

BANK OF ALBANIA AND EUROPIAN
INTEGRATION

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Distinguished Governors and participants of this round table,

Albania, as the other countries of the region, shares the same objective, European integration. As this may be considered as a strategic objective, perhaps a long term one, it is important that we elaborate and follow mid term objectives during this transitory phase. During the previous decade, Albania and the Balkans in general, became part of Europe through migration. Issue of the economic transition, difficult to be addressed and highly complex in optimizing the decision-making mainly dominated agenda of reforms. Our objectives of the integration, which most probably will dominate the agenda of this decade, must intend to europeanisation of the society of our region.

In these processes, there is need and space for the contribution of each individual, institution and entity, for every one to have his say. I would like to follow on the role the Bank of Albania will play in the process of European integration of my country.

Developing this concept first of all within our organization, **the institutional model** the Bank of Albania has chosen to develop, is that of the European Central Bank.

This commitment is explicitly mentioned on our document "Mid Term Strategy of the Development of the Bank of Albania", approved by our Supervisory Council since 1999. We are aware that achieving the full compatibility of our central banking practices and standards with that of the ECB will require its time. They will be developed and refined in parallel with the economic development of my country and the democratization of the Albanian society.

In the first stages of transition, monetary and foreign exchange policies were hindered by the absence of financial markets, indirect monetary policy interments, a weak central bank, huge budget deficits and the need for quick relative price adjustments. Although the relations of the Bank of Albania with the government budget, for example, are not the same as during the first half of '90s, where the budget was mainly financed through direct credit, they far from ECB practices. We still continue to provide direct finance for some part of the deficit. Such practices, as defined on the law "On the Bank of Albania", are a witness that the law on central bank itself, is needed to gradually be amended in order to be harmonized with the legislation on the European System of the Central Banks. On the other hand, the development of the institutional independence requires among others, a supporting public and a market, which transmit the monetary policy decisions, quickly and correctly, in the economy.

I am pleased to notice today that Bank of Albania, by providing its independent opinions on the state of economic development of the country and other important economic issues, has attracted the attention of the public and is well received on the specialized public opinion.

Addressing of these issues, as well as internal structural refining and development of analytical skills within our organization, is the backbone of the strategic document I referred above.

Transformation processes of the economy so far, have contributed to deepening of the convergence of economic and trade structures with that of the European Union. Trade transactions with the EU member countries amounts to 80 per cent. On the same levels remains the origin of foreign direct investments in Albania.

Deepening of the convergence naturally leads to deepening of the economic interdependency, thus increasing the symmetry of economic shocks. As a result, economic and monetary developments on the EU area will have deeper effects on our economic and monetary developments. In this sense, we today pay more attention in monitoring these developments in the EU area and adjust our policy decisions.

Empiric evidences, although they are still limited, prove that development on the business cycle on the EU, changes on the exchange rates and interest rates, affect the Albanian economy¹⁰⁴. As a result, decisions of the ECB are serving as an anchor for the conduct of our monetary policy.

The introduction of the new European currency to be used in 12 EU member countries starting next month, is undoubtedly, the most important event not only for Europe, but also for the whole international financial system. Bank of Albania is paying a special attention to these developments, first to ensure a smooth currency change over for the currencies circulating within our country.

To that end, we have initiated a public education campaign, in full cooperation with the central banks from the Euro area and with our commercial bank's network. On a longer term perspective, the Bank of Albania is studying the degree to which Euro is used in our national economy and will gradually be prepared to move towards the new Exchange Rate Mechanism, the so called ERM-2. Refining of the indirect monetary policy instruments and adoption on due time of the new monetary policy regime of "Inflation Targeting" will serve to that purpose.

In the preparation process for the EU and later on the EMU membership, we are paying particular attention to meeting of the normative convergence criteria as defined on the Maastricht Treaty. From the point of view of the Bank of Albania, maintaining

¹⁰⁴ Robert A. Feldman and Heliodoro Temprano-Arroyo, 1998, "Impact of EMU on selected country groups" IMF WP/98/82.

of price stability at the levels closed to that reference on the Treaty, is our primary objective. We have defined our price stability as a 3 per cent annual inflation, which is close to the reference value and meantime allows for a smooth relative price adjustment with the Euro area¹⁰⁵. Maintaining of price stability, in the conditions of stable currency, will allow for the gradual reduction on the interest rate differential.

Achieving of these objectives are part of our commitments on the mid term. Although the Albanian economy has made considerable progress on its economic transformations, other structural measures will be needed to be undertaken on the coming years. These forces will enable more inflationary pressure on economy, which will be needed to be accommodated by a careful coordination of monetary and fiscal policies. On the other hand, issues of real convergence, such as those of economic structures, incomes, etc., will take some more time than normative convergence criteria.

An important part of the real convergence, is the rapprochement of the financial markets and harmonization of the legislation on this sector.

We heard in the previous sessions of this conference, presentations describing in full developments on the banking system. I would like therefore, to focus on some issues related to the degree of our financial liberalization and further harmonization of the legislation.

Legal framework related to the banking system is revised and improved several times during the last decade. Therefore, on our negotiations for the membership in the World Trade Organization, Albania was represented with a liberal offer on the banking services. The only restrictions applied remain:

- Requirement that branches of foreign banks to operate in Albania should be licensed as "banks" by the Bank of Albania; and
- Approval by the Bank of Albania for capital transfers abroad by the residents.

These restrictions we consider as prudent measures for the security and quality of the banking system at the actual stage of development of the banking supervision practices and standards.

¹⁰⁵ Philipp C. Rother, 2000, "Inflation in Albania", IMF WP/00/207.

However, the Bank of Albania is studying the possibilities for the full capital account liberalization, before the scheduled time of 10 years provided on the agreement.

Albanian banking system today is comprised of 13 commercial banks, of which only one is yet of state ownership, actually on the privatization stage. Foreign strategic investors will be sought to participate on this process. Strong presence of foreign capital on this industry, dominating about 84 per cent in terms of paid-up capital, while it is expected to generate positive effects on the domestic economy, it will require strengthening of the supervision regulations. To this end, we have signed cooperation agreements with supervisory institutions of Greece and Turkey and we are negotiating with Bulgarian and Polish authorities.

The actual structure of our financial system, being still underdeveloped and highly dominated by the banking system only, in a sense makes easy the supervision functions. As we do not yet have a securities market and a non-functional stock exchange and when intermediation of savings and investments is performed almost all by the banking system, this does not yet rise the emergency of reconsidering of the institutional arrangements of the financial market supervision.

Recent improvements of the base legislation and regulatory framework on the establishment of the securities market and of financial intermediaries provide good basis for the diversification of financial structure. Consolidations of the private sector, on the other hand, will put pressures on the diversification of the financial instruments, contributing thus to the sophistication of the financial system.

With these developments taking place, it will be indispensable for the authorities to reconsider the structural arrangements of the financial market supervision. At this point, standards and best practices of the European Union and directives of the European Commission will be taken into consideration.

Stability of the financial system depends, on the other hand, on the policies to be followed by owners and managers of the banks and on national standards of supervision. Their interaction will ensure the public confidence. But, even at the best standards, we can not avoid possibilities of accidents at particular financial institutions. Therefore, the Bank of Albania and other authorities will be forced to prevent spreading of trouble in other financial institutions and thus minimizing the risks of running a financial crisis. Important

structural measures will be needed on that respect. The first step on that direction is already taken with the preparation of the draft law on "On Deposit Insurance", soon to be adopted by the Parliament.

Integration process in the European structures includes not only the domestic reforms and individual country preparations. Strengthening of the regional cooperation is part of this process. Regional initiatives on the framework of the Stability Pact serve to that objective and Albania is an active participant on these initiatives. Bank of Albania is also an active participant on such regional initiatives. I would like to refer in particular to our Governor's Club, which has proved to be successful in discussing experiences and coordinating the mutual assistance. Your participation today on this round table, distinguished Governors, is a witness of cooperation, which we will further strengthen on the future.

Distinguished participants,

What I briefly touched upon so far, is just a part of important steps Albania will need to go through on the years ahead. Integration and membership on the EU will be a long-term process. We wish and we will work speed up these processes, by closely monitoring economic developments and opportunities offered by the new economic realities. Albanian economy today doesn't need 'therapy', but more dynamism and partnership.

For a long time, we lived in another system, in a system with different rules and values. However, the Albanian people wish to build a new society, a society which shares the same values as those of developed nations of Europe. Therefore, the state and its institutions has not the right nor justification to prevent our people living in a better and more prosperous society.

Thank you for your attention.