

## Albania: A Small Economy with A Great Hope

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### Abstract

*In this paper we explore the necessary proposals needed to implement aiming the revitalization of the Albanian economy under a multidisciplinary context by simultaneously ensuring the banking system prosperity and the continuity of this symbiosis in favorable conditions for the parties of interest which can really boost the above mentioned economy.*

*Definitely under globalization perspective the consequences of the global financial crisis appeared in the albanian emerging economy also albeit they weren't devastating even though the country was willing to pay the price in reward of the European membership. The external shocks slowly transmitted to the Albanian economy a rapid fall of the remittances from the migrant workers, a jump of fiscal deficit, the increase of public debt, a sudden lending decline, an immediate fall of the foreign direct investments, an abducted increase of the inflation rate pursued from a partial trade collapse especially from euro zone, etc.*

**Keywords:** *economic growth, Albanian banking system development*

### 1. Introduction

Although the actual overview of the Albanian economy has stable patterns such as: open market economy, there are no restrictions on profit and capital repatriation, the exchange rate regime is floating and so on aiming to strength its position by aspiring the EU membership it still remains a fragile economy from different circumstances. Currently it faces additional troubles derived from neighbourhood: Greek and Italian crises. The foreign direct investments and trade relations with these countries are vital for the Albanian economy by representing the main contributors to the country GDP growth rate in previous years without skipping the impact of remittances from the albanian workers. They account together for almost 80% of the overall remittances.

All this revealed the conservatism and the fear of the Albanian banking system which dominates the financial system, as mainly foreign-owned from the international banking group's affiliates strategically established in order to exploit profitable opportunities to extend loans to both household and enterprise

sectors due to the relatively high returns available in this emerging market with underdeveloped financial systems.

The above mentioned circumstances enabled turbulences in the albanian banking system such as: mass emigrants deposit withdrawals, liquidity problems in foreign currencies that caused the detention of lending in foreign currency for a certain period of time, an increase of non-performing loans and so on...what compulsory impacted even the expansion of bank outlets, consequently other successive problems affected the real economy with final result : a reduced GDP growth rate by the end of 2009 even more in 2011 and the same trend remains for the forecasted figures of 2012.And unfortunately what was expected from the Albanian economy performance on 2012 was quite the opposite. Thus, the Albanian situation becomes even more worrying when its European accession challenge is also threatened and the billion euro question is: How it can be possible to boost the Albanian economy?

## **2. A Foreign-owned Albanian Financial System**

The dominance of banking sector in Albanian financial system, and embryonic developments of other segments of financial system (see Table 1) highlights the structuring importance of the above mentioned system as a key element of transition reforms. Meanwhile, with all the necessary efforts made regarding wasn't possible to build and maintain a dynamic financial environment as per additional requirements not yet established in the country.

But it must be admitted that during the two last decades this system learned how to deal with international banking group's affiliates encouraged from the experience of the first joint venture founded in 1994 between the "Banca di Roma" and the "National Commercial Bank", with a minority shareholding of the European Bank for Reconstruction and Development (EBRD). According to favorable legal and financial conditions as well as to the autonomy gained from Albania's Central Bank on 1997 the system was literally "resized". Thus, by exercising its duties the Central Bank authorized also the entrance of other important banking groups through respective affiliates in the home- market, which met the requirements of the economy for the time being. Actually in Albania operates sixteen second level banks (see Table 2). The undisputable leader in terms of market share is Raiffeisen Bank (ex Savings Bank) totally owned from Raiffeisen International Bank Ag, followed from the National Commercial Bank 100% owned from Turkish Group Çalik. Three banks among these are controlled by Greek commercial banking companies (Alpha Bank, National Bank of Greece, Tirana Bank) as Emporiki Bank was sold out to Credit Agricole on 2006. In 2007, 75% of Popular Bank's capital was transferred to the French Société General as well as in July 2007, the licence was granted to another foreign bank, to the First Investment Bank Jnt. Stk. which is a branch office of the Bulgarian First Investment Bank. Two Italian banks are also integrative part of the system: since 1 January 2008, the Italian-Albanian Bank of the Intesa Sanpaolo Group (in joint-venture with SIMEST "Società Italiana per le Imprese all'Estero" and the European Bank for Reconstructon and Development, EBRD) merged with the American Bank of Albania, founded by the AAEF (Albanian American Enterprise Fund) that founded the brand American Bank of Albania, actually operating under the name of Intesa Sanpaolo bank. And the "Veneto Banca " as a member of the Italian Veneto Banca Holding.

While on February 2008 the selling of 22.17% of Credins Bank's capital to the Dutch group BFSE Holding BV took place. With regard to Credins Bank, the sale of common shares, owned by a private Albanian shareholder, to two foreign investors (BFSE Holding BV the Netherlands, and SECO through

SIFEM, Switzerland) raised the share of foreign capital in this bank to 33.34%, as compared to 5% in 2007.

Whereas ProCredit Bank (The German ProCredit Bank is a valuable part of the above mentioned system with focus to the micro and small size business), two of its shareholders, FEFAD (domestic capital) and IFC (foreign capital- USA), sold out all their shares, 25% and 11.25% respectively, to Procredit Holding, by turning this bank into a bank entirely owned by foreign capital originating from the European Union. Other banks totally owned from foreign-capital are: Credit Bank of Albania, International Commercial Bank and United Bank of Albania.

The only one banking institute with domestic ownership, Union Bank: that began its activity in early 2006, sold out 12.5% of the shareholders' capital to the European Bank for Reconstruction and Development during 2008. This development marks the entry of foreign capital to the last bank of the system that was entirely owned by domestic capital, by decreasing the share of domestic capital in the albanian banking system. Same situation regarding foreign capital persistence is present even in other segments of Albanian financial system. The structural changes, and the increase of paid-in capital during 2008, have resulted in 12.5 billion Lek (33%) more foreign capital, and 266 million Lek (5.6%) less Albanian capital. Thus, at the end of December 2008, the foreign capital in the system was 50.3 billion Lek, or 91.8% (versus 88.8% in 2007), while domestic capital was 4.5 billion Lek, or 8.2% of the total capital.

### *2.1 The Partial Immunity of the Albanian Banking System toward Global Crisis*

Beyond the presence of foreign banks in the Albanian banking system should be outlined its solid character during the global crisis. By this way, it's lack of dynamism became a force, and the main features that helped to deviate under certain limits the global financial crisis consequences as well as make it regulated are:

- The embryonic development of alternative segments of financial system as the Albanian economy is still largely cash-based.
- The financial markets are not developed. Practically no securities transactions are executed in Tirana Stock Exchange. The only securities being trade are T-bills, and Government bonds both managed from Central Bank as means to finance Government budget deficit.
- The foreign exchange market remains the most developed due to the high trade request (respective incomes are a consistent part of the overall financial system) while the derivatives aren't used by corporations.
- Debt markets are inexistent. Credit is constrained by difficulties to assess credit-worthiness, the lack of liquid collateral (especially land titles are used as collateral due to the limited market), other execution problems are present especially related to a limited institutional framework.
- The lack of financial market complexity means restricted sources for investments and lack of diversity of broad spectrum of financial services. Fortunately in our case the lack of capital market does not leave enough space to the speculations. The major part of individual's savings is channelled in term deposits and T-bills.
- The banking sector can't be considered diversified. The sources of bank's profit are acquired from very high interest rates implemented in mortgage and business loans by unfolding their commercial approach.
- The lack of investment in foreign assets characterizes the whole banking sector (due to the strict requirements of Central Bank in order to make in safe the local system). The banks are mainly

focused on the domestic market, and only 10% of their portfolio (ex: placements, etc) is invested abroad.

- The non-banking intermediaries' operative in Albania also invests in traditional way.

### *2.2 The Albanian Banking System Performance During 2011*

In contrast to the GDP growth rate the Albanian banking system during 2011 has performed much better compared with the previous year results especially with regard to: total assets, total deposits, and credit to economy as well as shareholder's equity. The same can be confirmed in the operational prism as: no of ATM's, no of POS, no of credit and debit cards are expanded but anyway the banks have been more careful in the opening of new branches. While the number of employees has increased due to more frequent needs in reporting and monitoring issues. In terms of lending it can be affirmed that the system is merely focused on corporate lending due to syndicate agreements and strategic behaviors obtained aiming a general proactive credit risk management. Retail lending is contracted due to low individual's portfolio hedge ratio, negative consequences derived from the local currency depreciation and to the liquidity problems in foreign currencies faced from small and medium enterprises in trade relations in particular with greek and italian business partners. It should be mentioned also that the system couldn't reached the target in respect of incoming payments commissions because of remittances reduction. In the same time massive emigrant's deposits withdrawals in foreign currencies were present with the scope to meet respective family expenses due to job losses in neighboring countries Italy and Greece, what is overcome by an increase of residents' savings. Besides this the World Bank ranked Albania as the country with the slowest rate of deposit increase in the whole Balkan region. But more worrying is the loans performance, a rapid increased of non-performing loans is reported from 2007 up to date what necessarily brings troubles in the system in respect of technical and managerial terms. The non-performing loans ratio is about 19% by negatively affecting the returns on assets and returns on equity rates of the entire system even why NIM is still high. Thus, 8 banks out of 16 had losses by December 2011. Furthermore its capital adequacy is at satisfactory levels and all the banks remain well-capitalized. In general by the end of 2011 bank's assets structure was composed mainly from: credit outstanding; interbank and treasury operations; security operations and fixed assets. But it can be stated that already the system have no intention to eagerly expand as before by depriving the Albanian economy.

### **3. Overview and Growth Prospective of the Albanian Real Economy**

Albania is the only European country besides Poland that managed to avoid a recession in the fallout from the euro area crisis and is set to take a temporary toll on the economy, aiming to see growth picking up again in the medium-term – even though the strong pre-crisis performance (see Table 3).

However Albanian economy still remains one of the smallest and least sophisticated economies in Europe, services constitute the largest sector, generating more than half of GDP. Agriculture is the second largest, generating almost one fifth of GDP but accounting for more than half of employment. Generating approximately one seventh of GDP, construction qualifies as the largest industrial sector.

All this explains the Albania's trade and financial links with different countries, in particular to Italy and Greece, and its dependence on the inflow of remittances makes the economy vulnerable to developments in the euro area. Therefore, from 2007-2011 the export and import of goods increased in a gradual way except on 2009. In 2011 the export of goods increased 21.9 percent and import of goods increased 13.9 percent, compared with the previous year. While on 2011

the percentage of covering is 36.2 compared with 33.8 percent in 2010. The export of goods from inward processing of textile products and footwear are the products that dominated the Albanian export for the period 2007-2011.

In fact, this is not pure export, but is a re-export from inward process. In Albania there are many enterprises of “façon”, so it explains the great quantity of textile production and footwear exported by making always reference to the available resources. Thus, in 2011 the export of “textile and their production” covered 32.6 percent of export.

From the other side in 2011 the import value is dominated from the import of group commodities of “machineries, equipments and spare parts” and “food, beverages, tobacco” by covering respectively 20.2 percent and 16.9 percent.

In 2011 the import of vegetable, as part of import of agriculture products, decreased 23.5 percent while the import of fruits decreased 14 percent, compared with the previous year.

The trade figures derived from our main partners Italy and Greece (see Table 4&5) are: in 2011 export and import of goods with Italy increased respectively 27.9 percent and 23.4 percent, compared with the previous year. While the overall export of goods with Greece decreased 14.2 percent, the import of goods decreased 7.7 percent in 2011, compared with the previous year. In general the export to EU countries for 2011 is 72.7 percent of total export, increased by 33 percent and the import of goods from EU countries is 62.7 percent of total import, increased by 10.6 percent, compared with the previous year. Under this context is reflected the Albanian’s visionary strategy to build and maintain strong trade relations with different countries with the intention to explore the possibility of being attractive also from the foreign direct investments aiming to grow up even indirectly by leaving apart the negative results of trade balance ( see Table 6). Almost that these data can explain the foreign exchange rates fluctuations for the mentioned period (see Table 7).

In any case Albania has maintained high public debts during the same period (see Table 8). And the highest level was established currently with 59.7 % GDP where respective statutory limit is 60%. This indicator also reflects the Albania’s exposure toward other potential economical issues. Under these circumstances is very important that inflation rate to be maintained within the target band such as: 3% as the inflation rate this year reach in 3.5% (see Table 9). Also current account deficit is considerable (see Table 10) and should be proactively managed by paying particular attention to the export conditions of elements with affect it positively such as: electricity, industrial production, oil, natural gas, etc.

While referring to the country fiscal deficit rate can be said that is consistent but allowed in order to support the aggregate demand, after remaining still reforms to be done aiming to combat the informality and have a more concrete approach as per population incomes level.

As known the foreign direct investments major destinations in Albania were: telecommunication, banking, manufacturing, and increasingly hydroelectricity, oil, and gas. Reflecting the importance of large-scale privatizations and concessions, FDI has primarily been in the form of equity capital, e.g., greenfield investments and cross-border mergers and acquisitions, in the banking sector it has recently tilted toward reinvested earnings and capital injections. Nowadays FDI trend declined due to the completion of the privatisation program considering also that Greece and Italy were the most valuable contributors.

In the same way remittances have suffered the Greek and Italian crisis consequences where live and work a considerable part of the Albanian labor force. More than 25 percent of Albanian citizens are living abroad, making the country the fourth in the world in terms of emigrants to population ratio. Neighboring

Greece and Italy attract most of the Albanian emigrants and account for 90 percent of remittances to Albania. Estimates commonly put the diaspora in Greece at 800,000 and Italy at 300,000, as high as 40 percent of Albanian labor force. Over 50 percent of the first generation of Albanian emigrants to Greece and Italy had secondary or higher education. Around 60 percent of Albanian remittances are from Greece, 30 percent from Italy, and the rest from the U.S., Germany, and other European countries. Remittances played an important role in alleviating poverty and promoting financial development during the two last decades. The Albanian Living Standard Measurement Survey (LSMS) in 2005 estimated that remittances on average accounted for a third of disposable income of recipient families and 40 percent for rural families. Remittances were mostly used for importing consumer goods, services, and for the purchase or construction of houses. The level and particularly the severity of poverty as a result were greatly reduced among households receiving remittances. Remittances also helped promote financial development in Albania through the increasing demand of banking access and services from both senders and receivers and raising banking deposits and credit to GDP.

Fortunately the unemployment rate slightly decreased compared to the 2010 data (see Table 11), reasonably due to the high academic education rate and according to different professional opportunities given from the albanian private and state universities.

So, after 2% GDP growth in 2011 and all identified anomalies, is expected a GDP growth to slow down to around 1% by the end of 2012 and to remain below 2% in 2013. Albania's external position is characterised by a persistent high current account deficit as previously mentioned and FDI inflows are normally expected to moderate somewhat against the slowdown in the euro area. In any case, the government managed to cut down its fiscal deficit by acting only in a few dimensions. Nevertheless, against a slowdown in economic growth, there is a substantial risk that the 2012/13 fiscal targets of 3% of GDP might be missed.

The management of a satisfactory country economical performance should be promoted and consolidated contemporary with the implementation of necessary reforms aiming to accelerate the accession in the European Union.

#### **4. Growth and Welfare Opportunities to be Explored within the Country**

As noted, the identified problems above have a double impact on the Albanian economy, by this way their influence on certain circumstances can be considered as a disadvantage while in other cases it can be treated as an added value..... Thereby the acting philosophy should be more flexible!!!! A strategic action plan must be implemented within the country by giving particular priority to the reforms in the most important areas that constitute a steady growth and hereinafter welfare:

##### *4.1. Policy Making Environment*

- Fruitful political cooperation between opposition and majority is a must for the accomplishment of the European Union required standards;
- Property rights must be secured and enforcement contracts must be improved;
- The Albanian districts should be engaged in territorial development planning;
- The Administrative Court should be established in order to solve the business issues in acceptable timeframes;
- The grey economy should be limited through appropriate incentives;
- To aim trade-relations with different countries from which Albania can benefit;
- Special attention should be paid to the Tourism as well as to its professional education;

- Should be acted appropriately to absorb foreign investments which are actually suffering the crisis in the country of origin;
- Infrastructure investments must be oriented toward the opening of new markets,
- Financial sector policy needs to remain nimble and quickly adapt to evolving risks
- The fight against corruption must be intensified and supported from all the actors of economy, etc.

#### 4.2. *Economical Behavior*

- Government Debt to Revenue ratio should be reduced in order to support in medium –long term this emerging economy growth;
- The inflation target should be maintained by enabling the GDP growth;
- Fiscal Policy should be flexible among sectors of economy with the main scope to reduce as much as possible the unemployment rate;
- Fiscal policy should also provide relief to the small and medium sized enterprises as they are crucial for the albanian economy growth ;
- To be created and maintained a stable macroeconomic climate by enabling the opportunity to activate the Tirana Stock Exchange which appears another dimension for the economy;
- Monetary Policy should be prudent aiming to ensure the price stability, comply with the inflation target and anchored long-term expectations of the economy;
- The business community should be more creative, transparent and formal in its operation. It should comply with all obligations arising from the contractual relations with the banking system as well as with the regional tax offices in order to be guaranteed a solid collaboration;
- Exploitation of hydro capacity becomes a necessity for a sustainable development within the country, etc.

#### 4.3. *Banking System Challenge*

- Central Bank of Albania should also supervise the cost of service in the second level banks by offering to its customers the deprive comfort;
- The banks' role should be re-dimensioned vs partnership with its own clientele and all this must be integrative part of the entire system philosophy;
- Banks should be prepared to deal within its customers difficulties by proposing alternative solution in order to establish long term relations (dedicated consulting departments should be part of banking organizational charts);
- Banks should perform in ongoing basis stress tests in order to capture on time the potential vulnerabilities;
- Further expansion of banking retail chains and products, more banking coverage needs to be established;
- Innovation increase in the sector such as e-banking and mobile-banking is very important;
- The permanent control function should be enhanced within the institutions;
- Managers should act in a balanced way between target and conservatism;
- Auditors role should be exchange with the consulate one;
- The banks procedures should be revised under a more proactive risk management approach;
- The collaboration with the private bailiff offices should be established under a more transparent context versus the clientele, etc.

## **5. Conclusions**

Albania has withstood the global crisis consequences better than most other regional and European economies, and probably it can lead the recovery in the region. Despite the failure to achieve formal candidate status for EU membership in November 2010, Albania's long-term perspective of deepened EU integration supports economic and political progress. Premises of development are omnipresent in politics, economy, administration, justice, financial markets, tourism, etc but immediately the necessary efforts must be made in order to exploit them in par condicio.

The effectiveness of the mentioned reforms in each area must be obtained from an opened dialogue between academics, politics and professionals a priori aiming to avoid potential troubles for the economy as well as to open the onset of cooperation for a better future at the European family. To be honest, already Albania has accumulated the right experience by learning also from the mistakes done in the past to convert the vulnerabilities into force and continue its path toward new challenges thanks to the intellectual and material capabilities that possesses. And the new mentality that should guide us has to do with the fact that welfare is built through working.

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<i>Non-bank financial institutions established in Albania</i>	2003	2004	2005	2006	2007	2008	2009	2010	2011
<i>Insurance Companies</i>	5	10	10	10	10	10	13	13	13
<i>Pension funds</i>	1	1	3	3	3	3	3	3	3
<i>Leasing Companies</i>	1	1	2	3	4	4	4	5	5

**Table 1-** Non financial institution's established in Albania

Source : [http:// www.bankofalbania.org.al/](http://www.bankofalbania.org.al/)

<i>Institution's typology in Albania</i>	2003	2004	2005	2006	2007	2008	2009	2010	2011
<i>Bank and branches of foreign banks</i>	15	16	17	17	17	16	16	16	16
<i>Non-bank financial institutions</i>	7	7	7	5	6	7	7	17	17
<i>Foreign exchange bureaus</i>	58	54	58	60	112	189	207	236	289
<i>Unions of save &amp; loan associations</i>	2	2	2	2	2	2	2	3	3

**Table 2-** Institution's typology in Albania

Source : [http:// www.bankofalbania.org.al/](http://www.bankofalbania.org.al/)

<i>Country</i>	1999	2000	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
<i>Albania</i>	8	7.5	5	7	5.6	5.5	5	6	6.1	3.3	3.5	2

**Table 3-** Albanian's GDP - real growth rate (%)

Source: <http://www.indexmundi.com/>

Structure of eksport by main trade partners

%							
<i>Vitet</i>	<i>Itali</i>	<i>Kosovë</i>	<i>Turqi</i>	<i>Greqi</i>	<i>Kinë</i>	<i>Të tjerët</i>	
<i>Years</i>	<i>Italy</i>	<i>Kosovo</i>	<i>Turkey</i>	<i>Greece</i>	<i>China</i>	<i>Others</i>	
2007	68.1	4.8	2.3	8.3	2.6	13.9	
2008	61.8	6.6	1.9	8.8	2.8	18.1	
2009	62.0	6.9	0.5	7.4	4.7	18.5	
2010	50.8	6.2	5.9	5.4	5.5	26.2	
2011	53.3	7.4	7.4	5.1	2.5	24.3	

**Table 4-** Albania's Main Export Structure

Source: INSTAT Annual Report 2011

## Structure of total import by main trade partners

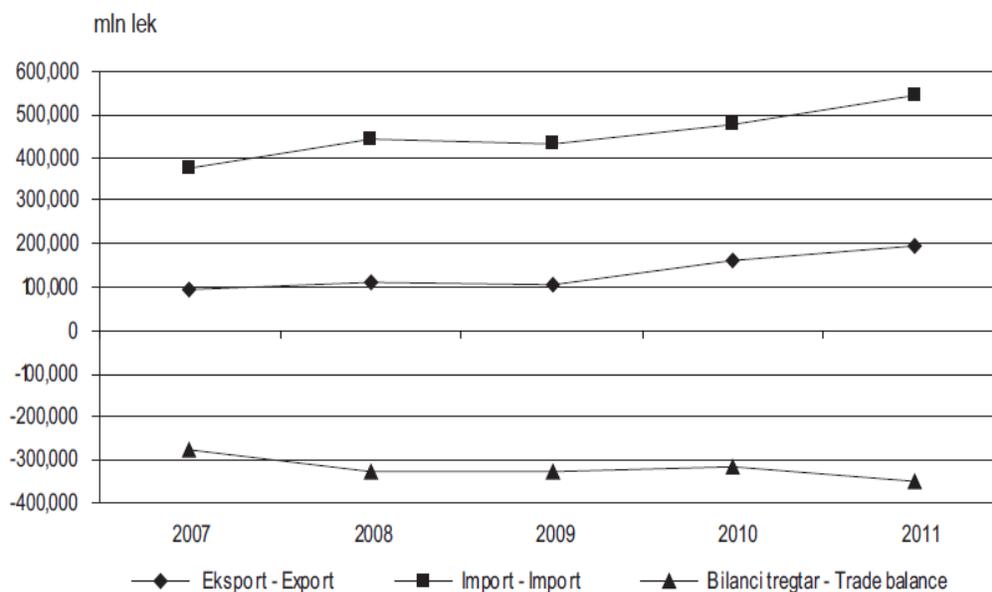
%

Vitet Years	Itali Italy	Greqi Greece	Kinë China	Turqi Turkey	Gjermani Germany	Të tjerët Others
2007	26.8	14.6	6.7	7.3	5.5	39.1
2008	26.5	14.6	7.4	6.0	6.1	39.4
2009	26.2	15.5	7.2	6.5	6.5	38.1
2010	28.2	13.1	6.3	5.7	5.6	41.1
2011	30.5	10.6	6.4	5.6	5.7	41.2

**Table 5-** Albania's Main Import Structure

Source: INSTAT Annual Report 2011

## Trade balance

**Table 6-** Albania's Trade balance trend

Source: INSTAT Annual Report 2011

## Exchange rate

	2007	2008	2009	2010	2011	
Kursi mesatar i dollarit me lekun	90.4	83.9	95.0	103.9	100.8	Average exchange rate of dollar with lek
Kursi mesatar i EURO-s me lekun	123.6	122.8	132.1	137.8	140.3	Average exchange rate of EURO with lek

**Table 7-** Main currencies exchange rate trend

Source: INSTAT Annual Report 2011

Country	2007	2008	2009	2010	2011
<b>Albania's Debt as % of GDP</b>	51.4	51.9	58.1	59.3	59.7

**Table 8-** Albania's Public debt (% of GDP) dataSource: <http://www.indexmundi.com/>

Country	1999	2000	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
<b>Albania</b>	0.5	1	6	2.4	3.2	2.4	2.5	2.9	3.4	2.2	3.6	3.5

**Table 9-** Inflation rate (consumer prices -%) dataSource: <http://www.indexmundi.com/>

Country	2004	2005	2006	2007	2008	2009	2010	2011
<b>Albania</b>	-504,000	-416,000	-679,900	-1,202,000	-1,906,000	-1,845,000	-1,404,000	-1,595,000

**Table 10-** Current Account Balance results (Thsd USD\$)Source: <http://www.indexmundi.com/>

<i>Country</i>	<i>1997</i>	<i>2000</i>	<i>2002</i>	<i>2003</i>	<i>2004</i>	<i>2005</i>	<i>2006</i>	<i>2007</i>	<i>2008</i>	<i>2009</i>	<i>2010</i>	<i>2011</i>
<i>Albania</i>	<i>14</i>	<i>16</i>	<i>17</i>	<i>17</i>	<i>15.8</i>	<i>14.8</i>	<i>14.3</i>	<i>13.8</i>	<i>12.5</i>	<i>12.8</i>	<i>13.5</i>	<i>13.3</i>

**Table 11-** *Unemployment rate (%)*

*Source: <http://www.indexmundi.com/>*