

## “THE SAVING BANK” - THE CHALLENGE OF 2001

### INTRODUCTION.

Banking performance and the privatisation of state-owned banks in Albania. - That is the topic that Minister Angjeli and I would like to discuss amongst colleagues. We are mostly concerned about the banking system reform, and especially, the privatisation of state-owned banks that comprises a key element in this process.

It is for the third year successively (2000 included) that the macroeconomic situation of the country is perceived within the frames of mid-term development program. The application of this program has ensured macroeconomic stability providing premises for long-term development, compilation of development strategies for specific sectors of the economy, the strengthening of institutions and the ability to focus on aspects of highest priority. I would like to mention some of the banking system's latest developments that I appoint as of great importance: developments in the Bank of Albania's monetary policy, credit expansion to economy, and the improvement in the overall situation of commercial banks.

During 2000, Bank of Albania took all the necessary measures to facilitate **the transition from direct to indirect monetary policy instruments**. It is an already a well known fact that our central bank does not rely on the credit ceiling or the minimum interest rate on time deposits in domestic currency. Both instruments have become 'obsolete'. The role of the reference or the 'core' interest rate is currently taken up by the Repo rate fixed in Repo auctions.

Owing to its prudent policy, the Bank of Albania has proved to be successful in its endeavours to replace the former direct monetary policy instruments with indirect ones. This success was promoted by the relatively favourable economic environment in the country, and the sound co-operation with the Ministry of Finance in terms of administering the process of internal financing of the budget deficit.

The achieved macroeconomic stability and the need to ensure an economic growth, enabled the Bank of Albania to relent its monetary policy for the third year successively by the continuous cutting of interest rates on the whole economy.

These factors are estimated to affect **the increase of banking credit to economy**. I am aware of the fact that everyone present in the room would be reacting with an ironic grin as many times as it is taken up the discussion on 'credit to economy'. However, I can not neglect the fact that the credit stock during 2000 results three times as that of 1999; that the newly posted credits almost equal the credit supply at the end of 2000, as lost loans were insignificant.

As at beginning of 2001, **the Albanian banking system is considered to be relatively safe and sound**. Amongst the most significant developments, I may rank the expansion of the bank network, structural changes in ownership, capitalisation and its financial situation.

\* *Bank network extended beyond Tirana.* Alpha Bank Branch expanded on operation in Elbasani and Durrës; Tirana Bank expanded to Gjirokastra; FEFAD Bank began to operate in Fier and Elbasani; the American Bank of Albania opened its subsidiary in Durrës and an agency in the American Embassy in Tirana. It may seem as a pun, but this agency constitutes the first Albanian banking unit outside the national border.

\* *The ownership structure has changed significantly at the benefit of non-state owners and representatives of foreign capital.* The end privatisation of the National Commercial Bank reduced the level of the state equity in the banking system from 38.1 percent at the end of 1999 to 13.4 percent at the end of 2000. On the other hand, the share of foreign capital in the banking system increased from 59.8 to 84 percent respectively.

That is a direct indicator for the addition of foreign investments and the relatively high confidence of foreign investors to invest in the banking sector compared to the entire economy.

- \* *The capitalisation of the banking system is very satisfactory.* Capital adequacy as direct indicator of capitalisation, increased from 8.2 percent at the end of 1999, to 41.8 percent by the end of 2000, exceeding by 3.5 times Bank of Albania's allowed minimum. This situation is a direct result of the Bank of Albania<sup>1</sup>'s decision to extend the level of banks' paid-up capital and Government capitalisation of the Savings Bank<sup>2</sup>.
- \* *It's for the second year in succession that banking system result on profit.* Net profit at the end of 2000 amounted at Lek 5.4 billion or 4.5 times more than in 1999. Profit addition and the satisfactory capitalisation mean more credits and investments from banks.

The addition of foreign capital (private) in the banking system, the improvement of the financial situation, the adequate capitalisation of banks, the strengthening of competition and stable economic prospects, have created the conditions for **banks increase their contribution in domestic economy within 2001.**

We are aware of the fact that the banking system in Albania lacks as many features to secure it a place amongst the modern banking systems of the world. The development of this system will be setting us in front of many problems and challenges. **The current year challenge is called the Savings Bank.** This bank privatisation scheduled to take place interim this year, will strengthen the development tendency of Albanian banking system or impede it. This depends on how successful we will be in this process.

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<sup>1</sup> Regulation of the Supervisory Council of the Bank of Albania, March, 1998 according to which until end of March, 2001 all the banks should have a minimum paid in capital of 700 million leke.

<sup>2</sup> Regulation of the Council of Ministers, no.37, 28/12/2000.

## I. THEORETIC APPROACH ON PRIVATIZATION.

What does privatisation mean? What are privatisation targets? The answers to these questions vary with experience and current interests.

In narrow sense, privatisation is defined as a legal shift of ownership entitlements from public to private agents. In broader sense, privatisation includes all measures that contribute in the denationalisation of economic activity<sup>3</sup>.

Privatisation targets vary with process. *From the political viewpoint*, privatisation ensures state expropriation and the establishment of a new stratum of capitalists and entrepreneurs.

*From equity viewpoint*, privatisation aims restitution of ownership to that group of persons that were forcibly expropriated in the process of nationalisation. Privatisation can also grant priority to the state unit employees, or simply, carry out the distribution of equity among citizens.

Privatisation may simply target the increase of *efficiency*. Privatisation may be used to *ensure revenues for the budget of state*. Lastly, governments use the privatisation process *as an additional instrument to stability*<sup>4</sup>. Therefore, any privatisation process may follow a single target or a group of targets at the same time. The privatisation of a highly centralised Albanian economy became an immediate target after 1992.

As already known, this process was organised in three stages, as to the size (the relevance) of the enterprises to be privatised. To the end of 1996, most of the small and mid-sized enterprises were privatised. From this year on, the focus went further to the privatisation of large-size enterprises, and especially, strategic sectors

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<sup>3</sup> Lavigne Marie "The economics of transition" from socialist economy to market economy, USA, 1999 page, 162.

<sup>4</sup> Lavigne Marie "The economics of transition from socialist economy to market economy", USA, 1999 page, 163- 164.

of the economy. For this reason, in 1998, the Parliament approved the privatisation strategy for strategic sectors of domestic economy. The privatisation of state-owned commercial banks was an important part of this strategy.

However, it can not be said that the privatisation of public banks, started in 1998, was just an outcome of the privatisation of strategic sectors of the economy. Bank privatisation is one of the three main pillars of financial sector reforms for a country in transition besides the reestablishment of macroeconomic stability, including the achievement of low inflation rates, and granting access to foreign bank initiative<sup>5</sup>.

Whether in the recent decade, we had a favorable experience in macroeconomic stability, inflation reduction and the opening of the country, especially the banking system to foreign capital initiative, this framework needs to be completed with the privatization of the public banks.

Public banks should be privatised, as they represent potential risk resources to the economic development of the country. Political interventions in the banking system were considered an important factor in the financial crisis of Eastern Asia in 1997<sup>6</sup>. Political ownership makes it easier for politicians to channel the lending activity to public enterprises or other enterprises favoured by state, in spite of their inefficiency.

That's why bank privatisation, in the first place, requires from the state to resign from the direct governance of banks and assume the legitimate role and authority as regulator and supervisor of banks. A similar fact is underlined, as bank privatisation has not always led independent governance to them<sup>7</sup>. When public banks are notably large, and especially, when the banks' policymakers

face conflicts of interest, privatisation is not a guarantee for independence.

Such a scenario was encountered in the Czech Republic. Even after privatisation banks in this country continued to extend political credits<sup>8</sup>. These loans were frequently used as financing instruments for political parties or selected clients in addition to their large debts and mismanagement.

Suffices to mention the widely known case of IPB in the Czech Republic. The roots of this scandal stemmed from the deficient privatisation scheme. The management of IPB did not change even when 46 percent of the shares, went under the ownership of a foreign bank.<sup>9</sup>

However, we do not intend to permanently and theoretically resolve the question of defining privatisation and targets. Today we are trying and hoping to find these answers as they apply to the privatisation of the Savings Bank.

## II. PRIVATISING SAVINGS BANK.

Albanian authorities have certified their pro-privatisation attitude in the matter and, furthermore, this process has started a couple of years ago.

It can be said that we are almost at the end-process for the privatisation of the Savings Bank. We are acquainted with steps taken to accomplish the privatisation of the Savings Bank. With this respect it must be admitted that two of the most important instruments of this process are the privatisation formula and the strategy to be followed.

**I hold these instruments as most important as the Albanian authorities amongst numerous recommendations selected them and suggestions set on the table of debate at the wake of the Savings Bank privatisation.**

What does "to privatise the Savings Bank" mean? At first, the answer may seem

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<sup>5</sup> "Starting from scratch", 'The banker' magazine, October 1999, page 55.

<sup>6</sup> Bath James R. et al " *Choosing the right financial system for growth*", Policy Brief. Milken Institute no. 8 February 28, 2000, page 14.

<sup>7</sup> Bonin John P. et al, "Banking in transition economies" EE, 1998, page 1-2.

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<sup>8</sup> European Banker, no.185, December 2000, page 18.

<sup>9</sup> "The Business Week", August 7, 2000, page 60-62 and "European Banker" no. 180, July 2000, page 21.

straightforward and easy. **To the Bank's owner, it means conveying 100% of the ownership to a third party.** The foreign investor is entitled to not less than 35 % of the shares. Additionally, international financial institutions (entitled to no more than 49 % of the shares) and Albanian natural bodies and legal entities (invited to no more than 24 % of the shares) are expected to be Bank's owners.

But what does "the privatisation of the Savings Bank" actually signify? The answer to this question is not simple: **The difficulty of the problem arises with the identification of the basic target for the privatisation of the Bank.** In other words, which of the downward targets is going to guide the process?

- providing state budget revenue, possibly more than expected;
- improving the fiscal position;
- ensuring a strategic investor who enjoys reputation; whose presence in Albania will provide a different attitude of the financial world to the Albanian banking system;
- encouraging competition in the Albanian banking system;
- improving the Savings Bank's operation and that of the Albanian banking system as a result, and inciting its development;
- increasing the Bank effectiveness that will be privatised and the whole system's as a result;
- diversification of the origin of foreign capital invested in the domestic banking system that will bring about the access of different banking cultures; or
- Other goals totally different from the above listed ones.

It is relevant to take a look at the steps made so far on privatizing Savings Bank and check the extent to which recommendations provided by the theory of bank privatization, are considered.

What's commonly recommended is that bank privatisation be set up in such a way as to promote a competitive environment so that the financial sector may not be dominated by few bank institutions. Privatisation should seek to guarantee that the privatised institutions conduct their operation independently from the government.

The Bank of Albania urges that the Savings Bank need not have as its primary goal the "procurement of more revenue to the state budget". **What is worth here is the long-term profit envisaged to achieve by the financial system in place.**

*When established as joint ventures, state-owned banks should be considered as independent financial units.* Privatisation should lead to improvement of quality in management and operations' effectiveness.

*Re-capitalisation should be directly related to the privatisation process.*

The equity structure of bank under privatisation also has its own importance. At the very core, the management and the banks' business strategy will depend on the equity structure resulting from privatisation.

***The selected privatization method should maximize the possibility that bank's management be independent from the State. That is more likely to happen when a key investor gets a considerable share in the Bank.***

***Particularly, the foreign strategic investors are positive accessories independent management.***

**Despite a legitimate concern about foreigners' rule on the domestic banking, foreign investments represent the best source for strategic investors, who can increase the bank's capital position and may bring about immediate independent management.**

Such a strategy allows not only the increase in the bank's equity, but also results in an increase in the market value because of the equity and the reputation offered by the foreign investor.

Not willing to repeat the Minister of Finance, concerning the steps made, and the measures taken, in the privatisation process of Savings Bank, I find it necessary to emphasise that **the selected privatisation strategy, on the whole, takes well into account these theoretical recommendations.**

The privatisation formula of the Savings Bank includes the commitment of a strategic investor, which needs to be a bank institution. Meeting our target in getting international financial institutions involved, is a strong guarantee for a satisfactory performance of the bank, as well as a painless transition to complete privatisation.

This process is also helpfully to maintain the creditors' confidence in the bank. The government intention of selling 100 percent of the bank's capital communicates its commitment towards respecting the managerial independence of the bank.

Further, the Savings Bank is transformed into a shareholding company and its capitalisation is assured to comply with the respective articles of "Bank of Albania" law. It is also expected that, during March, legal requirements concerning the regulatory capital must be met. Following the already important measures taken, the authorities will continue to pursue other measures about restructuring its activities before the privatisation. All these measures will create a successful basis on which the Savings Bank privatisation will take place.

What's worth stressing, is that we need to choose and adopt a forward-looking structure where to integrate all structural and regulatory measures before we get at actual privatisation, itself. Privatisation process is not a substitute of the possible reorganising measures. On the other hand **the policy of "first privatise, then reorganise" has proved to a failure** because the

privatisation process may introduce such interests that might disable later efforts to regulate. These are useful conclusions to be taken into account before each privatisation process, even if one banking institution is included.

Though the degree of influence of threatening factors on the privatisation process is variable with different states, we must live with the idea that such factors are present in Albania. It is this presence that makes the privatisation process fragile. This is the reason that all the Albanian authorities are engaged in a prudential supervision of this process. Bank of Albania also plays a special role, as a government adviser on economical matters.

I consider the privatisation of the Savings Bank as a challenge to the Albanian authorities for the important position it holds in the banking system. The success or not of this undertaking will have serious repercussions, not only for this bank prospect but also for entire Albanian banking system. I did mention above that the privatisation process has taken into account the theoretical recommendations and it is good moving straight ahead. This is a guarantee for a successful privatisation. However, I would like to draw your attention by emphasising the three following aspects:

- \* the process transparency;
- \* achieving a consensus for the process, and
- \* Publicity.

**Transparency** is a fundamental component of the privatisation process success. It is the messenger of our objectives in this privatisation and, accordingly, it should bring the public support on our side. Public support is necessary if we want to avoid speculative situations, panic dissemination or false alarms, which not only present a barrier, but might endanger the whole process as well, and also pose a threat to the entire banking system stability. The Albanian public has the right to ask this question "Our state banks are being sold but is there any state without a bank of its own?" Knowing the Albanian public tradition and

psychology makes us believe that it might take a long time before the public gets completely used to the free trade mechanism. Our people have traditionally confided state to guarantee their savings. I think that this problem must be cured with prudence and care as much as by state institutions and not simply with publicity and propaganda by media. In this sense, we must hurry up with the approval of the draft law on the deposits insurance and with the quickly establishment of the respective authority. It is a very positive step, that, the Government approved the draft law within March 2001. This process must not be hampered in any case.

Privatisation process transparency helps immunity from speculation with it, but it does not guarantee it. **The Albanian authorities must make every possible effort to achieve the consensus** of such groups that, at least potentially, might find in their interest to speculate or disseminate panic. We are getting used to demands for reaching a political consensus. This, in part, reflects the fact that it is not so difficult to find politicians that have interest in speculating or in disseminating panic.

However, I would appeal for reaching a broader consensus. Additionally to political groups, we must bring to the table even business or consumer representative groups. This is because the Savings Bank privatisation has complex implications. Hence, I consider as very important the engagement of the Ministry of Finance and the co-operation between our institutions in calling this conference meeting today. It serves not only to enhance transparency but also to discuss an important problem collectively and, why not, drive at a consensus.

Amongst the problems we must pay attention to be the **publicity** for this process. Publicity helps directly in the enhancement of strategic investor's quality. I think, that the Minister of Finance will understand, but I believe, we are somewhat late in this element. Normally, publicity begins with the propaganda on the bank profile to be privatised. Everyone must find an answer to

the question: Why should I invest to the Savings Bank of Albania? Publicity needs to be developed for a long period of time and by some domestic and foreign media. Do not forget; the Savings Bank privatisation coincides with parliamentary elections, which as already known by all of us are commonly, anticipated by aggravated electoral campaigns. What is likely to happen is that this event may eclipse the propaganda and misuse the process of bank privatisation? We must keep well in our minds that we are privatising of the largest bank of our system.

### III. POST-PRIVATISATION.

What about post-privatisation? I drop this question for discussion for the post-privatisation prospect will change the places amongst authorities. If until privatisation, the main burden of problems, criticism or praises, responsibilities or compliments is carried by its owner, Ministry of Finance, after privatisation, Bank of Albania will be at the centre of this process.

Being the responsible authority for the regulation and supervision of the banking system, its interest in the success of privatisation process goes beyond the shift of ownership. It is in the interest of the Bank of Albania that from this process be generated a safe sound bank in order to contribute in the banking and financial system development. For this reason, Bank of Albania requests a strict adherence to rules and regulations, and is actually trying to complete and improve these regulations in order to avoid unexpected situations and its incapacity to react.

To this moment, we have asked ourselves many questions about the privatisation consequences of the Savings Bank:

\* Will the public hold deposits in this bank, as previously?

If the answer is yes, will we meet the same deposit flows or will we have a gradual and silent deposit displacement to other banks?

\* What will happen with the dominant position of this bank in the domestic bank market today? Will it reduce by

strengthening competition or we will experience a strengthening of its ruling position as result of the improvements in its management?

\* What will happen with bank's network? What about budget payments, pensions etc.?

We are discussing and examining some of these problems among specialists. The above issues are also attended with high concern by the foreign advisors who assist the privatisation process. The questions

posed above present crucial problems and they call for special attention in our debate today.

Indeed, the challenge of 2001 is called the Savings Bank. It is the duty of Albanian authorities to successfully accomplish it.

Thank you !

**Shkëlqim Cani**

**Governor**