

## The Financial System and Its Impact on the Albanian Economy

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### Abstract

*This is a problem-related analytical article whose aim is to offer an in-depth description and exploration of the shortcomings of the Albanian financial system. Its analysis focuses on pinpointing the incompetent measures and misjudged fiscal and monetary policies applied by the government and its main financial supervisory body, the Albanian Central Bank, in order to establish and administer an adequate market economy's financial system for the country, since the fall of the single-party system 24 years ago. Furthermore, it explores various fiscal and monetary standards that should have been considered, and need to currently be put to practice, in order to avoid deeper financial disappointments in the face of a seven-year-long financial crisis that continues to sway over Southern Europe. Finally, it draws several conclusions on what the country's fiscal and monetary approaches should be in the near and mid-term future in order to start building a solid financial system, which rigorously reflects Albania's economic potential, deficiencies and particularities as a small developing country in Europe.*

**Keywords:** Financial System; Insurance Market; Micro-credit; Stock Market; Bank; Recession; Economic Model.

### 1. Introduction

This analytical work is an attempt to explore several social properties of the financial system and to determine what its impact on the Albanian economy is. We have put together an overview of the development of the financial system after the 90s, pointing out this system's main characteristics; the bi-model: "stock market — bank" and "bank — stock market", and we have determined several weaknesses of the model applied in Albania.

Our focus is mostly narrowed on the banking market, and we have done so by analyzing the monetary policies in support of the fiscal ones during the 2006-2013 period. This is because fiscal policies adopted in Albania have progressed in an expansionary continuity shown by a growth of government expenses and a decline of tax revenue. Overall, the economic direction chosen by the government is theoretically fair, but in our view, the means chosen are not grounded in theory. In relation to the latter, we have presented a table with the main macroeconomic indicators for the 2005-2013 period.

When designing and implementing the monetary policies in support of fiscal policies, Bank of Albania did not take into account that the factors specific to the Albanian economy were: lack - or irrelevant presence - of real estate market, housing market, capital and financial capital market. It acted and took decisions as if its principal objective was to reach and maintain a safe inflation level.

Bank of Albania did not follow the policy guidelines of major banking institutions like the Fed and Central European Bank, neither did it support government's fiscal policies, thereby influencing negatively in: currency diversification, "crowding out" effect, investment stimulation in production sectors, making local currency (Albanian Lek) efficient, etc. In order to maintain the inflation rate in the pre-assigned levels, applying very high levels of interest rates in relation to other national banks, BOA influenced negatively the national economic growth.

In fact, BOA's applied policies do not have any impact on the inflation rate. This is proven in this paper, through the relation between the interest rate and inflation rate. The respective curves show the same tendencies. This is further sustained by the connection of the interest rates with loan rates (in Lek and foreign currency).

The impact of BOA's policies is clearly expressed in the level of monetary aggregates in which the monetary base, out-of-bank (loaned) money, and M1 aggregate, have mostly had a declining trend.

- The insurance market, as an integral part of the financial system, has experienced growth, but its revenues are mainly obtained through obligatory insurance policies such as car insurance, insurance of assets accounted as collateral, etc. There exist considerable differences between insurance costs (borne by the clients) and insurance due payments (borne by the insurance companies).
- Social security market is weak and has started only after 2009.
- Micro-credit institutions have seen a notable expansion; there are 135 of them in the country. A shortcoming in

this field of the economy is that they are localized in the main urban centers.

- Tirana's Stock Market - as part of the country's financial system - exists solely as a concept, because hitherto there is no business entity to have its capital listed in it.

The article will explore in detail each one of the above-mentioned topics, attempting to provide ample insight and adequate assessments in support of the authors' conclusions for each topic.

## 2. Objective

The scope of this article has been to tackle an array of problems concerning the current financial system in Albania. Financial policies are of great importance in the economic development of a country. We are mainly focused in the banking sector since this sector in Albania generally corresponds with the eastern model (in which banks have a priority), not the western model (in which capital markets have the priority).

## 3. Methodology

The approach used in this article involves a combination of secondary data analysis and theoretical analysis. The main sources of data used to structure the article's framework are the periodical reports issued by Bank of Albania, which contain freely accessible data available to the public. It should be noted that data are selected so as to fulfill the purpose of the topics addressed in this article, and its interpretation is solely a product of the authors of this article.

The theoretical framework adopted in our study makes use of the main principles derived from Western free market macroeconomics, according to which capital markets and stock markets are the main driving forces behind national economic growth. The authors contend that Albania's path towards true free market economy is diverted by - accidentally or deliberately - failing to adhere these principles. Each topic explored in the article delivers an in-depth synthesis related to how and why capital and stock markets' underdevelopment in Albania deters overall economic progress.

## 4. Article's Content

1. Albania's financial system transformation up to the recent days
2. Banking sector
3. Insurance market
4. Social security market
5. Micro-credit financial institutions
6. Tirana's stock market

### 4.1 Albania's financial system transformation up to the recent days

Albania today has a dysfunctional financial and banking system. In the center of this system is positioned the Central Bank of Albania (BOA), followed by 16 commercial banks, 13 non-banking financial institutions specialized in the loaning and in money transfer businesses, 2 credit saving unions, 221 currency exchange offices, 135 credit saving companies, 11 insurance companies, and 3 pension funds. (Matraku, 2009)

From its previous political system, Albania inherited a single-level banking system. The transformation of the financial system started after 1990. At the end of 1990, the replacement would be reflected by many radical changes, one of which was the transformation of the banking system to a bi-level one. As a result, in April 22, 1992, BOA was created through passing law no. 7559 "On Bank of Albania"; a law that was later revised to reflect western European models and international organizations recommendations. (Bank of Albania, 2013)

BOA is the central bank of the Republic of Albania. BOA's status is sanctioned in Article 161 of the Constitution of Albania and in law no. 8269 of Dec. 27, 1997, "On Bank of Albania", a law which determines the objectives, tasks, relationships to the banking system and the government, managerial framework, financial capital proprietorship, financial reports and profit distribution.

BOA is a bank whose stock is entirely owned by the Albanian government, and its higher management responds to the Albanian Parliament. The institution is led by the Supervisory Council, composed of 9 members, who are all elected by the Albanian Parliament for a 7-year term, with the right to be reelected.

After 1990, two second level banks were operating in the country: Banka Kombetare Tregëtare (National

Commercial Bank) and Banka Tregëtare Agrare (Commercial Agricultural Bank), as well as a savings agency which later became Savings Bank. The stock of both these banks was entirely owned by the government. In the upcoming years the parliament passed a number of laws and legal acts designed to encourage [1] the participation of private capital in this sector, and [2] the initiation of the privatization process, as in every other sector of the economy.

For an effective financial-banking system of a country, it is necessary to:

- firstly, have the potential to attract effortlessly the savings of individuals, households, and other economic entities,
- secondly, to distribute these savings towards reliable return projects, giving priority to the business sector project, and,
- thirdly, to ensure all the necessary means and conditions to control the well-functioning of the capital market.

This is precisely what was intended even for the Albanian financial system.

Theoretically speaking, there are two known models of a financial system.

- First model - a banking system predominates
- Second model - a capital market predominates

In Albania, as the case is for many countries of Eastern Europe, the first model is used; in other words, the banking system prevails, while the capital market is far less developed. This situation exists also because of the fact that Albanians did not inherit any significant foundation in capital markets from the previous political system, so all the attention was at once concentrated on the banking sector.

The second model is a characteristic of the developed western countries, where the stock market is one of the main liquidity suppliers for the economy, while banks occupy the second place. During the first years of the market economy in Albania, a strong move towards a sound banking system was considered an achievement. This was also perceived as an adequate step for this sector, to not remain behind other sectors of the economy such as production and services. But time showed that there were two shortcomings:

- Firstly, no government-held capital second-level bank was left
- Secondly, not enough work was done towards the sector of capital and stock markets

Both these shortcomings brought extremely negative consequences in the progress of the Albanian economy.

Three important segments can be distinguished in a typical financial system. They are:

1. the banks,
2. private sector loans market
3. stock market

The performance of these segments is shown by indicators such as:

- number of banks
- value of assets occupied by foreign banks activities in the assets' total
- value of private sector loans
- the bad loans/total loans ratio, and,
- value of stocks as a percentage of GDP

After a 20 year political transition period, we see that in Albania almost all banks have foreign capital, and foreign capital assets occupy the largest part of all banking sector assets in the country.

- Private sector loan value has experienced growth, but with a lower percentage compared to the GDP, as well as the total of deposit savings.
- Up to 2008, bad loans stood at 1.5% of total loans, while in 2012 they stand at 21% of total loans, becoming a serious concern for the economy.
- The only financial tools which represent the capital market in Albania are Treasury Bonds, which are debt bonds issued by the Albanian government. No business entity has its capitals listed in Tirana's Stock Market. This means that banks remain the only source of financial inflow, and they have played a crucial role in the growth and stability of the Albanian economy. Banking assets comprise over 90% of the financial market assets, and about 60% of the country's GDP. (Matraku, 2009)

#### 4.2 The banking sector

After 1990, two banks with entirely government-held stock operated in Albania, National Commercial Bank and Commercial Agricultural Bank. In 1992, two other foreign banks were licensed, but the government held shares in both these banks. These banks were Islamic Arab-Albanian Bank and Italian-Albanian Bank. Today the country's banking sector counts 16 commercial banks. Their main activity is that of banking intermediary, which means that they receive the

money from individuals and entities that have them available and plan on saving, and lend them to other individuals and entities that are in need of money. They lend the money requiring interest from the loans according to specified rates. In short, these are financial institutions receiving loans in the form of saving accounts, and lending the received money in the form of loans, with higher interests. How have commercial banks in Albania managed this task? We will analyze the 2005-2011 period to determine what position have these banks held over this time-span. Since Albania is a country in which banks play the most important role in the financial system, their position is a position held towards the Albanian economy as the only source of credit, in an environment where stock markets are absent.

The financial system is of significant importance for the development of a country's economy. This importance becomes even more significant when we are dealing with economies of countries such as Albania, Montenegro, Macedonia, Kosovo, etc. These countries, being small and with a recent transitory political past, display certain peculiarities compared to other countries. This is a reason to take into account all the determining factors when analyzing these economies, be those inherited from past political systems or acquired during the transition years.

The Albanian economy is a small open economy. As such, in many economic aspects it is mostly dependent on the world, especially in aspects related to monetary policies. In this case, we use the term "monetary policies" because even in Albania, as the case may be for many other market economies, macroeconomic standings are reached through political instruments, among which the most obvious are fiscal and monetary instruments.

Fiscal instruments are utilized by the government in support of other instruments, to stimulate the economic development and growth. In Albania's case, they are mostly mere imitations of other countries' fiscal policies, especially of those countries that have recently entered the market economy. This is noticed in the taxation structure and the fiscal legislation, in the removal of progressive tax and application of flat tax, or other indirect taxes. This is also noticed in the system of tariffs and that of customs.

Albanian government politics is mainly characterized by an expansionary fiscal policy on both sides; fiscal side and income distribution side. During the recent 6-7 years, the Albanian government has shifted its focus towards increasing revenues from taxes. This was achieved in two respects: first, through decreasing taxes and increasing the eligibility of taxpaying entities and, second, through starting a zero-tolerance battle against fiscal evasion. These policies brought notable success, which was evident in budget and macroeconomic indicators. The table below shows some of the main macroeconomic indicators of the Albanian economy for the 2005-2012 period.

**Table 1:** Some macroeconomic indicators (2005-2012)

	Nominal GDP	Real yearly growth (in previous period prices)	Unemployment rate	Total CPI (Dec. 2007 = 100%)	Budget deficit including grants (as a % of GDP)	Public debt. (as a % of GDP)	Checking accounts (as a % of GDP)	Exchange rates. (1 US Dollar in Albanian Lek)	Exchange rates. (1 EURO in Albanian Lek)	GDP per capita (in US Dollars)
2005	815	5.7	14.2	2	-3.5	57.4	-10	99.9	124.2	2597
2006	882	5.4	13.9	2.5	-3.3	56.1	-7.3	98.1	123.1	2854
2007	968	5.9	13.5	3.1	-3.5	53.5	-11.4	90.4	123.6	3394
2008	1089	7.5	13.2	2.2	-5.5	54.8	-15.8	83.9	122.8	4073
2009	1151	3.3	13.6	3.7	-7	59.5	-15.6	95	132.1	3765
2010	1222	3.8	13.5	3.4	-3.1	59.7	-11.4	103.9	137.8	3682
2011	1289	3.6	13.4	2.2	-3.3	60	-11.6	101.5	140.1	3992
2012	1340	3.5	13.3	1.68	-3.4	61	-11.7	103.9	140.3	4601
Exp.2013 (12)	x	2.7	13.3	2.4	x	62	x	107.78	139.7	x

Data show that budget revenues from 2006 to 2012 increased by 93.5 billion Lek (324.7-229.4). From 2008 to 2010 they increased by 33.5 billion Lek (324.7-291.2). Government expenses from 2006 to 2010 increased by 104 billion Lek (362.8-258.8), while from 2008 to 2010 they increased by 11.3 billion Lek (362.8-351.5).

From the above figures we notice that the government has undertaken expansionary fiscal policies reaching, in this fashion, unhealthy levels of public debt. In 2012 total public debt/GDP ratio mounted and surpassed the critical level of 60%. This is a far-from-normal figure for an economy like the Albanian one, which, during the later years, has largely invested in infrastructure, remaining behind in other steady sectors of the economy.

Particularly after 2008, a year that corresponds with a global recession pinnacle, the Albanian government undertook exceedingly expansionary fiscal policies. Cash inflows in Lek and foreign currency were attained not only through revenues from the tax system, but also from sales of state property and loans received from foreign banks. The Albanian government also made an effort to sell a Eurobond valued 300 million Euros. Treasury bonds became an

important source of reimbursing periodic deficits, and they were massively used.

In general, the policies implemented by the government in the fiscal line of work were complex and in coordination with domestic and foreign situations. In order to maintain the economic growth trends the government stimulated the aggregate demand through government expenditures. These expenditures were mainly made for investments in infrastructure, mostly roads and highways, and besides them operation expenditures increased as well. Every year there has been an increase in salaries and retirement payments ranging from 3 to 10 percent according specific work categories and sectors. *In general terms, the government chosen strategy was theoretically correct, but the means used, in our judgment, are not grounded in theory, even though an increase of several macroeconomic indicators is noticed.* In the following portion of the article will not concern this kind of analysis, but that of the monetary policies.

In the case of a global recession, many in Albania would rightly be concerned about the following issues:

- When the government implemented expansionary fiscal policies, what policies did the country's central bank follow?
- Did the central bank support the government's expansionary fiscal policies with monetary policies of its own?
- Did the central bank follow the guidelines of major foreign central banks such as the Fed, Central European Bank, etc., when implementing its own monetary policies?

The focus of our analysis will precisely be providing answers for these questions. Being a part of the Albanian general financial system, how did the banking system react towards foreign influences, in order to alleviate their negative impact and contribute to the country's macroeconomic growth?

In my judgement, the Albanian banking system, and central bank policies specifically, have not been reactive to the level required by the economy. The main reason why this happened is that the Albanian economy has a number of particularities compared to the countries of Western Europe affected by the recession. The Albanian economy is characterized by a significant lag behind in the organizational structure of economic factors, and this is clearly reflected by the lack of markets.

- Albania has no proper real estate market. Today there still are numerous problems with real estate property, lands occupied by people other than their lawful owners. The lack of real estate market hampers business development, especially the permeation of foreign capital.
- There is a lack of residence market in Albania. The government has created an artificial organism such as ALUIZNI in order to carry out the privatization of residences built without papers. According to official data, there are over 100 thousand residences without proper papers that have a value of roughly 1 billion Euros.
- There is a lack financial capital market in Albania. There virtually exists a so-called "stock market" in Tirana, but it is not operational. Treasury Bonds are emitted by the central bank on behalf of the Albanian government.
- The financial capital, by which we understand "industrial capital" merged with "banking monetary capital," is absent in Albania. Today we do not have large industrial companies, which can build unique relations with commercial banks in such ways that the phenomena happening in banks could carry over to the companies and vice-versa. Simply put, the absence of financial capital avoids or diminishes the transmission effect. With such characteristics, the Albanian economy resembles an undeveloped economy of the 1980s, rather than a 21<sup>st</sup> century European market economy. As such, the Albanian economy cannot and does not operate like the economies of major European countries, and consequently cannot be affected by the same phenomena affecting the latter.

When designing and implementing its short-term and long-term monetary policies, BOA should take into account precisely these characteristics of the Albanian economy, carefully considering its position in the economic fluctuation, as well as the greater impacts of major currents in the world economy. BOA has followed the example of the European Central Bank when establishing organization and operation structures. Not only that, but it has followed to the letter its long-term and short-term strategic objectives, such as "reaching and maintaining price stability." Therefore when establishing its policies, BOA mainly focuses in the inflation figures, considering them a critical indicator, skipping other economic indicators. In an indirect manner, BOA views these indicators fiscal policy objectives; in other words, government objectives. It does not view them as indicators closely related to that of inflation. *In my judgment, BOA's policy planning based only on this indicator is not correct, because it prevents the stability and development of the economy, economic expansion and consequently the decline of the unemployment rate.*

A central bank of an underdeveloped country such as Albania should not maintain this objective, just as the European Central Bank does not pursue any objectives of this kind. Why this objective is not suitable? The economies of Western European countries operate in an almost "potential product", which presumes a complete utilization of the economic factors and a natural unemployment rate. That is why they rightfully set inflation - not economic growth or unemployment - as a principal objective. They perceive the economic growth level as a natural level in accordance with

the population (and accordingly the aggregate demand). The case of the Albanian economy differs because the unemployment rate in Albania today is 13.3%. *In these conditions, BOA should not set objectives based on the inflation rate only, but should set them based on the economic growth and the unemployment rate as well. If these indicators would be included in its strategies, its monetary policies could be much more harmonized to the fiscal policies implemented by the government to fit the overall objective of the economic growth.*

Since the beginning of the recession in 2007-2008, BOA's decision makers stood in surveillance of the emerging conditions without reacting, having the conviction the "the global crisis will not impact the domestic economy." This was, in fact, a mistaken decision because the global recession had a major impact on the domestic economy. While the government was active in taking the necessary measures to absorb the recession effects, BOA did not follow up through policies of its own. When not followed by the central bank policies, the governmental policies tend to have short term effects, while the monetary policies effects last considerably longer. It was precisely because of the governmental efforts, which in turn required a considerable deepening of the public debt, that the right levels of economic growth were maintained. If the government would have also failed to implement expansionary fiscal policies, the Albanian economy would have entered the recession "head on," since 2009.

The central bank should have supported the expansionary fiscal policies implemented by the government because:

- First, it would have diversified the used currency,
- Second, it would have lowered the government's chances to pull out domestic currency cash from the market,
- Third, it would have encouraged investment in productive sectors,
- Fourth, it would turn the Albanian Lek into a much more efficient currency, significantly invigorating domestic currency loans, because the foremost part of the country's loaning power is provided in foreign currency (usually Euros).

Generally, the domestic currency (Lek) is extracted out of the economy through the sale of Treasury Bonds. Treasury bonds sale increase from 224 billion in 2008 to 242 billion in 2011 has also made the interest rate reach very high figures, even higher than the deposits' rate. For instance, in December 2007 yearly treasury bonds rate was 8.26%, in December 2008 it was 8.56%, in December 2009 it was 9.14%, in December 2010 it was 7.01%, and in October 2011 it was 7.5%. Very small amounts of cash is pulled of business companies, because loan interest rates offered by the commercial banks has been and remains very high compared to the loan interest rates in Dollars and Euros.

BOA's failure to react in accordance with the strategies chosen by the Fed and the European Central Bank, made its policies apathetic, and their impact in relation to the country's economic growth a negative one.

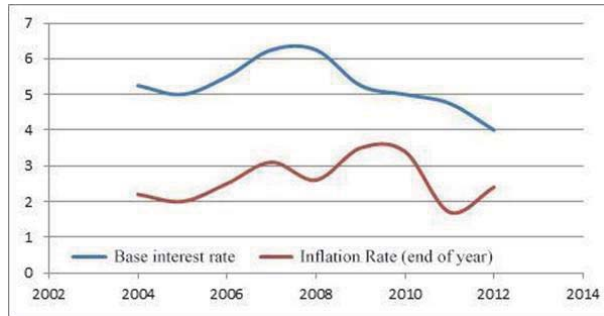
BOA's higher management did not make any proactive moves, having the conviction that by lowering the interest rate - just as other central banks did including the Fed, that lowered it down to 0.2%, and the European Central Bank, that currently has it at 1.5% - the inflation would rise. During the 2005-2007 period BOA implemented a shrinking fiscal policy by increasing the base interest rate from 5.5% to 6.25%. During the two following years (2008-2009), it kept the interest rate unchanged at 6.25%, and in December 2009, it lowered it by only 1%, at 5.25%. It kept it at those figures until July 2010, and after July it lowered it once more at 5%. In March 2011, it increased up to 5.25%, it lowered it again down to 4.75% in 2011, and currently has it set at 4%.

*Data indicate that BOA has not been proactive towards the market, fearing that by lowering too much the interest rate it would ignite inflation in the domestic economy decelerating thereby its growth.* This, in my view, marks one of its erroneous assessments. How do we reach to this conclusion? We know that the cash flow out of the bank mainly affects the GDP deflator price indicator, and not as much the CPI indicator. Because of the structure of the customer basket items and their acquirement sources in Albania, the country's inflation model is generally a Scandinavian one, so all-together, inflation in Albania is brought in. Therefore, we should emphasize that the central bank policies have little impact on the country's inflation, which is also shown in the graph below by the synchronicity between the inflation rate and the base interest rate.

**Table 2:** Base interest rate and inflation rate

Year	2004	2005	2006	2007	2008	2009	2010	2011	2012
Base interest rate	5.25	5	5.5	6.25	6.25	5.25	5	4.75	4
End-of-year inflation rate	2.2	2	2.5	3.1	2.6	3.5	3.4	1.7	2.4

Base interest rate / inflation rate synchronicity



BOA should have followed the example of other central banks; good guiding policies could have been those implemented by the Fed and the European Central Bank. An additional reason to do this is that most of Albania's volume of trade exchange is carried out with European countries as leading partners.

BOA's failure to react towards interest rate trends has produced a phenomenon in which the interest rate of the Albanian Lek stays in high figures whereas Euros and Dollars loans rates are very low. Hence, checking account rates in Lek have been high, and foreign currency loan rates have also been high. The reserve of domestic currency remained in bank vaults because of business loaning inability (since interest rates were too high), was bailed through the only financial mechanism the government has at its disposal: the sale of Treasury Bonds. Therefore, BOA's contracting policies, instead of helping distribute the domestic currency towards private business projects, naively stimulated the "private investment shrinking" phenomenon, or better known as the "crowding out" phenomenon.

**Table 3:** Loan interest rates in commercial banks (in %)

	Lek		Euros		Dollars	
	6m-1yr	1-3yrs	6m-1yr	1-3yrs	6m-1yr	1-3yrs
2008	11.11	13.29	6.72	7.89	6.98	6.96
2009	12.04	15.71	8.31	9.24	6.37	9.33
2010	11.52	15.42	6.18	8.49	6.66	7.84
2011(10)	11.17	12.16	6.34	8.61	6.88	7.68

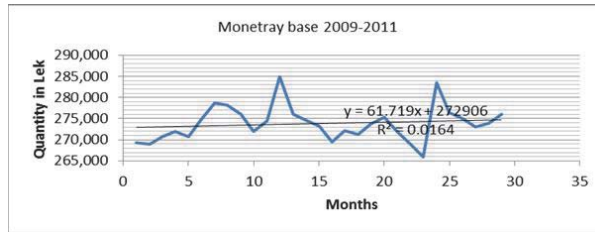
The above data show that domestic currency loan interest rates have been significantly high compared to those in Euros and Dollars. This occurrence has led the economic entities towards foreign currency loans, instead of Lek loans. In these conditions, foreign currency takes preceding importance compared to the Albanian Lek in domestic investments, a phenomenon that should not have happened and should not happen even today.

There is an array of other indicators along with the ones above that show the contracting policies of the central bank that have negatively influenced the development and the stimulation of the market economy. These are noted in the monetary aggregates such as "money outside banks", monetary base, and M1, M2 and M3 aggregates. The dynamics of these aggregates shows that generally they either have been steady (and/or marginally improving) or have been in decline.

**Table 4:** Monetary aggregates

Average in bln. Lek	2008	2,009	2,010	2011
Monetary base	229,108	274,212	205,829	274,889
Money outside banks	155,631	203,348	194,422	186,744
M1 aggregate	213,146	278,032	269,816	263,945
M2 aggregate	514,802	559,349	584,347	610,058
M3 aggregate	783,743	830,953	837,782	987,225

Based on the indicators shown above, we can chart a graphic illustration of the monetary base:



It is worth analyzing the first three aggregates because the last one requires a more specific analysis since it has to do not only with foreign currency loans granted within the country, but also with the flow of foreign currency outside Albania through the commercial banks' profits as well as investments in financial products.

It is clearly shown from the data that compared to 2009 we have either stagnation or a decline of the indicators. This situation is reflected in the economic growth. Economic growth cannot occur without an increase in currency quantity within the domestic economy. It is enough to remind ourselves of the monetary equation  $V \cdot M = p \cdot P \cdot B \cdot R$  in order to conclude that Albania's central bank policies have not produced the required impact for economic growth and the attainment of other macroeconomic indicators.

#### 4.3 Insurance Market

The data we have at our disposal indicates that the assets of the banking sector have been in continuous increase but the specific weight of the other non-banking sectors compared to the total is very low and with no significant impact in the development and stability of the country's financial system. However, the insurance market has been an exception delivering considerable improvement. Albania's insurance market counts over 10 insurance companies: Sigal, INSIG, ATLANTIC, Albsig, InterAlbanian, SIGMA, SICRED, EUROSIG, etc. They provide services such as: vehicle insurance, life insurance, wealth insurance, health insurance, business activity insurance, liability insurance, bank guarantee, commercial guarantee, etc. The insurance market offers a narrow array distinguished services, among which obligatory vehicle insurance packages are the dominant service (53% of the total).

Lastly, this market is connected to other markets such as the banking market through the obligatory insurance of possessions considered as collateral, the property or resource being bought, or even the buyer's life. These innovations have contributed to the growth and empowerment of these businesses, however, while revenues from insurance payments (borne by the clients) have increased considerably, insurance due payments (borne by the insurance companies) have not followed the same growth trend. This (last) indicator is very distant from those of similar markets in Europe, which display figures 60%-80% higher compared to those of Albania. This evidence shows that damage estimations in this sector are not real, but stand well below actual damage costs.

#### 4.4 Retirement Pensions Market

This is a virtually unknown market in Albania. This is the reason why this market performs at very low levels, is mainly based on payments made by the government, according to a plan called "Pensions Scheme." In 1995, the government passed a law concerning supplementary retirement pensions and retirement pensions private institutes. The activity of private firms in the retirement pensions' field has started in 2006. In 2009, the government passed a new law regarding retirement pensions "On Funds of Voluntary Retirement Pensions", a law that improves considerably the legislative foundation on this issue. The number of people contributing financially in these companies does not exceed the 5000 mark.

The retirement pensions sector has increased the number of its services but it has a long way ahead to become a competitor for the banking sector. As of now, banks dominate the financial market.

#### 4.5 Micro-credit financial institutions

During the last number of years a very positive development is noticed, which is the presence of micro-credit institutions, which are represented by the Credit Saving Associations (CSAs; Alb.: "SHKK"), which in essence are loaning cooperatives that mobilize the savings of their members and provide loans only for them. The activity of these institutions



is based on law "On the Associations of Mutual Collaboration" and law "On the Credit Saving Associations." The necessity of the existence of micro-credit institutions arose as a result of banks disinterest to provide small loans for the community small businesses and farming activities in the rural areas. Various donors, through projects by now well-recognized, are playing an important role in projecting, consolidating and supporting the CSAs. There are 135 CSAs operating in Albania today, and they all are in their consolidation phase. The amount of savings mobilized by the CSA members is still modest, but seen from a psychological viewpoint this process must be considered as quite positive. (Ibrahimi & Salko, 2002)

What are the financial markets in Albania?

**Money market.** This is the market where loan instruments of short-term maturity, low risk and high liquidity are traded. The market of Treasury Bonds of the Albanian government is the most developed money market in Albania today.

**Financial capital market.** This is the market where stocks and bonds of a maturity time longer than 1 year, high risk and low liquidity are traded. This is the least developed market in Albania today. This market is composed of:

#### 4.6 Tirana's Stock Market

In Tirana's stock market there is yet to be a company to list its capital. Put differently, this market has no function; it is non-existent. The absence of a stock exchange has created a circumstance in which the denationalization of small, large, and strategic enterprises be carried out in forms other than via a domestic stock exchange. If the government would have acted in a more supportive manner towards Tirana's Stock Exchange and national property in general, it would have listed at least all the large and strategic state enterprises in this market. Tirana's Stock Market would have guaranteed a fair market value for them, while, if auction announcements are used, which are considered the standard practice to denationalize state property in Albania, corruption chances are significantly higher. Would have not been a better option to have the stock of AMC, Savings Bank, Altelecom, INSiG, etc., listed in a stock market? Would not these organizations have the value of their stock increased further?

The Albanian government is responsible for Tirana's stock market failure to operate, and just as responsible for the absurd prices with which national possessions have been (and are) sold. The current government continues to maintain the same position in relation to this stock market, by avoiding to list the stock of the (very few) remaining nationalized companies. The avoidance to start this stock market, intentionally or unintentionally, creates a large gap between the Albanian economy and the Western economies with regard to the financial system performance. The lack of a stock market has, in this sense, transformed the Albanian capitalism into a primitive capitalism of the 1800s when the stock markets were not born yet. Albanian economics experts still do not have a good grasp of how stock markets work, so the government should stimulate their technical comprehension and operation.

*Had Albania had a stock market, all the dormant financial capital that could have been harnessed through banks from [1] the difference between savings and loan interests and [2] the difference between loans in domestic and foreign currency, would have been yielding tremendous dividend for the economy.* A stock market is the best way of attracting dormant financial capital, increasing the currency inflow, and increasing the wealth of business enterprises. Just as companies apply for loans in banks, they could very well list their capital in the stock market and have their stock purchased. Capital listing in stock markets would increase not only companies' economic leverage, but would also ensure a far better capital and revenue distribution. In such scenario, even people with modest earnings and wealth could be owners.

Publicly available capital through stock markets was one of the main avenues through which the Western countries became economic superpowers. The countries where stock markets are absent, such as Albania, are destined to remain banks' victims. It is worth highlighting that if Tirana had a functioning stock market all the earnings of Albanian emigrants would have been collected there instead of being collected by the banks. Albania would have had a publicly attainable and much more effective redistribution of business capital.

The absence of a stock market is an economic handicap that only Albania suffers in the region, because stock markets are present in all other Balkan counties. Such an environment increases corruption premises and practices inside the domestic economy, because of the "friends and relatives" effect, which is the main source partiality in the privatization process. This is a well-known long-lasting negative phenomenon in Albania.

Western capitalism cannot be perceived without the presence of stock markets. Their role fully complements the role of banks. Banks in the West do not operate like banks in Albania, because there is a presence of financial capital in the West. Such presence urges the banks to remain tightly linked to the production firms and develop a strong financial interdependence, whose authenticity is the very backbone of each party's business prosperity. In this case banks and production firms have their representatives oversee each-other's operations, and banks often provide not only a mean for

currency flow but also assume the role of a good financial manager and adviser for the production firms.

Such cases are absent in Albania because in the majority of cases banks are unrelated to production firms or other businesses. If a bank goes bankrupt, no business enterprises are affected. Those affected mainly are the individuals that have their savings deposits with that bank. All the same, if a production firm goes bankrupt, all a bank may be worried about is the firm's unpaid loans, but it remains unaffected in any other way. These are fundamental differences between the Western financial system and the Albanian one.

The lack of these institutions has created in Albania phenomena that are unknown in the West. For instance, in Albania we do not experience the 'company - bank - stock market' transmission phenomenon that is ever-present in the West. Albania's economic phenomena are isolated. This was witnessed even during the 2008 global recession and the accompanying financial crisis, which was in turn a banking crisis mingled with a currency crisis.

It was precisely:

- the lack of financial capital,
- the absence of a stock market,
- the low amount of loans,
- loan insurance backed by a collateral,
- imports and exports distribution efficiency in many countries,
- Albania's weak connection to the Western countries,
- the use of Dollar and Euro as legal tender in all Albanian markets,

...and several additional factors that contributed to a downsizing of the recession footprint in Albania. One of the main sources of balancing the Albanian trade deficit are immigrants' remittances, which reach the figure of 700 million Euros annually. Whereas the main source of balancing the country's budget deficit has been the money obtained from the denationalization of state property. The depletion of these two sources would display correctly the soundness of reforms, economic model and financial system used in Albania since 1990.

Very few objects that are national property have remained. Those include the three large hydropower dams located in northern Albania; the remaining mid-sized and small-sized dams are sold. Part of the immigrants is returning to live in Albania, while a considerable part has settled their livelihoods in the countries where they have migrated. Therefore, in a foreseeable future [1] the sources coming from denationalized property will be in nonexistent, and [2] the remittances will become more and more insignificant. Along this period we will witness the effects of terrible decision-making as to the injudicious sale of national property, with no concern regarding the long term prospective of the country's economy.

## 5. Conclusions

From all we have considered above, Albania's financial system, as a first model system based solely on banking, has experienced considerable change regarding the policies and rules framework, network broadening and services level.

The principal element of this system has been the banking sector, which has undergone a series of developments with regard to:

- a) its gradual spread over the whole country's territory;
- b) the broadening of the range of offered products and the improvement of service quality in the country's main cities;
- c) decreasing the financial activity focused on two banks only, because, even though Albania has gone through denationalization process, the banking market structure has remained an oligopoly, in which one of the banks leads and determines the prices.
- d) the improvement of profitability and capital sufficiency indicators.
- e) the crediting level from the banking sector, which is still low, occupying not more than 25-30% of the GDP; this is quite a low indicator compared to other European countries.

Even though prevailing in the Albanian economy, the banking sector has not been able to influence the overall economic development.

Salary distribution system has improved noticeably by introducing ATMs. Debit and credit cards, the RTGS system and a customer care improvement constitute the mid-term and long-term challenges.

Auditing practices and savings accounts transparency have increased, but less transparency exists in the credit sector.

A Credit Catalogue is published to assist second level banks keep track of their clients' credit records.

Life and property insurance companies have increased in number, reaching the figure of 10, nonetheless the insurance market can still be considered an oligopoly and lacks fair competition.

Market concentration in these companies is noticed in two aspects:

- a) the specific weight of the governmental company INSIG, along with few other companies, occupies over 90% of the overall assets;
- b) the insurance market's revenue structure is mainly composed of revenue deriving from automotive and physical property items (buildings) which must be ensured by law, while people have little to no incentive to purchase insurance products for anything not anticipated by the law.

An early development of the micro-credit financial market is witnessed; however, it remains in its early stages regarding the amounts and units financed.

The retirement pensions market is also in its early stages and it is not currently matching the competitiveness of other markets, however it is established and it is functional.

The actual stage of development requires a simultaneous continuation of reforms pertaining to the financial system's constituents, particularly in the capital market; this constitutes the main challenge of the system's future.

The Albanian banking system has not hitherto been considerably affected by the global recession and the financial crisis for a number of reasons, among which need mention:

- There are no established and consolidated capitalist relationships in production. The Albanian economy differs from western economies because Albania has an uncompleted process of land and capital privatization. There is a lack of capital markets. The housing market is imperfect, because thousands of houses are not legalized.
- There is a lack of pertinent legislation adopted to adjust these relationships, so as to attract foreign investors.
- The country's financial system is outdated, and with an absent financial capital and an non-existent stock market. Therefore, there is no way for Albanian business companies to list their stock holdings within their country. A stock market can mobilize the financial resources of a country's companies, and consequently its banking procedures and production. This financial mobility is currently absent in Albania. Even Treasury Bonds, which are debt instruments, are marketed by BOA on behalf of the Albanian government.

How has the global recession affected the Albanian economy?

In our judgment, the global recession has brought mainly negative effects to the Albanian economy. Those few positive effects have ensued because of the isolation of the Albanian financial system in relation to the foreign one. To be mentioned among those are:

- Second level banks operating in Albania are branches of larger regional banks, which were slightly affected by the financial crisis. A good portion of these banks' revenue has derived from investment in low-risk products such as purchases of Treasury Bonds. In addition, interest rates have had modest impact on their profits, with other resources contributing more in this regard.
- There is an absence of large companies' bankruptcies, which could negatively affect the local banking system situation; nor is there occurred any bank failure that could in turn result in a larger regional economy stock decline.
- The country has relatively insignificant capital, land and housing markets; these are usually the markets that provoke recessions or shocks in a west-European financial system.

During the 2012-2013 period, however, global recession has caught up with Albania also. Bad credit records have increased in an almost exponential fashion. House sales have reached all-time lows since the beginning of the market economy system in the early 90s. Funds from remittances during the 2012-13 period stood in dwarfed levels, compared to those of several years ago. These are clear signs that liquidity among end consumers lies in considerably low standings.

If Albania has yet to experience an overall economic development, as the case with other similar countries might be, this certainly is because of the economic model implemented in the country, a model that has hindered the country's economic growth and its overall development.

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