Comparative Perspective of Financial Sector Development of Two EU Candidate Countries in Transition: Albania and Macedonia

PhD C. Erinda Imeraj

Department of Banking and Finance, Epoka University, Albania

Abstract

Albania and Macedonia in a difference of two years met the important criteria of the accession imposed from European Union and now they are candidate countries. These two countries are transition economies of the Western Balkan or known as South- East European countries and regarding the latest international official reports they have been progressing through the financial sector reform and economic growth. This study aims to investigate on the progress of the financial sector of two neighborhood economies and specify the characteristics and commonalities this sector share. Based on statistic data of World Bank (WB) and European Bank for Reconstruction and Development (EBRD) this study will firstly cover an overview of the macroeconomic situation of Albania and Macedonia. The transition situation and the neighborhood of these economies impose the idea of a lot of commonalities but specifically the study will effort the specification of the differences between them. The Financial sector reform and development covers most of the study through the compare of main financial indicators of Albania and Macedonia and their relation to the economic growth. In specific the focus is on the banking sector indicators through the evidences on the ownership of the capital of the banks, their ratio on the state capital or foreign one, privatization method of the banking public sector, difference in the lending and borrowing rates etc. These two economies are as near as far from each other despite similar rules and regulations especially on the financial sector.

Keywords: Financial Development, Transition, Financial Indicators, Banking Sector.

Introduction

Western Balkan countries known as East European Countries are countries with economies in transition. This fact, but not only, brought together countries like Albania and Macedonia. These countries are also candidate countries of the European Union from 2014 and 2005 respectively for Albania and Macedonia. According to the latest report of the European Bank for Reconstruction and Development (EBRD, 2014) these countries are part of the countries with faster economic growth compared with other countries part of the report on the transition.

In the following section will be presented in more details the rapid pace of economic development of selected economies, including the basic indicators.

This study aims to investigate on the progress of the financial sector of two neighbor hood economies and specify the characteristics and commonalities this sector share. The first part of the study is based entirely on financial sector reform that Albania and Macedonia have implemented in the first years of transition. These countries are supervised by the EBRD and the reforms undertaken by it. Financial sector reform is not the main purpose, or financial development, but economic development is the main purpose of these economies, so this study will bring the development of the financial sector as a function of economic development faced by the selected economies as a comperative prespective. According to the official reports and statistics of World the study will present a macroeconomic overview of the two economies selected by specifying the mos important macroeconomic indicators and the report conclustions of the international researches.

Among the objectives of this study is also the presentation of commonalities and features that the EU accession process of these candidate countries face. In specific the focus is on the banking sector indicators through the evidences on the ownership of the capital of the banks, their ratio on the state capital or foreign one, privatization method of the banking public sector, difference in the lending and borrowing rates etc. In support of the fact that these economies are in transition as well as part of the same process, the study will conclude that these countries go through a similar trajectory of development, regardless of economic or financial crisis, their recoveries continue at the same pace.

2 Literature Review

Financial sector and the reforms undertaken in this sector are part of numerous studies of different countries. In particular focus of these studies is frequently on transition economies. There is always has a special attention for scholars and policy makers to economic development and financial sector development as a function of the first. Financial development can be achieved as part of the reforms undertaken to decentralize the system as a process of transition. The starting point of the financial sector development for the countries of Central and Eastern Europe are generally the same. Similarly are also the main objectives of economic development reforms undertaken by these countries. This makes it possible also the formulation of the same strategies for the development of these economies. The overall strategy for the management of the financial system in transition countries consists of two components. The first component sums building a financial infrastructure for these countries and the second component follows the privatization of the remaining banks in the state ownership. (Verbeek, 1996)

Among the studies on the reforms of the financial system a valuable conclusion was reached from the study of authors Golubovic (2005) on the reform of the financial sector in transition countries in the Balkans. According to the study in financial sector reform for these countries firstly should be reviewed the role of the financial sector, which should focus on the adequate mobilization and allocation of scarce financial resources of the economies. It is important to use a gradual methodology for passing the economic transition period. The change of political systems is not in favor of changes to the structure of economic sectors. According to the study it is necessary the synchronization of recovery of the banking system, the social security system, financial instruments and the positioning of institutional investors. Synchronization of these processes would enable the recovery of the entire financial system as function of the economic development. (Golubovic & Golubovic, 2005)

During the last 25 years various reforms have been implemented in transition countries based on the objectives of global market development. In all these economies the implemented reforms have lodged economic and political challenges, but what stands out most strongly is prioritizing the firms and large enterprises. In most studies it is focused the segmentation of the financial sector reforms implemented by giving priority to "the greatest". Yet in small countries in transition population of low and middle income level do not use most of the banking services. (Torre, Gozzi, & Schmukler, 2007)

Part of the numerous studies and analysis of financial development and growth have been also transition countries of Central Asia. The study under revision presents the differences between these countries and countries in transition in Central and Eastern Europe. Results of the study have proven the fact that all transition economies have reached a point in their development where the financial sector has become an important determinant of economic growth. But again the impact of various financial institutions, including banks and capital markets, environment and framework, is very different and of major changes and effects. These changes began in the early stages of the transition has shown a difference in the developing of not the Asian countries and Europe but also within the countries of Asia. (Djalilov & Piesse, 2011)

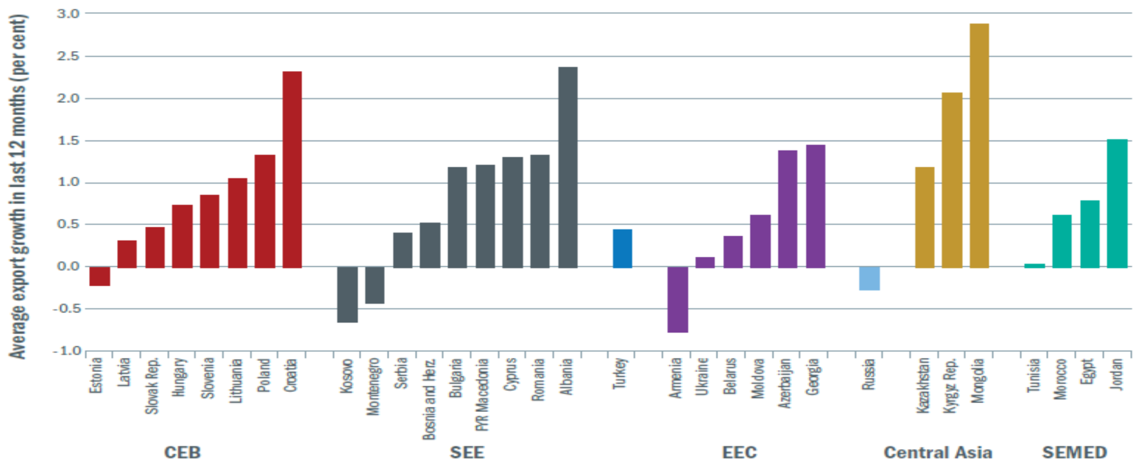
3 Macroeconomic Overview

Two selected economies in this study are part of the transition countries that undertake reforms of the European Bank for Reconstruction and Development. According to the latest annual report of the EBRD the average growth in transition countries is falling and among the various causes related to the policy of neighboring countries, important cause is expected to be the impact of monetary tightening in the United States and other developed countries that are associated with these economies.

The region had an annual growth of 2.3 percent in 2013 and 2.6 percent in 2012. The highest growth among countries in transition was observed in countries of South-Eastern Europe (SEE). The average annual growth is declining since 2011 and continued to stay below 3 per cent also in 2014, expecting the same trend and for 2015.

External conditions have been a key factor of the improvement of the financial situation after the crisis. SEE countries have been ahead, where in most of these countries growth in exports is the support of the recovery of the crisis. The graph below is detached from the EBRD report and indicates precisely the contribution of export growth in various countries in transition where is easily observed the supremacy of the SEE countries. (EBRD, 2014)

Graph 1. Contribution of Exports in the Economic Recovery.



Source: (EBRD, 2014)

Macroeconomic policies of the EBRD region countries are generally characterized by a fiscal tightening combined with appropriate monetary policy. Among the countries of South-Eastern Europe Albania has implemented even more cuts on the interest rate to stimulate aggregate demand. These cuts have been facilitated by low levels of inflation and tempered expectations. (EBRD, 2014)

According to the Albanian and Macedonian annual report of EBRD for 2014 there is a difference of the economic performance of these two countries. While economic performance of Albania remains still fragile, the Macedonian economic performance has recovered well after 2012 recession.

Table 1 shows the macroeconomic indicators for these two countries in a period of 5 years which covers the most delicate years.

Table 1. Macroeconomic Indicators

Macroeconomic Indicators	**2010**		**2011**		**2012**		**2013**		**2014**	
	Alb.	**Mac.**	**Alb.**	**Mac.**	**Alb.**	**Mac.**	**Alb.**	**Mac.**	**Alb.**	**Mac.**
GDP growth	3.5	2.9	2.3	2.8	1.1	-0.4	0.4	2.9	1.7	3
Inflation (average)	3.5	1.5	3.4	3.9	2	3.3	1.9	2.8	2	1.5
Government balance/GDP	-4.3	-2.4	-3.6	-2.5	-3.5	-3.9	-5.2	-4.1	-6.7	-3.5
Current account balance/GDP	-11.2	-2	-13.3	-2.5	-10	-3	-10.4	-1.9	-11	-4.6
Net FDI/GDP	8.7	2.2	6.4	4.5	6.7	1	9	3.3	9.4	3.8
External debt/GDP	33.9	58	33.9	65.1	36.5	70.8	36.3	75.4	n.a.	n.a.
Gross reserves/GDP	21.6	24.3	21	27.7	20.9	29.4	21	25.9	n.a.	n.a.
Credit to private sector/GDP	38.2	44.5	40.1	45.3	39.6	47.7	38.2	49.1	n.a.	n.a.

Source: (EBRD, 2014)

In Albania growth in the past two years has slowed greatly, which reflect domestic problems and as well as a falling in the remittances and difficulties through the problems in the international trade area. GDP growth from 2012 to 2014 passed from 1.1 percent to 0.4 percent in 2013 and 1.7 percent in 2014. While in Macedonia there exists a strong progress from 0.4

percent on the back in 2012 to about 3 percent in 2014. Weak aggregate demand and low imported inflation kept in Albania the rate of inflation below the targeting of the Central Bank from 2-4 percent over a year. In motion of the decreasing trend of the inflation the central bank implemented and expansionary monetary policy by cutting the base interest rate down to an historic low of 2.5 percent. The unemployment rate has increased to 17.7 percent during 2014. While in Macedonia the active economy is not followed in the labor market as the unemployment rate remained high, nearly 30 percent. (EBRD, 2014)

The budget deficit stands at 6.7 percent in Albania for 2014, which result to be more than 5 percent of the 2013 year that firstly was considered to stand at 3.5 percent from the 2013 budget law. This difference is considered to have a positive relation with the year of elections for Albania and the problems derived in the revenue collection. While public debt reached around 70 percent of GDP at the end of 2013. Meanwhile, in Macedonia budget deficit rose at about 4.1 percent in 2013 and about 3.5 percent in 2014. Totally in contrast of Albania the public debt remains moderate for Macedonia at a percentage of 46.8 of GDP in 2014. (EBRD, 2014)

4 Financial Sector Reform

In the former socialist economies including two selcted economies in this study financial sector was completely adapted to the requirements of centralized economic management. Socialist economies are characterized by strong state intervention in the economy as the inclusion in controlling prices, subsidizing etc.

Management and allocation of scarce financial resources was carried out through the monobank system and any other financial institution was owned by the state. The financial sector had a passive role as any transaction or financial operation was planned and carried out by the country's central bank. Financial institutions as mentioned above were dependent by the state power through the Central Bank which had the responsibility to confirm their economic activities as a central authority. The loss was covered by the state using later this deficit by the Central Bank monetary emission. (Golubovic & Golubovic, 2005)

In the beginning of the transition all Balkan countries had a common characteristic of avoiding any radical reform in the financial sector. They took some partial changes ranging from the banking system transformation from the monobank system to two-level banking system where the central bank had its traditional functions and while commercial banks took responsibility for transactions with citizens and economic entities. Simultaneously with the transformation of the banking system, these countries liberalized the establishment of new banks and decentralized the decisions regarding the volume and price level of financial services.

There exist an exception regarding the banking system structure and is Yugoslavia, part of which has been Macedonia. It did not have a monobank system but had a considerable number of banks operating during the socialist era but the banks conducted to the planning immunity of the central authorities. This made Yugoslavia not much different from the other centrally planned economies. (Sherif, Borish, & Gross, 2003)

The 90's brought the first changes in the financial sector of these economies. They applied a series of provisions affecting the functioning and the structure of the financial sector. A successful provision to these first steps of financial sector restructuring means also the creation of the appropriate legal conditions. Legislature of early 90's presented many obstacles to the smooth functioning of the financial sector. For this reason all Balkan countries, including two selected countries in this study by the end of the 90's adopted completely new laws in line with European Union standards, especially regarding the independence of the Central Bank from the executive power, the regulation of the banking system, the financial market functions etc.

Adopted laws are mostly in agreement with European rules and regulations for determining the main tasks of CB, giving priority to price stability in the country and maintain its independence from the executive power. At the same time they applied some changes to the positioning of the banks, nonbank financial institutions and the functioning of financial markets. In the banking area and the financial intermediation, the European standards are not well defined as in the case of the adjustment of the Central Bank position as there were limited functions in financial intermediation and for years these countries lacked the interest of opening other foreign banks. Capital market was another aspect which stood on the goals of any transition economy, and here lies a feature of the two selected countries, where Macedonia since 1995 had a capital market despite the previous attempts in years. Unfortunately Albania is the country that still has attemptes on such a step. But it should be understood that the functioning of the financial system in accordance with the European regulation also depends on the countries level of development and the ability to stand in open market competition. (Cani & Haderi, 2002)

However, analysis of the legislation shows that the best standards are met in relation with the approval of the license, the definition of minimum capital requirements needed for the establishment of banks, the determination of the scope of banking activities, the responsibility of the owner, etc. The same goes for the legislation whith regulats the financial market, agents, the definition of instruments, the rights and obligations arising from these instruments.

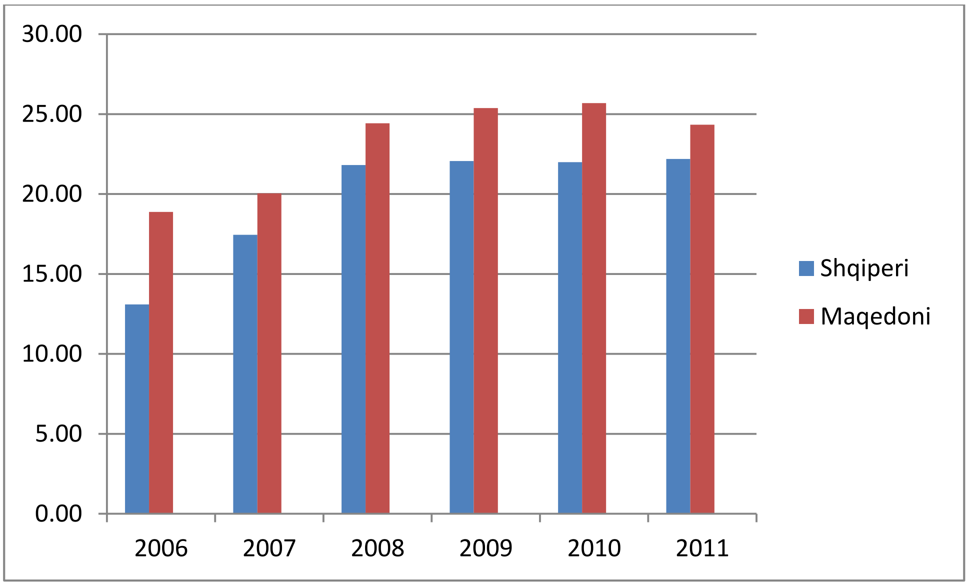
5 Banking Sectors of Albania and Macedonia

The privatization of state-owned banks is a very important element of the adequate transition of the SEE countries banking system. In all SEE countries there have been delays in the privatization process mainly due to government policy reluctance. The privatization of the SEE countries the banking system was defined by the entry of foreign banks in the market. Foreign banks usually enter the market either by acquiring local banks (state-owned or private) or by establishing subsidiaries and branches. The entry of foreign banks was very important, since they introduced modern risk management techniques. This way of foreign ownership noted to be very important condition for the efficient transition of the banking sector. (Stubos & Tsikripis, 2004)

An important part of this comparative research is the study of the main indicators of the banking system of the selected economies. Therefore there are selected the most important indicators that will be presented in tables or graphs to show the compliance of the banking system in Albania and Macedonia.

Meanwhile in Albania operate 16 commercial banks and in Macedonia 17 of them so the first indicator that is studied despite the territorial area and the population number is the number of bank branches operating in every 100 000 of adults. Graph 2 shows the levels of this indicator for both countries from 2006 to 2011. All the statistical data are sourced from the International Monetary Fund (IMF).

Graph 2. Number of Bank Branches per 100 000 adults.



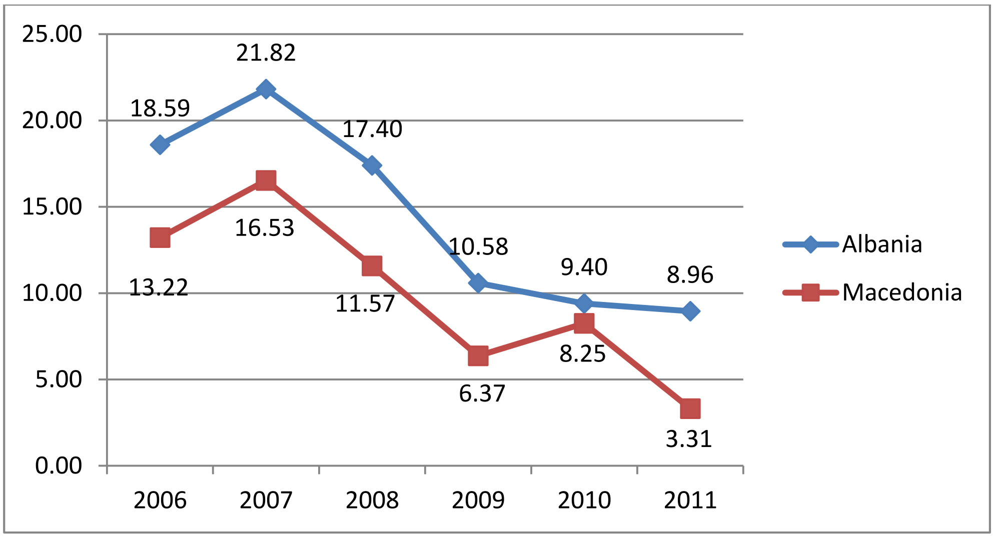
Source: (IMF, 2013)

Furthermore Albania and Macedonia have a small difference in this indicator, which is decreased from year to year. From the graph and their difference it can be said that both countries commercial banks operate in the same inclusiveness strategy.

Graph 3 presents data on the level of the Bank Return on Equity for the years 2006 to 2011, it is noted that in Albania, though there are fewer bank branches than in Macedonia, return is higher. Year 2007 is the one that represents the highest profitability for the two economies 21.82 percent and 16.53 percent for Albania and Macedonia respectively and the decline due to the financial crisis is evident starting from 2009 onwards.

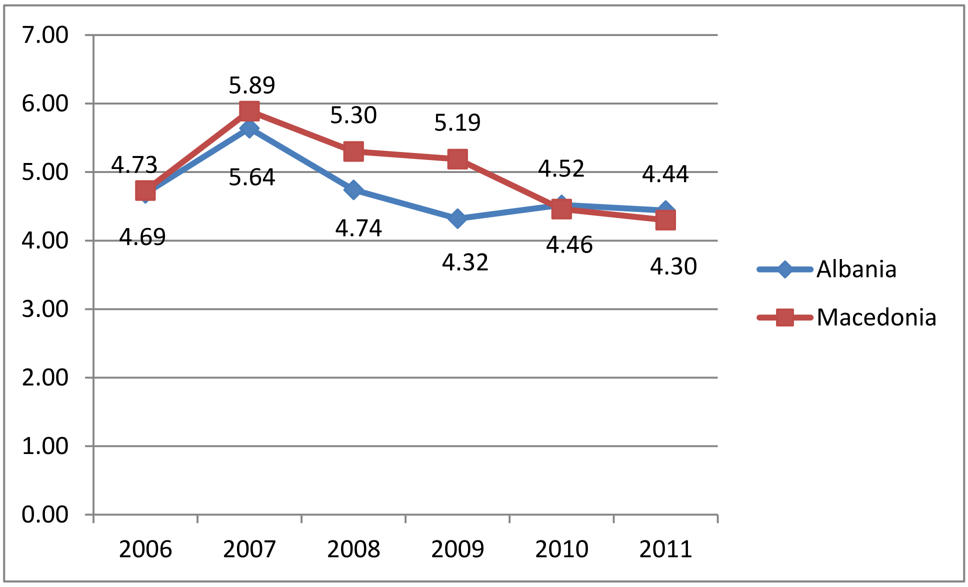
Graph 4 shows another important bank indicator for Albania and Macedonia for years from 2006 to 2011. Bank Net Interest Margin is a measure of the difference between the interest income generated by banks or other financial institutions and the amount of interest paid out to their lenders. Comparing Albania and Macedonia regarding the graph below and the percentages for every year it can be noticed the approximate levels of the interest rate margin. Even though different banks use different strategies basically there are similarities of the banks operating in Albania and Macedonia.

Graph 3. Bank Return on Equity (ROE).



Source: (IMF, 2013)

Graph 4. Bank Net Interest Margin.



Source: (IMF, 2013)

Table 2 below shows three more banking indicators for Albania and Macedonia for the rage of years from 2006 to 2013.

The first indicator is the ratio of bank capital together with the reserves against its total assets. This ratio is important to understand whether or not the bank has sufficient capital relative to the minimum rate defined. As noted, Albania has the lowest levels compare to Macedonia, although highlighted a slight increase over the years. Ratio rates of capital to total assets are more stable for Macedonia through the years.

The second indicator presented below shows the ratio between the amounts of liquid assets (reserves) to total assets of the banks. For Albania 2006 indicates the highest level and for Macedonia 2011 shows the highest level. For 2013 this ratio is 13.89 percent and 22.58 percent for Albania and Macedonia respectively.

Last indicator of the nonperforming loans remains high for Albania and addresess problems. While for Macedonia this level is moderated and lower, but according to the annual report of Albania and Macedonia from the EBRD this ratio has been decreasing since mid-2013 to 10.6 percent as of March 2014. Meanwhile according to the same report the level of NPLs fo Albania stand in high levels to 24.1 percent as of mid 2014.

Table 2. Banking System Indicators

Treguesit	**Shtetet**	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**
Bank capital to total assets (%)	***Albania***	6.80	7.60	8.60	9.60	9.40	8.70	8.60	9.30
	Macedonia	13.30	11.40	11.50	11.40	10.60	11.00	11.20	11.30
Bank liquid reserves to bank assets ratio (%)	***Albania***	21.15	18.24	15.88	14.39	14.57	13.48	13.41	13.89
	Macedonia	18.60	24.38	21.27	21.63	25.28	26.95	25.12	22.58
Bank Nonperforming loans to gross loans (%)	***Albania***	3.10	3.40	6.60	10.50	14.00	18.80	22.50	23.50
	Macedonia	11.21	7.51	6.71	8.94	9.04	9.52	10.11	10.94

Source: (IMF, 2013)

6 Conclusions

According to this study, we can say that economies selected Albania and Macedonia have much in common as well as features as economies of the same region. It is important to note that both economies undertake financial sector reforms monitored from EBRD and both are candidates of EU. Therefore, having the same goal these economies can be perceived that go parallel.

Despite to the geographical position and the previous political regime these economies continue to walk in similar paths also in the economic growth, where we can mention 1) legislation of the financial system reforming towards the goal of EU accession, 2) two-level banking system, 3) achievement of Central Bank independence from Executive power, 4) privatization of the banking system characterized by the entry of foreign banks 5) price level stabilization, 6) low credit in the early years of transition and low interest rates, 7) positive report of transition in recent years by prominent increase in exports.

As it is mentioned above these economies have been through the same political regime but they are liberated from this regime and have opened the trade in different years and the regimes pressure has not been the same where can be pointed the high pressure for Albania, necessarily these economies have particular features during their transition. While the study is based on the financial sector and it reforms then we can distinguish different developments of these countries on 1) the functioning of financial intermediaries in years, 2) insurance market with a slower development as regards Albania compared with other countries of the region, 3) while Albania was transforming the monobank system, Macedonia already had many banks operating 4) non-performing loans stand way to higher in Albania 5)economic growth of recent years in different trends despite the same financial crises that the economies suffered 6) the lack of a capital market for Albania as a country that has performed very well in the implementation of the same financial reforms.

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