SCIENTIFIC NOVELTIES AT THE BANK OF ALBANIA

Contents:

I. FRIDAY SEMINARS

During the first half of 2011, the Friday Seminar Series welcomed several presentations from representatives of the Bank of Albania, other institutions, and foreign and domestic scholars. The presentation themes were various, mostly focusing on monetary policy and financial stability, on issues of fiscal policy and development policies, and on other issues of competitiveness of the Albanian economy, in terms of tourism and agriculture. The paragraphs below provide a detailed description of the presented materials.

"MAFIA AND PUBLIC SPENDING: EVIDENCE ON THE FISCAL MULTIPLIER FROM A QUASI-EXPERIMENT", BY SAVERIO SIMONELLI (THE UNIVERSITY OF NAPLES FEDERICO II, ITALY)

This study aimed to analyze the multipliers of public spending in output, based on the expenditures for infrastructure in various regions of Italy, and also based on the 1991 Law that mandated the interruption of local public work on evidence of Mafia infiltration of local administration. In identifying these multipliers, the authors have employed the panel methodology for various provinces. Empirical results show that this multiplier varies from 1.4 to 2, taking into consideration the contemporary and the lagged effect of governmental anti-measures on output.

"GROWTH EFFECTS OF INTERNATIONAL INTEGRATION IN SOUTH-EASTERN EUROPE – IMPLICATIONS ON FDI AND TRADE", BY JONEL KRISTO, RESEARCH DEPARTMENT

This study aims to assess the impact of regional integration on growth, to study the transmission channels of such growth, and to measure the intensity of these relationships. A data panel approach with fixed effects has been used to measure such effects, including 9 countries from South-eastern Europe for the period 1996-2009. The findings of this study suggest that an integrated region benefits more in terms of trade, especially through exports,

and in terms of foreign direct investment. Another finding of this study is that an integrated region grows more in volume if it stimulates trade integration and inter-industrial convergence at an international level, compared to a region lacking these initiatives. Also, an integrated region attracts more foreign investment, but the analysis shows that a precondition to this is a competent and readily available labour force. The results are valid in the context of a region dominated by cost-oriented industries, and not by high-tech industry.

"DEVELOPMENT OF SUSTAINABLE TOURISM: AN EMPIRICAL APPROACH FOR ALBANIA", BY LORENA SKUFI, THE WINNER OF FIRST GOVERNOR'S AWARD FOR THE BEST DIPLOMA OF YEAR 2010

Some of the addressed issues dealt with the understanding and sustainable development of tourism, and the future challenges regarding its development in Albania. The main aim of this study is to analyze the sustainable tourism in its three dimensions, to measure the economic, environmental, and social impact on the revenues generated by tourism. In quantitatively analyzing the development of tourism, the study uses the Vector Error Correction Model. The research covers the period 1995-2008, and the results show that revenues from tourism are more positively related to the Gross Domestic Product, social development, and negatively related to the environmental degradation.

"CONSPICUOUS CONSUMPTION: THE EFFECTS OF SOCIAL INFLUENCES ON FIRMS' DEMAND, PRICE AND EARNINGS: CONSPICUOUS CONSUMPTION IN ALBANIA", BY ARMANDO MEMUSHI, FACULTY OF ECONOMICS, UNIVERSITY OF TIRANA

This study aims to understand the behaviour of "social" consumer behaviour in determining prices of conspicuous goods and earnings of firms' market share, which produce and sell such products. The study uses an analytical model, which includes social influences on the consumer behaviour, and then explores its impact on prices, earnings, and firms' market share. The results for the Albanian consumer behaviour show that the consumption of conspicuous goods constitutes a small part of total consumption. Also, gender and education of the head of family are the main driving factors behind conspicuous consumption, and that individuals living in Tirana have on average a higher level of conspicuous consumption compared to other cities.

"CURRENT ACCOUNT DEFICIT IN ALBANIA AND POLITICAL IMPLICATIONS", BY ILIR VIKA, RESEARCH DEPARTMENT

This study aims to assess the equilibrium level of the current account in Albania. Its estimation is based on two approaches: first, the accounting framework proposed by Lane and Milesi-Ferreti (2006), and second, the empirical approach based on panel data estimation. The equilibrium levels of current account suggested by these approaches are different; therefore, the adjustment magnitude needs to be

carefully interpreted. This material also aims to shed light on possible implications derived from the impact that the further worsening of the current account can have on monetary and fiscal policy. Such tendency has been observed during the last years.

"EVALUATING THE TOURISM-LED ECONOMIC GROWTH IN ALBANIA", BY JONEL KRISTO, RESEARCH DEPARTMENT

This study aims to measure the effect of the tourism sector on the Albanian economic growth during 1995-2008. In doing this, the author analyses the foreign tourist inflows, and the total real earnings in economy. The final estimation suggests that a 5% sustainable increase in tourism earnings leads to an increase of 1% in GDP. Also, a deviation from the equilibrium needs 3.4 quarters to be adjusted.

"MACROECONOMIC DETERMINANTS OF REMITTANCES: THE CASE OF ALBANIA", BY ESIDA ABAZAJ, RESEARCH DEPARTMENT

This paper aims to empirically estimate the macroeconomic determinants of emigrants' remittances to Albania over the period 1996-2010. This study is the first of its kind in the case of Albania. The author employs the Vector Error Correction Model to study the long- and short-run dynamics of remittances. The findings suggest that remittances in the long run depend solely on the macroeconomic conditions of the host country, which is proxied by the unemployment rate in host countries, weighted on the basis of shares of remittances received from each host country. An increase of the unemployment rate by 1 pp decreases remittance transfers by 0.13% in the long run. The other two explanatory variables (exchange rate and Albania's Gross Domestic Product) proved insignificant, both in the long and short run, thus rejecting the conventional hypothesis that remittances are primarily remitted to meet the consumption needs of emigrants' households in the home country. The only finding supporting the altruism hypothesis is the fast adjustment of remittances to their long-run equilibrium, indicated by the high and statistically significant error correction term. The study also found no evidence of the investment motive driving Albanian emigrants' remitting decision.

"CORPORATE GOVERNANCE IN THE ALBANIAN BANKING SYSTEM – SURVEY ANALYSIS ON THE CORPORATE GOVERNANCE OF THE ALBANIAN BANKING SYSTEM", BY KLITI CECA, IRINI KALLUCI, ORIELA KODRA (RESEARCH DEPARTMENT), VASILIKA KOTA (FINANCIAL STABILITY DEPARTMENT) AND ARZANA HAXHIAJ (HUMAN RESOURCES DEPARTMENT)

The aim of this study is to identify the role and importance of sound corporate governance in Albania, through calculating the Corporate Governance Index for the Albanian banking system.

"POLITICAL CYCLES IN PRIVATIZATION EARNINGS: THE CASE OF ALBANIA", BY DRINI IMANI, ENDRIT LAME (AGRICULTURAL UNIVERSITY OF TIRANA) AND HOLGER KÄCHELEIN (FACULTY OF ECONOMICS, TIRANA)

This study aims to identify the political cycles in Albania, mainly during election processes, by means of different economic instruments, like monetary and fiscal policy instruments. In the previous study regarding the identification of political cycles in Albania, the results showed clear evidence of fiscal expansion prior to elections. In this study, earnings from privatization are taken as elements of government financing and fiscal expansion growth in transition countries, in order to test if there is an increase in these earnings prior to elections. Empirical results show considerable and statistically important growth in privatization earnings prior to elections, contributing as an essential element in financing the growth of governmental expenditures prior to elections.

"OPTIMAL LEVEL OF RESERVE HOLDINGS: AN EMPIRICAL INVESTIGATION IN THE CASE OF ALBANIA", BY GERTI SHIJAKU, RESEARCH DEPARTMENT

This discussion material makes an attempt to test the importance of the relative precautionary and mercantilist motives that seek to explain the reserve holdings, namely variation payments and receipts, financial costs and reserve holdings in the case of Albania. First, the aim is to evaluate the impact of changes in international transactions on reserve holdings. Second, the author intends to evaluate reserve holdings from a cost opportunity perspective. The material is based on the Buffer Stock model. This model assumes that reserve holdings are affected by changes of payments and receipts in the balance of payments. Reserves serve as a buffer stock to accommodate fluctuations of external transactions, while the initial stock is the optimal level. The focus of the model is to estimate the optimal level of reserves against possible exogenous shocks or a crisis, particularly fluctuations of foreign capital inflows, mainly remittances. The volatility of reserve holdings is generated by Autoregressive Conditional Heteroskedasticity (ARCH) estimation, while the Buffer Stock model is estimated with an ARDL approach. Results indicate a negative relationship of reserve holdings with opportunity cost, volatility and deviation of exchange rate from the trend and positive relationship with imports. The approach estimation suggests that the level of optimal reserve holdings is more sensitive to precautionary rather than mercantilist motives.

"AFTER THE CRISIS, NEW STRATEGIES FOR THE EUROPEAN MONETARY POLICY AND ITS MANAGEMENT", BY PROF. FRANCO BRUNI, UNIVERSITY OF BOCCONI, MILAN

In his presentation, Prof. Bruni addressed issues related to new strategies and challenges, which need to be faced by the European Union in the future, in the context of growth pact, and stability and governance of its members. The financial crisis that affected the globe in 2007 brought a new viewpoint for the monetary policy in the world. Its focus in the future will be not only price stability but also financial stability, as an explicit target of monetary policy in the future.

"CAN THE SMALL AGRICULTURAL ECONOMY OF ALBANIA COMPETE AMID REGIONAL AND EUROPEAN AGRICULTURAL MARKET COMPETITION", BY ISMAIL BEKA, VICE DIRECTOR OF GIZ (DEUTSCHE GESELLSCHAFT FÜR INTERNATIONALE ZUSAMMENARBEIT)

This presentation aims to analyse the agricultural sector in Albania, its actual problems, and the identification of future challenges. Official data of Instat show that half of Albanian population lives in rural areas, and that agriculture is one of their most vital activities. During the whole period of transition, reforms in this sector have been scarce, enabling the Albanian economy to continue being a net importer, regardless of its potential natural resources. So, some of the future challenges in further reviving the agricultural sector are: urbanisation of certain areas, rural and spatial planning, individuals' education and qualification, defining new strategies with long-term vision, etc

II. RECENTLY CONCLUDED RESEARCH PAPERS

"THE ROLE OF BUDGET CONSTRAINTS IN THE THEORY OF RATIONAL EXPECTATIONS – A FRAMEWORK FOR MODELLING AND DISCUSSING FINANCIAL STABILITY", BY ARDIAN FULLANI (GOVERNOR OF THE BANK OF ALBANIA) AND ALTIN TANKU, (HEAD OF RESEARCH DEPARTMENT)

This paper extends the work on modelling with two particular objectives: first, the paper revisits the rational expectations argument to propose a new method to bring models closer to reality, and second, to provide a definition and a general framework for the analysis of financial stability issues in the framework of monetary policy. The paper observes that the current literature has not taken full advantage of Blanchard and Kahn (B&K) solution of rational expectation models. In a practical way, the paper proposes to substitute current resource identities in the model with cointegration relationships, as a way to introduce more flexibility in the model without affecting the priorities or the total number of restrictions, which are necessary to solve the model in the rational expectations setup. This is done by augmenting the DSGE with the power of VECM (cointegration). The main assumption here is that agents are rational but this is true only in the long run, as they experience intentional or accidental irrationalities and/or information loss in the short run. Despite allowing more flexibility, this proposal yields a more realistic and logical approach solution for the hybrid model or structural shocks proposed by other authors.

"CORPORATE GOVERNANCE IN THE ALBANIAN BANKING SYSTEM – SURVEY ANALYSIS ON THE CORPORATE GOVERNANCE OF THE ALBANIAN BANKING SYSTEM[1]", BY KLITI CECA, IRINI KALLUCI, ORIELA KODRA (RESEARCH DEPARTMENT), VASILIKA KOTA (FINANCIAL STABILITY DEPARTMENT) AND ARZANA HAXHIAJ (HUMANRESOURCES DEPARTMENT)

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1 Confidential.

In the context of the increasing importance of the banking sector in Albania, this paper aims to estimate the quality of banks' governance in the country. This study is of particular significance because sound governance in banks affects the establishment and preservation of a stable and profitable banking system. For the first time, it is measured the quality of Albanian banking system governance in the form of a Bank Governance Index, based on information collected from banks through filled questionnaires. As comparative basis are used the practices of sound governance, set by the Bank for International Settlements (BIS), in order to estimate not only how the Albanian banks apply these practices, but also to compare banks with each other. The BIS Principles were regrouped under six main sections:

1. Institutional framework and governance system in banks;
2. Auditing process;
3. The role of Board of Directors and Senior Management;
4. Human resources management in banks;
5. The specification of duties and the role of management;
6. Remuneration.

Besides measuring a general index for all aspects of bank governance, 6 sub-indices were also measured, one for each of the sections explained above.

III. WORKING PAPERS IN PROGRESS

"EMPIRICAL ASSESSMENT OF THE GRAVITY MODEL: THE ALBANIAN CASE", BY ALBAN PLLAHA, RESEARCH DEPARTMENT

This paper aims to assess the specific contribution played by each of the below listed factors: contiguity, common language, common history and free trade area, to trade flows. This study applies new evaluated coefficients, to the previous gravity model equation, in evaluating trade flows between Albania and its main trading partners. The material emphasizes some of the key variables that affect trade flows. It also defines which specific elements contribute the most to each specific bilateral trade flow. One of the main findings is that the bilateral free trade agreements between Albania and regional countries have had a positive impact on trade flows. On the other hand, the contiguity variable has not resulted as significant as suggested by the traditional literature.

"CREDIT BEHAVIOUR: HAVE WE ACHIEVED THE POSSIBLE POTENTIAL IN ALBANIA?", BY IRINI KALLUCI, RESEARCH DEPARTMENT

The aim of this paper is to study the behaviour of credit in Albania, the forces driving its rapid growth during the years 2004-2008, and also the change in tendencies observed in years following the global financial crisis. For transition countries, this estimation is somehow difficult, as the credit growth and the deviation from the long-term equilibrium can be part of the convergence process. Additionally, the behaviour of credit has changed right after the beginning

of the global financial crisis, and the slowdown in its growth may have been caused by the economic slowdown (due to the crisis) and also from achieving its possible potential (equilibrium level of credit). This study aims to answer exactly these questions. This paper will try to measure the long-term equilibrium level of credit in Albania, through identifying the natural benchmark provided by the Euro zone developed countries or the developing ones (in the region).

"FOREIGN EXCHANGE MARKET SENSITIVITY TO ECONOMIC NEWS", BY ILIR VIKA, RESEARCH DEPARTMENT

This study aims to explain the exchange rate volatility in the short run. This is tested by estimating whether the foreign exchange market reacts immediately to economic news, and whether these changes are transmitted in the following days. Additionally, this study aims to measure whether the economic news impose changes on the exchange rate through purchase-sales volume in the foreign exchange market.

"FINANCIAL INTERMEDIATION AND MACROECONOMIC EFFICIENCY OF THE ALBANIAN ECONOMY IN FORMING AND ALLOCATING CAPITAL", BY JONEL KRISTO, RESEARCH DEPARTMENT

In an inefficient economy, there are excess savings that may bring excess capital accumulation, and therefore, inefficient resource allocation system-wide. The implications are many, but most of all we could mention the fallback from full investment potential, as well as a waste of capital resources. The goal of this study is to evaluate whether there is a balance between savings and consumption, and the rate of capital formation in the Albanian economy. We use financial intermediation as part of the explanatory side, to see how the Albanian banking system contributed to this balance.

IV. ARTICLES

During the first half of 2011, Research Department prepared the following articles:

"ACTUAL TO POTENTIAL TRADE BETWEEN ALBANIA AND ITS MAIN TRADING PARTNERS", BY ALBAN PLLAHA, RESEARCH DEPARTMENT

This article offers a methodological description of the gravity model for trade applied in this study, the data characteristics used to obtain the predicted results, as well as a short summary of the main findings. Thus, the projected results from the model suggest that the level of trade flows between Albania and regional countries of South-eastern Europe are far below their potentials. The gravity model outcomes suggest that, in the current economic situation, trade flows between Albania and other regional countries could intensify by more than 80% compared to the current ones. The obtained results suggest that trade flows between Albania and its main EU trading partners (Italy

and Greece) are close to their optimal levels. On the other hand, the model identifies the unexploited opportunity of trade intensification between Albania and Germany. These two trading partners could escalate their trade flows by more than 90% compared to the actual ones.

"THE BEHAVIOUR OF REMITTANCES IN ALBANIA FOR THE PERIOD 1996-2010, AND THEIR MAIN DETERMINANTS", BY ESIDA ABAZAJ, RESEARCH DEPARTMENT

This article aims to empirically estimate the macroeconomic determinants of emigrants' remittances to Albania over the period 1996-2010. This study is the first of its kind in the case of Albania. The methodology employed is the Vector Error Correction Mechanism, which enables the study of the short- and long-term dynamics of remittances. The findings suggest that remittances in the long run depend only on the macroeconomic conditions of the host countries, which are proxied by the unemployment rate in these countries, weighted with the share received by each of them. An increase in the unemployment rate by 1 pp reduces remittance inflows by 0.13% in the long run. The other explanatory variables (exchange rate, and home country Gross Domestic Product) turn out to be statistically insignificant, both in the long and short run, rejecting thus the hypothesis that remittances are

remitted to meet the consumption needs of the Albanian emigrants' households in the origin country. The only finding supporting the altruism hypothesis is the high and statistically significant error correction term. The study found no evidence of the investment motive driving Albanian emigrant's remitting decision.

"EVALUATING THE VOLATILITY OF RESERVE HOLDINGS AND THE DIFFERENCES TO THE OPTIMAL LEVEL: THE CASE OF ALBANIA", BY GERTI SHIJAKU, RESEARCH DEPARTMENT

This material aims to analyze the volatility of reserve holdings in Albania, based on empirical evidence from the working paper on "The Optimal Level of Reserve Holdings: An Empirical Evaluation in the Case of Albania"[2]. Empirical evaluations highlight that the current level of reserve holdings is higher than the estimated optimal level. The analysis of the weighted contribution of each macroeconomic explanatory variable suggests that the growing difference between the actual and optimal level is mainly caused by the diminishing opportunity cost of reserve holdings and the raising level of volatility throughout the global financial crisis. The results also show that the economic and financial crisis had a distinguished impact on the dynamics of reserve holdings.

V. MISCELLANEOUS

TWO-WEEK SEMINAR IN THE RESEARCH AND TRAINING CENTER OF THE BANK OF ALBANIA

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2   Shijaku, G., 2011, published in "Economic Policy in SEE: Design, Performance and Challenges", Workshop Book, by Fullani, A., 2011.

Bank of Albania, in cooperation with the IMF Institute, organized in the Research and Banking Studies of Berat, on 6-17th June 2011, the two-week seminar "Macroeconomic Management and Issues of Financial Stability in the South-eastern Europe". The aim of this important activity was to equip the participants with a practical understanding of topics related to macroeconomic policy. Therefore, the programme stressed the analytical framework used in estimating the debt sustainability and competitiveness in foreign markets; the importance of macro-financial linkages of financial sector issues, and the role of structural reforms designed to enhance economic growth and development. The activity programme also included a high-level concluding panel on the recent and expected economic developments in the South-eastern Europe. This activity welcomed 25 middle-level officials from regional Central Banks or Ministries of Finance, who are considered to be responsible in designing financial and macroeconomic policies in the near future.

HIGH-LEVEL SEMINAR BETWEEN THE UNIVERSITY OF OXFORD AND BANK OF ALBANIA

Bank of Albania, in cooperation with the University of Oxford, organized on 21 June 2011 a high-level seminar on "Current Economic Challenges and Regional Co-operation in South-eastern Europe". The aim of this seminar was to identify the economic challenges faced by the South East European countries and to identify the possible scopes for intensifying regional co-operation. The

seminar addressed three main issues:

1. Identifying a sustainable growth agenda for our region;
2. The positive influence of external anchors in enhancing regional economic cooperation;
3. Future areas of regional economic cooperation.

The seminar brought together high-level participants from the academia in Albania, the region and beyond, representatives from the banking system, state agencies, international organizations operating in Albania and the Bank of Albania. The organized seminar is part of the co-operation agreement between the Bank of Albania and the University of Oxford, which was signed in September 2010. This activity stressed the role of the Bank of Albania in being an active player in regional cooperation initiatives in South-eastern Europe.

TECHNICAL SEMINARS

The Research Department, in line with the Medium-Term Strategy of Research Development at the Bank of Albania, organizes once in two months the Technical Seminar. This seminar aims to introduce the latest scientific news in the field of economics, new methods of solving different problems, the development of original mathematical models of processes and phenomena, and the results derived from the use of these models. During the period January-June 2011, the following three topics were addressed:

i) "Application of Bayesian Econometric

Techniques", by Armela Mancellari, Research Department

This seminar aimed to apply Bayesian econometric techniques, designed in three presentations. The first presentation, held in April, focused on demonstrating the Bayesian techniques in simple linear or autoregressive equations during the modelling and forecasting process. This presentation combined the classic methodology of econometric estimation, Ordinary Least Square, with the concept of priors and posteriors in Bayesian estimation, which was conducted by applying the Gibbs sampling algorithm. What is special about the Bayesian technique is that in econometric estimations, it allows including judgment that experts have on estimated parameters. Such judgment can be theoretical or practical, gained by experts' experience on economic relationships. The main advantages offered by the application of Bayesian techniques in modelling is its accuracy in deriving conclusions in small samples, and the inclusion of qualitative information, in addition to the quantitative information.

ii) "Corporate Governance: Sound Corporate Governance Principles", by Oriela Kodra, Research Department

The aim of this technical seminar was to introduce the concept of "corporate governance", its importance, why it emerged, and the main principles it is based on. The corporate governance, as defined in details by OECD, includes "the whole relationships between company management, its Board of Directors, shareholders, and stakeholders". In this context, corporate governance deals with all the procedures that are followed in running a company, the way objectives are set, tools and means designed to achieve these objectives, and the performance evaluation techniques.The sound corporate governance (of banks) enables the effective use of company's resources. Considering that banks constitute a representative part of the banking system, their sound governance takes special interest in the economic development of the country as a whole.

iii) "Labour Market and Unemployment in Albania", by Jonel Kristo, Research Department

This presentation aimed to analyze the labour market and unemployment data in Albania and other countries of the world. It paid special attention to the definition of various indicators, description of actual measurements, review of measurement methodology of the unemployment rate, and their comparison to those of EU and USA. The presentation also addressed the main characteristics of the unemployment rate series, in terms of structural breaks and its performance in years. Some alternative estimations of the unemployment rate were also presented, such as NAIRU (Non-Accelerating Inflation Rate of Unemployment), NAWRU (Non-Accelerating Wage Rate of Unemployment) and the links between the behaviour of unemployment and rate of inflation, and their application in the future.

LINKS:

RESEARCH AT OTHER CENTRAL BANKS

Banca d'Italia (http://www.bancaditalia.it/studiricerche)

Banco de Espana (http://www.bde.es/informes/be/docs/docse.htm)

Bank of England (http://www.bankofengland.co.uk/publications/workingpapers/index.htm)

Bank of Finland (http://www.bof.fi/en/julkaisut/bofit_julkaisut/index.htm)

Bank of Greece (http://eng.bankofgreece.gr/en/publications/research.asp)

Czech National Bank (http://www.cnb.cz/en/research/)

Deutsche Bundesbank (http://www.bundesbank.de/vfz/vfz_diskussionspapiere_2009.en.php)

European Central Bank (http://www.ecb.int/home/html/researcher.en.html)

Oesterreichische Nationalbank (http://www.oenb.at/en/presse_pub/research/research.jsp)

Federal Reserve (http://www.federalreserve.gov/econresdata/default.htm)

OTHER

BIS Central Bank Research Hub (http://www.bis.org/cbhub/index.htm)

International Journal of Central Banking (http://www.ijcb.org/)

National Bureau of Economic Research (http://www.nber.org/)

International Monetary Fund (http://www.imf.org/external/pubind.htm)