



The Evolution of the Financial System in Albania

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Abstract: *This paper aims to bring a general framework of the financial system in Albania: how it has evolved and how the situation has been presented in the last 10 years. The Albanian economy continues to be an economy in transition and Albania is considered a developing country, that aims to join the European Union and as such the economy faces great challenges and difficulties, but at the same time, there are still unexploited development opportunities. The level of financial development significantly influences economic development as a whole, so there remains an important system that must be analyzed at any time: problems, challenges and future perspectives. The more complex the economy, the more evident the role of the financial system in it. The objective is to conclude in which directions it is suggested to invest in order to improve, modernize and evolve our financial system so that in the future it can operate freely with the European and world markets.*

1. INTRODUCTION

Today Albania is in the phase where the main role is played by the banking sector and the role of other financial intermediaries is growing. In recent years, we have had an expansion of the credit system. Not only the number of institutions has increased, but also financial instruments, when in the first 10-15 years (post-dictatorship) we had a cash economy and the only functioning market institution was that of goods. Albania is still far from European countries in this effort, but it cannot say that there is no progress.

The system of national accounts classifies institutional units based on the main economic activity and according to the role they play in the country's economy. The institutional sectors are: non-financial corporations, financial corporations, general government, family economies and non-profit institutions serving families. Non-financial corporations and financial corporations include both private and public corporations (with shares owned by the government).

Financial assets and liabilities are classified into financial instruments: currency and deposits, debt securities, loans, equity and shares in investment funds, insurance and pension schemes, financial derivatives and other accounts receivable/payable. Two other instruments, monetary gold and SDR holdings, appear only in the financial corporation sector in the central bank subsector.

The paper deals with an observational study, with comparative quantitative data. Based on the data of the Bank of Albania on the financial accounts of the last 10 years, presented in financial instruments and obligations of the institutional sectors, detailed in financial instruments, the study has drawn some conclusions on the progress of the financial system in Albania and the future trend, how it has grown in recent years and how much work is still to be done.

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In the economy of financial markets, the financial system has the appearance of an infinite set of connections, transactions, relationships and exchanges in financial and cash flows, operations and institutions of a country, which form a continuous chain of transactions, closed spirals and that only when conceived as a whole give meaning to the financial system itself. The financial system is the totality of financial markets, the totality of financial intermediaries, the totality of services and financial institutions that make possible the permanent and one-time communication, without limitation of time, volume and space, of the finances of families with the finances of businesses and with public finances (Bundo et al., 2004, p. 301).

The economy of Albania went through a process of transition from a centralized economy to a market-based economy on the principles of the free market.

Albania has an asymmetrically developed financial system with the banking sector as a more developed pillar and the non-banking system which is modestly developed. Thus, as part of the non-bank financial sector, Albania has an almost absent capital market, although many market operators are licensed (brokerage firms, custodians, investment funds, pension funds, life insurance, etc.). On the other hand, despite a clear presence of collective saving schemes (investment funds and pension funds, life insurance schemes) over the last ten years, their further development is strictly hampered by the lack of domestic capital market and alternative investments (ALSE, n.d.-a).

In this paper, it should be shown how our financial system has changed in these years of transition (when we moved from a planned economy to a free market economy) and what improvements and changes we expect to happen in the future.

2. THE ROLE OF THE FINANCIAL SYSTEM ON ECONOMIC STABILITY

The first important stage in the reform of the financial system in countries with a planned economy begins with the transition from the system mono-banking, to a two-tier system in which the state bank assumes the traditional functions of the central bank (which performs issue function, implements monetary policy, intervenes in the field of foreign exchange, etc.) and established commercial banks newly charged with the transactions related to the acceptance of deposits and granting loans (Imbrahimi & Salko, 2002, p. 214).

The financial system feeds on information (macroeconomic, including forecasting, political-social, microeconomic, etc.), including non-public information, and produces information (in terms of prices of financial instruments traded in organized markets) necessary for economic operators to define their investment plans and strategies and to make the economy work in general.

The sustainability of the financial system is a fundamental condition for the financial system to increase its level of efficiency in the mediation process, contributing to the orientation of financial resources towards investment in productive projects, within known and controlled parameters of activity risk. In this way, the contribution of the financial system to the economic development of the country and to meeting the needs of its customers is inherent.

In order to achieve and maintain the stability of the financial system, healthy financial institutions are needed that operate in a financial market with a developed and protected infrastructure, where there are mechanisms that promote the effective management of financial resources and risks by investors.

Central banks play an important role in achieving and maintaining the stability of the financial system, but this role is not exclusive. The importance of the objective, as well as the diversity and complexity of the issues that are intertwined within it, require the harmonization of efforts with other institutions, notably the supervisory authorities of banking and non-banking financial institutions, and the deposit insurance agency. Other institutions that can be included in this framework are those that supervise the development of competition conditions in the financial market, promote the adoption and control the implementation of various standards, etc. In the conditions of the opening and integration of the financial markets, the authorities of different countries have found it necessary to extend this cooperation at the international level.

The Law on the Bank of Albania also defines the role of the Bank of Albania, as the central bank of the country, for maintaining the stability of the financial system. In articles 3, 12, 16, 21 and 69, of this law, the responsibility of the Bank of Albania for licensing and supervision of banking activity, for promoting the functioning of payment systems and their supervision, for providing liquidity in the market is sanctioned, the role of lender of last resort, as well as to speak publicly about the nature and type of threats that may exist to the stability of the financial system.

During the first half of 2023, the share of financial system assets to Gross Domestic Product (GDP) dropped by 4 percentage points, to 92.1%. This performance reflects the fact that the annual growth rate of GDP was higher compared to the growth of the financial system balance. The banking sector has provided the main contribution to this decline by almost 4.3 percentage points. Within the financial system, the banking sector continues to dominate by around 91% of total assets (Bank of Albania, 2019).

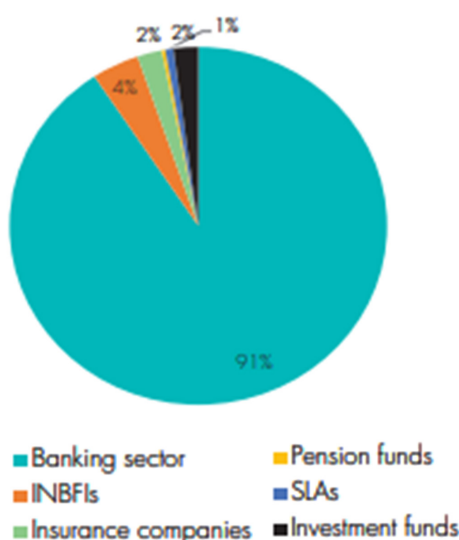


Figure 1. Share of financial system segments to total financial system assets, June 2023

Source: Bank of Albania, 2023

The table below shows the weight of assets to the GDP (The shares are calculated using nominal GDP at current prices according to INSTAT) and as can be seen, the data reconfirms what concluded in the first part of the study: the banking system has the largest weight and role in our financial system and GDP. The exposure of the banking sector to the non-banking sector remains low and stable, while the sensitivity of the non-banking sector to the activity of the banking sector remains high but has marked a slight decrease during the period. The years 2020 and 2021 mark the years with the highest percentages.

Table 1. Share of the financial system segments to GDP over the years (in %)

Albanian Financial Supervisory Authority	Bank of Albania			Albanian Authority Financial Supervisory			Financial intermediation
Financial system	Banking sector	IFJB	SIAs and Union	Insurance companies	Pension funds	Investment funds	
2011	86.1	2.6	0.8	1.5	0,0		91.0
2012	89.1	2.7	0.8	1.6	0,0	1.2	95.4
2013	91.4	2.6	0.7	1.6	0.0	3.7	100.2
2014	92.7	2.8	0.8	1.8	0.0	4.6	102,7
2015	91.9	2.7	0.7	2.0	0.1	4,7	102.0
2016	95.5	2.8	0.6	2.0	0.1	4.5	105.5
2018	88.8	3.2	0.6	1.9	0.1	4.2	98.8
2019	87.2	3.9	0.6	2.0	0.2	4.0	97.9
2021	95.5	4.1	0.7	2.2	0.2	4.2	107.0
2022	88.0	3.8	0.7	2.0	0.3	1.9	96.7
2023	85.4	3.8	0.7	2.0	0.3	2.0	94,2

Source: Bank of Albania, 2023

Table 2. Specific weight of financial institutions (30.09.2001)

Institutions	Absolute size of assets	In %
Banking system	301.0	95.0
Pension fund	7.60	2.4
Insurance companies	8.0	2.6
	316.6	100.0

Source: Own processing (Imbrahimi & Salko, 2002)

In the second table, which reflects the data of 2001 (Imbrahimi & Salko, 2002), it can be noticed that the banking system dominated and occupied the main weight with 95% and besides the banks, only the Pension Fund and the Insurance Institutions have operated in Albania, without having a great variety of financial institutions. Their number and type has increased significantly in recent years.

The main functions of the financial system are to:

- provide the economic system with the means of payment necessary to ensure the functioning of the circuit of production and distribution of income (monetary function);
- encourage the distribution of financial resources in the various economic sectors for the purpose of productive use (allocative function);
- management of the financial risks associated with the investments made (Consob, n.d.).

The financial system in Albania seems to best fulfill its monetary function and to some extent the allocative one, but it still does not fully fulfill the function of risk management and in this direction, it is expected to develop in the future.

3. THE CAPITAL MARKET

For many years, Tirana Stock Exchange (TSE) was the only exchange ever created in Albania. Initially, it was set up as a department of the Bank of Albania (BoA) targeting the spin-off after a certain period. TSE's core activity included the primary and secondary market for short-term government debt securities (treasury bills). TSE finally span off BoA in July 2002, to be established and function as an independent state-owned shareholding company (ALSE, n.d.-a).

Albanian Securities Exchange was launched in 2014 by a team of experts on securities and capital markets as an ambitious project with the support of Credins Bank, to create a privately-owned electronic trading platform that would match the supply and demand for securities in Albania. This electronic platform would fill the lack of a functional market (stock exchange), where domestic businesses can raise capital as an alternative capital to the banking sector (ALSE, n.d.-a).

Table 3. Transactions number in ALSE

Transactions number in ALSE	2018			2019			2020			2021			2022			2023		
	PM	SM	DM	PM	SM	DM	PM	SM	DM	PM	SM	DM	PM	SM	DM	PM	SM	DM
Shares																		
Treasury Bonds	42			25			38			14			24			48		
Treasury Bills	85			76			62			74			89			100		
Corporate Bonds																	12	
Municipal Bonds																		
Commercial paper																		

Note: PM-prime market, SM- standard market, DM-direct market

Source: Own processing (ALSE, n.d.-b)

Only government debt securities are traded on the Albanian Stock Exchange, mainly treasury bills and treasury bonds and only in 2023 corporate bonds, too.

The fact that in Albania a large part of people do not invest is related to several reasons and several factors. First, low income or the lack of opportunity to save means that a high percentage of the population does not have access to the financial or banking market. But even among those strata of the population with relatively high incomes, a good part of citizens do not invest due to the lack of information on the financial market and the fact that they consider it very complex and risky.

Also, for a long period in Albania, especially after what happened in 1997, people were oppressed due to the insecurity of the institutions to protect their income. They see it as a safer alternative to keep their money at home or to invest in the purchase of assets (land, property, etc.) compared to investments in the financial market.

Another reason could be the mentality and culture of the Albanians. Even though we moved to a free market economy, the influence of the dictatorial system with a closed economy, where the financial market was completely underdeveloped, has still an influence.

Even today, the role of the state has changed in the monitoring and supervision of the financial sector, once again the Albanians do not have the culture to buy securities in the stock market, invest in a pension fund, or ensure the capital and life of them in an insurance company. Thanks to globalization and the influence every day more and more from foreign markets, of course, this situation has changed somewhat and is expected to influence even more in the future. Overall, it is expected that the Albanian economy will emerge from this transition phase as soon as possible and become unified with the EU markets and economy.

4. FINANCIAL ACCOUNTS AND FINANCIAL INSTRUMENTS OF INSTITUTIONAL SECTORS

The system of national accounts classifies institutional units based on the main economic activity and according to the role they play in the country's economy. Institutional sectors are: non-financial corporations, financial corporations, general government, family economies and non-profit institutions serving families. Non-financial corporations and financial corporations include both private and public corporations (with shares owned by the government).

The sector of financial corporations consists of institutional units, which are independent legal entities, and market producers, whose main activity is the production of financial services. Such institutional units include all corporations and quasi-corporations, which are primarily engaged in a) financial intermediation, and/or b) auxiliary financial activities. Financial corporations include the following sub-sectors:

- a. Central Bank;
- b. Corporations that accept deposits;
- c. Money market funds;
- d. Non-money market mutual funds;
- e. Other financial intermediaries;
- f. Financial aid institutions;
- g. Finance companies controlled by other companies and money lenders;
- h. Insurance companies;
- i. Pension funds.

At the end of 2023, the following are operating in Albania:

Table 4. Number of institutional units in Albania

Institutional units	Number
Central Bank	1
Corporations that accept deposits	27
Money market funds	-
Non-money market mutual funds	15
Other financial intermediaries	25
Financial aid institutions	38 + 626
Finance companies controlled by other companies and money lenders	-
Insurance companies	12
Pension funds	6

Source: Own processing (Bank of Albania, n.d.-a)

In terms of financial aid institutions, in addition to 28 institutions such as Albanian Financial Supervisory Authority (AFSA), Albanian Securities Exchange etc., 626 are currency exchange offices licensed by the Bank of Albania.

As can be seen in Table 4, the largest number of units is occupied by corporations that accept deposits (which include second-level banks and savings and credit companies) as well as financial aid institutions. There is still no money market fund or finance company controlled by other companies and money lenders in Albania.

The classification of financial instruments is mainly based on the degree of liquidity and their characteristics (Bank of Albania, n.d.-b):

- Monetary gold and SDR;
- Currency and deposits;
- Debt securities;
- Loans;
- Capital and shares/quotas of the investment fund;
- Technical reserves and life insurance and annual pension schemes;
- Financial derivatives;
- Other accounts receivable/payable.

5. CONCLUSION

The financial system in Albania has had relatively positive changes during the last years, even though there have been many problems and challenges towards its consolidation. In addition to the consolidation of the banking system and the growth of insurance companies, steps have also been taken towards the growth of savings and loan institutions. A shortcoming of our financial system is the fact that personal finance still feels unintegrated in the financial system for several reasons. Our financial system offers limited opportunities for the creation, operation, development and real progress of joint stock companies. Insurance companies and the insurance market should be oriented towards voluntary insurance in addition to compulsory insurance and premiums. The capital market, which for a long time has been almost non-existent, has started to develop in the last 10 years with small steps and mainly focused on government debt securities.

It seems that Albania has passed the stage of an underdeveloped financial system and a cash economy and has entered the stage of the credit economy, where the main role in the market is played by second level banks and other intermediaries institutions are also growing. Many steps still need to be taken, in order to enter a third phase where we have genuine financial markets where not only liquidity brokerage institutions operate, but also financial rights brokerage institutions, where invisible money is operated and electronic and titles and capitals are transferred and invested without recognizing time and space boundaries. The development of the stock market in the financial market of Albania will allow to establish a high-quality loan portfolio and expand it, help support innovations, improve the asset and business management system, expand asset restructuring and recovery, expand brokerage activities, improve investment banking and securities, and introduce the process of asset securitization.

It can be concluded that our financial system, although not very modern and developed, is complex and requires investment in many directions. The more stable this system appears, the more stable our entire economy appears. Of course, the development of the financial system is related to the economic development of the country as a whole, and it is expected that with the exit of our economy from this long period of transition, greater steps will be taken in the evolution of the financial system.

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