISTANCE AND VETERINARY CHECKING

After privatization, other agricultural services such as advisory or veterinarian ones are carried out on payment. Veterinary services, inter alia, should respond to the prophylactics and heavy epidemic disease of animal husbandry at butchery shops, meat processing and sausage factories and in the market. The distribution of animal husbandry to farmers accelerated the problems on veterinarians who had to move from one farm to another to actually carry out their work. This hardened the issuing of information and farmers training as well. The law on organizing the veterinary service (Law No. 7630) was approved on October 23, 1999.

4.4 RURAL LOANS

In 1990-1992 the rural lending policy based its activity on a great number of new farmers, who had newly acquired ownership of their land. Lending operations were in small amounts, mainly for purchasing cattle and seeds. It was necessary to operate with a very large number of creditors, a part of which remain difficult customers due to their bad credit performance.

In 1992-1995, the rural sector was financed by two main sources:

• The funds of the Rural Commercial Bank; and
• Various donors' funds, which have financed and continue to finance the Albanian agriculture through different programs. Projects of the World Bank, the European Bank (PHARE

project) and those of German Bank for Development must be mentioned amongst the most important projects of the period.

The rural lending policy of 1992-1993 mainly sustained the agricultural automation, which represented a living need for the rural sector of that time, since the existing mechanization was inappropriate for the small established farms and could not respond to the new farmer claims of that time.

The period 1993-1995 accentuated the claim for credit support of the ago-food industry.

This sector was round out on credit issuing by the Rural Commercial Bank, the National Commercial Bank and different donors. Interest rates on granted credits moved from 40 per cent in 1992 (annual) to 17 per cent in 1995. Lending procedures evolved with the farmers' mentality.

Lending procedures were very simple in 1992 and they began to reflect improvement of the legal framework after 1995. The credit performance of the Rural Commercial Bank over 1992-1995 is revealed in the following table:

Table 5

000 Lek

Selected items	1992	1993	1994	1995
Private sector	638 159	2 780 299	2 479 662	1 545 169
From which in %:				
Agro-business	25.3	12.1	9.8	12.2
Food-processing industry	3.8	1.9	1.5	6.1
Agricultural machinery & equipment and transport	17.7	16.5	21.9	11.4
Trade of agricultural inputs	0	4.2	7.8	10.2
Trade of products	41.8	45.9	46.2	54.8
Construction	4.4	0.008	1.9	1.0
Others	7	19.4	10.9	4.3

Source: Statistical Report 1995, the Rural Commercial Bank.

Albanian experience proved the need of accompanying economic transition with institutional reforms. In general, the financial system reform and the banking system's reform in particular recorded a very slow progress. The first tangible result of bank privatization in Albania was the liquidation of the Rural

Commercial Bank which was envisaged to close in December 1997. Its dissolution was approved in the first quarter of 1998.

This bank was abrogated the license in 1998. A part of its activity was transferred to the National Commercial Bank and the rest to the Loan Recovery Agency.

5 DOMESTIC AND INTERNATIONAL MARKET OF AGRICULTURAL PRODUCTS IN 1990-2000

5. 1 DOMESTIC MARKET

The transition to free market economy and land distribution to farmers created the conditions for farmers' incentives to produce for individual needs and the market. The current market is furnished by a large number of small producers, with a restricted variety of goods in small quantity.

According to a survey carried out by the World Bank, nearly 1/3 of farmers produce for individual consumption.

Private farmers are not yet capable of concluding trading contracts. Yet, no wholesale or retail market structure is real on most agricultural products. Market information is still inadequate. On the whole, it can be asserted that agricultural product marketing is still undeveloped.

The competition of imported products is still tough for the Albanian farmer.

Average retail prices of some agricultural and ago-food products over the period 1994-1999 are presented as follows:

Table 6

Selected items	1994	1995	1996	1997	1998	1999
Veal	228.5	251.7	297.7	384.3	583.0	584.3
White Cheese	194.1	197.9	222.8	261.0	333.0	331.8
Butter	203.8	235.5	336.2	420.9	547.0	549.1
Wheat flour	31.4	31.9	46.4	61.8	66.0	60.3
White bread	25.9	27.8	37.8	56.7	64.0	62.8

Potatoes	35.1	36.5	36.8	50.2	55.0	55.3
Apples	53.6	61.4	71.8	83.0	100.0	112.5
Dried beans	68.5	113.7	93.8	101.4	193.0	167.9
Tomatoes	75.8	75.7	96.8	117.6	142.0	146.2
Vegetal oil	105.6	110.3	121.8	171.3	193.0	169.4

Source: INSTAT and MAF Statistics

Chart 3 Price performance
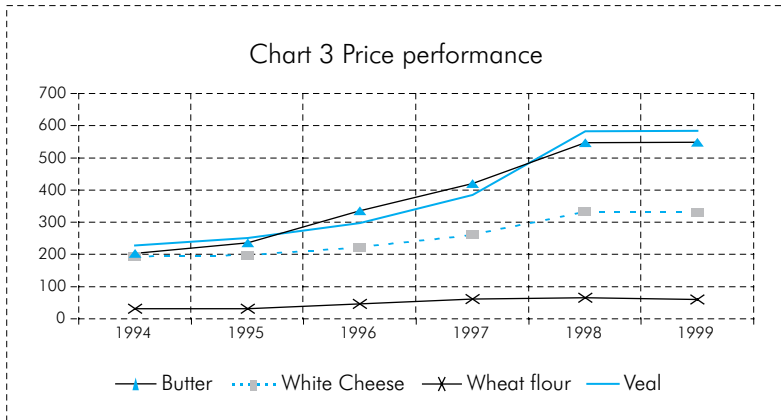
5.2 INTERNATIONAL MARKET

Exports

Agricultural products have always occupied an important position in the Albanian export structure, both before the Second World War and after years 1980. Therefore in 1992 the share of rural exports to the total exports of the country was nearly 38.4 per cent. The growth of specific weight of rural exports to the total of exports is due to the export decline from other sectors, as an outcome of changes taking place in 1990's. Within the exported agricultural products, the highest specific share has been constantly occupied by tobacco and its by products (up to 60 per cent), while agro-industry products occupied only 40 per cent of agricultural and foodstuff exports (this structure is reversed by the European Community countries, where 30 per cent are raw material and 70 per cent are processed products).

Eastern European countries have been the main destination of agricultural products.

EU countries have mainly purchased medical plants or ether-oil substances.

Table 7

000 Lek

Selected items	1995	1996	1997	1998	1999
Total exports	1742312	3685489	4252699	4947023	3877257
Agriculture	961047	1559048	2312778	2411208	1639694
Live animals	164135	5974	284715	179218	8783
Agro-industry	145238	1467383	1365783	1938630	1825035
Fishery	471892	653084	289423	591507	403745

Source: INSTAT, Statistical Bulletin of MAF; Data-processing for years 1995, 1996 L. File

Eastern European countries have been the main geography of agro-exports and other exports of Albania until 1990, whereas today they are mostly carried out with Western European countries and specifically with the neighboring countries. Nearly 36 per cent of agro-export activity in 1998 was carried out with Greece and about 19 per cent with Italy.

Table 8

000 Lek

Countries	1950	1960	1970	1980	1990	91-93	1994	1995	1997	1998
Eastern Europe	100	93.4	56.0	40.8	46.6	...	...	6.2	10.9	...10.5
Industrialized		1.0	13.1	37.7	37.9	...	89.0	75.2	84.8	83

Source: MAF statistics

Imports

Agro-imports over 1990-1999 period were mainly composed by wheat, maze, rice, sugar, flour, oil and other seasonal products. The current data reflect no possibility for a changing structure in the near future.

Table 9

000 Lek

Selected items	1995	1996	1997	1998	1999
Total imports	17244834	33004970	28309735	37101799	33215102
Agriculture	2800559	8466702	6150740	9437549	7804926
Animal husbandry	3277180	2404074	2652239	3769182	4014509
Fishery	104109	345230	309938	603152	533826
Agro-industry	11062986	21788964	19008998	23269069	21006444

Source: INSTAT, Statistical Bulletin of MAF; data processing L.File

As it is noticed, agro-imports are nearly 10 times higher than agro-exports in absolute figures. Since January 1990 to 1993, international community subsidies, foreign grants for purchasing foodstuffs mainly from EU countries (tradable imports in general) comprised 80-90 per cent of the daily consumption in foodstuffs of Albanians.

A governmental decision of August 1991 liberalized the foreign trade business.

Prior to the initial economic reforms of 1992, existing foreign trade enterprises (EXIMAGRO, AGROEXPORT, ALBIMPEX) were the only structures having relationship with the international market of agro-products.

They practiced fixed prices, with no relation to foreign exchange rates and international market prices. The state budget used to earn the income and cover the loss deriving from foreign trade transactions of agro-products.

In the early reforms of 1992-1993, these enterprises passed over to self-financing and they are currently in the course of complete privatization.

Foreign trade transactions of agro-products will excessively profit from the improvement of transport lines according to the recent projects of the region. Western European markets, well-supplied with high-quality products, would be difficult to open for agro- products of Albanian industry.

Albanian potentialities for agro-exports are restricted because of:

a) Total absence of marketing conditions (storage, processing, safekeeping, packaging, etc);
b) Low standards of foodstuff checking and veterinary checking;
c) Farm subsistence on excessively small areas (producing mainly for self consumption).

In the framework of the integrating process of Albania to the WTO (bilateral negotiations concluded in 1999), the market policies in Albania are amongst the most liberal ones compared to all countries of South-Eastern Europe.

Concerning the tariff level:

1. No agricultural product is financially sustained and no minimum prices are guaranteed.
2. There is no subsidy of input prices or agricultural services.
3. Imports of all agricultural products are liberalized and there is no restriction on them (the maximum customs tariff is 18 per cent) and exported products are treated on no subvention.

In conclusion, it can be emphasized that the rural sector will continue to remain the main branch of the Albanian economy for a long time. Emerging from a centralized economy, where every economic activity was state controlled and where self-surviving economy prevailed, and from a situation of huge deficiencies, the rural policy objectives are significant: *Agricultural production should be increased in quantity and quality to meet domestic market claims and be exported*. The political slogan, backing up the initial economic reforms of 1992, was "Let's go ahead towards Europe". What remains important is determining ways to achieve this goal even in the rural sector.

ANNEX

Foreign projects for the Albanian agriculture

Financing institution/ State	Sectors & Projects	Amount (millions USD)	Time-duration (Years)	Initial date
World Bank	Project on critical imports	53	3,5	June 1992
	Reorganization of rural sector	55	3	November 1993
	Reduction rural poverty	6,7		April 1993
	Rural development project	12		1993
	Rehabilitation of irrigation system	44,1	6	November 1994
	Project on development of agro-industry	7	3	February 1996
	Project of rural roads	34	3	October 1995
	Wood's projects	21,6	6	June 1996
EU	Phare 1992	18,34		
	Phare 1993	12,1		
	Phare 1994	6,05		
IFAD	Development of South-Eastern area	254		
	Rehabilitation of irrigation system	9,64		
FAO	Institutional strengthening of MAF	3,019	4	1992
	Assistance for Rural production in Albania	7,5	3	1995
USAID	Fertilizers' marketing	33,32		
	SARA project		4	1994
Austria	Farmers' sustenance Skrapar	0,77	3	1993
Netherlands	Agricultural development in Fier district	3,4	1	1996
	Genetic improvement of cattle	0,545	3	1992
Italy	Agricultural machinery and equipment Milk processing Co-financing of irrigation project	22,74		
Germany	Agricultural machinery and equipment Milk processing factory AJKA Rural development Financial backing for agricultural schools	31,47		
Greece	Tractor and industrial bakery supply	11,54		

Source: "Lálbanie une agriculture en transition", CIHEAM, Paris 1997.

NOTES

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[1] From June 1991 to the beginning of 1993, the total amount of aid granted by this community reached at USD 900.000.
[2] "The World Bank Atlas 1991" and "The Albanian human development report 1996".
[3] There is no data about the amount and surface of hired land until 1999.

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BRIEFLY THE ALBANIAN BANKING SYSTEM IN 1999

Miranda Ramaj
Vjollca Berberi*

1. OVERALL FEATURES OF BANKING SYSTEM DURING 1999

The Albanian banking structure significantly improved in favour of the private bank activity during 1999. The banking system experienced initial operation of three new private banks: The FEFAD Bank, the Intercommercial Bank and the First Investments Bank (Tirana branch).

So, the number of joint venture and private banks reached 11 from 13 banks altogether in the banking system in Albania.

Their growing number increased the competition in the domestic bank market. For the first time, private banks and foreign bank branches expanded their activity to other country areas. Until 1998, only state-owned banks were extended to other districts of the country and Tirana Bank established two branches, in Durrës and Fier. Other private banks licensed, had concentrated their activity only in Tirana.

Currently, the FEFAD Bank has two branches, in Fier and Durrës; the Albanian - Italian Bank has one bank agency in

Durrës; the National Bank of Greece has two bank agencies in Durrës and Korçë. The private banks and branches of foreign bank have started to compete with the state-owned banks in terms of the quality of service and the variety of products they offer.

The paid up capital of these banks occupies 47.6 per cent of the whole banking equity, from 26.1 per cent in 1998.

Privatization of state-owned banks kept running during 1999, consequently restricting their activity. This brought about the growth of private banks' share, by turning into an additional factor of support for the increasing competition of the domestic banking market.

New shareholders assigned to the National Commercial Bank: the European Bank for Reconstruction and Development, International Financial Corporation (which is part of the World Bank group) and Kent Bank (Turkish private bank) have signed the contract with the Ministry of Finance. Within 2000, the National Commercial Bank is expected to have totally passed over to the new shareholders, after performing the payment of the required capital, and act as a private bank in the market, maintaining its establishments in other districts of the country.

The Savings Bank is reorganizing and preparing for the process of privatization.

The new private banks' entry into the market has changed significantly the bank market behaviour in terms of banking service improvement; the privatization of state owned banks will eventually change the domestic mentality of the Albanian public, to have confidence in a new banking institution – that is in a bank of no state ownership.

Thus, at the end of the vast transformation decade, the Albanian banking system (accounting 13 banks by its composition, from which 11 are private and joint venture banks) took over the responsibility of changing the bitter taste of 1997 events; made

safe steps to change the psychology and the attitude of the domestic and foreign opinion toward state-owned banks, by concluding the privatization of one the currently biggest state-owned banks, (the National Commercial Bank).

Challenging projects of the current year will increase the public confidence in banks and will improve their established relationship.

2. PRIVATIZATION OF THE SAVINGS BANK

The process for the privatization of the state-owned banks began with the approval of the Law No. 8033, dated 16.11.1995, "On the transformation of public commercial banks into commercial companies and their privatization admission.

The Council of Ministers' decision, No. 655 dated 23. 9.1996 on "The privatization strategy for public commercial banks" was drafted and approved, based on this law.

The strategy has defined that the goal of this process is the improvement and establishment of an effective, stable and financially sound banking system to support the rapid economic growth of the country. As stated in the strategy, the government target is "selling state-owned banks to strategic investors, aiming at broad distribution of capital, development of domestic markets of capital, attraction of foreign investors, safeguarding customer interests, and their total transfer to the private system."

The strategy defined the concluding schedule of privatization (end of 2000), and the sale guidelines and stages of this process.

Based on the above framework, the Ministry of Finance has taken a number of decisions concerning transformation of state-owned banks into commercial companies and reorganization of the public share of the banking system.

Upon entry into force of the Law No. 8365, dated 2.7.1998 "On the banking system in the Republic of Albania" and

pursuant to it, the Bank of Albania made the re-licensing of all state-owned banks, setting them on equal conditions to all other banks operating in Albania.

The privatization experience of state-owned banks in the Eastern European countries has pointed out that though the state resigns its total or partial ownership of banks, it still remains a guaranty for foreign investors, at least in the first years after privatization. In this way foreign investors are encouraged to approach. A similar thing was ensured to the National Commercial Bank investors, upon underwriting of the "put option" contract. This will furthermore affect attraction of strategic investors in the privatization of the Savings Bank.

During 1998 the Rural Commercial Bank was revoked the license and its assets were partly transferred to other state-owned banks, whereas non-performing assets were transferred to the Loan Recovery Agency, established for this purpose. The reducing number of state-owned banks affected the shortening and acceleration of procedures for two other banks.

More prudence and care should be shown to the privatization of the Savings Bank, currently the biggest bank of the system, having the largest extension in the country. This is the only bank covering all operations related to the state budget and the pension system in Albania.

Due to its extension to the whole territory of the Republic of Albania, it holds 67.9 per cent of the total assets of the banking system, 75 per cent of the total deposits; and 88.9 per cent of the treasury bill market.

In May 1998 a governance (two-year) contract was signed, with the World Bank's assistance, aiming at bank's preparation for reorganization/ privatization procedures.

During this period, the Savings Bank's management has been constantly assisted by foreign bank advisors (Bank of Ireland, International Service Ltd.), with respect to:

(i) Drafting a five-year strategic plan;
(ii) Drafting the annual budget of the bank;
(iii) Establishing an information system of management;
(iv) Deciding the activity efficiency of separate branches;
(v) Reorganization and clarification of departments' functions and functions of the head office of the bank according to international standards.

However, during this period the Savings Bank continued to disobey the Bank of Albania requirements, the bank supervisory authority in the country, concerning capital rates and other prudential regulations. Taking this into account and the fact of over 80 per cent of non-performing loan portfolio made the Bank of Albania forbid the lending activity to the Savings Bank.

The Bank of Albania is interested in the timely completion of privatization, since continuous delays in the privatization schedule for the Savings Bank have negative impacts over other banks' condition, whose agony increases the possibility for further loss of their value and impedes the efficient implementation of monetary policy.

So, the privatization process of the Savings Bank, as the biggest bank of the system, accounting for 75 per cent of the deposits of the population, should be as transparent as possible to the public concerning all its stages. The law on the privatization formulae of the Savings Bank and the decisions of the Council of Ministers should be published; and the strategy for its reorganization and privatization should be subject to public debates, etc.

Also, the approval of the law on deposit insurance would provide guarantee to the public about their deposits, so that similar occurrences such as the massive deposit withdrawal because of lack of confidence, with consequences in the entire banking system, be avoided during the process of privatization.

The Bank of Albania has played the role of Advisor in the process of privatization of state-owned banks, by giving opinions and making remarks on the legal acts and regulations delivered

to this end; such as the law on the privatization formulae, various decisions of the Council of Ministers, by closely collaborating with the Ministry of Finance and the World Bank. The increasing number of private banks and the continuation of privatization procedures have rather influenced the monopoly position of the Savings Bank in the banking system, since:

- The privatization of the National Commercial Bank will bring its reaction to resume its lost positions in the market;
- The increase number of new banks; their expansion to deposits, credits, treasury bill market, customer attraction through qualitative services and introduction of new services, growing number of foreign bank branches, 10 branches for 2000 and 8 for 2001;
- The privatization procedures naturally restrains the bank's activity and it can not be aggressive any more; the lowering yield of treasury bills will make other banks more aggressive;
- The Savings Bank will experience restriction in credits, investments, technology, etc., because of its privatization process;
- The budget should start the partial transfer of own operations to other banks, which may be realised by means of tender or by using better conditions.

The Albanian authorities are in the favour of the Savings Bank's privatization and have clearly expressed their interest in the development of the privatization process for the state-owned banks. Each delay will create problems to the banks, the banking market, the monetary policy, by instantly becoming the focus of public debates. After the approval of the Law "On the privatization formulae of the Savings Bank", the Council of Ministers will issue other rules and regulations to serve the privatization process. At this stage, further steps of the process have been drafted based on the NCB's experience.

The program drafted by the government in collaboration with the World Bank contains the following schedule:

1. Selling of the NCB	June 2000
2. Selection of privatization advisor	End of April 2000
3. Definition of transparent accounts concerning the role of NCB units as fiscal and payment agencies in favour of the government	December 1999
4. Analysis of profitable activity of specific branches	March 2000
5. Strengthening of accounting practices in the whole NCB, including computerization	June 2000
6. Closure of loosing branches	
7. Government will carry out the tender for the NCB	End of September 2000
8. Selection of the purchaser	End of 2000

3. BANKING SYSTEM STRUCTURE

Based on the origin and capital ownership of banks and foreign bank branches, the banking system would appear as follows:

- 2 banks with state-owned capital (G1)
- 2 joint venture banks (domestic and foreign) (G2)
- 6 banks with private and foreign capital (G3)
- 3 foreign bank branches[1] (G3)

These bank groups have their own features which change over time.

The first group is composed of commercial banks with state-owned capital.

Constituent banks of this group continue to be under the privatization process.

Although their activity is reduced during privatization, this bank group has not lost its monopoly position in the market.

The first group banks, holding the monopoly position in the banking system, compete with other new banks and impede the Bank of Albania in implementing the prudential regulations, as well as create problems about monetary policy implementation, especially in terms of introducing indirect instruments. Privatization of state-owned banks is expected to impact on changing the competition structure in the bank market and will

bring about further development of the banking system. The entry into the market of new banks and foreign bank branches as well as the length of their activity (of 3-4 years for some of them) reduced the monopoly position of the state-owned banks, but this reduction was relatively small. As you can see in the table:

The bank groups' share to the banking system (in percent) is as follows:

Indicators:	G1		G2		G3	
	Dec. 1999	Dec. 1998	Dec. 1999	Dec. 1998	Dec. 1999	Dec. 1998
Total of assets	81.4	85.6	5.8	5.1	12.8	9.3
Total of deposits	84.8	91.3	4.6	3.5	10.6	5.2
Total of loans extended	78.1	85.9	11.4	10.1	10.5	4.0
Total of securities	95.9	98.3	0.8	0.6	3.3	1.1

As noticed, we have a slow lowering of the indicators.

The second bank group, joint ventures account for nearly 6 per cent of the banking system. The banks of this group are earlier than private banks but in the first years of their activity they were very withdrawn and the number of their costumers remained restricted for some years.

Year 1999 has recorded a change in their activity, recovery and increase in the number of customers, improvement in the service quality, especially in the growing amount of extended credits.

A feature of these banks is that they are more capitalized and their capital includes 38.1 per cent of the shareholder equity of the banking system. This bank group has remained unchanged in number, in the size of the paid up capital and in the network.

The third bank group, composed of private banks and foreign bank branches, is relatively new.

Within this bank group of 9 banks, there are included banks of 2-3 years activity which have actually started to expand

their activity, but there are also banks in the first year of their operation which are at their stage of adjustment to the market, finding a place in it.

However, their clearly observed tendency is expansion of activity and gradual growth of the share to the banking system. Their share to the banking system is increasing at rapid paces. They occupied 3.7 per cent of the system in 1997; their share increased to 9.3 per cent in 1998, amounting to 12.8 per cent of the banking system at the end of 1999.

This growth of indicators by this bank group was not only affected by the new banks' activity extension but also by the expansion of the existing banks' activity.

Therefore, the total balance sheet of this bank group, compared to the previous year, has increased by 68.8 per cent. 45.7 per cent of this growth was due to the growing activity of the existing banks and the rest of 23.1 per cent was due to the starting operation of new banks.

A typical feature of G2 and G3 banks is that they carry out their activity mainly in foreign currency. So G2 banks represent 93, 3 per cent of the total balance-sheet in foreign currency to the total balance sheet in the aggregate, while this indicator results 81.7 per cent for the G3.

4. CAPITAL ADEQUACY

The capital adequacy ratio, as a qualitative indicator of the banking stability, encountered a significant improvement during 1999. For the first time after some years, it is in the positive value of 8.2 per cent, from 1.8 per cent at the end of 1998. The factor affecting on the growth of this indicator was the increase of the regulatory capital of the banking system as a result of the accretion of the minimum bank capital and the bank profit collected during this year-end.

The increase of paid-up capital is connected with decision no. 43 dated 31.03.1998 of the Supervisory Council of the Bank of Albania, according to which all banks and foreign bank branches should meet the minimum paid-up capital of Lek 500 million. Based on this decision, all banks and foreign bank branches (group III) which have been licensed and commenced activity on Lek 200 million or 350 million improved their paid up capital to Lek 500 million. These banks should meet the minimum capital required on bank opening of Lek 700 million within March 2001.

The growth of this indicator was influenced by the structure of bank assets, assessed according to their risk exposure. As noticed from the table, G1 banks have invested 71.5 per cent of their assets in free-risk assets, i.e., in treasury bills, whereas G2 and G3 banks have mainly invested in low risk assets (deposits in other banks).

In the meantime, G3 banks reduced the low risk investments and increased credit investments to 7.6 percent and treasury bill investments as well.

Table of risk-weighted assets (in per cent to the total balance-sheet of each group):

Risk-weighted assets	SB		G1		G2		G3	
	1999	1998	1999	1998	1999	1998	1999	1998
Risk-free assets (0 %)	61.4	60	71.5	67.6	11.2	13.1	20.4	15.4
Low risk assets (20 %)	19.5	23.8	11.7	17.7	48.2	39.4	56.0	70.9
Average risk assets (50 %)	1.4	1.2	0.7	0.2	10.2	18.4	1.8	0.1
High risk assets (100 %)	14.4	13.1	12.7	12.1	27.4	31.5	19.3	11.7

Capital adequacy for the first bank group is negative and affects on decreasing the indicator of the whole system. The reverse happens with the second and third bank groups, which appear excessively capitalized for 1999.

The capital adequacy ratio on both bank groups is presented respectively 44.8 and 43.5 per cent, from the 12 per cent rate (which is the fixed rate). Such asset structure in this bank group led to high capital adequacy ratios and a high excess of the regulatory capital.

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Mortgage loans (for buying leasing and improving apartments) are included within the average risk assets, whereas all other extended loans are regarded as of high risk. These assets, having a high rate of return, have significantly influenced on growing the financial incomes of banks, not leaving aside the effect of lending on the development of the economy and of different private businesses. The low rate of bank participation in these activities has a direct effect on the financial income of banks.

5. BANK BALANCE AND ASSET QUALITY

Compared to '98 year end, the total balance-sheet of the banking system accounted for 23.6 per cent increase. This was mainly affected by G2 and G3 banks, which had a significant growing result in the total balance-sheet from the absorption of current accounts and customer deposits.

As to the total balance sheet, each group's share to the banking system is as follows:

	Dec. 1997	Dec. 1998	Dec. 1999
Group I	89,8	85,3	81,4
Group II	6,5	5,7	5,8
Group III	3,7	9,0	12,6
Total of balance-sheet (in millions of lek)	167,3	212,3	252,5

From the above results, state-owned banks continue to remain dominant in the banking system, despite the continuous growth of the specific weight of private banks and foreign bank branches.

Even during 1999, the banking system assets are noted on no feature compared to their previous years' structure. Banks have mainly invested their funds in treasury bills, placements at banks and in lending, which increased compared to 1998.

Table of main assets (in per cent to the total balance-sheet of the respective group)

Assets	G1		G2		G3	
	1998	1999	1998	1999	1998	1999
1. Interbank and treasury operations	87.4	89.9	52.5	61.7	86.3	81.0
From these:						

- Treasury bills	55.2	60.0	4.4	6.0	5.4	12.2
- Central bank transactions	11.6	12.2	7.2	7.1	5.3	7.3
- Other bank transactions	19.3	16.7	39.5	44.4	71.8	55.7
2. Customer operations	2.2	1.1	33.5	30.1	7.5	12.5

The asset structure does not appear the same for the three bank groups. G1 banks record investments in treasury bills to cover deposit expenditures, while G2 and G3 banks have mostly invested their free fund deposits at other banks.

Bank lending has been carried out only by G2 and G3 banks. From the risk viewpoint, the banking system generally appears as very conservative, concentrating its investments mainly in free-risk or low risk assets.

Table of main liabilities (in percent to the total balance)

Liabilities	G1		G2		G3	
	1998	1999	1998	1999	1998	1999
1. Interbank and treasury operations	1.0	0.4	3.0	6.6	4.7	5.0
2. Customer operations	88.5	86.5	57.3	64.5	46.1	68.9
From these :						
- term deposits	73.5	72.0	11.4	16.8	21.9	33.5
3. Shareholders' equity	0.1	0.3	32.4	23.6	12.1	15.6

The increase of current accounts and customer deposits in 1999 record the following changes compared to 1998, while the banking system has grown only 23 per cent. G1, G2, G3 banks result with 14.3, 59.3 and 153 per cent increase, respectively.

This extreme growth of current accounts and deposits at G3 banks was affected by extension of the number of bank (nearly 21.1 per cent of this growth derived from the initial operation of three new banks) and from the increase of this indicator at the existing banks (this indicator increased 131 per cent at the existing banks).

G2 and G3 banks have covered the major part of deposit expenditures through placements in the form of deposits at non-resident banks, feeling more security at them, and through credit extensions, though they showed highly prudent.

The lending activity of the banking system is very insignificant compared to the total balance, occupying only 4.2 per cent of it, considerably influencing on the big problems inherited over years with respect to their return.

While G1 banks are banks with many accumulated problems throughout their lending activity, G2 and G3 banks have a better position, appearing excessively prudent.

Table of loan portfolio (in per cent to the total outstanding credits)

Loan portfolio	SB		G1		G2		G3	
	1998	1999	1998	1999	1998	1999	1998	1999
Classified loans								
- standard	41.6	48.0	19.8	13.4	90.9	85.0	80.9	89.2
- special-mention	2.5	2.9	2.7	1.9	0.5	6.6	5.5	1.2
- sub-standard	7.6	6.6	10.8	9.3	0.8	2.0	.6	5.0
- doubtful	6.3	2.4	6.2	2.7	5.7	3.8	8.0	0.1
- lost	41.2	36.6	59.5	67.0	1.9	1.7	2.8	3.2

Concerning banks of the first group, i.e., banks of state-owned capital, the performance and the problems accumulated over years are known; their ratio of non-performing loans to the total loans is excessively high.

Banks of the second group have a better position; standard loans represent 85 of the total loans. Non-performing loans to total loans occupy only 7.5 per cent, whereas the ratio of credits to the total of deposits is 49.1 per cent.

For the third bank group, standard loans represent 90 per cent of the outstanding credit, whereas the ratio of the total credit to total deposit is 19.2 per cent. Not all the banks of this bank group extend loans. Three of them began to operate in 1999, whereas one of them is forbidden to lend because of the deterioration of its loan portfolio.

6. FINANCIAL RESULT AND PROFITABILITY INDICATORS

At this year-end, the banking system presents, for the first time after a five-year period, a financial net positive result, assessing 1999 as the most prosperous year with respect to financial result.

However, the level of income is still insufficient to cover the loss per nearly Lek 12.8 billion (inherited from the previous years).

The profit resulting at this year-end was Lek 1267.8 billion, from which 76.8 per cent was accomplished by G1 banks, 16.9 per cent from G2 banks and 6.3 per cent from G3 banks.

The financial result affects on return on assets and return on equity, which come out to be improved at this year-end.

ROA[2] indicator of the banking system results 0.6 per cent, where G1, G2, G3 banks record the result of 0.5, 1.6. 0.3 % respectively. So, only G3 banks are under the appropriate rate of this indicator.

The ROE[3] of the banking system accounts for 16 per cent. Concerning G1 banks, this indicator is not calculated due to the negative result, whereas for G2 and G3 banks this indicator is 6.1 and 2 per cent, respectively.

The reduction of deposit rates had a significant effect on improving the financial result almost on all G1 banks (as dominants of Lek deposits).

We say this because the net interest result is the basic income of the banking system, which for 1999 accounted for Lek 5.1 billion profit, from Lek 39.3 million losses at the end of '98. The net interest result is positive in all banks.

The high level of interest incomes, together with the banking commission incomes have made possible that the banking

system not only affords both, the expenditures for provisions to cover loan losses (in compliance with the rules and regulations issued for this purpose) and the operating expenditures of own banks, but also come out with a profit. In view of sources of financial income and performing expenditures, the following highlights are noticed for bank groups:

1. Concerning interest income and their payment:

- While G1 banks ensured 84 per cent of interest income from treasury bill investments, 93,3 per cent of interest expenditures went for paying interests on customer accounts and deposits;
- G2 banks have ensured 36.1 per cent of their income from collection of interests on bank placements, 49,9 per cent from interests on loans, whereas 14 per cent from treasury bill investments.
- G3 banks ensured nearly 45 per cent of their interest incomes from bank placements, 24,4 per cent from lending and 208,8 per cent from treasury bill investments, whereas 87,2 per cent of interest expenditures belong to the customer accounts and deposits.

2. Concerning operating expenditures:

- nearly 4,7 per cent of financial incomes of G1 banks went for operating expenditures of banks or 2,4 per cent of financial expenditures were used for bank staff only;
- These indicators result respectively by 37.1 per cent and 14.6 per cent for G2 banks.
- G3 banks show 32.4 and 9.1 per cent result.

The above data show higher technological and staff payment expenditures in G2 and G3 banks.

3. Provision expenditures:

- In G1 banks, 180.9 per cent of income on loans goes for establishing provisions to cover loan losses;

- In G2 banks, 20.7 of income on loans goes for establishing provisions to cover loan losses;
- In G3 banks, this indicator results 10.1 per cent (there are 3 banks that have not carried out lending activity and therefore, they have not established provisions).

CONCLUSIONS

The banking system developments are closely related with the overall development of the national economy and with the development and strengthening of private companies.

During 1999 the banking system underwent structural changes in the favour of private banking activity, highlighting the privatised National Commercial Bank in 2000.

The banking system is generally investing in improving the technology, in order to impact on increasing the quality and speed of banking services, and as a consequence the number of bank customers.

The policy followed by the Bank of Albania in terms of interest rate cut on Lek deposits for state-owned banks, which is closely related to the private banks' interests in absorbing the Lek deposits, had a positive effect on improving investment structures.

In this overall framework, the banking supervision plays its role through its regulatory aspect, on-site examinations, specific or overall analysis of banks, as well as through corrective measures proposed in the due time.

NOTES

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[1] Based on the law "On the banking system in the Republic of Albania", foreign bank branches are considered equal to other banks. Either the foreign bank or its branch bear legal personality and as such they are both registered by the law court. Foreign bank branches are established as banks and consequently all requirements to them are equal to the banks. The difference for foreign bank branches lies in the fact foreign bank branches are total equity of other foreign banks which respond for the branch in the case of fulfilling capital or in case of various financial difficulties. This distinction is worth even in the structural area, bank branches have no managing boards, or monitoring committees etc., elected by themselves, they share the same structures with their motherly bank.
[2] ROA - Return on assets.
[3] ROE - Return on equity.

INITIAL PUBLIC OFFER (IPO)

Elvin Meka
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I. INTRODUCTION

The initial public offer refers to the first time selling shares of an anonymous enterprise (AE) to the public. IPO should not be confused with "Initial Offers" which imply successive selling of shares to the public.

An anonymous enterprise can perform only one IPO and many "initial bids" throughout activity.

II. PROCEDURE STEPS FOR ACCOMPLISHING AN IPO

First step: Contacting with an investment bank or a specialized intermediary acting as advisor and subscriber.

AEs, which are interested in increasing their capital through IPO, may not be seeking for investment bank services or other specialized intermediaries but accomplish them by themselves. Practically there is no act or regulation to force AEs to contact investment banks for performing IPOs.

In case of performing IPO through investment banks, both parties should agree on capital amount to be offered, sort of securities to be issued, price of securities (per unit), any specific or peculiar feature as well as the firm' expenditure for issuing securities.

Only in this case, investment banks can act as intermediaries between AEs and the public.

There exist two sorts of contracts between investment banks and AEs.

1. Firm Commitment. Through this contract investment banks agree to buy all securities issued by AE and then resell them to the public. Through this agreement investment banks are obliged to ensure the required money to AE. In this case, the risk of issuing (that is the total selling of securities) falls on the investment bank.
2. Best Efforts Agreement. Through this agreement investment banks agree to sell AE securities, recognizing no risk or responsibility on the amount of money to be earned by their issuing (in this case, the risk or responsibility of not selling securities is recognized/ held by AE itself).

FIRM COMMITMENT
Generally, IPOs are carried by more than one investment bank and this happens mainly because of the distribution of the issuing risk. In this case a trade union is formed. The trade union is a group of investors (banks or non-banks) which are interested in participating in the securities auction. Generally, the selected leader of the trade union drafts a commitment paper.

This paper serves to formalize relations within the trade union (its members) and AE (however it does not hold an obligatory feature practically). Immediately after the Securities Commission approves the AE prospect, all underwriting parties are pair of this contract, compelling them on application. Three sorts of contracts are designed to this end; subscribers' contract, subscription contract and dealers' contract.

1. Subscribers' agreement
   Relations among subscribers, the head of the trade union as well as all the cases when leader of the trade union acts on other members' behalf.

2. Subscription commitment defines all relations between AEs and subscribers (or subscriber if there is no trade union). This agreement is executed from the leader of the trade union relying on the authority granted by the subscribers' agreement.

3. Dealers' commitment defines that securities' dealers have the right to purchase a part of securities to be issued as well as the right of their purchasing on discount from the initial price established in the public offer. The amount of securities and their discount is clearly stated in the agreement.

BEST EFFORTS AGREEMENT

Once formed the "Selling board" takes care only for the selling process of securities issued by AE. Each board member, (according to the board agreement with AE, takes respective part of securities he wants to sell and makes maximum efforts to sell them entirely.

In this case: AE will earn and be satisfied with the cash yield by even the partial selling of securities. However there exists a sort of special agreement between AE and the selling board called "All or nothing" agreement. According to which subscribers agree to make best efforts possible to sell all securities issued at a certain date. All incomes are streamed in a separate account (indirectly in favor of AE). If securities are not fully sold within this date, then the money will be returned to the customers and the auction will be annulled.

Second step: Accomplishing all legal obligations for a comprehensive exhibition of the economic activity of AEs

AE(s) is/are legally obliged to perform prospect drafts. Investment banks or AEs should fill it up following all rules

established by the Securities Commission and in collaboration with it. The day AEs submit own prospect draft to the Securities Commission, is recognized as the "documentation date".

This prospect draft includes full information on what investors and professional advisors will search and hope to find so as to perform a correct assessment of assets, liabilities, financial condition, profits/losses and future prospects of AE, rights connected with securities information or additional data as well as some other requirements and standards established by the Securities Commission.

Statements of the authorized public accountant play an important role in the quality of accounting reports (tables) of AEs.

As the prospect draft is submitted to the Securities Commission, the latter is allowed of a period of time recognized as the cooling off period during which the Securities Commission examines the condition of exhibited information.

In the meantime, AE makes efforts to awake the public interest on issuing and distributing a preliminary prospect in order to publicly introduce AE and measure public interest on issuing above mentioned securities.

The preliminary prospect almost includes all prospect information. The price of IPO and the effective issuing date is not evidenced in the preliminary prospect. Both of these indicators should not be acclaimed during the "cooling off period".

The price of initial public offer is generally acknowledged on the effective date. The effective date is the date when IPOs are officially announced to the public.

During "the cooling off period", the customers should not be provided or availed of any information in addition to data included in "the preliminary prospect". There is allowed no suggestion, evidence, report, recommendation or literature on AEs.

Prior to the effective date, AEs establish a date with all pairs engaged in the process, called the "Due Diligence meeting", where are fixed and leveled all problems of the last moment emerged interim the documentation date and effective date.

This meeting generally corresponds with the date of project admission by the securities Commission. The prospect, already public available (officially distributed in public) includes all the information on preliminary prospect together with price of initial public offer and the effective date of its selling.

III. FIXING IPO'S PRICE

To fix the IPO's price, the specialized mediator needs to perform a careful and professional analysis of the following AE indicators:

1. Financial indicators

In this section, the analysis is focused on examining tables and accounting papers of AE, preliminary audited by the public certified accountant. More concretely, the focus is concentrated on the following matters:

- the accounting method applied and their effect on reporting;
- instruments;
- capital expense;
- overall and administrative expenditures in per cent to sales;
- long term debts;
- profit spread;
- own capital (the capital offered by ordinary customers).

2. Common indicators

In this section, the analysis is focused on the following matters:

- Area and period of economic activity;
- production cost;
- managers' training and experience;
- growth prospects in the geographic and technological aspect;
- Market share of AE
- Raw material suppliers;

3. Legal indicators

In this section the analysis is focused on the following matters:

- Environment assessments;
- Legal duties and legal charges;
- National, state or local legislation (favorable and discriminating provisions for AE);
- Trade marks, licenses or other equity of this kind.

After analyzing the above indicators, it is defined the necessary amount of money as well as the profit per unit of securities and is accounted automatically the amount of share holdings to be offered in public.

Herewith, there must be considered the optimum between the price and amount of securities to be issued in order to ensure satisfactory liquidity and issuing of AE securities.

Normally, a month before the effective date, AE promotion is developed by AE and the work group.

This stage is acknowledged as "road show". This is one of the most difficult and important stages dependent on the market performance of AEs. This stage consists in performing encounters with:

- High officials of subscribers. These are individual meetings even in cases when offices are not personally visited; a video cassette is generally prepared for this purpose;

- Trade union leaders;
- Institutional investors (in groups or one by one); and
- analysts.

This stage has an important role in fixing the initial public offer price and the amount of share holdings to be issued. The successive key of this stage is recognized as the key of 4 Be's.

Be trustful;
Be conservative in assessments;
Be well-prepared;
Be impressive since at the first instant.

Third step: Selling and closing of IPO

The selling process of IPO can be ordered through:

1. Selling by the Stock Market[1]
2. Bids' method

This method can be applied in two ways:

- By constant prices;
- By changing prices.

After the prospect admission, AEs are legally obliged to bid listing own shares in a written form to the stock market (the bid form has been already prepared).

The prospect draft and all necessary documentation required by the stock market are normally attached to this bid form.

After examining the bid and all necessary documentation, the stock market lists AE share holdings in case they are assessed appropriate for listing (meeting all criteria).

Trading shares further submit to all rules and procedures established in the stock market rules and regulations.

IPOs of the second method are accomplished by bank counters where every individual can bid for purchasing shares of AEs.

IPOs are considered closed after all transactions and procedures connected with transfers of shares, money and performing commissions have been concluded.

The closing session varies with selected method for performing an IPO.

Closing[2]

Closing according to Firm Commitment (first case of IPO)

In this case, the closing session generally happens one or two weeks after the effective date. This interval is generally necessary for the accurate accounting of money and to prepare the necessary documentation.

The obligatory documentation to be shown at the end is composed by:

- A paper form granted by AE, including all names and printed shares.
- Legalized certificate of the act of AE's establishment.
- A paper form granted by high officials of AE, certifying that AE has obeyed all legal duties and requirements and agrees to all steps and procedures followed until the closing phase of IPO and that no information or data material has been issued through other channels to compromise the IPO's price.
- A paper form granted by the legal representative of the subscriber, stating the final opinion of the subscriber connected with IPO.
- A paper form granted by the legal representative of AE, stating A.E final opinion with respect to IPO.

Closing according to the "Best Efforts Agreement" (the second case of IPO)

This method is generally followed for small issuing. In general, this kind of bid has a selling interval 60-120 days beyond the effective date.

In this case, the closing interval for the "Best Efforts Agreement" is evidenced in the front page of the prospect and in specific paragraphs.

In the stage of closing bid, the subscriber and any member of the trade union has the right to draw all the money deposited in a separate account after selling (not directly in favor to AE). In conclusion, the legal representative of the trade union submits a closing memorandum which states the closing process and specifies pairs to be equipped with original documents and their copies. All pairs are must sign the memorandum.

A certificate which asserts that all underwriting representatives are employed by respective enterprises and exert listed functions is also attached to this memorandum. The public certified accountant of AE delivers a paper underlining that anything is in tune with rules and regulations. The documentation to be presented in the end:

- A paper granted by AE or its agent including all share holders' names and their printed share holdings.
- The legalized certificate of AE's founding act.
- A paper form granted by high officials of AE certifying that AE has obeyed all legal duties and requirements and agrees with all steps and procedures followed up to the closing phase of IPO and that it has issued no information or material through other channels to compromise the IPO's price.
- A paper granted by the legal representative of subscriber stating the final opinion of subscriber connected with IPO.
- A paper from the legal representative of AE stating its final opinion with respect to IPO.

The closing process is followed by these reliable individuals:
- AE, executive director, head of finance, head of accounting

and the head of the legal department.
- The subscriber; executive director
- A representative of investment banks' trade union (subscribers) and its legal representative.
- The bank holding this specific account: executive director, head of finance, accounting and legal department.

This bank supervises the purchase, shares' transfer as well as records all movements, share certificates according to their holders and respective sums deposited by them in a separate account.

IV. IPO ADVANTAGES

Securities issuing (shares) through IPOs show some advantages where the most important are the following:

- The "unrestricted" use of funds
Incomes earned from IPOs can be used for various "broad" scopes such as research and development, purchase of imobiliaries, plants, machinery and equipment, raw materials, reduction of current debt, increase of circulating capital etc enough to comply with paragraph "use of incomes" established in the prospect.

- Compensation instruments
The fact of performing an IPO on an AE included an excellent strategy of compensation to attract and hold skilled managers and employees.

- Improvement of financial condition
Selling initial public offer adds up to the net value of AEs and improves their borrowing capacity. If AEs have good market performance then other additional funds can be raised on more favorable conditions, enabling increase of investment alternatives on curtailed expenses.

- Buying monitoring frameworks
Funds earned from IPOs (but even from other bids) can be

used by AE to purchase other AEs shares traded publicly in the stock market, enabling it to buy above mentioned frameworks on no need to borrow or sell own assets.

• Prestige

Becoming public on more available information even through publicity and press exposures, AEs and their products, marketing and business opportunities are multiplied. Therefore, an AE becomes more noticeable and its image remains in the eye of business community. Many customers prefer to make business with an AE whose indicators are publicly acknowledged.

• Accounting and delivering the real market value and liquidity

When an AE is made public its share market is automatically established, by allowing its shareholders the possibility to account the market value of the shares they are holding and ensure investment liquidity (selling shares) at any moment according to their needs.

V. CONCLUSIONS ON IPOs

From the stock market viewpoint, there is no essential distinction in performing a public bid (even if it is an IPO) on a private AE or privatization of state-owned enterprises, through the stock market, being even of a strategic character. This is because the procedure for listing and trading shares in the stock market is not similar.

The duty schedule presented further below includes all persons, committed for performing an IPO, and their respective duties (responsibilities) in this respect.

DUTY SCHEDULE

Stages	DUTY	Liable Person
Initial	Contacting counselor firm resuming the responsibility to prepare A.E for IPO Contacting public certified accountant (PCA) Contacting legal expect (LE). Contract between pairs or above persons on respective duties.	MPE&P
Preparatory	The preparation of A.E for privatization as on public offer: - A.E establishment as on public offer; - assessment of overall indicators; - assessment of legal indicators; - assessment of financial indicators; - prospect (and preliminary prospect) drafting; - Collaboration with Securities Commission. Documentation of SC.	MPE&P PCA, LE
Assessment	The assessment of initial public offer. Fixing IPO's price 1.Fixing capital amount; - analysis of all indicators; - due diligence date - road show - measurement of interest rate 2.Fixing the amount of shares to be issued 3. Determining the selling method.	MPE&P/PCA/LE (Consultant)
	PROSPECT admission (Cooling off period).	SC
Selling and closing session	Admission and management of bids. Partly or whole return of money to unsuccessful bidders. Price fixing. Securities dissemination. Necessary documentation.[3]	BoA, (Tirana Stock Market) Brokers; LSHA; MPE & P PCA; LE

MPE&P – Ministry of Public Economy and Privatization
PCA – Certified public accountant
LE – Legal expert
SC – Securities Commission
LSHA – Listing shares Agency

Duties and liabilities on Tirana Stock Market (in case of selling through stock market).

On the entire process, Tirana Stock Market has following duties and liabilities.

- Listing admission
- price fixing and distribution of securities (last stage)

LAST CONSIDERATIONS

Privatization by Stock market in addition to above mentioned theoretical advantages would serve for:

1. fixing a transparent price of AE shares;
2. reducing possible corruptive elements in the process of privatization;
3. attracting and immediate materialization of foreign investment in Albania;
4. saving time and reducing bureaucratic procedures for their enlistment by the Tirana stock market;
5. increasing and facile fulfilling of their capital claims (in rather larger amounts unaffordable by a single bank in Albania) through the stock market;
6. Further institutional development of the Tirana Stock Market and above all, the formality and initial procedure for the real capital market in our country.

NOTES

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[1] For further details see section V, IPO conclusions.
[2] "The Closing Session" is a meeting participated by all parts engaged in performing offer and it is generally held 3 or 4 working days after the selling session of securities. This period allows the contractors the possibility to collect funds from their customers. The meeting purpose is to exchange papers, certificates, checks or different bills. During this exchange, the contractor gives a check to AE. for all the funds collected by selling the offer after discounting the contract expenditures (commissions).
[3] The official trade in the secondary market of AE shares begins with the termination of this stage.

FINANCIAL INTERMEDIATION COSTS FOR 1999

Suzana Kodra*

Commercial banks are financial institutions which accept deposits from broad public and provide credits to different sectors of the economy. The mobilization of savings from temporary free financial asset units and their movement towards credit requiring units through the commercial banks' assistance is another form of indirect financing recognized as intermediation. Intermediation activity bears its own costs.

Accounting and analyzing the spread between posted deposit and lending rates is referred to as an assessment of intermediation costs. The spread between deposit and lending rates should be at the level that reflects the risk, normal operating costs and profits.

An assessment of intermediation costs is particularly important for the Albanian banking sector, which has newly stepped in the process of state-owned banks' privatization. Additionally, the data on the intermediation costs can be utilized alongside other macroeconomic factors in setting interest rates on Lek deposits.

High intermediation costs are usually associated with inefficiency, lack of competition and other factors that would increase the spread. There are two different methods of measuring the intermediation costs of the banking sector[1].

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The first is calculated as a difference between the average weighted interests on Lek investments (new credits and treasury bills purchased in primary auctions) and the newly posted deposits of the banking sector in the domestic currency (method 1. is also referred to as *ex ante* spread), whereas the second method utilizes the financial result data (method. 2 which is also called *ex post* spread).

The application of both methods allows us to create a view on the level of intermediation costs and the dissemination of the newly entered resources in the banking system.

The coordination of both methods is made to disallow banks' coverage of poor performance, concerning the past due and lost loans which would be included as relevant data of this interval, ignoring the current situation of banks.

METHOD 1

The first method is based on the difference (ex ante spread) between average weighted rates on new deposits in Lek[2] and the treasury bill and new credit investments of each bank within a month's interval.

The same method also finds application to the whole banking system.

The spread between average weighted rates on Lek investments (new lending and treasury bills purchased in primary auctions) and the newly posted deposits in domestic currency of the banking sector during 1999 oscillates between 9.24 - 11.87 per cent values.

The most accurate assessment for the spread is provided by its average level from 1996 until 1999, as quarterly and annual average.

Table 1 The average spread (in percent)

	Q1	Q2	Q3	Q4	Annual average rate
1999	9.94	11.20	11.54	9.95	10.65
1998	13.18	15.02	14.09	13.02	13.83
1997	17.67	18.64	12.66	15.83	16.20
1996	15.26	17.24	20.46	21.83	19.70

From the comparison of data over years, year 1999 results with the lowest average spread either per quarter or annually.

The running process of banking reformation and other financial reformations concerning the money and capital market development, as well as other operations, which enhance the competition amongst market participants, would lead this interval to developing countries' values, approaching to the level of developed countries.

Chart 1 The interval between average weighted rates for bank deposits and loans
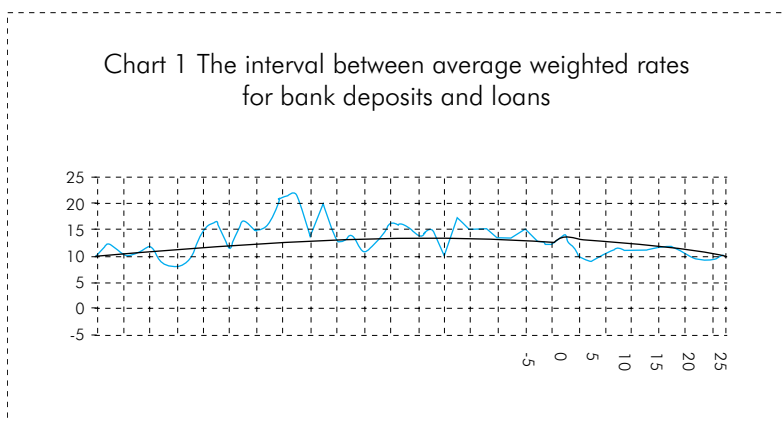
Onward, we will perform an analysis of all factors, affecting spread, which would indicate, whether this banking tendency observed on 1999, came from the good operation of banks, or from the effect of factors unaffiliated to it.

A. The average weighted interest on the newly posted deposits in domestic currency for years 1998, 1999, has been concisely presented as in the table below:

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Table 2 The average weighted rate on new deposits (in per cent)

	Q I	Q II	Q III	Q IV	Annual average rate
1999	11.22	9.23	6.98	5.86	8.32
1998	20.37	16.35	12.31	10.56	14.89

The average weighted rate on the new deposits[3] in domestic currency has been significantly falling from one year into another, from one quarter into the other, reaching the average from 14.89 per cent in 1998 to 8.23 per cent in 1999.

The change in the average weighted rate on the new deposits in domestic currency over this period was affected by:

A. I The changing level of interest rates on Lek deposits

The constant decline in the level of annual inflation, from 8.7 per cent at the end of 1998 into - 1.0 per cent at 1999-end made the level of interest rates on Lek deposits remain positive in real terms and at high limits.

This fact and the positive effect of other factors provided the conditions for the six times decline in the level of obligatory minimum on the three types of time deposit rates during the year, (7.5 per cent on 12-month deposits and 7.25 per cent on six- and three- month deposits).

The reaction toward reducing the obligatory minimum by state-owned banks, followed by non-state ones affected the decline of the average weighted rates on Lek deposits, providing *positive effect on cutting banks' costs.*

In addition to the interest level on Lek deposits, the changing interval was also affected by:

A. II. The change in deposit structure

The data are on quarterly and annual average.

The effect of the *new credit structure, in Lek,* is insignificant in this change.

Table 3 The monthly average of the newly posted deposits in Lek, (in millions of Lek)

Deposits	T1	T2	T3	T4	1999 Year	Year 1998
12-month	4.007	4.039	3.144	2.486	3.419	4.298
6-month	1.578	1.260	1.236	1.078	1.288	895
3-month	11.884	13.308	12.874	12.238	12.576	9.756
Total	17.469	18.607	17.254	15.481	17.283	14.949
Current accounts	9.738	15.072	16.760	18.044	14.903	11.178

The newly posted deposits in time and current accounts during 1999 have been higher than in 1998. Only in 1999, time deposits had high growing rates each quarter and in the fourth quarter there was noted a decline in the level of the newly posted deposits.

The reverse happened with the new posted deposits in current accounts. These accounts had a constant growing trend each quarter, doubling their level in the fourth quarter compared to the first. Passing higher budget expenditures by different business accounts of private and public companies affected the high growth of new demand deposits in the fourth quarter of the year.

Their growing share to the total of newly posted deposits affected decrease in their average weighted rate, effecting reduction of bank costs.

The new structure of time deposits viewed by quarters of 1999 had almost a stable tendency in three-month deposits and a declining share of newly posted deposits of three- and six-month term.

However the highest decline in the newly accepted deposits is noticed for the 12-month ones.

Taking into account the private banks share to total new deposits, we note that this banks have increased their new deposit share against the total each quarter, moving by Lek 1,2; 3,5; 2,7; and .5, 4 billion, or 4.4; 10.4; 10.9 and 13.4 per cent respectively for quarter I, II, III, IV.

New bank investments in the system reflect a decline in the average weighted rate on the banking system from quarter to quarter as well as on each quarter of the year 1999 compared to 1998.

The average interest rate on performed investments had a constant declining tendency. As annual average it decreased by 9.75 per cent compared to 1998.

Table 4

(In per cent)

	Q1	Q2	Q3	Q4	Annual average rate
1999	21.16	20.42	18.52	15.81	18.97
1998	33.55	31.37	26.4	23.59	28.72

Let's see the factors affecting this decline, according to their effect.

B. I. The structure of bank investments according to their risk exposure would be as estimated below:

Table 5

(In millions of Lek)

Items					1999 Year	Year 1998
	Q1	Q2	Q3	Q4	Year	1998
Lek credits	152.49	388.20	553.13	547.38	410.3	18.93
Treasury bills	9689.58	10001.74	9905.73	13848.64	10861.31	10512.07
New investments	9842.07	10389.94	10458.40	14396.02	11271.61	10531.0
% of loans/ investments	1.55%	3.74%	5.28%	3.80%	3.64%	0.17%

This year, Lek credits have been mainly issued by Tirana Bank, the International Malaysian Bank, the FEFAD Bank and the Alpha Credit Bank. The main share is occupied by the FEFAD Bank and the Tirana Bank. The main lending tendency is from 6 months to one year or over three years.

Compared to 1998 the change in the investment structure by risk exposure was with respect to the new credit share in domestic currency against the total investments. Although not

so underlying, this tendency indicates that banks have started to increase their credit amount in Lek.

The liberalization of credit ceiling at the end of 1999 will release banks from the previous "psychological barriers" for meeting the demand for credit to the domestic economy. This and the liberalization of time deposit rates in Lek will further grow the role of market forces in the effective extension of credits to the economy.

The abrogation of credit ceiling and the increase of deposit rate flexibility in domestic currency will lead to improved allocation of financial resources.

Although credit to the economy was higher than in previous year and the advantage of treasury bill[4] investments had a growing tendency, *treasury bill investments still continued to occupy the main share.*

In the new deposit aggregate, treasury bill investments of primary auctions occupy 35, 30, 30 and 42 per cent per each quarter, respectively.

Private and joint venture banks have increased their participation in the primary auctions of treasury bills compared to 1998. These banks' investments in treasury bill auction per each quarter of 1999 was about Lek 1.7; 1.2; 1.2 and 1.7 billion or 17.7; 12; 12.1 and 12.3 per cent (on discounted value).

Notwithstanding the growing number of primary market participants and the volume in which the private and joint venture banks generally participate in the primary auctions, it can not be pretended that the market competition between the demand and supply is decisive for the treasury bill yield. The monopoly position of the Savings Bank, which is also the main investor in the market, leads to deformation of this definition. The changing position of this bank will put participant banks of the system on equal competitive positions in setting a real market rate between the demand and supply.

B.II. The effect of treasury bill yield

The change in time deposit rates in Lek in the state-owned banks should be normally accompanied with a change in the same direction of the treasury bill yields of equal maturities. And so it happened practically. The six times cutting of deposit rates during 1999 affected on the reduction of the yield, which at year-end reached the lowest level, at least since 1996.

However, reductions of treasury bill yields have not been instantaneous and on the same levels. This led to a temporary increase of their spread and deposit rates. The spread behaviour was variable on different maturities. So, notwithstanding the change taking place during the year, the spread between the treasury bill yield and the time deposit rates of 12-month maturity maintained the same levels either at the beginning or at end of the year.

Whereas, we note a growing spread on three- and six-month maturities compared to the year start. Moreover, the three maturities reflect a growing spread tendency between the treasury bill yields and deposit rates. However, this spread is more highlighted for the 3-month maturity. In absolute figures, highest spreads are found for the 12-month maturity. Chart 2 Illustrates what we mentioned above.

Chart 2 The difference between the treasury bill yields and deposit rates
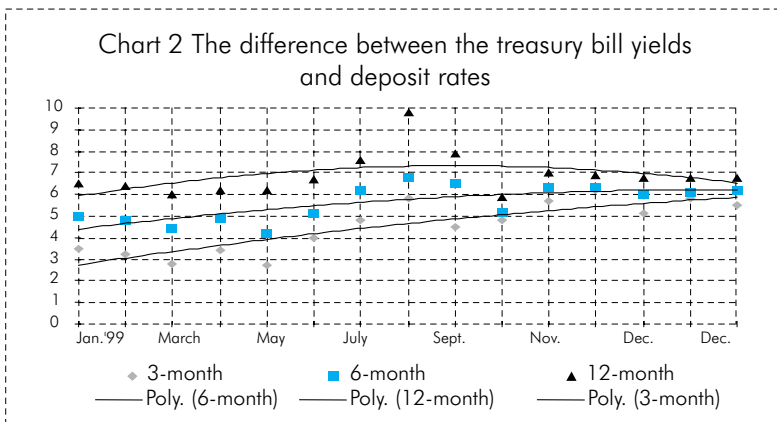
The falling rates are higher in average weighed interest for investments than in the newly posted deposits in domestic currency.

The narrowing spread in 1999 indicates that banks aimed at reduction of financial intermediation costs throughout their activity, endeavouring maintenance of the lowest spread they had since 1996.

Table 6

(In per cent)

Year	Investment annual average rates	Deposit annual average rates	Difference (in per cent)
1997	32.05	15.85	17.38
1998	28.72	14.89	13.83
Annual change	-3.33	-0.96	
1999	18.97	8.32	10.65
Annual change	-9.75	-6.57	

Finally, the 1999 spread has been significantly narrowed compared to both years included in the comparison. This spread level compared to its moving levels for developing countries is 3- 4 times higher whereas for more developed countries it is 3-5 times higher.

Existence of a some times higher spread than in the developing countries is an aftermath of the high operating expenses of the banks and the insufficient competition in the financial sector, etc.

METHOD 2

The second method (otherwise called *ex post spread*) consists in the assessment of the financial result of banks and the system through the level of interest, gross and net margins.

According to the second method[5], based on the bank financial results for 1999, the banking system appears with better indicators on gross and net margins than in 1998.

As appears from chart 3, *ex post spread* in monthly averages either on gross or net margins remained positive mainly in August.

In the table below there are provided monthly averages of *ex post spread* on interest, net and gross operating margins either quarterly or annually:

Table 7

(In millions of Lek)

	Q1	Q2	Q3	Q4	1999
Interest margin	47.6	287.8	504.9	891.1	432.8
Gross margin	200.6	269.4	625.4	948.8	511.0
Net margin	45.6	-17.1	373.3	651.2	263.2

The fact that the monthly ex post spread of interest margin had a quarterly increase indicates that the banking system had growing tendency in terms of interest collections compared to their expenditures. From an average monthly spread of Lek 47.6 million of interest margin in the *first quarter*, it reached to Lek 891.1 million in the *fourth quarter*.

With some exemptions, all other operating incomes had a growing tendency, bringing increased average monthly ex post spread of the gross margin from one quarter to another. After discounting the operating expenditures, the level of net margin movements within the system, excluding the second quarter, remains positive on average monthly levels. The increase of their monthly spread in the third and the fourth quarter was an aftermath of the growing interest collected from other operating incomes, while the operating expenditures of commercial banks did not recognize significant change during the year.

The calculation of the above indicators per specific banks in the system reflects improvement of these indicators for 1999.

From the above analysis, we could say that the banking system during 1999:

Chart 3 The flow of net and gross margin movements within the system
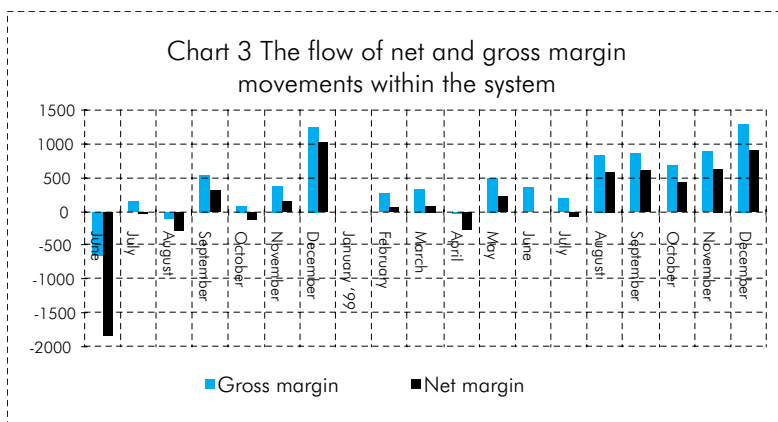
- recognized the lowest annual spread between the average weighted interests on Lek deposits and new investments. However, this interval is 3-4 times higher compared with developing countries and 3-5 times higher compared with OCDE countries;
- the narrowing spread indicates that participating banks of the system have aimed at reducing the intermediation costs throughout their operation, endeavouring maintenance of the lowest spread they have ever had;
- financial result indicators of commercial banks, each specific bank of the system and the entire banking system in general reached the highest indicators for the first time;
- despite their growing tendency compared to 1998, investments in economy occupy an insignificant share against the treasury bill investments.

Under the circumstances, when the current performance of the financial system does not enable the mobilization of resources through other market forms and the treasury bill yields show a high level, a similar investment type of Lek liquidity has facilitated banks' operations in terms of facing the costs of deposits in Lek.

On the other side, this does not serve as a promotion for banks' research in the management of Lek liabilities, undertaking the risk.

Transition to indirect monetary policy instruments – development of the financial market, - the growing cooperation between banks, - the increase of financial discipline, - the improvement of payments system, - clearance of the balance sheet of state-owned banks from assets not bearing market interest, - the privatization of the Savings Bank and other reformations of the banking system will promote competition, maintain the financial stability and help in setting optimum spreads between deposit and investment rates, where financial intermediaries should be moving in order to fulfil their operating expenditures and achieve optimum profit.

The money market deficiency, bad loan portfolio and the current operating expenditures of commercial banks provide lower average rates on new deposits and higher average rates for new investments.

NOTES

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This material has been prepared with data from the second-tier banks, reported to the Bank of Albania according to the international standard methods for assessment of the average interval. The data accuracy depends on the quality of information and the Bank of Albania is not responsible for any deficiencies in the reported data.

[1] These both methods utilize the data reported by the central bank, whereas the commercial banks have additional methods to be oriented by the management of funds, different risks, etc.

[2] New deposits include new deposits posted by the commercial banks over a certain interval (a month) - here is included the reinvestment of deposits matured interim the period.

[3] The average weighted interest on new deposits in Lek is the product of the amount of the newly posted deposits by each term and the applicable interest rate against their total.

[4] The risk of return is zero.

[5] The data have been taken from the monthly table of operating income and expenditures prepared by Supervision Department. The financial result includes Lek and foreign exchange operations.

ENHANCING TRANSPARENCY IN BANK OF ALBANIA'S ACTIVITY

Teuta Baleta
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Adriana Meko*

I. INTRODUCTION

In November 1999 the Bank of Albania's Supervisory Council approved the medium term strategy for the institutional development of the Bank of Albania. "Public awareness" was ranked amongst the principle strategic targets of this document.

"Public awareness" as a specific target on its own is planned to be achieved through the quantitative and qualitative enhancement of public transparency. As a manner of behaviour and world out-look the increase of transparency contains two principle elements. The first is the observance of the public right for information. The second is the increase of Bank of Albania's responsibility for achieving the principle target of its activity.

This target implies not only a re-conception of institutional relations between the central bank and the public but also an engagement of all central bank structures to achieve contemporary rates of transparency.

In view of this attitude, some principle steps were taken into consideration in order to initiate this process:

- Drafting and approving a regulatory platform inside the Bank of Albania, based on the Constitution and the effective laws;
- Establishing and adopting individual or collegial structures to serve the laws, rules and regulations whose scope is transparency enhancement;
- Awareness of Bank of Albania's employees of the significance of transparency enhancement, so that their commitment to this "new task" is as natural as possible;
- Indirect awareness of the public.

This article is in view of enhancing the transparency. It is also intended to assist the public audiences and the Bank of Albania's employees in better understanding their right for public information and Bank of Albania's transparency.

II. WHY IS TRANSPARENCY NEEDED?

Transparency is currently getting ever more space in public discussions and institutional life. International institutions, mainly the IMF, have already prepared standards of being transparent. This became ever more underlying after the sweeping crises of the South-Eastern Asia and the incorrect signals given to this region by the way the information was reported. Thus, we are living in an epoch which has already assimilated the philosophy of transparency. This is one more reason for Bank of Albania to stride along a general model.

On the whole, the term "transparent' implies being clear and easily understandable, identifiable, open, straightforward and sincere to allow penetration of light. From this viewpoint, "the enhancement of transparency" in Bank of Albania's activity implies publication, information, explanation of Bank of Albania's policies and procedures, targets and opinions, which should be first announced and allowed for knowledge; second, they should be clear and easily understandable; third they should be open and not confidential; and fourth Bank's actions should be sincere and fair. Transparency indicates how

much opened the Bank of Albania intends to be, primarily in its monetary policy and activity.

Second, the enhancement of transparency promotes accountability in central bank's activity. Its activity is subject to a public debate and possibilities of confrontation are created to understand how fair the decisions have been made or the policies have been pursued, whether they should be corrected or not, and where, when and how.

Third, the enhancement of transparency with other state institutions helps coordination of policies and activities and promotes consultation.

Fourth, the enhancement of transparency, especially with the media and the public audiences increases the degree of knowledge on the Bank of Albania as an institution and provides it with the opportunities to grow its own influence and authority even on other state institutions.

Fifth, the enhancement of transparency will also serve another purpose, that of "education". For many reasons, the media and public audiences are less accommodated with economic issues. In case the public information and the simplicity of providing it increases, assessment on economic policies and decisions will become an indivisible part of the activity of these groups, of businesses and economists, will discipline their economic behaviour and will orient them. In the long run, this helps the Bank of Albania build and set into efficiency the transmission mechanisms of its decisions into the economy. If nobody understands why a certain decision is taken, no decision is guaranteed for its future success and the signals received by the central bank and the economic environment will be distorted, thus making other decision-making difficult.

Finally, the enhancement of Bank of Albania's transparency will lead to change of mentality and tradition of "keeping secrets" and "the monopoly of information" or "the power on information".

III. TRANSPARENCY AND THE RIGHT FOR INFORMATION

To understand the target of transparency it is important to clarify that transparency is an obligation, not a right. Transparency is directly enforced by the public right for information on official documents.

The right to get informed on official documents is one of the essential human rights in a democratic society and legal state. This is a basic right for democracy. And it's through this that public audiences exert their power to assess the level of governance of a public institution. Only a well-informed public has the capacity to appropriately perform its duty to render its contribution to a country's democracy and to give the proper form to public administration.

In modern democracies, the public right for information is instrumentalized in two directions. First, the public constrains, through the legislator, the executive and judicial powers to not censure the information. Second, it is the legitimacy of individual research, of information collection and analysis by individuals, acknowledging them the right to get informed on official papers of various types.

The right of information on official documents enjoys legal and constitutional protection in many countries with a developed democracy. Its guaranty and regulation modes have the Constitution as the highest level, whereas legally this varies in three main directions;

a) Countries sanctioning it by separate laws;
b) Countries ensuring it through different acts such as on mass media, elected organs, administrative procedures etc;
c) Countries formulating in a law the right for information and the right for personal rights protection.

The United States of America, sanctioning the legal obligation of information, have played an important role in

transforming the American public administration and in making it a real transparent administration. Consequently, the American jurisprudence on the right for information has been considerably developed, affecting directly the quality of service of public institutions.

The spirit of transparency philosophy and the right for information has been conveyed even to Europe, though it is not as dominant as in the United States of America.

Some member states of the European Union have approved legal acts to directly regulate this right through private initiatives.

Other countries have achieved it indirectly through specific acts and furthermore through rules and regulations. The European Parliament and the European Council, based on the European Convention of Human Rights, have approved some acts to support this human right, such as recommendations on adopting them in the legislation of member states.

However, in no case the individual's liberty is absolute. It is relative, since it is restricted only to public interest and to guaranty the thirds' interests. The Law No. 8417, dated 21.10.1998, Article 17 sanctions these two cases as the only occasion when the information right is restricted. It is also important to mention that the restriction in both cases must be made by law only, (currently, by the Law No. 8457, dated 11.02.01999 "On official confidence" and the Law No. 8503, dated 30.06.1999 "On the right to get informed on official documents").

The Albanian Constitution is based on international principles of human rights. Based on this, Article 23 of the Constitution guarantees the right for information on the institutional activity of state organs, classifying it as a fundamental right. As sanctioned by the Constitution, this right is regulated by law. In fact, the legislation in implementation of the constitutional right for information can be found in two separate laws, practically, in the Code of Administrative Procedures (Article

51 and 55) and in the Law on the right to get informed on official documents.

The provisions of the Code of Administrative Procedures and of the right to get informed regulates the relationship in the cases when any administrative proceeding is taking place, directly related to any individual. When an individual is part of an administrative proceeding, especially when there is a prosecution or a handling of private data, the right to get informed is ensured even by the Law on safeguarding private data, which in this case does not act as a restriction but as a guaranty of this right. The provisions of both laws establish also the time schedules within which interested persons should get informed. In both cases, the information of interested persons is made on the presumption that they do not have and can not have knowledge of the fact that they or the data related to them, have become part of an administrative proceeding. In this regard, it is clear that the legislator is interested that the right of information can be automatically enjoyed, even in the cases when there is no specific request for obtaining information.

The Law on the information right for official documents is not only an accomplishment of the code for administrative procedures, but a further development of it, as sanctioned in Article 23 of the Albanian Constitution. Through this law, the legal, practical and procedural base for the application of this right is established. On one hand, this law makes the public aware of the ways and modes to enjoy the constitutional right of getting informed. On the other hand, the law indicates to the public administration the way of working in order to be as transparent as possible in its activity.

IV. HOW DOES THE BANK OF ALBANIA INTEND TO ENHANCE ITS OWN TRANSPERANCY?

Perhaps, as to begin with, it is in place to make a small intervention in order to clarify for the first time "officially" that genuine communication is merely a relationship in the long run

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and as such, it requires at least two agreeable parties in principle, which should be equally willing to reciprocally benefit from and respect one-another. One party should appraise the Bank of Albania's commitment to increasing its transparency; esteem the actions undertaken by the central bank and not endeavour to speculate with them (particularly in media). This needs also the proper time for establishment. However, if confronted with the correct attitude of the central bank, surely its reaction will be ever more serious. We believe that this is the first prerequisite to have a basis on which the relationship will be set up, which in our case is called communication.

Further continuing with this simple abstraction that we have tried to use for supporting our argument, we should not forget that any kind of relationship which is born, grown up and located inside a certain reality is forced to meet with a certain mentality; become part of this opinion that in the best occasion precedes a new dimension in the existing world out-look.

In the current case, the Bank of Albania's relationship with public audiences is an utterly new phenomenon, for many reasons. Firstly, and most important, is lack of tradition. It's already known to all that Albanians have been bank attracted in this recent decade. So, they had no need to know what a bank was, and how to go there. Less were they interested to know "its jargon", the services it can offer, the guaranty it provides or the physical accommodation it provides in money movements. And all this was never for their fault.

Secondly, is the degree of bank affinity demonstrated against them until lately. Initially conceived as genuine institutions of the state, the only banks inherited from the socialist economy continued to stay remote from their customers and individuals, who already had a pressing need for bank service, information, support and guaranty. Their "drowsiness" was coupled with a remarkable indifference of foreign or joint venture banks licensed over these years towards the Albanian business and customers. As frequently taking place in the theory and practice of these cases, the vacuum spaces are always filled up with

what's simpler from the reality. The simplest thing offered by the Albanian reality, largely besieged from the desire for easy and quick earnings and the tendency toward financial adventures of the newly shaped stratum of businessmen, was the pyramid scheme phenomenon.

As any tremendous overthrowing of confidence based on lucky lotteries, even the termination of the "golden pyramidal scheme epoch" was more than agonizing for Albanians. This moment should have been better exploited by banks to occupy the place they deserved in the economy, in business and in the Albanian financial opinion. Thus, we have come to another issue, that of the mentality, where for facility we will include at the same time the common public (which is normally our interlocutor) and the bank predisposition to be open and sincere.

Given the above reasons, it seems that the biggest difficulty lies in the formation and the economic culture of the Albanian public. In order not to hide endlessly behind the past and to take the courage of the most sagacious in taking the share of fault belonging to us, we should accept that the greatest difficulties lie in the "overthrowing" of the world out-look, which should be first of all conquered inside the institution.

To be open throughout its activity, the Bank of Albania transparency against public audiences should be regarded as a basic necessity that can not be tolerated either by its management units or its staff. This is so because the experience has shown that when such a delicate problem is simultaneously an important one, the engaged persons are the sceptic ones, who doubt its success and the result is always shaky. The one that doubts in the usefulness of what he's performing can convince nobody of what he says.

The practical steps that the Bank of Albania has decided to undertake in this regard take into account the satisfaction of all interested strata for the moment. We say for the moment for several reasons which are not a subject matter of this article. The information and education gap should be filled up

by the common investment of all banks currently operating in the Albanian banking system. What really happens is utterly second-tier bank indifference against conspicuous deficiencies in education.

Sparing the details, we have all the reasons to believe that what bears upon the Bank of Albania is more than that, and it's in its honour to play the leading role in this "neglected" obligation so far, that of the bank institution against domestic audiences.

This is one of the barriers to be overcome to utterly change it, which quite well could be called the current banker's opinion. It would be fair to talk about a new stratum of bankers and their civilized opinion. We can not officially assert it, because unfortunately, we have been lacking such a one so far.

To be availed of bankers official opinion means to have a public pronouncement (written and verbal) from the most outstanding bank authorities, a public explanations for the followed policies from the most successful managers, a competent and professional technicians giving public certainty for all financial phenomena they comprehend or not; in other words to have transparency in decision-making and communication in the entire chain of the banking system. At least this has been the similar practice until lately. These things have recognized incipience in elementary forms. The end of the calendar year marked some Bank of Albania's Governor appearances before the Parliament, various press conferences or meetings of conversing character. What is targeted has to do with the successiveness of the phenomenon.

To be more successful in its engagement, the Bank of Albania has processed a simple and a very comfortable strategy, which will release certainly notably positive results consequently.

What's to be achieved is already known. How to realize it remains to be explained further below. The Bank of Albania will apply the classic forms of communication: verbal and written.

The first consists in the presentations before the Republic of Albania's Parliament and the Parliamentary Commission of Economy and Finance press conferences, presentations before electronic media, participation in conferences or other activities. The written communication consists in publications, press conferences, written interviews and articles. So far, the Bank of Albania has not missed such kind of activities. However, drafting a regulation on transparency ensures their well-functioning and organization. The arrangement of a Press Office and the provision of appropriate environments for holding press conferences is a Bank of Albania's prerequisite. Based on the importance that a similar unit represents a central bank, the organizational structure approved in the meeting of the Bank of Albania's Supervisory Council of October 4 includes a similar office.

The other side of the process is the enhancement of Bank of Albania's transparency throughout its activity. According to the performed estimation, it is concluded that Bank of Albania's reporting and explanation through processed standards for transparency practices of the monetary area compiled by the IMF until now is unsatisfactory. This weakness is anticipated to overcome through the following steps:

IV. I ENHANCING THE TRANSPARENCY IN SUPERVISORY COUNCIL'S ACTIVITY

This point is worth being dealt in detail, in order to explain it as a new phenomenon of collective decision-making in our country. Elected by the Republic of Albania's Parliament, the Supervisory Council is responsible for the decisions it takes whether collectively or individually. The publication of these decisions and the way they are decided, the calendar of its customary meetings or a summary of these meetings' protocol is neither an excessive nor a courageous requirement. On the contrary, it is an accomplishment of a civil and professional duty and an indicator of the fair understanding of individual responsibilities in the collective decision-making.

IV.II ENHANCING TRANSPARENCY IN MONETARY POLICY, MONETARY OPERATIONS, BANKING SUPERVISION, LEGAL AND REGULATORY FRAMEWORK AS WELL AS IN ACCOUNTING AREA

Practically, an enhancement of transparency in Bank of Albania's activity is required, highlighting its main activities, its policy and monetary operations.

Information will be provided on various issues, such as:

- Announcement of targets, policies, decisions, procedures and changes they suffer;
- Explanation of targets, policies, decisions, procedures and changes they suffer in plain and clear language. We will always try to find an answer to the following questions: "Why was it done?", "Why now?", "What is expected to change; or what is its forthcoming effect?"

In the same way, the increase of Bank of Albania's audiences is required, differentiating its various categories. Therefore, the levels of providing information will include:

- The Parliament as the highest legislative unit of the state, where the Bank of Albania is legally obliged to report as the law requires;
- Other senior institutions engaged with economy or economic policy issues as the President, the Prime Minister, ministries, mainly the Ministry of Finance, that of Public Economy and Privatization, Economic Coordination and Trade as well as other international organizations;
- Significant professional users that are part of the transmission mechanism, such as banks, financial institutions, the Economic Faculty, the Faculty of Justice, businesses and embassies;
- Other users, such as the media, institutes of economic studies and the public.

To feel certain in the success of this gallant undertaking of the Bank of Albania and in the name of transparency in

communicating with the public, each of the above steps should be accompanied with increased collective awareness of Bank of Albania's specialists and managers.

Three additional elements that will enhance the Bank of Albania's transparency are:

1. Opening the library. This implies the public opportunity to exploit the fund of Bank of Albania's library.
2. Opening the archive. It is a process that acquaints the public audiences with the history of Bank of Albania's relations with other institutions, makes transparent its institutional experiences and the decisions taken in the past.
3. Publishing a phone book. It synthesizes a manner of Bank of Albania's communication with those interested for information. The Bank of Albania should draft a phone book, including the name of the official, the unit he works for, the area he covers for which he/she may also provide answers to questions and the phone number.

It was considered rationale to accompany the last elements with some clarifying sentences, for these are utterly new elements of the central bank activity and as such they perfectly complete the central bank efforts to be more clear and transparent with the public audiences, providing also the respective accommodation.

V. PRESS OFFICE DELIBERATIONS

Upon the approval of the new organizational structure of the Bank of Albania, a press office will be put into function, as in all other institutions. Based on the relevance it bears for a central bank, especially in the process of transparency enhancement, and its first time establishment, we deem worthy to render some deliberations on it. The Press Office must be able to understand the public and be understood by it. Until now the Bank of Albania has communicated with public audiences at a rather significant level and with adequate dignity, due to its various publications. In this way, it has succeeded in establishing honest, regular and

serious relationship with press and interested public audiences inside and outside Albania.

The Press Office will also provide the possibility to the Bank of Albania and its vested authority to complete the institutional, professional and civil portrait. More than that, a genuine Press Office adds up to the safety of Bank of Albania's authorities and makes them feel at ease when reading the daily press. This is so because the Press Office performs with adequate competence the role of a mediator between the institution and the media.

To fulfil the above function, it needs to harmonize at best the following features:

1. Managing the establishment of a vivid relationship with written and electronic media, just like all its homologues. In view of this, it is obliged to respond before the public by means of press conferences, written and verbal interviews, brief announcements and telephone calls.
2. Being aggressive in accomplishing its obligation to the institution for constant maintaining and improvement of Bank of Albania's image to the public. This implies having competence, audacity, capacity to react at any movement on behalf of the Bank of Albania and in its interest.
3. Being clearly positioned in the technical aspect of its duties. This means that a Press Office serves the institution, being utterly unaffected by the changes in governing programs and policies. This means that it will be operating in compliance with the laws that regulate Bank of Albania's activity and its relationship with other financial structures, either domestic or foreign.
4. Being morally decent, civilized and elegant in its public confronts. This means that in the throng of its meetings, introductions or innumerable talks with which domestic audiences are daily fed up, what the Bank of Albania makes them see in the face of its press persons and what makes them hear from their voice be more than commendatory and aesthetically processed.
5. Being ambitious for the place it should occupy in an unwritten

ranking of its homologues, a ranking that spontaneously appears in the media' preference for a certain press office. To be the best, there should be dexterity in grasping the most biting problems of the moment, far-sightedness in the anticipation of various financial phenomena and all the necessary authority to intervene when appropriate, either for clarifying or preventing various situations.

The Bank of Albania deserves to have such a structure. In addition, the Bank of Albania is an institution that deserves to be independent and possesses all the necessary capacities to be a similar one.

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MONETARY POLICY REGIMES AND BANK OF ALBANIA'S ATTITUDE

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Keywords
- Monetary Policy - Inflation targeting - Inflation-targeting regime - Dynamic programming -

A monetary policy is able to perform everything and this could evenly happen either to a sound or a fragile economy, otherwise called "economy in transition".

Irrespective of the growth rate of economy, the macroeconomic stability should be doubted evenly, if the monetary policy will constantly be expansive or whether the obtained macroeconomic indicators will be far from the established targets. The results will be obvious in the growing prices, which tend to make the monetary policy even more expansive, by establishing a vicious circle between monetary policy and inflation.

The inefficiency of monetary policy may be as a consequence of two factors:

i) Taking wrong decisions: if the policy makers provide a wrong interpretation about the achieved figures and if they are not characterized by the capability to anticipate future developments, it is only but understandable that the received decisions will lead to erroneous results, generating disfigurement of macroeconomic offset.

ii) The deficiency of an efficient monetary instrument: on the other hand, having a highly developed skill of analyst is not

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enough. You may be equipped with a fair assessing skill over a certain phenomenon and the exact programming for the future; however, if you do not possess at least a single efficient monetary instrument, the uselessness of monetary policy will be happening for sure. We made mention of these two phenomena only, because other factors related to the legal and institutional framework, the economic growth and individual features of each country have been taken for granted.

Which is the principal target of monetary policy? Actually, the consumer price stability is ever more regarded as the only target that monetary policy should comply to the strictest mode possible, notwithstanding the fact that many conjecturers are of the opinion that the economic growth, the foreign position of the country, employment and so on should be a bound part of monetary policy.

The debate remains hot even nowadays and the idea that the monetary policy should tend to a single direction, that of controlling inflation, is more dominant. The first part of this article intends to provide an answer for the above question based on the contemporary ideas on the function of monetary policy[1].

I. WHAT CAN NOT MONETARY POLICY MAKE?

Before drafting a logic framework for conducting monetary policy, it is essential to know what it can or can not make. The monetary policy on its own is the integrity of central bank operations undertaken to realize its targets.

In most of the developed countries, the most important element of monetary policy is the short-term rate fixed by the central bank to affect financial factors of economy which, on their side, have effects on the aggregate supply, consequently.

In other countries, especially where financial markets are undeveloped, the central bank effect is achieved through the

obligatory reserves and the managing control on interest rates supplied by commercial banks even on lending activity.

From a performing survey[2] on 77 countries, it has been noticed that the monetary policy is mostly practiced through the application of indirect instruments. More precisely, 60 per cent of the countries under survey use the required reserves, 48 per cent use Repo agreements and 45 per cent operate on securities transactions. Only 3 per cent, including our country use direct instruments of control[3].

The standard monetary model is based on the principle of the interest rate effect on the aggregate demand of economy. A lower interest rate elevates the required money, while the use of the excessive reserves, which hoists the aggregate demand, is more advantageous for banks; otherwise the growing interest rate reduces the money claim because the fund costs exceed the potential rate of return for banks.

Alan Blinder (1998, page 14) underlines that a rational monetary policy should begin with a target function and with a macroeconomic model at least, whose minimum requirement should be a single monetary instrument to affect the economy. Furthermore, Blinder adds that the macroeconomic model should be based on the concept of dynamic programming, which consists in the idea "think before for the decisions you are making today". This must be understood that the decision-maker should be able to find out the appropriate way that will be successfully leading him from the present to the desired future. It is precisely the compatibility of a dynamic programming, based on the tardy effect of one variable over the other that eliminates any potential failure in meeting future targets. The alternative compatibility, i.e., the static programming, the tightening or mitigating of monetary policy depending on the current inflation rate, would enforce the monetary policy be stagnant for a long time in the sense of its tightening or mitigating.

Making a summary of both approaches, Blinder concludes, "Pondering on a dynamic program is not sufficiently ingrained

in the custom of the policy makers who, frequently view outside the window and take the occasional decisions based only on the assessment of the instant situation." This basic mistake is another reason why central banks frequently maintain a stagnant policy for a long period of time.

According to Blinder, a typical example of dynamic programming is the case of the premonitory measures of the Federal Reserve in 1994, where the monetary policy was tightened before inflation was increased. However, the apparent bewilders in the case of dynamic programming is connected with the fact that in certain occasions, the tight measures of monetary policy seem to be unnecessary.

In the case when premonitory measures turn out to be successfully, inflation will remain at low levels. This would furnish the critiques with the argument that the tightening of monetary policy was unnecessary. Naturally, a perfect premonitory policy obscures some relations of monetary policy decisions with macroeconomics variables. More precisely, if inflation is maintained at 2.5 per cent rate for a long period of time, it would be impossible to discover the monetary policy effect on it (the secondary variable will be constant).

It is already known that the monetary policy control is a mechanic process of controlling money through the interest rates. The money supply may have several shocks, which enforce the emergency for interest rate changes within a rational interval. This means that the central bank is always compelled to regulate the money supply through acceptable interest rates. Even through this will initially require time, in market-oriented economies, if the control on the quantity of money is not achieved immediately, sure enough it will be achieved with the passing of time.

The debate on what monetary policy can and can not make is still going on even currently. On one side is the opinion that in addition to consumer price stability, the monetary policy should be also targeting employment and economic growth.

On the reverse side, the alternative opinion is focused only on the consumer price stability. Per irony, both opinions converge in the idea that the monetary policy serves employment and the economic growth only in the case of the consumer price stability.

Thus, the consumer price stability is a necessary prerequisite for a stable economic growth and consequently the only appropriate objective of monetary policy. The argument between both alternatives has a long history.

Actually, the balance is weighing in favour of the second viewpoint: an ever-growing number of central banks insist on the consumer price stability. The opinions on what the monetary policy can do, have been in constant change during the XX century. While, Irving Fischer (1992- the quantitative theory) concluded that the primary effect of the monetary policy was in that changes in the money amount affected changes in price rates, Keynes (1959- Radcliffe Report) found out that money role in macroeconomics was less feeble. Milton Friedman and other monetary conjecturers challenged Keynes' findings when they concluded that there is a casual relation between the money and inflation growth.

Two very important facts of this literature are related to the empirical job of Bill Philips (1958), on the relation between unemployment and change of money wage rate in the Great Britain and on the successive article of Robert Solow (1960) about the reduction of inflation cost in terms of slowing economic growth rates.

In 1958, Bill Philips demonstrated the existence of a stable relation between employment and the rate of change in money wage rates in the United Kingdom, throughout the previous century.

He used this relation to estimate the maximum of aggregate demand and the minimum unemployment rate in consistency with the consumer price stability.

Figure 1 The original curve of Philips
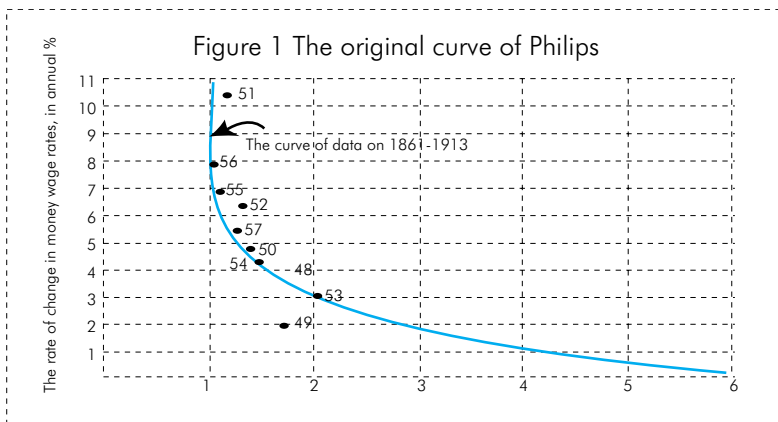
He discovered that some combinations of low unemployment rates associated with positive inflation constitute a disallowed area for macroeconomic concepts and as such they should be avoided, consequently.

Within the four years of this discovery, Samuelson and Solow (1960) capsized Philips analysis and concluded that an inflation rate of 3-4 per cent was necessary to reduce the unemployment rate at 3 per cent in USA. Samuelson and Solow introduced the Philips curve more as a relation between inflation and unemployment than as a relation between the change in wages and unemployment. This transformation was in line with Philips claim that low growth of productivity in Britain, in order to maintain the consumer price stability, allowed 2 per cent growth on the nominal wage. In other words, it was deemed reasonable to assume 2 per cent growth of productivity. Therefore, the Y-axis of the Philips diagram was repositioned on inflation rate 2 percentage points lower than the corresponding change in wages.

The combination of assumptions for a constant growth of productivity and labour force enabled Arthur Okun (1960) to deviate with a monotonous relation between growth and employment. In this way, the Philips curve was transformed from a falling into an upward curve through inflation and the

Figure 2 The transformed Philips curve 1961-1969
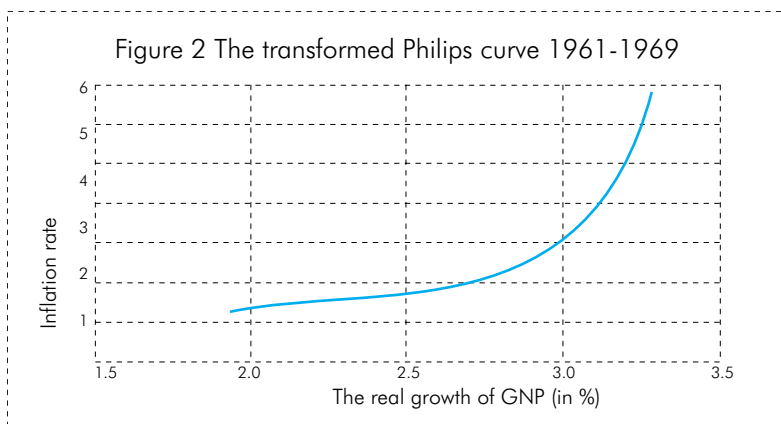
economic growth rates: a higher growth rate could be ensured by a higher inflation price. Chart 2 presents the transformed Philips curve for USA during the first post-war years, beginning with 1 per cent inflation rate and less than 2 per cent economic growth rate in 1961. For all developing countries, the Philips curve may be practically introduced in the transformed shape due to the lack of employment data.

In 60's the economic theory accepted the proportional reality of a certain type of relation between inflation and growth: a higher growth rate could be attained on a higher inflation cost. In fact, Philips (1958) evidenced that due to the insufficient action of the policy-makers to use the Philips curve relation, the original curve relation began to disappear. Therefore 10 years after discovery, the Philips curve was found under the pressure of several attacks. In fact, Philips curve disappeared within the two successive decades. From an upward curve, expressing the relation between inflation and growth, it was transformed into vertical curve, which means that the long term relation between the economic growth and inflation could no longer be confirmed, particularly, with the data collected after year 1970.

In the two recent decades, Philips curve has been twisted again, discovering a negative relation between growth and inflation for a large number of countries on no time distinction. The currently accepted idea is that in long-term periods, the relation

between production and inflation is negative: the increasing inflation is accompanied by a falling production. (Barro 1995, Fischer 1994). The negative effects of high inflation are easily noticeable in the disturbances they cause to savings, monetary mechanisms and the price structure.

There is a multitude of potential channels through which inflation exerts its positive or negative effect on the economic growth and vice-versa. In developing countries, fixed nominal interest and exchange rates might have been destabilization factors. (Fry 1995). While inflation arises, the real decreasing interest rates (a fixed nominal rate result) dampen the willingness to extend credits and skew the new credit accordance. In the meantime the export prices remain outside international markets due to the fixed exchange rate. Both effects discourage the economic growth rates.

The negative relation between economic growth and inflation in the recent years could be due to the money demand shocks on the whole world during the 70's and 80's: A left side displacement of the money supply curve reduces the quantity and elevates the price. The following years (1988-1995) were not characterized by supply shocks and in consequence, the demand vacillations affected the prices and quantity in the same direction. Moreover, this negative relation seems to be more powerful in the recent years.

Notwithstanding what above mentioned, based on what was evidenced from the developing countries and those in transition, the idea that the monetary policy could accelerate the economic growth and reduce the number of unemployed persons is not supported at any case.

II. RULES VERSUS DISCRETION

An important issue is related to the fact whether the central bank is obliged to use fixed rules or is free to use its own discretion throughout the application of its monetary policy.

Milton Friedman (1960, page 87) underlines that monetary policy decisions provide expected effects at a latter period than that of decision-making.

"There are many cases when monetary policy decisions provide their effects only after a considerable delay or a long period of time, this lag of time is, moreover variable by itself".

Since these are unexpected delays in view of time, it is impossible to achieve the desirable results through an arbitrary application of monetary policy, simply, through discretion.

Given the incomplete knowledge on the functioning mode of economy and the inappropriate measures for fighting risks on the side of decision-making authorities, it would be better for any specialist to apply one rule of monetary policy (for example: that of money growth by a certain rate), than simply base on own intuition or discretion. Only in this way, it will be enabled to avoid a pro-cyclic expansionary monetary policy.

Although imperfect, this rule could bring more stability than a simple action based on discretion.

The modern argument on this issue is more focused on the problem of time discrepancy. This argument could be illustrated by the licence case. A licence promotes development, contributing to the growth of the social welfare. Although the innovation might have happened, the social welfare would be raised only if the licensing right is trespassed, enabling the production of unlicensed products under a competitive situation. Per analogy, in the case of monetary policy, there is a thrilling motive (the growth of production) to trespass, though temporally, on the rule of consumer prices stability and to generate unexpected inflation.

The unexpected rise of consumer price rates due to the presence of the Philips curve raise the economic activity in real terms, the expansion of which, although providing utility, still needs to be doubted since the cost caused by it is still high.

On the other hand, individuals of one economy understand the motives stimulating the decision-makers and the functioning mode of economy by their rationality. So they understand that inflation rise serves the growth of production and in terms of full balance, the current inflation is correctly accelerated only on average terms. Therefore to maximize the national wealth, the decision-makers create unexpected inflation to the point when the margin cost of inflation equals the margin advantage of sudden inflation. (Barro 1986, page 16-19).

Under these conditions, the balance rate of inflation is relatively high; since it is the inflation cost on its own.

However the decision-maker can improve the social welfare, by the commitment for a low inflation rate. If this commitment is reliable, individuals will accelerate the decrease of inflation and the balance will correspond to a low and stable inflation, although on the same unexpected amount of inflation on average terms (zero), as previously.

The ability to enforce commitment is very important to ensure credibility. Under the conditions of a low reputation of decision-makers, individuals will realize that the authority's efforts to maintain a low inflation rate will result pointlessly and the maximizing policies of equity will turn the economy to the balance of flared up inflation.

Due to the difficulty to undertake serious and reliable commitments, various alternatives have been put forward to operate against inflationary deviations in the standard monetary frame.

i) A free and competitive bank activity. Only competition would ensure the public to accept commercial banks only in bidding a real competitive rate of return on deposits.
ii) Monetary Constitution, "a constitutional regime which could be changed only in main line with constitutional amendments" Yeager (1992, page 731).
iii) The safety that central bank advantages, perhaps financially

be connected with the setting and maintaining of consumer price stability.

iv) Recruiting conservative central bankers.

v) The motivation of central bankers not only based on small financial stimulus but also on inflation utility as the only scope to be achieved.

vi) Linking the central bank operation with inflation performance. Many scholars have concluded that inflation targeting[4] is the best medicine to successfully advance in the above-mentioned duality as a rule or discretion. "Enforcing a conceptual structure and internal discipline on the central bank, surely not eliminating the whole flexibility, inflation targeting combines some fixed priorities from rules with some of those attributed to discretion" - Bernmarke Laubach, Miskin and Posen (1999, page 6).

III. MONETARY POLICY REGIMES

Actually, monetary policy regimes are practiced through the application of a certain appointed regime of market effect.

Normally, central banks have only one direct macroeconomic indicator, i.e., money.

However, we must not forget that central banks, in many cases, also have the exclusivity of selecting monetary policy, thus having another opportunity to control the economy.
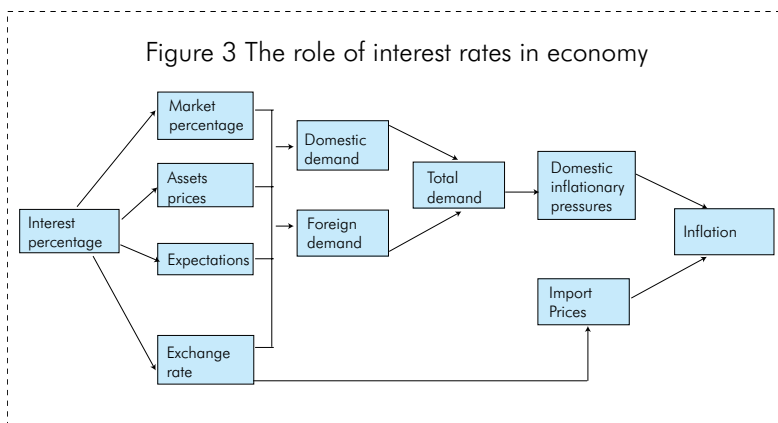
Nowadays, it is getting ever more stylish for central banks to be more straightforward with respect to expected inflation and this is enabled by announcing the inflation target for the future and the strategy that the central bank will follow to make the expected inflation comply with the target.

Notwithstanding the fact that the final target of monetary policy will be the consumer price stability or other targets like the economic growth, employment or the external balance, what's more important to underline is that the final success of

monetary policy will be achieved thanks to the selected regime for maintaining monetary policy.

This regime implies the selection of an intermediate objective after all, which is assessed to be the main factor in achieving the final targets.

Differently from final objectives, intermediate targets are macroeconomic variables, which in one way or another are under the direct control of central banks, such as the monetary base, the exchange rate, etc.

Figure 3 The role of interest rates in economy

Interest percentage					
Market percentage	Domestic demand	Total demand	Domestic inflationary pressures	Inflation	
Assets prices	Foreign demand		Import Prices		
Expectations					
Exchange rate					

The classic manner of controlling these variables is simply through active participation in the market (the money and foreign exchange market), where the central bank price becomes the main determinant in establishing all other market prices as those of lending and foreign exchange transactions.

The above scheme simply illustrates the way how the central bank manages to control inflationary pressures in the economy through interest rate manipulation.

Actually, inflation control is getting an even more difficult process to attain. Nowadays, inflation is not simply a phenomenon related to whether the money demand is increased or not.

There are many casual shocks, which from the anticipation incapacity turn into phenomena that tend to break the established balances of the economy.

The success of establishing control on inflation is mostly dependent on fiscal consolidation, which still comprises a serious challenge for transition and developing country authorities. It must not be forgotten that an open market economy means free exchange of goods, services and capital which in one way or another mean imported inflation at a certain extends.

Moreover, nowadays, the globalization of finical markets, besides ousting the geographical distinctions, is absorbing more and more capitals, and on the other hand is making the central bank commitment more difficult. The large subordination amongst markets has made their contagious effect be higher in the form of "domino effect", imposing the big economic powers pay more time to the enforcement of rules and their supervision. The crisis events in Asia and Russia are clear evidence of the latter. Under a new focus, the monetary policy should be more prudent especially when it has to assess future inflation.

This is one of the reasons, which together with the need for more transparency have made very trendy the inflation-targeting regime or more simply inflation-a target to be achieved.

In conclusion, it must be asserted that there are three monetary policy regimes, monetary targeting, exchange rate targeting and inflation targeting. The economic environment and the nature of transmission mechanism, particularly typical for any specific country, condition the selection of the monetary policy regime.

Based on the fact that different countries face different economic, financial structures or environments, it is but understandable that even the monetary policy anchors will be variable in different countries.

As Andrew Crocketts writes, "a measure must not indispensably correspond to all dimensions" (1999 page 222).

IV. MONETARY TARGETING

Monetary targeting is considered as the most appropriate regime for the so-called economies in transition or emergency. In these countries, where financial channels are not developed (our country is a typical case of it), a better control on credit expansion is followed by fixing monetary targets, generally.

In these countries, credit transmission conduits are practically amongst the most important channels, in view of monetary policy.

On the other hand, the intermediate targets of monetary policy help the settlement and household of budget discipline. This is one more reason why the International Monetary Fund, through its assistance programs, imposes preliminaries on the growing rate of money and lending.

Other favourable factors to the application of this regime have to do with the immense difficulties acquainted in the adoption of the other two regimes by those economies.

Foreign exchange targeting bears the risk of breaking the external balance under the conditions when the domestic affected inflation remains out of control. In the meantime, inflation targeting may suffer from the slight confidence in a macroeconomic environment of unstable inflation. This would hamper the achieving of a core objective for inflation targeting, i.e., the orienting of consumer price expectations, domestically.

V. EXCHANGE RATE TARGETING

Although in several cases, the exchange rate regime has led into foreign exchange crises, it can not be denied that the foreign exchange regime where the exchange rate has been pegged to another currency has managed to restrain inflation outbursts in the economy. It may be asserted that a pegged exchange rate, carefully managed, could constitute a very useful political

framework for a developing market at a certain extent of its development.

Some observers suggest that this might be a useful instrument of monetary policy in the first steps of anti- inflation packet, which with the passing of time should be replaced by a monetary policy regime based on the domestic instruments of monetary policy.

Frequently, the exchange rate might have effects on the economy. This may happen when a large part of domestic production is influenced by the international prices or when inflationary pressures are conditioned by the exchange rate (Albania included herewith). Under the conditions when the consumer price sensitivity against political and economic changes is high, especially, in a low and medium income society, the decision-makers' efforts to mitigate imported price vacillations will become more difficult. Unfortunately, they will be incapable of managing the exchange rate only through decreasing or increasing the interest rate domestically. This is a changing point between these countries and the developing countries where the domestic interest rate reflects an unexpected effect on capital movements and exchange rate.

Another and the last point has to with the rate of confidence. If the level of confidence is low and authorities fail to establish it, than the selection of this regime could be of negative consequences, which may lead to smashing of external balance, as well as may be prey of speculations.

In conclusion, it is hard to make an accurate assessment on the use of this anchor of monetary policy. "The difficulty lies in a very practical issue: very few countries have succeeded in preparing a successful "emergence strategy" from the application of a fixed exchange rate. As long as the banking system is functioning appropriately, the monetary authorities do not find the reasons to replace it. While the domestic currency is under pressure, authorities, abandoning its secondary exchange rate, do not want to affirm their willingness to accept even this failure of monetary policy"- Andrew Crockett, (1999, page 224).

VI. INFLATION TARGETING

Inflation targeting is a mode for maintaining monetary policy, under which the political decisions are conceived from the ratio of future expected inflation with its previously announced target. Under the inflation targeting regime, the authorities declare a single figure or an interval (the second is more typical) as an inflation target for future inflation (J. H. Green), 1996). If the expected interval falls out of the announced interval in the following period (one or two years later), this implies that something is not working with the monetary policy; Hence something must be changed to increase its efficiency. From this point of view, the expected inflation is nothing else but "an intermediate target" of monetary policy.

Under a certain regime of inflation targeting, the monetary authority (usually, the central bank) announces the targeted band of inflation in compliance with the final objective of monetary policy, that of consumer price stability. In practice, it is aimed at maintaining the forthcoming inflation within the limits of the announced interval. It may happen that for a certain group of casual phenomena, whose effect on the band has been studied and announced previously, the expected inflation be someway outside the announced interval, but anyway within some additional spaces which have been already admitted. So, the previously announced deviations reveal the necessity to measure the core inflation, an indicator that overlooks the inflationary pressures which are out of the monetary policy control.

As already assessed, another important element of inflation targeting is its transparency in weight, simply because the success of this monetary policy regime is largely dependent on whether the private agents, individuals or the public at large, will accept this officially announced target or not. This important principle of inflation targeting is closely linked with the institutional credibility and the applied policy. Inflation targeting on its own provides free spaces for politics, which may tempt the monetary policy to adopt expansive policies to support the increase of production in the short run.

In other words, the distinct discrepancies between inflation targeting and the preference to increase production beyond the potential capacities could reduce either its credibility or its role in the economy. In this context, most of the countries adopting this regime, have primarily introduced strict measures to increase credibility, including open policy arguments and interpretation of economic data.

A distinguishing feature of inflation targeting is that the intermediate target of forthcoming inflation is not an observed variable.

So from an operating viewpoint, inflation targeting may be regarded as a two- step-process, where the monetary authority first of all provides an inflation forecast to assess whether inflation under the current policy will stay within the target band or not. The second step will arrive on the stage if the forthcoming inflation is expected to fall out of the targeted band.

In this case, a well-defined rule that joins the decision-making process with the projected inflation should determine the direction for the monetary policy instruments to enable the channelling of projected inflation within the targeted band.

By definition, inflation targeting is a medium-term monetary policy, which implies five major elements:

1) The announcement of inflation rate as a target to be achieved on a medium term;
2) The institutional commitment to consumer price stability, as the principal target of monetary policy on which depend all other goals of monetary policy;
3) Preparing a strategy to include many variables, besides monetary aggregates and exchange rates which have been used to establish the framework of monetary policy instruments;
4) The growing transparency of monetary policy strategy through public and market communication of monetary authority plans, targets and decisions;

5) Increase of the central bank's responsibility to hit its inflation targets.

All above-mentioned elements (the fifth of them) are important; however, the most conspicuous of them is, surely, the announcement of the target rate for the coming year.

However, to pretend that the adopted regime corresponds to inflation targeting is important to adhere to four other principles.

This is a highly indicative fact for economies in transition, because many of them report their inflation target, partly as a routine of the economic plan of the government for the coming year, while the strategy of their monetary policies is not yet characterized as an inflation targeting regime, which requires even the application of four other elements, as a potential support beyond the medium term periods.

VII. INFLATION TARGETING PRIORITIES

Inflation targeting has several priorities, as a medium term strategy of monetary policy.

Contrary to a fixed foreign exchange regime, inflation targeting allows the monetary policy to concentrate in concrete situations and react to the shock effects of economy. Contrary to a monetary policy which has money growth as intermediate target (monetary targeting), inflation targeting has the advantage of a living reality of a stable relation between money and inflation which is not a key factor for achieving success of monetary policy. This strategy does not depend on such a relation, but it uses all the available information to define the best group of monetary policy instruments instead of it. Inflation targeting has also another larger priority: it is easy to be understood by the public and very transparent at the same time.

Based on the fact that we have to do with a concrete inflation

rate, the central bank accountability grows, while the possibility to be entrapped in the time instability decreases.

Time instability appears in the type of political pressures over the central bank intending the undertaking of expansive monetary policy initiatives. In this context, inflation targeting has the advantage of channelling the political debate more to what central bank can do for long-term periods, such as: inflation control, rather than on what it can not do, such as: the increase of production, decrease of unemployment, enhancement of external competitions, etc.

To be successful with inflation targeting, it is very important to have a strong institutional commitment, where to specify consumer price stability as the principal target of the central bank. This is particularly important for free market economies in transition, which have had monetary management deficiencies in the past. Institutional commitment implies legal support for a central bank independence, which should have two basic features:

1) Complete separation of the policy makers of the central bank council from other politicians (government members and others) to be protected from arbitrariness;
2) Conceding the central bank a comprehensive and exclusive control for the selection and use of monetary policy instruments.

The institutional commitment to maintaining consumer price stability also requires conceding a central bank mandate where to specify the consumer price stability as its primary target. This mandate should also clarify that in case of inconsistency with other targets, such as the exchange rate stability or the increase of employment rate, the consumer price stability should be of priority.

Inflation targeting underlines the indispensability for making the monetary policy ever more transparent and for maintaining communication with the public; these features have actually been

at the centre of success of the strategies applied by industrialized countries. Central banks have made a step forward in terms of inflation targeting: they publish the inflation report (for the first time it was published by the Bank of England), a printed document to clarify the present, past and future viewpoints on inflation and monetary policy performance.

Another important feature of inflation targeting is that the increase of transparency follows the same intensity on the central bank responsibility to the public. The constant success of monetary policy, measured as an achievement of the announced inflation target, even in the absence of legal, well-defined standards to appraise or object it, would lead to the establishment of public support for an independent central bank.

VIII. INFLATION TARGETING WEAKNESSES

Critiques on inflation targeting have been concentrated in some directions of this monetary policy strategy. The first to specify is that inflation targeting under a single announced figure as a target constitutes a very strict regime which under specific circumstances would cause instability in production, bringing decline in the economic growth of the country.

These weaknesses have been discussed over by Mishkin (1999) and Bernanke (1999) and actually they do not comprise serious problems for an inflation targeting strategy compiled appropriately.

Serious weaknesses are related to adoption of this monetary policy regime in transition economies. First, inflation targeting could lead to weakening of central bank accountability. In addition to inflation control difficulties encountered in transition economies, the effect of monetary policy instruments becomes more tangible in a second relatively distant period.

Inflation control difficulty becomes more problematic especially in economies where inflation has dropped to very low levels,

from some relatively high ones. Under these circumstances, inflation forecasts will embody big mistakes. Therefore, inflation target will not be attained. So, it would be hard for a central bank to gain the credibility from such a strategy; moreover it would be impossible for the public to understand the reasons of these deviations.

According to some authors, inflation targeting is assessed as an efficient strategy even if it is applied after a relatively long disinflationary period.

On the other hand, the degree of institutional collaboration, fiscal evasion and the accompanying risk of a flexible exchange rate are assessed as the main factors to compromise the success of an inflation targeting strategy. Another factor to affect the inflation control, mostly evidenced in the developing countries is the presence of consumer prices officially checked up. As a result, inflation targeting may require a high level of coordination between monetary and fiscal authorities on the term and magnitude of future changes in controlled prices, or alternatively excluding all of them from consumer price index, which would serve as inflation target (the case of the Czech Republic).

Inflation targeting is not sufficient to guarantee an efficient fiscal discipline; moreover, it does not eliminate the application of irresponsible fiscal policies from governments. The high fiscal deficits cumulative on long-term periods would lead to inflation rise and cause a complete failure of inflation targeting regime.

Prevention of fiscal disorder is the key for an inflation targeting strategy. Building institutions will help in the control of fiscal policy, assessed as of primary importance in the achievement of success. In the same line, a solid finical system is another crucial element for its success. However, the financial stability and the fiscal consolidation make up the basis of success for any monetary policy strategy.

Finally, a high dollar level of economy may provide a serious potential problem for inflation targeting. Actually, many

countries of economic emergency, the balance sheet of banks, companies and private businesses on both sides of it (including the long-term debt) is expressed in dollars. That's why, inflation targeting requires a flexible exchange rate; however, the latter oscillations are unavoidable.

The high and abusive deprecations may increase the weight of debt denominated in dollar. This would lead into the deterioration of balances, raising the risk for financial emergencies.

Therefore, it has been suggested that developing economies should not ignore the exchange rate, when they try to apply an inflation targeting strategy. Another suggestion is that this strategy, in partly dollar economies, may not be stable, that's why prudent adjustments should be undertaken to control the finical institutions, so that the whole system is resistant to exchange rate shocks.

IX. INFLATION TARGETING REGIME IN ALBANIA

For about a three-year period, inflation has dropped to very low levels, under a high economic growth situation in Albania. Privatization revenues for 2000 and aids received for 1999 released the government duty in covering budget expenditures, maintaining the budgetary deficit at the planned levels.

Notwithstanding the efforts made, unemployment remains at a constant rate, while GDP has not reached the 1989 rate yet (basic year).

Notwithstanding the achievements in the consolidation of macroeconomic stability, other factors, to assure long-term stability are still considered as secondary factors, and continue to be sidestepped for many reasons (both objective and subjective).

This phenomenon is observed in achieving structural reforms, which continue to be characterized by unjustifiable lags, despite

the privatization of some institutions and relevant entities, such as the NCB, AMC, the Cement factory, the Beer factory, etc. Furthermore, markets continue to be characterized by a general tumult and the obscure economy remains prevalent.

This introduction briefly includes a condensed reflection of the overall economic environment, where the authorities should decide whether the monetary policy should change, of course, in favour of the adoption of inflation-targeting regime. To fully reply to a similar question, perhaps, it should be more rational to reflect on the previous year policy and the achieved results, as well.

X. MONETARY POLICY IN THE PREVIOUS DECADE

Monetary policy in Albania was for the first time compiled and applied in the mid-1992, as a part of the IMF support, when some monetary decisions, introduced for the first time, aimed at establishing control over the money supply through the use of direct instruments. Since the first law of the Bank of Albania, maintaining the value of the domestic currency and ensuring the consumer price stability was stipulated as the main target of monetary policy. In the Bank of Albania's Annual Report for 1992, the consumer price stability, the increase of production and the observance of a full balance in the foreign position of the country were mentioned as final targets of the monetary policy. The monetary base was chosen as an intermediate target of monetary policy, while the basic instruments of the monetary control were two: the credit ceiling and the interest rate on LEK time deposits at the state-owned banks. Since July 1992 onward a "free-flowing" exchange rate regime was adopted, while current account transactions were fully liberalized.

These measures, together with the adoption of a tight fiscal policy and the liberalization of most of consumer prices, led to a brusque refraining of further imbalance of macroeconomic balance. The galloping inflation of years 1990-1991 began

to fall, accompanied by a ceasing in the further decline of production. The macroeconomic consolidation of the country went on with rapid steps in years 1993-1995. It must be stressed that amongst the factors affecting the achievement of this macroeconomic situation, monetary policy decisions occupy a special position. The instantaneous growth of interest rates and the established control on credits to economy forced stopping of the vast monetary haemorrhage at 1999-end and the consumer price rise was only 6 per cent.

The consecutive two-year period corresponds to the "rise" and "fall" of pyramid schemes. The high interest rates of the pyramid schemes totally "replaced" the interest rates offered by banks and the effect of monetary policy was significantly reduced in the aftermath.

The high interest rates led to high deposit placements at the windows of these pyramid schemes, while their investment in securities and production was smallest compared to the collected amount.

Moreover, there was noticed the re-investment phenomenon of both the principal and the earned interests.

Their incapacity to manage the collected deposits made these companies post them at commercial banks, providing them with excessive reserves in huge quantities, which went directly for treasury bill purchasing. In conclusion, at the end of 1996, inflation resulted three-times higher than the previous year-end, reflecting high growth of credit to the government.

Breakdown consequences of these rental companies were comprehensive and carried along a considerable economic charge. At end of 1997, the downfall in production was accompanied with an acceleration of inflation, deterioration of the foreign position of the country and an unemployment increment. However, the Bank of Albania' efforts to raise the interest rates by about 32 per cent began to yield their results.

Monetary policy and fiscal results became more tangible at end of 1998. As part of the Post-Conflict Emergency Program, signed with the IMF, some quantitative restrictions were enforced on the growth of Net International Reserves, on the growth of Bank of Albania's credit to the Government. Year 1999 and the year we just left by registered inflation[5] rates uncommon for an economy as that of Albania. Though during 1999 Albania was forced to face the apostolic exodus of the Kosova people, still for many reasons explained above, inflation remained at low rates. From this moment till end of 2000, interest rates have recognized constant cutting, though remaining very high in real terms.

On the other hand, the market reaction has not been instantaneous and this is also reflected in the high spread existing between the minimum deposit rates and the Treasury bill yields. Under these conditions, considering rational the removal of the floor limit on ALL time deposit rates at state-owned banks, the Bank of Albania intended to tread on a new path, that of the monetary control through market rates.

Drawing some conclusions about the whole period of 1992-2000, the monetary policy was generally characterized by:

- A final and clear target, i.e., maintaining the consumer price stability. As part of the various programs through which the economic progress of our country has moved on, every year has been recognizing quantitative targets on inflation at the end of each fiscal year, though the applied discretion has never been transparent. However roads to run this stability have generally been unclear. There has been discovered no durable connection between inflation and money growth throughout the whole period. On rare exemptions, monetary aggregates have not stuck to their programmed rates; however, inflation has been maintained under control (in many cases, significantly below the target).
- Fixing an intermediate target for money growth. Money growth is considered as an intermediate target, which

would lead to the meeting of the final objective of the Bank of Albania. In fact, money (the monetary base) is one of the unique indicators that the Bank of Albania can comprehensively control. In spite of that, as above mentioned, inflation and this indicator revealed no durable connection, so other factors, specifically the exchange rate, are assessed as direct determinants of the behaviour of inflationary pressures on the economy.

- The application of quantitative restrictions on the asset side. Since the second half of 1992, there were established upper and floor limits on the position of monetary indicators, such as: Bank of Albania's Net Foreign Assets (floor limit), Net Domestic Assets of the banking system (upper limit) divided into Net Credit to the Government and Credit to the Economy. The so-called criteria for achieving success continue to be applied even nowadays, though somewhat differently from the years before transition. Not dealing specifically with the type of those used actually, we would like to underline that the three quantitative targets have been realized within the fixed limits, at least for the period of 1998-2000. In the meantime, the actual realization of the monetary indicators, particularly the money reserve and monetary aggregates are far from their programmed rates.

- Exercising a direct monetary control. The application of direct instruments of monetary control was finally abrogated in the third quarter of 2000, when the Supervisory Council decision "played off" the minimum interest rate for time deposits in Lek, set at second-tier banks of state-owned capital. In the meantime, new credit restrictions were removed earlier.

- Uncertainty and low efficiency of monetary transmission mechanism. Since the third quarter of 2000, the Bank of Albania began to control the money supply through the application of indirect instruments, where Repo auctions occupy the main place in the money market. In reality, the history of applying indirect instruments is earlier, since mid-1992.

In spite of that, it must be noted that their efficiency has been low and monetary policy decisions have been mainly transmitted through the administrative interest rate in all cases. This is true as long as it has been attempted to restrain further rise of inflation for other periods; it has been tended to ease the monetary policy, though this measure has not been very helpful.

From this viewpoint, it's right to ask the question: Will the Repo rate be able to transmit Bank of Albania's decisions to economy? This question is relatively difficult to answer. In spite of Bank of Albania's efforts, the money market is still undeveloped, inflexible, concentrated, etc. The number of transactions remains low in it, where the Savings Bank is a party in most cases, and the volume of performed transactions does not make up any relevant amount. It is a fact that for many years from now, the state budget has been a regular consumer of the excessive reserves.

Restrictions of bank supervision have deprived the banks of considerable lending capacities (NCB and NB) of financing the economy, and their excessive reserves have been transformed into operating budget expenditures, consequently.

This situation has made the Treasury bill market be dominated by the Savings Banks, something reflected in maintaining a relatively high spread between the Treasury bill yields and bank operating costs. Though for some time from now the market is being regulated through Repo auctions, it's unclear whether there exists any optimal level for the position of excessive reserves in the system.

A high credit supply to the Government. Banks managed to purchase the greatest part of government debt initially in a direct form and latter on through Treasury bill issuing. In this way, the state budget was transformed into the largest money "consumer". By all signs, the scenario of treasury bill issuing and purchasing by banks (mostly by the Savings Bank) is likely to be repeated even in 2001 and it seems that the basic interest rate will be the treasury bill yield of 12-month maturity.

A decrease of the money demand on the budget side would reduce the Treasury bill yield and the reverse; an increase of the money demand would intensify the Treasury bill yield despite the Repo rate rise or fall in the money market. A change of the interest rate by the central bank would influence the market credit rates, securities investments, fixed assets prices and overall expectations in the same direction. In the case of an undeveloped banking market, a highly concentrated Treasury bill market and a formal credit market where most borrowings are in foreign currency, it is understandable that the central bank signals can hardly penetrate in the "terrain" and in consequence, the efficiency remains modest.

XI. DO WE REALLY HAVE TO ADOPT INFLATION TARGETING IN ALBANIA?

Replying to the above question, we may state that inflation targeting is a successful strategy when it finds a sound macroeconomic and institutional situation on the one hand, and when it is put forward to an audience (of economic agents, individuals and common public in general) that realizes and welcomes it as a strategy.

Recently, one of the most applied expressions is the one that cites the further crystallization of macroeconomic stability. In fact this expression is mostly found in official statements (including those of the IMF), while other analysts talk about achievements and non-fulfilment, as well as about a large tumult caused by the actual data. Many suspicions, even by Bank of Albania have been raised on how to measure inflation.

Referring to each of the above-mentioned aspects, we would start with:

XI.1 MACROECONOMIC ASPECT

XI.1.1 Inflation

Literature generally recommends that a period of 2-3 years with a low inflation should generally precede the adoption of
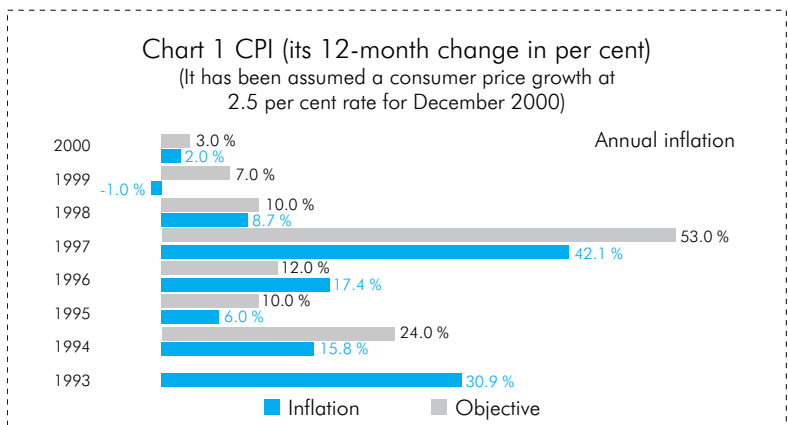
inflation targeting regime, where a low inflation rate implies a rate fluctuating between 2-3 per cent.

Currently, inflation is at very low levels, resulting for the third year in succession below the announced target (chart 1). On the whole, the inflation rate reduction has been a tendency of the last years.

However, the shock factor has been present in different years, either for high or low inflation rates.
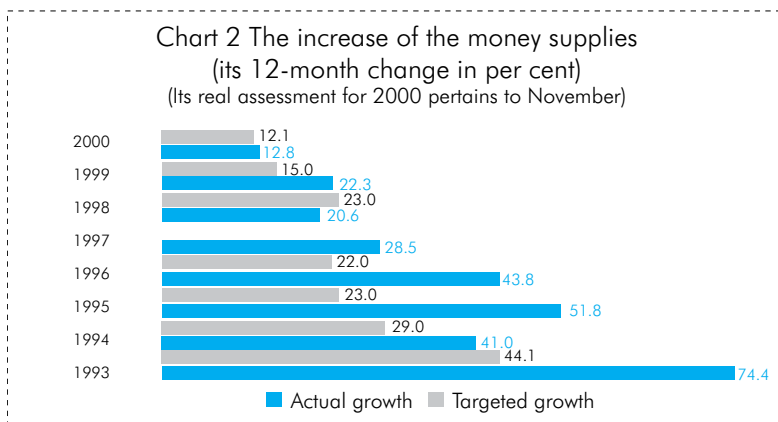
The annual average rate of inflation for January 1993 - November 2000 has been 26.2 per cent, while only for the three last years it has been 7.4 per cent.

If we cast a glance at each year of the latest period, we would have 21.6, 0.4 and 0.2 per cent, respectively for 1998, 1999 and 2000.

Chart 1 CPI (its 12-month change in per cent)
(It has been assumed a consumer price growth at
2.5 per cent rate for December 2000)

Year	Objective	Inflation		Annual inflation
2000	3.0 %	2.0 %		
1999	7.0 %	-1.0 %		
1998	10.0 %	8.7 %		
1997		42.1 %	53.0 %	
1996	12.0 %	17.4 %		
1995	10.0 %	6.0 %		
1994	24.0 %	15.8 %		
1993		30.9 %		

Inflation   Objective

What's most noticeable from the chart is that actual inflation has been lower than the targeted rate in all cases, except in 1996, while in other years, including 1999, it has been far from the targeted rate. A similar phenomenon but on the reverse direction has occurred with the increase of the money supply (measured by M3). A similar thing is demonstrated by Chart 2,

where most noticeable in all cases is the higher than the forecast growth of M3.

Chart 2 The increase of the money supplies
(its 12-month change in per cent)
(Its real assessment for 2000 pertains to November)

Year	Actual growth	Targeted growth
2000	12.8	12.1
1999	22.3	15.0
1998	20.6	23.0
1997	28.5	
1996	43.8	22.0
1995	51.8	23.0
1994	41.0	29.0
1993	74.4	44.1

■ Actual growth ■ Targeted growth

From a theoretical viewpoint, both charts disclose a sort of paradox; higher than expected growth of the monetary supply has led to reduction of inflation below the target?!

Such sort of paradox highlights once more the question whether the announced inflation is real or the program compilers have been wrong during all the period? In fact, analysts (like, Haderi and Mytkolli, Kunst and Luniku 1998) have drawn the conclusion that the money-inflation relation is still weak and other factors are believed to have a stronger effect on inflation. Finding an answer to the above question is really an integral part of an inflation targeting strategy. In consequence, based on the so-far inflation performance, though it has been low for only two years, we may state that there premises for the application of an inflation-targeting regime.

XI.1.2 Exchange rate

The exchange rate is one of the strongest points for adopting inflation targeting regime. In our country's case it is real luck that the Bank of Albania has the exclusive right for making the decisions, which select and manage foreign exchange policy within the territory of the Republic of Albania. Moreover, since

1992, the Bank of Albania has chosen a free-float foreign exchange regime, whose main feature is the fixing of the currency price on the basis of the demand-supply. The application of this regime is one of the criteria for the application of inflation targeting. So, we may state that even this indicator makes up a strong point of support to start with the application of inflation targeting regime.

Recent years have recorded important steps in relation to fiscal consolidation. It is a fact that the state budget of both years 1999, 2000, had the "advantage" to collect considerable income in foreign currency (in the type of aids and privatization income). According to the 2001 forecasts, the state budget will continue to collect privatization revenues in foreign exchange.

These revenues have significantly mitigated the pressure of fiscal policy over the monetary one, and in consequence the banking system has not been faced with liquidity shortages, while the Bank of Albania has observed the limits defined by law in budget deficit financing.

However it is still early to talk about fiscal consolidation and stability. For such kind of assessment we take into account the structure of budget revenues (where incomes from customs duties still occupy the greatest part), the high level of fiscal evasion and somewhat arbitrary practices in tax collection and in the application of reference prices. On the other hand, the fiscal authority has not adopted appropriate degree of transparency. This means that the efficiency of using the budget revenues is not completely clear.

Finally, the low standard of living in Albania (being the fourth poorest country in Europe), high unemployment rate and not-good practices in managing budget revenues are factors that exert a strong pressure on the authority for budget expansion and weakening of the fiscal position and stability.

From this viewpoint, given the difficulties in recognizing that part of inflation caused by the fiscal policy, it could be asserted

that as long as the treasury bill market is the only securities market in Albania, as long as government borrowing from the Bank of Albania will not be legally forbidden and as long as the political parties lack a total and reliable commitment to a strict and transparent management of fiscal revenues, etc., the successful application of inflation targeting will be hard to apply.

XI.1.4 Financial stability

Considering the financial system crises, Albania has not encountered such ones. This is partly due to that part of economy otherwise called formal economy. Notwithstanding the establishment of two institutes of social insurance, the financial system de facto may be identified with the banking one in Albania. On the other hand, we should not forget that though the 1997 was not a product of the banking system, it still had in its core a typical financial phenomenon, whose consequences weighted very heavily on the main macroeconomic indicators, such as on domestic production, inflation, unemployment, balance of payments, etc.

Given the above, a question arises: Which is the immune system of Albania against financial crises?

Notwithstanding the constant efforts made for strengthening the banking supervision, the banking system in Albania still remains undeveloped and offers a low rate of intermediation. It appears as highly concentrated and operates under a high-risk reality (for the whole spectrum from the political to the operational one). Its regulative framework is incomplete and marks defects in the application of rules and regulations, etc.

On the other hand, markets and other financial institutions remain infantile and reflect a high rate of exposure. Notwithstanding the bitter experience, there are data to provide showing that borrowing still exists, though in small dimensions. As already noticed, the immune system of Albania against financial crisis reveals several problems, which although recognizable

in time are not yet managed to eliminate. This weak immunity makes the Albanian economy have a high rate of exposure and in consequence, a very important prerequisite of inflation targeting remains unfulfilled.

XI.2 Institutional aspect

While the macroeconomic aspect includes factors that encourage the selection of inflation targeting as a monetary policy regime, in institutional aspect it is deemed that more weight depends on its weak points.

XI.2.1 Central Bank Independence

Although the central bank is legally provided with an independent position, however, bank independence remains far off the legal standard and under menace. Other authorities should bear the tendency to comply with the central bank independence. And on the other side there no sufficient guaranty that independence vested under the current law (entirely or buy separate elements of it) will not be submitted to latter changes.

XI.2.2 Central Bank Transparency

The Bank of Albania is engaged in enhancing its transparency, though it is still far from the standards. The Bank of Albania is not yet transparent in its core: in explaining the decision-making process, especially for monetary policy issues.

XI.2.3 Central Bank Reliability

It can not be affirmed that the Bank of Albania has finally won the public confidence. It should be realized that Albanians initially needed to know about the existence of the central bank, named the Bank of Albania. On the other hand, public confidence will be hard to ensure in general and still harder under the conditions of inflation targeting. As inflation is highly affected by shock and speculative factors, its possibility to deviate from the target remains high in Albania.

XI.2.4 Central Bank Accountability

The Bank of Albania by law is assigned a considerable level of accountability, estimated by its reporting duties. However, in reality the central bank accountability should be raised. The Bank of Albania is engaged in the observance of all the reporting duties, but the quality of this reporting is subject to further improvement, which is expected to raise its real accountability.

XI.2.5 Not good relations with the fiscal authority

The level of coordination between the fiscal and monetary authority is not in the level required by inflation targeting. Practically, this lack of coordination impedes the Bank of Albania to efficiently apply the instruments for achieving monetary policy.

Thus, the whole institutional aspect is considered as a weak point for adopting inflation targeting.

XI.2.6 Public Awareness

Albanians took the first practical lectures on what inflation is at early 90's. With the passing of time everybody realized that the consumer price rise corrodes their income and savings and very few of them understand that the difficult mission for keeping them stable belongs to the institution named the Bank of Albania.

Albanians really understood one fact that "to enjoy tomorrow, they should save today", a strong appeal made by both political parties at the time of their coming into power.

In spite of this, they failed to see the mechanism that leads from the (destroyed) present to the richer and safer future. The prolonged transition period and numerous failures along it (mainly because of subjective reasons) also contributed to this.

A limited number of people are capable of explaining why such deep reforms are needed, while the rest is found in the

position of the disillusioned and the majority, with its indifference, accepts them as they are.

From this viewpoint, it is hard to believe that the Bank of Albania will find reliable "partners" to properly realize and interpret its own decisions. When the public understands and welcomes the central bank policy, it is transformed into a sort of factor for determining inflation in the future.

Practically public awareness, its familiarization with the monetary and banking policies and improvement of the overall institutional framework constitute a task of the moment, which does not need to wait for the meeting of other prerequisites.

The following highlights the paths, where the Bank of Albania should focus its efforts:

1. Enhancing the Bank of Albania's transparency. To this end, it has increased the number of publications, especially explanatory ones, media presentations, public contacts, meetings and workshops, and has adopted a strategy and a regulation on transparency.
2. Commitment to improving the relations with other state-owned institutions. To this end the Bank of Albania has adopted a more intensive stance in all inter-institutional organizations (such as: EU Integration, the Pact of Stability, the discussion of papers such as the strategy for the development of SME). More striking is the activity in the framework of the debt committee.
3. Commitment to raise accountability. The Bank has intensified contacts and the reporting to the People's Assembly, trying to raise the level of explanations for its decisions.
4. Commitment to enhancing its credibility. Besides achieving the objectives and advertising this fact, the Bank of Albania is trying to win the public and arrange systematic communication with it. The Bank is organizing campaigns (the credit campaign), is approaching to the business to realize its expectations, etc.
5. Commitment to carry out education. Education involves

the Bank of Albania itself, other authorities and the public. To this end, the Bank of Albania has offered its financial support.

6. Commitment to enhancing the central bank transparency:
7. Commitment to other issues that are not a direct duty of the Bank of Albania, but influence the establishment of prerequisites for adopting inflation targeting regime. As such we would mention its engagement in the projects for improving statistics. On this basis, the Bank of Albania is capable of establishing models for inflation analysis and forecast and for improving the transmission mechanism.

The fulfilment of each of the above-mentioned conditions or their improvement needs a period of 2-3 years, or perhaps even more. This period of time is specified, above all, based on the Bank of Albania's lack of clarity about other authorities' commitment to the regime, the way the public would react, the need for setting up a macroeconomic model (including a test period), the increase of the financial market efficiency, its extension through absorbing informal activities, the strengthening of banking supervision, etc., further improvement of the monetary market in order to establish an efficient instrument of control on money, etc.

NOTES

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[1] The deriving conclusions have been published by a group of English conjectures in their publication "Monetary policy frameworks in a Global Context" - Maxwell Fry, DeAnne Julius, Lahavan Mahaveda, Sandra Roger and Gabriel Stern - 1999.

[2] The Bank of England performed the survey by means of questionnaire disseminated in 77 countries, including the most industrialized countries, many countries in transition and a great number of developing economies. The results of this survey have been published in "Monetary Policy Frameworks in a global Context" - Maxwell Fry, DeAnne Julius, Lahavan Mahadeva, Sandra Roxher and Gabriel Sterne -1999.

[3] Bank of Albania has resigned the use of direct instruments to control the money supply from the third quarter 2000.

[4] A kind of monetary policy where inflation is a mid-term target.

[5] The paper has been prepared before the announcement of the inflation rate for 2000-end; as such, it refers to the November data. However, the rate of December 2000 is one more argument to the attention that must be shown while adopting inflation targeting.

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